ASEAN 2030

Toward a Borderless Economic Community

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Asian Development Bank Institute

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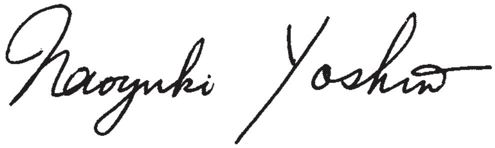
Foreword

For the last 47 years, the Association of Southeast Asian Nations (ASEAN) has been an integral part of Asia's ongoing socio-political and economic transformation and remains an example for other regional groups of how carefully crafted cooperation can benefit all members—even if extremely diverse in size, geography, culture, income level, and resource endowment. Today, ASEAN needs to think how to move to new stages of integration. As it approaches the target for the creation of an ASEAN Economic Community by the end of 2015, it will find merit in forging a longer term strategy for shared prosperity of its members, the wider Asian region, and the world at large.

This study *ASEAN 2030: Toward a Borderless Economic Community* is a collective effort led by the Asian Development Bank Institute (ADBI) in collaboration with the ASEAN Secretariat and the Southeast Asia Department of the Asian Development Bank (ADB) to help thinking in this direction. It looks at the key factors that will likely determine the next two decades of ASEAN economic development. By adopting a bottom–up approach and conducting extensive stakeholder consultations, it seeks to answer a set of three interrelated questions. It first identifies the aspirations of individual countries and the region as a whole by asking where they see themselves positioned in 2030. It then looks into the key challenges of development by asking what the outstanding hurdles in fulfilling aspirations are. It finally offers policy options by suggesting how to overcome those challenges in the next twenty years.

The *ASEAN 2030* study is part of a wider study led by ADBI in collaboration with several ADB departments titled: *ASEAN, PRC, and India: The Great Transformation*, which analyzes the 2030 growth potential of these economies and the challenges they face. Its findings suggest that, moving forward, ASEAN needs to create a borderless economic region. And it offers ideas to enhance the regional institutional framework and to bolster ASEAN's global role.

As Asia continues its economic transformation, it is important for ASEAN to solidify its role as a hub of regionalism by building itself into a family of nations striving for greater prosperity amid an ever more competitive world economy. I hope this study will stimulate debate in the region and beyond in identifying policies that raise opportunities for increased prosperity at the national, regional, and global level.



Naoyuki Yoshino
Dean
Asian Development Bank Institute

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The study is a collegial work by a team of scholars, policymakers, and other experts managed by the Asian Development Bank Institute (ADBI) under the supervision of a steering committee and the overall guidance of an external advisory board. The steering committee was chaired by the then Secretary-General of the Association of Southeast Asian Nations (ASEAN) Surin Pitsuwan and then ADBI Dean Masahiro Kawai, and comprised current and former staff of the Asian Development Bank (ADB): Rajat M. Nag, Kunio Senga, Changyong Rhee, and Iwan J. Azis. The external advisory board was formed by distinguished representatives from each ASEAN country, the ASEAN Secretariat, and the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). It included Dato' Lim Jock Hoi for Brunei Darussalam, Hang Chuon Naron for Cambodia, Emil Salim for Indonesia, Bounleua Sinxayvolavong for the Lao People's Democratic Republic, Tan Sri Ajit Singh for Malaysia, U Myint for Myanmar, Rodolfo Severino for the Philippines, Ong Keng Yong for Singapore, Suthiphand Chirathivat for Thailand, Tran Van Tho for Viet Nam, Pushanathan Sundram for the ASEAN Secretariat, and Noeleen Heyzer for UNESCAP.

Giovanni Capannelli, ADBI principal economist and special adviser to the dean, served as team leader and project task manager under the supervision of current ADBI Dean Naoyuki Yoshino, Deputy Dean Jae-Ha Park, and former and current research directors, Mario Lamberte and Ganeshan Wignaraja. Capacity building and training director, Yuqing Xing, and senior economist and capacity building specialist, Aladdin Rillo, provided comments for the study's finalization. The team of international scholars who contributed in various forms to the study was led by Chalongphob Sussangkarn. David Jay Green and Jean-Pierre Verbiest served as principal consultants, Srinivasa Madhur as special consultant, and Guy Sacerdoti as economics and manuscript editor.

ADB's Southeast Asia Department and the ASEAN Secretariat contributed to the study through various inputs and ideas. The team, respectively coordinated by Erick Sidgwick and Lim Chze Cheen, included Juzhong Zhuang, Arjun Goswami, Jun Tian, Jayant Menon, Sabyasachi Mitra, Douglas Brooks, Ba Hung Nguyen, and Rony Soerakoesoemah. Biswa Nath Bhattacharyay, Peter

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A selected team of distinguished ASEAN scholars prepared country reports. David J. Green and Teo Siew Yean worked on the Brunei Darussalam paper. Kimsun Tong, Hing Vutha, Khieng Sothy, Lun Pide, Saing Chan Hang, and Larry Strange prepared the paper for Cambodia. The paper on the economy of the Lao People's Democratic Republic was written by Leeber Leeboaupau and Phouphet Kyophilavong. Anggito Abimanyu and Bagus Santoso worked on the Indonesian paper, while the late Mahani Zainal Abidin prepared the paper on Malaysia. Jean-Pierre Verbiest and Tin Htoo Naing contributed the paper on Myanmar. Josef Yap and Ruperto Majuca worked on the paper on the Philippines. Chia Siow Yue prepared the paper on Singapore. The paper on Thailand was drafted by Somchai Jitsuchon, while Vo Tri Thanh and Duong Anh Nguyen worked on the paper on Viet Nam. The following experts provided comments during workshops and conferences: Medhi Krongkaew, Anwar Nasution, Nazmi Mohamad, Ooi Sang Kuan, Manasvi Srisodapol, I Gede Ngurah Swajaya, Wilfrido Villacorta, and Prasetijono Widjojo MJ.

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About the Study

This study, which analyzes long-term economic development aspirations, challenges, and policy options for the Association of Southeast Asian Nations (ASEAN), was conducted by the Asian Development Bank Institute (ADBI), in close consultation with the ASEAN Secretariat and the Asian Development Bank. It is a companion work to the ADB/ADBI study *ASEAN, PRC, and India: The Great Transformation*.

Consultative Approach

The study used a consultative approach to identify the region's 2030 growth aspirations and development challenges. After brainstorming meetings at ADB, the ASEAN Secretariat, and ADBI, seminars were held at the ASEAN Studies Centers in Washington, DC and Jakarta. The study largely benefited from consultation missions held in each ASEAN member country in 2011 and 2012, engaging with local policymakers, scholars, the civil society, think tanks, and other stakeholders. ADB resident missions provided inputs and technical support.

Inputs and Governance

Ten background papers were prepared on each ASEAN member country's perspectives and 29 other background papers were commissioned on thematic issues. ADB's Economics and Research Department prepared growth projections. A team of experts reviewed the quality of background papers and the final report. The ASEAN High-Level Task Force on Economic Integration provided guidance and ideas regularly.

ASEAN Think Tanks Involved in the Study

Cambodia Development Resource Institute, Phnom Penh; National Economic Research Institute, Vientiane; Centre for Strategic and International Studies, Jakarta; Institute of Strategic and International Studies, Kuala Lumpur; Myanmar Development Resource Institute, Yangon; Philippine Institute for Development Studies, Manila; Institute of Southeast Asian Studies, Singapore; Thailand Development Research Institute, Bangkok; Central Institute for Economic Management, Ha Noi; and the Economic Research Institute for ASEAN and East Asia, Jakarta.

Abbreviations

ABF	–	Asian Bond Funds
ABMI	–	Asian Bond Markets Initiative
ACA	–	ASEAN Competition Authority
ACF	–	ASEAN Convergence Fund
ACFS	–	ASEAN College of Financial Supervisors
ACI	–	ASEAN Competitiveness Institute
ACIA	–	ASEAN Comprehensive Investment Agreement
ADB	–	Asian Development Bank
ADBI	–	Asian Development Bank Institute
ADF	–	ASEAN Development Fund
AEC	–	ASEAN Economic Community
AFAS	–	ASEAN Framework Agreement on Services
AFEED	–	ASEAN Framework for Equitable Economic Development
AFMM	–	ASEAN Finance Ministers Meeting
AFTA	–	ASEAN Free Trade Area
AGI	–	ASEAN Governance Institute
AIA	–	ASEAN Investment Agreement
AIF	–	ASEAN Infrastructure Fund
ALMM	–	ASEAN Labour Ministers Meeting
AMAP	–	Agency for the certification and standardization of Made-in-ASEAN Products
AMRO	–	ASEAN+3 Macroeconomic and Research Office
APEC	–	Asia-Pacific Economic Cooperation
APSC	–	ASEAN Political-Security Community
APTA	–	ASEAN Preferential Trading Arrangement
ARA	–	ASEAN Rice Authority
ARF	–	ASEAN Regional Forum
ASA	–	ASEAN Swap Arrangement
ASAC	–	ASEAN Academy
ASCC	–	ASEAN Socio-Cultural Community
ASEAN	–	Association of Southeast Asian Nations

ASEAN+3	–	ASEAN plus People's Republic of China, Japan, Republic of Korea
ASEAN+6	–	ASEAN+3 plus Australia, India, New Zealand
ASEAN-5	–	Indonesia, Malaysia, Philippines, Singapore, Thailand
ASEAN-6	–	Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand
ASEM	–	Asia–Europe Meeting
ASW	–	ASEAN Single Window
ATC	–	ASEAN Tourism Council
ATIGA	–	ASEAN Trade in Goods Agreement
BIMP-EAGA	–	Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area
BIMSTEC	–	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
CEPEA	–	Comprehensive Economic Partnership for East Asia
CEPT	–	Common Effective Preferential Tariff
CGIF	–	Credit Guarantee and Investment Facility
C-J-K	–	People's Republic of China, Japan, Republic of Korea
CLMV	–	Cambodia, Lao People's Democratic Republic, Myanmar, Viet Nam
CMI	–	Chiang Mai Initiative
CMIM	–	Chiang Mai Initiative Multilateralization
CPR	–	Committee of Permanent Representatives
CTI	–	Coral Triangle Initiative
EAFTA	–	East Asian Free Trade Area
EAS	–	East Asia Summit
EC	–	European Commission
ECO	–	Economic Cooperation Organization
EPA	–	economic partnership agreement
EPG	–	Eminent Persons Group
ERDF	–	European Regional Development Fund
ESF	–	European Social Fund
EU	–	European Union
FDI	–	foreign direct investment
FEALAC	–	Forum for East Asia–Latin America Cooperation
FTA	–	free trade agreement
G20	–	Group of Twenty
GATS	–	General Agreement on Trade in Services
GCC	–	Gulf Cooperation Council
GCR	–	Global Competitiveness Report
GDP	–	gross domestic product
GMS	–	Greater Mekong Subregion

GNI	–	gross national income
HDI	–	Human Development Index
IAI	–	Initiative for ASEAN Integration
ICT	–	information and communication technology
IMF	–	International Monetary Fund
IMT-GT	–	Indonesia–Malaysia–Thailand Growth Triangle
Lao PDR	–	Lao People's Democratic Republic
LDC	–	least developed country
MAPHILINDO	–	Greater Malayan Confederation of Malaya–Philippines–Indonesia
MDG	–	Millennium Development Goal
MERCOSUR	–	Mercado Commún del Sur
MFSO	–	Macroeconomic and Finance Surveillance Office
MOP	–	margin of preference
MPAC	–	Master Plan on ASEAN Connectivity
MRA	–	mutual recognition agreement
N2O	–	nitrogen dioxide
NEM	–	New Economic Model
NSW	–	national single window
NTB	–	non-tariff barrier
OECD	–	Organisation for Economic Co-operation and Development
OFW	–	overseas foreign worker
PPP	–	public–private partnership
PRC	–	People's Republic of China
QE	–	quantitative easing
R&D	–	research and development
RCEP	–	Regional Comprehensive Economic Partnership
RIA-Fin	–	Roadmap for Monetary and Financial Integration
RICH	–	Resilient, Inclusive, Competitive, Harmonious
Ro-Ro	–	roll-on/roll-off
SAARC	–	South Asian Association for Regional Cooperation
SKRL	–	Singapore–Kunming Rail Link
SMEs	–	small and medium-sized enterprises
SWOT	–	strengths–weaknesses–opportunities–threats
TAI	–	Technology Achievement Index
TFP	–	total factor productivity
TPP	–	Trans-Pacific Partnership
UN	–	United Nations
UNDP	–	United Nations Development Programme
US	–	United States
WTO	–	World Trade Organization

Executive Summary

Executive Summary

The Association of Southeast Asian Nations (ASEAN), now in its late-forties, was created to address mainly political and security issues. Using flexibility and consensus—the *ASEAN Way*—it helped move the region from conflict to cooperation. Over time, the economy has taken center stage and today the association has reached a critical juncture. In 2015, its members will be launching the ASEAN Economic Community (AEC). This initiative, which is part of a broader "ASEAN Community" including political-security and socio-cultural pillars, will be taking shape just as the center of global economic gravity is shifting toward Asia. While the region's dynamism is being driven primarily by the People's Republic of China (PRC) and India, the AEC was also conceived for ASEAN to keep pace with the growth of these two regional powers, as well as with Japan, the Republic of Korea, and other economies in the region—through competition and cooperation.

While the AEC is a milestone in ASEAN's journey toward closer integration—and in maintaining its centrality in Asia's architecture for cooperation—it alone is insufficient to retain relevance in an increasingly multipolar global landscape. To strengthen their competitiveness and role as a hub of Asia's dynamism, ASEAN countries must also introduce deep structural reforms nationally. A proper combination of domestic reforms and initiatives for closer integration that complement and reinforce one another are needed to promote the region's equitable and inclusive development, strengthen its macroeconomic stability, and protect the environment. ASEAN countries must build their unique brand of integration—to close development gaps and maintain identity.

This study finds that the AEC should be considered a stepping stone to deeper integration. It suggests that by 2030 ASEAN should evolve into a truly borderless economic community, as its members realize that the whole is more than the sum of its parts. But ASEAN should not transform itself into a highly bureaucratic organization, or a structure similar to the European Union (EU). Although the group needs to significantly strengthen its institutional structure to maintain internal cohesion and govern newly created markets, it should not lose its pragmatism and flexibility; thus, a truly borderless ASEAN economic community by 2030 lies pragmatically somewhere between the AEC and the EU.

The study used a bottom–up approach to identify long-term economic aspirations, challenges, and policy options. Findings suggest that through an appropriate policy mix, ASEAN can enter a high-growth scenario leading to a tripling of per capita income by 2030, raising its citizens' quality of life to levels enjoyed today by members of the Organisation for Economic Co-operation and

Development (OECD). A low-growth scenario, however, leads to an average economic expansion of no more than 3% per year, as countries fall into the middle-income trap and are unable to manage emerging issues such as natural disasters, climate change, territorial disputes, and internal political tensions.

The study also concludes that ASEAN needs to reform some of its governance principles to keep pace with the evolving economic, political, and social environment. Resources for the ASEAN Secretariat must also increase considerably and functional institutions grow in number. The stakes are high. Closer integration will not only benefit ASEAN as a group, but Asia as a whole and the world at large. Together, ASEAN countries can form a partnership for shared prosperity through closer regional and global integration.

Conducted by the Asian Development Bank Institute (ADBI), in close consultation with the ASEAN Secretariat, ASEAN member states, and Asian Development Bank headquarters, this study looks to the future in answering three vital, interrelated questions: (i) What are the 2030 aspirations for individual ASEAN members and the region itself? (ii) What are the key challenges in meeting these aspirations? and (iii) What policies are needed to get there?

1 ASEAN Today

Created in 1967 mainly for political and security reasons, ASEAN has matured over time as an institution moving from cooperation by consensus to integration by choice. It is today a successful model for regionalism, widely recognized globally. The first ASEAN Leaders' Summit in 1976 was a watershed. It introduced a significant economic agenda that helped drive progressive trade and investment liberalization. By the early 1990s, the economies of ASEAN's five original members (Indonesia, Malaysia, the Philippines, Singapore, and Thailand)[1] were an integral part of the "East Asian Miracle." Remarkably, the group introduced several cooperative initiatives at a time when its membership considerably expanded with the admission of Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam (together known as the CLMV countries).[2]

The 1997/98 Asian financial crisis hit ASEAN economies hard. In the crisis aftermath, the group's dynamics changed dramatically, both internally and externally, creating a drive for expanded cooperation and integration with the PRC, Japan, and the Republic of Korea—through a newly established ASEAN+3

1 Brunei Darussalam joined in 1983.

2 Major economic cooperation initiatives included the 1992 ASEAN Free Trade Area (AFTA), the 1995 ASEAN Framework Agreement on Services (AFAS), and the 1998 ASEAN Investment Agreement (AIA).

process. Amid huge socio-economic uncertainties, ASEAN pushed its integration agenda forward with the adoption of Vision 2020—a major commitment to regional cohesion.

Further progress toward regional integration was made in 2003 with the decision to form the ASEAN Community[3] and, in 2007, with the adoption of the ASEAN Charter and the creation of the Committee of Permanent Representatives. More recently, ASEAN leaders promoted policies aimed at narrowing development gaps and strengthening the group's centrality in the regional architecture for cooperation. Today ASEAN represents a major economic bloc, home to about 620 million people with a gross domestic product (GDP) of more than $2.3 trillion—3.3% of the world total. Importantly, ASEAN economies are also among the world's most open, with merchandise exports over $1.2 trillion—nearly 7% of the global total.

The trend of proliferating free trade agreements (FTAs) with partners around the world started in the early 2000s. By the end of 2013, ASEAN countries had signed 40 FTAs, including five ASEAN+1 agreements with key East Asian partners (Australia/New Zealand, the PRC, India, Japan, and the Republic of Korea). The Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP), two of the 29 FTAs currently under negotiation, have massive economic implications and potentially hold significant benefits for signatories. This is particularly true for the RCEP, which would also greatly boost ASEAN's centrality in expanding Asian regionalism.

As for the AEC, although it is highly unlikely its blueprint will be completed by 2015, it nonetheless represents one of the most important milestones for ASEAN economic integration. It is structured on four pillars: (i) a single market and production base; (ii) a competitive economic region; (iii) equitable economic development; and (iv) integration into the global economy. Moving beyond the 2015 agenda toward 2030, ASEAN needs to further deepen regional integration by creating a truly borderless economic community. Otherwise, it will risk losing its centrality and competitive position vis-à-vis the PRC and India.

2 Aspirations for a "RICH" ASEAN

Despite the rapid development and progressive integration achieved over the past few decades, ASEAN economies remain extremely diverse, marked by a low degree of convergence. Yet, in responding to the changing international environment, they face common risks and must shape common strategies to promote development in the region. However, defining collective ASEAN aspirations within such a

3 The ASEAN Community was initially scheduled to be introduced in 2020. However, in 2007, its launch was advanced to 2015.

highly diverse membership is extremely difficult. National goals invariably differ across countries. Besides, it is not easy to ensure that the aspirations espoused are "ambitious enough" for setting broad regional goals for 2030, or "pragmatic enough" for individual countries' economic development. Therefore, this study took a holistic approach in formulating individual country aspirations and those for ASEAN itself.

In-depth background studies were prepared for each ASEAN member country and more than 20 thematic papers written on key issues and challenges the region will face. Goals cited in long-term national development strategies were considered in formulating aspiration targets and extensive consultations were held in member countries, together with national and regional think tanks and the ASEAN Secretariat. Surveys of opinion leaders were conducted. And as the study complemented these inputs with a SWOT (strengths, weaknesses, opportunities, and threats) analysis, it concluded that the region seeks to become *resilient, inclusive, competitive*, and *harmonious*—realizing a "RICH" ASEAN by 2030.

Resilience refers to the capacity to handle volatilities and shocks, from within or outside the region, reducing the likelihood of economic crises. It requires strong institutions and solid macroeconomic policies run by effective managers, capable of assessing risks and taking action. It also needs a regional framework for macroeconomic cooperation and management. *Inclusiveness* refers to the need for ASEAN to achieve equitable economic development, providing opportunities through cooperation strategies that reduce income gaps within and across countries, and promoting citizen welfare. *Competitiveness* requires a business environment where successful firms operate in efficient markets under effective national and regional regulations, as ASEAN products compete globally with improved productivity and more indigenous innovation. *Harmony* stems from environmentally sustainable development and growth, with proper consideration of the need to mitigate and adapt to climate change. It requires growing acceptance of ASEAN as a family of nations, where member countries live in peace, working together to resolve common problems.

Qualitative assessments were backed by quantitative measures to provide broad forecasts of per capita income trends between 2010 and 2030. The findings are that ASEAN members aspire to triple the region's average real per capita GDP to more than $9,000 by 2030—from about $3,000 in 2010. Average incomes are expected to grow faster in the least developed ASEAN economies (especially CLMV countries) than in those more advanced, narrowing income and other development gaps. However, if ASEAN members are unable to work together beyond the AEC toward creating a truly borderless economic community, if a major external shock hits the region, or if countries get stuck in the middle-income trap, growth will slow and aspiration targets will not be met.

Achieving a "RICH" ASEAN by 2030 implies further lowering intraregional economic barriers and more effective resource pooling. To realize a seamless regional economic community, ASEAN needs to introduce innovative systems to manage its labor and capital markets as it progressively liberalizes them. The group needs stronger institutional frameworks and policy coordination mechanisms on intraregional and external matters. Proper schemes for mutual recognition of standards and regulatory harmonization are required to shift responsibilities from national agencies to regional bodies, while strengthening functional institutions. And ASEAN needs to build an efficient regional civil service, requiring substantial amounts of additional financial resources.

3 Key 2030 Challenges

Achieving a “RICH” ASEAN by 2030 is an ambitious target. It requires meeting four key development challenges: enhancing macroeconomic and financial stability, supporting equitable growth, promoting competitiveness and innovation, and protecting the environment.

Enhancing Macroeconomic and Financial Stability

One important lesson from past financial crises is that policy frameworks overly designed for rapid growth can destabilize financial markets, damaging economic development. Prudent and coherent macroeconomic policies are instrumental in balancing the need to both sustain economic expansion and ensure overall economic and financial stability. And while national measures are always the first line of defense, the macroeconomic framework increases its regional dimension as national economic barriers are brought down over time, heightening the risk of contagion. Thus, policy cooperation and coordination assume central importance in formulating strategies aimed at preventing economic and financial crises.

Created in response to the 1997/98 Asian financial crisis, ASEAN+3 (ASEAN plus the PRC, Japan, and the Republic of Korea) started a process of intensifying regional policy dialogue. It launched several financial cooperation schemes, including the Chiang Mai Initiative and its Multilateralization (CMIM), the ASEAN+3 Macroeconomic Research Office (AMRO), and the Asian Bond Markets Initiative (ABMI). The combination of national macroeconomic policies and regional cooperation initiatives helped ASEAN economies effectively contain the damage from the 2008/09 global financial crisis.

Supporting Equitable Growth

ASEAN’s economic growth must not only be rapid and sustainable, but also inclusive and equitable. Development needs to ensure convergence in people’s incomes and quality of life, both across and within countries. Coupled with social and demographic transformations, inequality is indeed one of the most difficult challenges ASEAN countries face—collectively and individually. So far, development policies have drastically reduced poverty and led to a large improvement in living standards. Yet, many people in ASEAN continue to live on less than $2 a day. In addition, over recent decades the rich have tended to benefit more from growth than the poor. But islands of prosperity cannot survive in a sea of growing inequality. Failure to reduce income disparity risks building a society where citizens face unequal opportunities — a prospect neither politically acceptable nor sustainable. It undermines the very notion of an inclusive society and ASEAN as a family of nations.

Narrowing the development gap within and across ASEAN economies is a critical step for deepening integration. Given CLMV countries' large natural resource endowment, young and growing populations, and strategic position linking East Asia with South Asia, their growth potential is enormous. Progress on economic growth and closer integration depends on the speed and quality of convergence over a wide range of development indicators. To be sure, over the past two decades, CLMV countries have steadily caught up with the more advanced ASEAN-6 economies (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand): the ratio of average per capita GDP of the ASEAN-6 to CLMV countries declined from over 11 times in 1990 to about 3.5 times in 2012. And if 2030 per capita GDP growth aspirations are met, the ratio would further fall to about 2.4 times. However, if ASEAN countries are unable to introduce structural reforms domestically and embrace regional cooperation initiatives for creating a truly borderless economic community, they may fall into a low-growth scenario where intraregional income gaps may actually increase over time.

Promoting Competitiveness and Innovation

Globalization, marked by rapid progress in transportation and communication technology, has changed the way ASEAN production systems are organized. Ever more efficient logistics is improving the conceptualization, production, and distribution of goods and services. With competitiveness and innovation driving globalization, eliminating barriers to trade as well as increasing capital flows, labor mobility, and information flows have become critical factors in ensuring a country's economic progress. The process of trade and investment liberalization is indeed one of the main reasons behind Asia's economic success. But the rise of the PRC and India in the global economy increasingly challenges ASEAN to enhance its competitiveness. Over the coming decades, competitive pressures will not only come from within Asia, but also more distant economies such as the Russian Federation, Brazil, South Africa, and Turkey — to name a few.

What makes a region or country competitive? Research suggests several factors matter — institutions, macroeconomic policy, economic and social infrastructure, corporate strategies, the business climate, and links to production networks. Variations across ASEAN countries lead to pronounced diversity in global competitiveness rankings. While many remain product and process imitators, most economies should reach technological frontiers by 2030. In many ways, ASEAN's diversity represents both its strength and weakness. In the long run, as globalization increases the importance of multipolar development, the region should be able to leverage its diversity. Through investment in research and development (R&D) and innovation, competitiveness can be built in agriculture, manufacturing, and services—from high-yielding crops to industrial clusters, tourism, telecommunications, and finance, to name a few strategic sectors.

Protecting the Environment

Ensuring proper environmental stewardship—managing the natural resource endowment by balancing protection and exploitation—is a multi-faceted challenge. While abundant across Southeast Asia, natural resources are depleting rapidly as they are used for industry and to meet the consumption needs of growing populations. Depletion reduces national wealth. And most natural resources, when transformed into energy, unavoidably aggravate pollution. Accordingly, their mobilization and sale must be carefully weighed against economic and social costs. Market prices do not always reflect social costs. Similarly, corporate balance sheets rarely account for environmental effects. As ASEAN implements its AEC Blueprint and becomes an integrated production area, the lack of a unified regulatory regime for environmental protection may cause firms to gravitate to countries with weak environmental regimes—a regulatory arbitrage—worsening ASEAN's overall environmental standards. Rapidly expanding urban centers challenge governments to develop, enforce, and maintain "green" strategies and policies. Urbanization is associated with a high concentration of manufacturing production in relatively small areas with high population density—often resulting in air and water pollution.

Protecting the environment leads to a better quality of life on the path toward realizing the 2030 aspirations for a "RICH" ASEAN. The concept of sustainable, harmonious development relates to five issues closely interrelated with environmental protection: how to (i) balance rapid growth while ensuring environmental stewardship; (ii) manage energy supply and demand; (iii) handle urbanization and the expansion of the middle class; (iv) design regional cooperation initiatives, as natural resource management in one country affect its neighbors' environment; and (v) maintain peace and security within and across countries.

4 Enabling Factors

As ASEAN strives to fulfill its development aspirations, it needs to consider growth-enabling factors, or prerequisites to realizing a "RICH" ASEAN by 2030. These factors are closely interconnected and affect, more or less directly, each of the key development challenges.

Developing Financial Markets

Developed financial systems (efficient banks and financial institutions working alongside deep and integrated capital markets) support a country's economic growth. While Singapore is an exception, Southeast Asia's financial systems, especially its capital markets, tend to be relatively underdeveloped. Improvements are needed to efficiently mobilize regional savings, making them available for productive use, and to promote financial inclusion with consumer protection. ASEAN financial systems also face increasing demands to support economic development, including long-term infrastructure financing and improving access to credit for small and medium-sized enterprises (SMEs), and to improve inclusiveness.

Harnessing Human Capital

Better human capital tends to generate large social gains for an economy and to benefit individuals. Population dynamics are key to understanding human capital development as they affect labor supply, educational institutions, health providers, and ultimately economic growth. In the coming decades, ASEAN will generally see a decelerating population trend and aging societies, implying a slower rise in the workforce than in the past—unless increased participation rates more than offset this trend. Improved human capital is also important in enhancing citizens' overall quality of life. It relates to ensuring effective infrastructure for delivering public services that provide access to quality education and good health, as well as bring needed skills to people. An important growth-enabling factor is thus the formation of an ASEAN-wide labor market for skilled labor, as envisaged by the AEC.

Building Seamless Connectivity

Building seamless connectivity—the ability to travel, transit, and trade across borders—is a priority for ASEAN countries as they build a truly borderless economic community. Improved connectivity will allow ASEAN members to better exploit their strategic location next to the PRC and India, a perspective which has become more promising today as Myanmar's deep process of political and economic reform has brought the country back to the international scene. Domestic connectivity is also important in providing public services (electricity, water, sanitation, and telecommunications) where they are most needed and in linking peripheries to urban centers, allowing remote areas to unlock their development potential. Enhanced connectivity is crucial for improving competitiveness in all aspects of economic activity, including participation in production networks and supply chains.

Strengthening Governance

The quality of governance, broadly defined, has a huge impact on economic development, with institutions playing a large role. The lack of good institutions (and good governance) makes it impossible for developing economies to attract high and sustained levels of investment. Bad governance also hurts the poor most, while good governance, implying transparent rules and regulations, promotes development and leads to more equitable and inclusive growth. While improving governance is a key enabling factor for achieving a “RICH” ASEAN by 2030, identifying a region-wide strategy for strengthening governance is a difficult task, given ASEAN countries’ great diversity in governance indicators and priorities.

5 Institutional Architecture

A sound and effective institutional architecture is important for ASEAN to remain relevant to its member countries and external partners. It helps better balance national interests with the need to create a distinctive, outward-oriented, cohesive brand of regionalism — forming a partnership for shared prosperity that benefits not only individual members but also broader Asia and the rest of the world. Although the governing principles of the so-called *ASEAN Way* have served the region well, reforms are needed to improve the group’s institutional efficiency, maintain centrality, and lead ASEAN into its next phase of integration, moving beyond the AEC in 2015 toward a truly borderless economic community by 2030.

ASEAN’s institutional framework and basic governing principles were designed mainly to cover political and security matters. But economic and social issues have become the group’s main focus, requiring more flexibility, timely decision making, and efficiency. Therefore, ASEAN needs to structurally reform its basic governing principles. Areas for improvement include the group’s basic approach to decision making, financial contributions, and the delegation of powers from national to regional agencies.

Innovation is needed to upgrade the current system, which does not provide for proper treatment of sanctions, feedback, and compensating mechanisms for groups and countries where the costs of integration exceed its benefits. Structural reforms and efficiency updates are also important in providing the ASEAN Secretariat with the human and financial resources required to fulfill its expanding mandate, enhancing its capacity to manage the AEC.

A general lack of resources also limits the effectiveness of national agencies in charge of ASEAN affairs, as well as other subregional and regional agencies involved with the ASEAN process. The Committee of Permanent Representatives (CPR) can play a crucial role as an effective interface between member states and the ASEAN Secretariat, and in forging a new ASEAN approach to creating a regional civil service. An effective and dynamic CPR can also lead ASEAN to provide regional public goods, by identifying efficient mechanisms for regional cooperation and strengthening the institutional linkage with member states.

However, strong and effective leadership is needed to implement institutional reforms. Awareness needs to be built among civil society and various stakeholders on the importance of strengthening ASEAN's architecture for regional cooperation. Eventually, several functional bodies can be established through a regional decentralization approach, where individual member countries propose to host new institutions and agencies based on specific interests and availability of human and financial resources, spreading responsibilities among them.

6 Policy Options

To realize ASEAN's 2030 growth aspirations—tripling per capita income and raising the quality of life to levels enjoyed by OECD countries today—policymakers need an appropriate mix of national and regional policies. They need to introduce domestic structural reforms and deep regional integration initiatives to eliminate remaining barriers to the free flow of goods, services, and factors of production. The price ASEAN economies will pay for choosing a low-integration, insufficient-reform approach lies in the imminent risk of falling prey to the middle-income trap and losing comparative advantage against the PRC, India, and other emerging economies.

Macroeconomic and Financial Stability

To increase resilience to macroeconomic shocks, national economic authorities should include financial stability as a clear policy objective, conduct economic and financial supervision using proper macroprudential tools, and ensure banking soundness through periodical monitoring and stress tests. Policies must (i) ensure flexibility in adjusting to shocks, (ii) develop strong external positions as self-insurance against financial crises, (iii) carefully monitor short-term capital flows to manage risks and volatilities, (iv) upgrade technical regulatory and supervisory capacity, (v) pursue fiscal and monetary discipline, and (vi) reduce dollarization in CLMV countries.

Regionally, authorities should establish an ASEAN Financial Stability Dialogue (including finance ministries, central banks, financial supervisors, and market regulators), encourage dialogue with the private sector and promote the CMIM and AMRO evolution into an Asian Monetary Fund, to be established well before 2030. They should also introduce a flexible coordination mechanism to maintain stable exchange rates between regional currencies in times of stability, while providing flexibility in times of stress—for example, during sudden foreign exchange liquidity shortages. Developing informal regional guidelines on fiscal sustainability would help define tolerable levels of fiscal deficits and public debt ratios. ASEAN countries should also develop *regional guidelines on effective capital control measures* to assist authorities on deciding whether—in times of excessive short-term capital flows — capital controls are needed as an additional temporary and well-targeted macroeconomic tool to help maintain economic and financial stability. Predictability by itself also serves to reduce volatility and would be welcomed by the private sector.

Equitable and Inclusive Growth

With economic inequality rising in ASEAN, efforts to reduce poverty must be accompanied by coherent policies that redistribute the benefits of growth and development more equally to all people. A broad set of national policies should be designed to draw in the marginalized, offering equal opportunities to all. Macro-level programs are needed to narrow income gaps across the region, improving social cohesion and welfare. They must be accompanied by inclusive policies, introducing schemes that support SMEs, increase financial inclusion, and enhance governance and regulations to improve education and health care. A distinct set of policies is needed to avoid falling into the middle-income trap, including measures aimed at promoting knowledge-led growth and R&D investment, and reducing business costs.

ASEAN's regional approach to promote equity and inclusiveness is based on the Initiative for ASEAN Integration and the ASEAN Framework for Equitable Economic Development, which include support from the ASEAN-6 to CLMV countries. As ASEAN assumes a central role in the region's development process as an institution, it must garner substantial additional resources. In particular, authorities should consider establishing an ASEAN Convergence Fund to mitigate the negative impact of regional economic integration initiatives on specific groups of people and sectors, while fostering economic growth in lagging regions. One option is to substantially enlarge the existing ASEAN Development Fund (ADF). However, to ensure its effectiveness, the ADF should be properly administered by qualified professionals.

Competitiveness and Innovation

A broad range of policies that promote competitiveness and innovation cover improving social infrastructure, political institutions, the macro-economy, and the business climate. R&D investment is critical for technological advancement and innovation — prerequisite for higher productivity. Policies promoting competitiveness and innovation should be crafted nationally, given the differing individual contexts and needs. It is also important to introduce common ASEAN product and governance standards to create a single market for the region.

To complement national efforts, ASEAN members should consider establishing an ASEAN Competitiveness Institute aimed at introducing a regional innovation strategy and constructing a framework for a regional R&D policy. Accelerating technological diffusion and absorption in key areas with large spillovers to the rest of the economy should be one goal. Exploiting synergies with science, R&D, and innovation in biotechnology and nanotechnology could make ASEAN a leader in emerging market niches. ASEAN should create its own brand — a *Made-in-ASEAN* product label. Establishing a regional agency for the certification and standardization of *Made-in-ASEAN* products will have a multiplier effect not only on industrial development, but also in terms of strengthening the ASEAN identity of firms and individuals. ASEAN should also exploit its comparative advantage in tropical agriculture, in value chains, in parts and components related to production and distribution networks, and in services such as tourism. A bold initiative to assist members in organizing and managing rice production, supply chains, and trading networks, and to link food security with regional welfare, would be the creation of an ASEAN Rice Authority. An ASEAN Tourism Council could also help design and coordinate a variety of regional, multi-country tours and packages, further promoting regional tourism — from ecotourism to art, sports, and culture-related excursions. The tourism council should be introduced alongside the Single ASEAN Visa for tourists, which has been under discussion for some time and should be in place well before 2030. As these regional institutions will be created with the active participation of the private sector and other stakeholders, their fiscal burden on national governments should be fairly limited.

Environmental Protection

In 2010, the ASEAN Ministerial Meeting on the Environment introduced a blueprint of 10 priority areas for environmental protection. It has also produced several agreements to lower carbon emissions, reduce greenhouse gases, lower transboundary haze pollution, and manage water resources. While ASEAN resolutions are non-binding nationally, policymakers should proactively introduce long-term development plans that reflect decisions taken by ASEAN agencies and agree on an overall approach for mainstreaming green growth in national strategies. ASEAN members should promote "green" products — adopting common standards across the region — which can provide new impetus for joint development of niche sectors. Overall, national policies should be focused on controlling pollution and solid waste, improving energy efficiency, providing safe water, and managing urbanization.

As ASEAN implements the AEC Blueprint and becomes an integrated production area, policymakers should encourage policies that tax environmental "public bads" and eliminate harmful subsidies that encourage inefficient use of natural resources. The creation of a borderless economic community must go hand in hand with establishing a region-wide regulatory regime protecting the environment, including the introduction of strict product and governance standards. Without immediate, decisive collective action, by 2030 ASEAN's river quality, for example, will have seriously deteriorated, and drinking water will be in short supply. Air quality, especially in fast-growing urban areas, will also decline below acceptable levels. As pollution can easily spill over from one country to another, an effective dispute settlement mechanism is also needed to handle environmental externalities.

Financial Market Development

ASEAN countries need to develop broad-based and efficient financial markets supporting development of the real sector. National authorities must balance liberalization with new regulations that require closer cooperation among the region's financial supervisors—either through mutual recognition or regulatory harmonization and prudential norms. To mitigate the risks posed by liberalizing financial services, ASEAN members should set preconditions for easing market entry, sequencing the relaxation of entry rules—distinguishing between banks and insurance companies from within and outside ASEAN, for example—and ensure information sharing between home and host country supervisors. To deepen and widen domestic bond markets and increase liquidity, it is critical to expand the number of qualified issuers and potential buyers. Reaching a critical mass is of utmost importance for increasing the efficiency of equity markets. At the same time, local credit rating agencies need to be strengthened.

ASEAN has worked with the PRC, Japan, and the Republic of Korea under ASEAN+3 to promote capital market development. Initiatives such as ABMI, the Asian Bond Fund, and the Credit Guarantee and Investment Facility should be broadened and deepened. ABMI and the ASEAN Infrastructure Fund need to be linked to financing priority connectivity projects. As cross-border financial activity requires monitoring, a dedicated ASEAN College of Financial Supervisors could be created. Regional financial cooperation is required in several areas. For banks and capital markets, a regional payment and settlement system should be established to improve financial transaction efficiency across ASEAN—an important step in creating better market infrastructure for easing capital flows. Cooperation initiatives are also needed to further develop corporate bond markets in several countries and sovereign bond markets in others—adopting effective and consistent regulatory frameworks would help. To gain from economies of scale in equity markets, listing standards and information disclosure regulations should be harmonized. By 2030, an ASEAN-wide market for all locally issued securities should be created. Cooperation can also help promote microfinance, especially in CLMV countries, and create schemes for SME financing.

Human Capital Development

Given ASEAN's decelerating population growth and aging societies, members must develop their human capital to generate stronger and more inclusive development as well as improve productivity and competitiveness. Investment in urban and rural basic social services—safe water, sanitation, and other health-related services—is important, especially in the CLMV countries and least developed areas of ASEAN-6, such as Mindanao in the Philippines and Sulawesi, Maluku, and Papua provinces in Indonesia. Human capital development requires greater investment in enhancing the quality of education. Aside from continued efforts in primary and secondary education, ASEAN countries should invest more in basic science and in tertiary education, especially in CLMV countries. Increasing investment in vocational schools, including through public–private partnerships, can increase the scientific and technical skills needed to foster technological progress and innovation. Overall social security systems must also be enhanced.

ASEAN should expand the provision of scholarships and exchanges to allow students to study for substantial periods in other member countries, while receiving credit at their home university or other academic institution. An ASEAN Credit Transfer System has already been created within the ASEAN University Network to allow student mobility under the AEC. Other programs should be introduced for teacher exchange and vocational training. Policies to manage labor mobility are also needed. Mutual recognition of ASEAN educational standards and qualifications is a target included in ASEAN labor ministers' work program for 2010–2015, including the creation of national skills frameworks in each country. Policymakers must ensure that once these frameworks and mutual recognition agreements are in place, they can be used effectively to facilitate labor migration. Besides achieving the full recognition of skills and providing conditions for workers to transfer and live in other member countries — fully synchronizing immigration laws and visa schemes — policymakers should tackle the more difficult issue of unskilled worker migration. A system of "freer but managed migration for unskilled labor" must evolve from the 2007 ASEAN Declaration on the Protection and Promotion of the Rights of Migrant Workers. An ASEAN registry of foreign workers is needed to map the presence of migrant workers and provide them the proper legal protection against potential discrimination and abuse on the work site.

Seamless Connectivity

The need for physical infrastructure — roads, railways, ports, airports, and energy lines — varies dramatically across ASEAN countries. Expeditious implementation of the Master Plan on ASEAN Connectivity will help upgrade existing transport and communications facilities, as well as harmonize rules, regulations, and standards. Various subregional programs play an important role in this respect. These include the Greater Mekong Subregion, which has assisted transport infrastructure development in continental ASEAN since the mid-1990s. Today it focuses on transforming existing transport corridors into full economic corridors to reach out to neighboring countries such as the PRC and India — two important connectivity partners, especially for CLMV countries.

The ASEAN Infrastructure Fund, meant to fund priority regional and subregional infrastructure projects, should be expanded in size once it develops workable precedents, inviting the PRC, Japan, the Republic of Korea, and other countries to contribute while ensuring proper management control by ASEAN members. Public–private partnerships need to be considerably expanded to avail of private sector administrative expertise and financing, especially as new business models are developed to address social issues. In air transport, despite the agreement on the creation of an ASEAN Single Aviation Market by 2015, many impediments remain, obstructing development of regional tourism and shifting competitive advantages to PRC carriers. ASEAN authorities should work toward quickly establishing a truly unified regional aviation market by removing existing barriers and agreeing on higher integration targets.

Governance Issues

ASEAN countries need to proactively strengthen governance standards, starting from improving the effectiveness of existing institutions—which must be transparent, rule-bound, and designed to improve economic welfare for all, rather than serving particular interests. The introduction of proactive measures and actions to minimize the scope of rent-seeking and remove the potential for corruption is a necessary step in promoting good governance and the rule of law through building solid, transparent, and credible institutions. Among national policy reforms, those related to law enforcement are probably the most urgent.

Improving legal quality and integrity will help solidify ASEAN as a regional hub in production networks and supply chains. To work out regional regulatory issues, ASEAN should create a strong and independent agency—an ASEAN Governance Institute. It should also adopt a region-wide competition policy to avoid unfair competition in national markets, especially for attracting foreign direct investment or implementing free trade agreements with non-ASEAN members. While work is ongoing through the ASEAN Expert Group on Competition, an ASEAN Competition Authority should be set up before 2030 to monitor implementation and compliance with national competition laws. Its overall objectives should be to (i) limit the formation of cartels and monopolies, (ii) avoid anti-trust issues such as the abuse of market dominance and excessive concentration of economic power, (iii) advance consumer protection, and (iv) introduce campaigns that advocate the benefits of competition.

Institutional Architecture

ASEAN institutional reform is needed in five key areas. First, more powers must shift from national to regional institutions—particularly the ASEAN Secretariat. The AEC requires a set of rules and regulations whose standardization and harmonization need to be centrally organized. Ensuring that member states comply with their commitments also necessitates a common agency empowered with proper monitoring functions—with sanctioning ability. More powers should also be delegated to the ASEAN Chair and Secretary-General to effectively represent the group in international meetings.

Second, decision making should be made more flexible by introducing a qualified majority for day-to-day operations, avoiding the risk that small minorities block resolutions that benefit the many. Several ASEAN functional institutions have already adopted decision-making systems using consensus for fundamental issues and qualified majorities for daily operations. Similar systems should be applied more widely in ASEAN.

Third, the drastically increased scope of ASEAN operations introduced by the ASEAN Charter and the community blueprints require a corresponding expansion in the ASEAN Secretariat's human and financial resources. The principle of equal contribution, however, imposes a structurally low ceiling to the budget, as the smallest economies have limited capacity to pay. To meet its expanded resource needs, ASEAN must upgrade to a principle of diversified contributions based on both capacity and willingness of member states to pay. The current system implies heavy dependency on external funding sources, unsustainable in the long run. Several options used by other regional institutions are ready examples of workable solutions.

Fourth, the amount of human and financial resources available to the ASEAN Secretariat must significantly increase. In 2012, it employed about 300 people, of which more than 70 were openly recruited professionals. Its budget was only about $16 million. As its mandate has been expanding, it is clear resources must increase exponentially to meet ASEAN's needs. Based on an exercise prepared for this study, by 2030 the ASEAN Secretariat will need an estimated yearly budget of $220 million and more than 1,600 employees if it is to fulfill its expanded mandate.

Fifth, ASEAN leaders should establish an ASEAN Academy to build a regional civil service — a highly qualified technocracy capable of planning, introducing, and managing the reforms, rules, and regulations included in the blueprints for the three ASEAN communities. The new institution would be inspired by the ASEAN Charter's principles and offer capacity-building programs, focused on technical as well as regional matters.

For ASEAN's institutional development, new functional institutions could be established in addition to existing ones. They should cover macroeconomic policy cooperation, finance, tourism, agriculture, and competitiveness, to deal with regional disaster risk management, health and infectious diseases, natural resource management, tertiary and vocational education, environmental mitigation and adaptation, and the prevention of human and drug trafficking.

While the ASEAN Secretariat should strengthen its pivotal role as a coordinating agency, ASEAN members should also be invited to plan and host new functional institutions based on their fiscal capabilities, contributing larger shares than other countries if they so wish. A decentralized approach can allow a better spread across the region, as different members become hosts. Various members have stated on various occasions their interest in hosting new functional institutions to promote the ASEAN agenda, based on available internal resources, capabilities, and interests. Following a regionally decentralized approach can in turn create national champions on regional themes, contributing to the association's development and promoting the idea of ASEAN as a family of nations in an increasingly borderless economic region.

While building its institutional capabilities, it must be clear that new ASEAN bodies differ substantially from those of the EU. First, needed functional institutions cover specific areas — ASEAN is unlikely to establish a parliament, court of justice, or a unified central bank, as in the EU. Second, new bodies are expected to obtain powers confined to technical matters and to play coordinating roles with national and other regional agencies. If devolution from national to regional agencies happens, it will be focused in distinct areas with the delegation of powers to regional bodies based on a feedback system ensuring agreement from each stakeholder. Power and functions are expected to start small-scale and expand only after member countries embrace the institution's benefits and contributions. Third, as regional agencies are established with active participation of the private sector, the civil society, and other stakeholders, their fiscal burden on individual countries' public debts will be fairly limited.

ASEAN has traveled far since 1967. Its milestone of an AEC is fast approaching. The path beyond 2015 — the formation of a truly borderless ASEAN economic community by 2030 — requires a solid vision and strategy for retaining centrality in Asia's regionalism. Its member countries should introduce deep domestic structural reforms and solid regional integration initiatives to ensure good macroeconomic management, inclusive growth, competitive and innovative business, and an environmentally sustainable development. Most of all, ASEAN needs its current leadership to make the best commitments possible today for meeting the aspirations of a "RICH" ASEAN tomorrow.

Chapter 1
ASEAN Today

1 ASEAN Today

Now in its late-forties, the Association of Southeast Asian Nations (ASEAN) was created to address mainly political and security issues. Using flexibility and consensus—known as the *ASEAN Way*—it helped move the region from conflict to cooperation. Over time, the economy has taken center stage and today the association has reached a critical juncture. In 2015 its members will be launching the ASEAN Economic Community (AEC). This initiative, which is part of a broader "ASEAN Community" including also political-security and socio-cultural pillars, will be taking shape just as the center of global economic gravity is shifting toward Asia. The People's Republic of China (PRC) and India are two key economies driving Asia's dynamism. Their emergence as superpowers suggests that size matters to accelerate growth and development. The AEC has also been conceived to keep pace with the growth of these two giants, as well as with Japan, the Republic of Korea, and other economies in the region—through competition and cooperation.

While the AEC is a milestone in ASEAN's journey toward closer integration and centrality in Asia's architecture for regional cooperation, it alone is insufficient to retain relevance in an increasingly multipolar global landscape. To strengthen their competitiveness and role as a hub of the region's dynamism, ASEAN countries must also introduce deep structural reforms nationally. A combination of domestic reforms and initiatives for closer integration that complement and reinforce one another are needed to promote the region's equitable and inclusive development, strengthen its macroeconomic stability, and protect the environment. ASEAN must build its unique brand of integration—one that is able to close intraregional development gaps and maintain national and local identity, while recognizing that the whole is more than the sum of its parts.

This study suggests that the AEC should be considered as a stepping stone to reaching deeper integration. Moving forward, by 2030 ASEAN should evolve into a truly borderless economic community. It must be clear, however, that the association should not transform itself into a highly bureaucratic organization, or a structure similar to the European Union (EU). Although ASEAN needs a significant strengthening of its institutional structure to maintain its internal cohesion and govern the newly created markets under the AEC, the group should not lose its pragmatism. Jakarta—the location of the ASEAN Secretariat—should not become the Brussels of the East. Thus, the realization of a truly borderless economic community by 2030 lies pragmatically somewhere between the AEC and the EU.

The analytical framework adopted in this study follows a bottom–up approach to identify the group's long-term economic aspirations, key challenges, growth-enabling factors, and policy options. Findings suggest that ASEAN can enter a high-growth scenario leading to a tripling of average per capita income by 2030, raising the quality of life to levels enjoyed today by members of the Organisation for Economic Co-operation and Development (OECD). Another scenario, however, could lead to an average economic growth of no more than 3% per year, as countries fall into the middle-income trap and are unable to manage emerging issues such as natural disasters, climate change, territorial disputes, and internal political tensions.

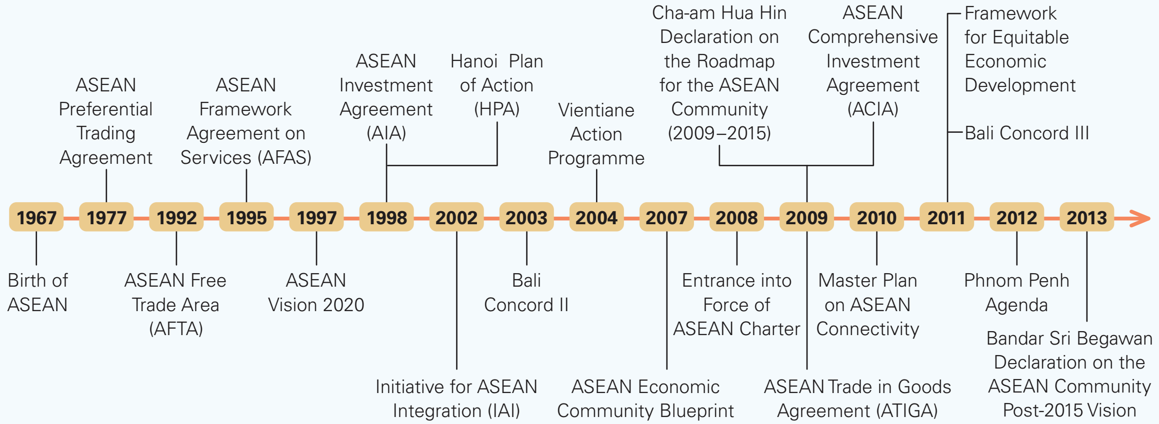
While the challenges ahead are indeed daunting, the study concludes that through proper policy action ASEAN has the potential to realize its aspirations. It needs, however, to reform some of its governance principles in order to keep pace with the evolving economic, political, and social environment. Resources destined to the ASEAN Secretariat must considerably increase and more functional institutions are also needed. The stakes are high because closer integration will not only benefit ASEAN as a group, but the whole of Asia and the world. Together, ASEAN countries can form a partnership for shared prosperity.

This first chapter analyzes how ASEAN has evolved over time as an overarching institution for regional integration. It reviews the group's key elements and mechanisms, discusses the importance of the region's economy in the global context, analyzes the progress made by the AEC to date, and reflects on the next steps of integration. Chapter 2 defines ASEAN's economic aspirations toward the year 2030, while chapter 3 presents an analysis of the key challenges the group is facing in fulfilling its aspirations. The growth-enabling factors leading to overcome these challenges are discussed in chapter 4. ASEAN's institutional architecture and mechanisms for the association to remain strategically at the core of Asia's economic dynamism are reviewed in chapter 5. Finally, chapter 6 discusses policy options for ASEAN countries to meet their 2030 aspirations at the national and regional level.

1.1 Evolution of Economic Cooperation

Extremely diverse, yet bound by a common desire for peace and prosperity for its people, ASEAN gradually broke through barriers that previously blocked cooperation in fighting common problems. Today, ASEAN is a unique model for socio-economic integration—widely recognized globally. It has matured as a regional grouping and has begun the process of moving from cooperation by consensus to integration by choice (Figure 1.1).

Figure 1.1 Milestones of ASEAN Economic Cooperation



ASEAN = Association of Southeast Asian Nations.
Source: ASEAN Secretariat and ADBI.

1.1.1 Early Times

Formed in 1967, ASEAN brought together five Southeast Asian countries—Indonesia, Malaysia, the Philippines, Singapore, and Thailand—to shield them from raging regional conflicts and to break through internecine disputes. Its geopolitical *raison d'être* was Cold War driven; primarily political and for collective security. Once the wars in the former "Indochina" ended, economic development became paramount.

The 1976 (first) Summit was a watershed. By then, import-substitution policies in the original ASEAN-5 had failed and progress in poverty reduction was slow. Oil and gas fields were being developed and refineries built. Foreign direct investment (FDI) was increasingly welcomed. And policymakers began to lean toward export-oriented growth. Creating a large regional market for synchronizing production and developing consumption was the way forward. The result was the ASEAN Preferential Trading Arrangement (APTA), signed in 1977. While slow off the mark, APTA paved the way for a huge economic transformation.[4] Brunei Darussalam joined ASEAN in 1984.

4 The first ASEAN Summit of 1976 not only resulted in the creation of APTA, but also introduced three other schemes which can be considered as the group's early attempts to deepen regional economic cooperation: (i) the ASEAN Industrial Project (1976); (ii) the ASEAN Industrial Complementation Scheme (1981); and (iii) the ASEAN Joint-Venture Scheme (1983). APTA was enhanced in 1987 by reducing the number of items in the exclusion list and relaxing rules of origin, and it eventually became the basic protocol for the establishment of the ASEAN Free Trade Area in 1992. The other three schemes, however, were later dismissed as the response from the private sector was less positive than expected.

During the 1980s, trade and investment regimes were progressively liberalized, accelerating FDI and exports, particularly after the 1985 Plaza Accord—as the appreciated yen drove the relocation of manufacturing across Asia. Multinational corporations saw major opportunities in the region's comparative advantage—planting the seeds of what would evolve into today's East Asian production networks and supply chains. Indeed, critical to ASEAN's economic success has been its increasing role in forging the economic dynamics of integration with Japan, the PRC, the Republic of Korea, and other economies in the region. Fragmenting manufacturing production required a qualitative leap in parts and components trade to assemble final goods, which allowed ASEAN members to successfully pursue competitive export-led development strategies. FDI continued to increase—both from outside and within the region, which started the creation of robust, flexible, and vibrant small and medium-sized enterprises (SMEs).

By the early 1990s, most ASEAN economies were an integral part of what the World Bank called the "East Asian Miracle" (World Bank 1993). ASEAN reached its first crossroads for several reasons. First, beginning in the late 1980s, non-ASEAN mainland Southeast Asia started market-oriented reforms to liberalize and open their economies—Viet Nam launched its *Doi Moi* program in 1986, the same year the Lao People's Democratic Republic (Lao PDR) embarked on reforms via its *New Economic Mechanism*. Second, as the 1980s ended, market-oriented reforms in the PRC began bearing fruit, challenging ASEAN's command in export markets, but at the same time opening massive opportunities for new business.[5] Third, as the Cold War ended, globalization expanded rapidly, forcing ASEAN to reposition itself as a major player in the emerging world economic environment.

Further integration to maintain ASEAN's competitiveness was pressing. By 1992—15 years after APTA—the ASEAN Free Trade Area (AFTA) was endorsed, paving the way for deeper economic integration. The 1993 AFTA Common Effective Preferential Tariff (CEPT) scheme was designed to ultimately eliminate all tariffs between members. Although AFTA originally covered 10 manufacturing sectors, it progressively expanded to most tariff lines—however with some exceptions. The ASEAN Framework Agreement on Services (AFAS) was adopted in 1995, also aimed at progressively eliminating restrictions on trade in services, and the ASEAN Investment Area (AIA) was created in 1998 to liberalize intra-ASEAN FDI and attract additional FDI flows from abroad.

These crucial economic cooperation agreements came at a time when ASEAN's membership considerably expanded with the admission of Cambodia, the Lao PDR, Myanmar, and Viet Nam (CLMV countries)—Viet Nam joined in 1995, followed by the Lao PDR and Myanmar in 1997, and Cambodia in 1999.

5 Actually the positive impact of market-oriented reforms in the agriculture sector was already felt in the early 1980s. India also began liberalizing its economy after four decades of import-substitution and state economic control.

With its expanded membership, ASEAN covered most of Southeast Asia and featured a considerable population and market size in terms of gross domestic product (GDP).[6]

ASEAN members have also been active in several important interregional groupings. These include Asia-Pacific Economic Cooperation (APEC) created in 1989 (although Cambodia, the Lao PDR, and Myanmar are not members), the wider ASEAN Regional Forum in 1994, the Asia–Europe Meeting established in 1996, the Forum for East Asia-Latin America Cooperation created in 1999, and several others (see chapter 5).[7]

1.1.2 The Asian Financial Crisis and Its Legacy

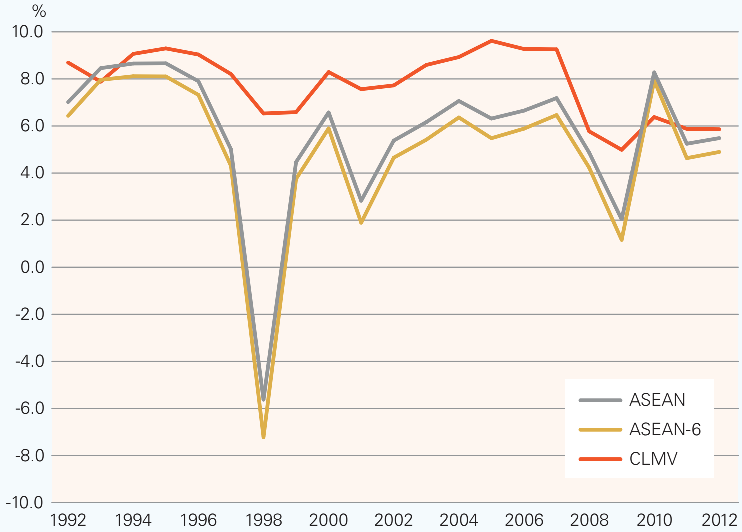
By the mid-1990s, rapid GDP growth—fueled by FDI, domestic investment, and increasingly large amounts of short-term capital inflows—created imbalances within ASEAN countries. These macroeconomic distortions combined with rigid exchange rate policies culminated in the 1997/98 Asian financial crisis. First viewed as a short-term correction confined to Thailand, the crisis quickly spread widely, deeply affecting most ASEAN members, the Republic of Korea, and several other East Asian economies. GDP of ASEAN-6 countries (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) contracted an average 8% in 1998. It took 6–7 years before these countries brought annual growth back to about 6% (Figure 1.2).

In the crisis aftermath, ASEAN dynamics changed dramatically—both internally and externally. No one became an isolationist, for the first time clearly indicating that the ASEAN ideal as a family of nations was accepted.[8] On 17 December 1997, at the peak of the crisis, ASEAN leaders in Kuala Lumpur adopted a "Vision 2020"—stressing their aim to build ASEAN as a "... *concert of Southeast Asian nations, outward looking, living in peace, stability and prosperity, bonded together in partnership in dynamic development and in a community of caring societies*" (ASEAN 1997). Amid huge socio-economic uncertainties, the ASEAN Vision 2020 came as a remarkable commitment to regional cohesion.

The crisis also institutionalized closer economic cooperation between ASEAN and other East Asian countries. The PRC was growing as an economic powerhouse and solidifying relations with individual ASEAN members and the group as a whole. "ASEAN+3" meetings—including the PRC, Japan, and the Republic of Korea—started in 1996, just before the crisis. Its importance was formalized and strengthened with the Joint Statement on East Asia Cooperation at the 1999 Manila

6 Timor-Leste submitted its official application for ASEAN membership in 2013, while Papua New Guinea has been considering a similar option for the last few years.
7 See chapter 5 for a discussion on intraregional and interregional institutions.
8 However, Malaysia's crisis response differed from other affected countries. Instead of allowing market forces correct via interest rate hikes and currency devaluation, it imposed strict capital controls and pegged the ringgit to the US dollar.

Figure 1.2 ASEAN GDP Growth, 1992–2012
(annual average growth rates in current $)



ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; CLMV = Cambodia, Lao PDR, Myanmar, and Viet Nam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic.
Source: International Monetary Fund, World Economic Outlook Database, April 2013. http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx (accessed October 2013).

Summit. Not surprisingly, financial cooperation was foremost on policymakers' minds—convening regular meetings of ASEAN+3 Finance Ministers and their Deputies, and the creation of an Economic Review and Policy Dialogue. This directly led to the creation of the ASEAN+3 Chiang Mai Initiative (CMI) in 2002 and the Asian Bond Markets Initiative (ABMI) in 2003.[9]

In tandem with increased macroeconomic, monetary, and financial cooperation at the ASEAN+3 level, the crisis led to the start of ASEAN Finance Ministers Meetings (AFMM). The AFMM grew out of the ASEAN Ministerial Understanding of Cooperation in Finance adopted in Phuket in March 1997, just a few months before the crisis erupted. By 1999, an ASEAN Surveillance Process unit partly supported by the Asian Development Bank (ADB) was established at the ASEAN Secretariat—expanded in 2010 to a Macroeconomic and Finance

9 The CMI was multilateralized in 2010 and the ASEAN+3 Macroeconomic Research Office was established in 2011 to support CMI Multilateralization implementation as an independent regional monitoring and surveillance unit. The ABMI—created to expand and deepen local currency bond markets—has led to significantly increased high-quality local currency bonds issued in domestic markets and raised disclosure and documentation standards (ADB 2008b)—see sections 3.1 and 4.1 for an in-depth analysis.

Surveillance Office. A detailed Roadmap for Monetary and Financial Integration of ASEAN to guide capital market development, financial services' liberalization, capital account liberalization, and currency cooperation was adopted in 2003.

As crises often do, the 1997/98 shock accelerated ASEAN's internal economic cooperation. Several internal arrangements and institutions were created. For instance, ASEAN formalized its annual Leaders' summits in 2001—becoming semiannual in 2007. These summits not only bring top-level dialogue and consultation, they also allow closer monitoring of integration initiatives, and prod policymakers when needed.[10]

The adoption of the ASEAN Charter in 2007—making ASEAN a legal entity and enunciating its purposes and principles—was another major milestone (see chapter 5). An Eminent Persons Group (EPG) prepared the ASEAN Charter, adding several important proposals (ASEAN 2007). Among others, the EPG recommended to (i) create a fund to narrow development gaps between members, (ii) introduce dispute settlement mechanisms, and (iii) significantly strengthen the ASEAN Secretariat and the Secretary-General's role. Some proposals were incorporated in the ASEAN Charter and have been implemented, while others will likely become part of the cooperation agenda in the coming decades.[11]

1.1.3 Recent Developments

As ASEAN members gradually recovered from the 1997/98 financial crisis—in part thanks to buoyant export demand and competitive exchange rates—investment (especially FDI) remained well below pre-crisis levels. The group was able to attract but a small fraction of FDI destined to the PRC.

ASEAN reacted by strengthening its cooperation initiatives. In October 2003, it took the ambitious, bold step agreeing to establish an ASEAN Community by 2020. The Bali Concord II[12] backed the ASEAN Vision 2020 adopted in 1997. The ASEAN Community would be based on three pillars: (i) the ASEAN Political and Security Community (APSC); (ii) the ASEAN Socio-Cultural Community (ASCC); and (iii) the AEC.[13] In 2004, the Vientiane Action Programme was introduced to accelerate economic integration among

10 An example was the 2010 Ha Noi Summit where, for the first time, leaders expressed dismay at the slow progress in trade facilitation initiatives—crucial for creating the AEC.

11 Among others, EPG members recommended to create a fund aimed at narrowing development gaps between members, introduce a number of dispute settlement mechanisms, and strengthen the ASEAN Secretariat and the role played by the Secretary-General.

12 The Bali Concord I was signed at the time of the First ASEAN Summit in 1976.

13 The APSC ensures that "countries in the region live at peace with one another and with the world in a just, democratic and harmonious environment" (ASEAN Political-Security Community, http://www.asean.org/communities/asean-political-security-community). The ASCC is focused on "nurturing the human, cultural and natural resources for sustained development in a harmonious and people-oriented ASEAN" (ASEAN Socio-Cultural Community, http://www.asean.org/communities/asean-socio-cultural-community). See chapter 5 for a more detailed analysis.

members through initiatives that improve the investment climate, accelerate tariff reductions under the AFTA-CEPT, remove non-tariff barriers, strengthen rules of origin, and liberalize services.

During the second half of the 2000s, ASEAN continued its central role in building broader regional cooperation across Asia—raising its global profile. In addition to ASEAN+3, an ASEAN+6 process was created in December 2005—adding Australia, India, and New Zealand under the East Asia Summit (EAS). EAS membership was expanded in 2010 to include the Russian Federation and the United States (US). ASEAN also concluded bilateral "ASEAN+1" free trade agreements (FTAs) with ASEAN+6 countries (starting in 2004 with the PRC, followed by the Republic of Korea in 2006, Japan in 2008, and India, as well as Australia and New Zealand in 2009.

ASEAN's 40th anniversary was celebrated in Singapore in November 2007 by adopting the AEC Blueprint—which advanced the AEC completion target to 2015 (from 2020).[14] The AEC Blueprint is a ground-breaking, comprehensive, detailed plan with a clear timetable for meeting targets. It defines the AEC through four pillars: (i) creating a single market and production base, (ii) increasing competitiveness, (iii) promoting equitable economic development, and (iv) further integrating ASEAN with the global economy.

Two major complementary steps were taken with the entry into force of the ASEAN Trade in Goods Agreement (ATIGA) in 2010 and the ASEAN Comprehensive Investment Agreement (ACIA) in 2012. The ACIA accelerates AEC Blueprint implementation in terms of investment cooperation beyond the 1998 AIA Framework Agreement, while the ATIGA consolidates commitments liberalizing tariff and non-tariff measures on trade in goods, and simplifies rules of origin and other customs and phyto-sanitary issues (see next section).

The 2008/09 global financial crisis and ensuing recession hurt ASEAN mainly through the trade channel—the more open economies were more heavily affected. After the initial shock, however, ASEAN by and large recovered rapidly—collectively bolstering the group's confidence with FDI back on the upswing and member countries strengthening their role in international and regional production networks as well as global supply chains.

In addition to the ACIA and ATIGA, ASEAN cooperation initiatives after the 2008/09 crisis were designed to maintain ASEAN's "centrality" in Asia's economic and institutional architecture. They also adopted a more people-centered approach—stressing benefits for ASEAN citizens as well as "member states." Priorities in narrowing development gaps both within and across countries became prominent goals. The 2011 Bali Concord III consolidates these priorities as part of an ASEAN Framework for Equitable Economic Development—designed

14 The adoption of the AEC Blueprint followed the decision made at the Cebu Summit in January 2007 to accelerate the creation of the ASEAN Community from 2020 to 2015.

to speed the Initiative for ASEAN Integration introduced in 2002 precisely to narrow development gaps.

To facilitate expanding ASEAN's outreach, Cambodia organized a "Global Dialogue" with major multilateral institutions in 2012. Its aim was to ensure ASEAN is included and actively participates in the evolving international order—boosting its voice as standards of global governance are redefined given the long-lasting global repercussions in the aftermath of the 2008/09 crisis. The Phnom Penh Agenda, also adopted in 2012, addresses climate change—raises awareness on adaptation and mitigation—and the sustainable management of energy, water, and other natural resources. The agenda stresses the need to forge a unified ASEAN spirit to motivate members to follow the 2015 AEC Blueprint.

The recently concluded 23rd Summit in Brunei Darussalam recognized the importance of strengthening ASEAN's institutional organs, the ASEAN Secretariat, the Committee of Permanent Representatives (CPR), and others, announcing the creation of a High-Level Task Force to prepare an action plan in this direction. Leaders also recognized the need to prepare an ASEAN Community's Post-2015 Vision (see section 1.3). Hopefully, such a vision—expected to be ready at the time of the 27th Summit in 2015—will include the creation of a truly "borderless" economic community by 2030.

1.2 Global and Regional Economic Context

Cooperation initiatives such as the AEC combined with the market forces that helped create production networks and supply chains across the region will contribute to ASEAN countries' growth and prosperity (Kawai et al. 2010).

Today, ASEAN already represents a major economic bloc in Asia—with a total land area of more than 4,300 square kilometers (about 1.5 times that of India or 0.5 times that of the PRC) and home to about 620 million people (nearly 9% of the world total). Its GDP is above $2.3 trillion, or about 3.3% of the global total—up from 1.6% in 1990. Its average per capita income (at market prices) was close to $3,800 (between that of India and the PRC), or about one-third the global average—up from one-fifth in 1990 (Table 1.1).

Despite the trend toward closer integration, ASEAN's diversity continues as one of its distinctive characteristics. Regional averages mask huge differences across and within members—both in stage of development and quality of life. For example, per capita GDP (at market prices) in Singapore in 2012 was almost 60 times that of Myanmar. Collectively, the CLMV countries share about 30% of ASEAN's total land mass and population, but only 10% of its GDP. Indonesia, ASEAN's largest country covering about 40% of the group's land area and GDP, has a population more than 560 times that of Brunei Darussalam, which with

Table 1.1 Selected Indicators for ASEAN and Other Asian Economies, 2012[a]

			Gross Domestic Product			GNI	Trade			
	Land Area[b]	Population[c]	Total ($ billion)	PPP[d] ($ billion)	Per Capita ($)	Per Capita ($)	Total Exports ($ billion)	Total Imports ($ billion)	Exports/ GDP (%)	Share of World Total Exports (%)
Brunei Dar.[e]	5.3	0.4	17.0	21.6	42,380	31,590	11.9	6.5	70.3	0.07
Cambodia	176.5	15.3	14.1	36.5	926	880	7.8	15.3	55.3	0.04
Indonesia	1,811.6	244.5	878.5	1,203.6	3,594	3,420	190.0	191.7	21.6	1.06
Lao PDR	230.8	6.6	9.2	18.9	1,380	1,260	3.3	6.3	36.2	0.02
Malaysia	328.6	29.5	304.7	494.7	10,345	9,800	227.6	196.8	74.7	1.27
Myanmar[f]	653.5	63.7	55.3	102.6	868	1,580	8.3	16.9	15.0	0.05
Philippines	298.2	95.8	250.2	419.6	2,612	2,470	52.0	61.7	20.8	0.29
Singapore	0.7	5.3	276.5	323.0	52,056	47,210	409.7	380.0	148.2	2.29
Thailand	510.9	67.9	366.0	645.2	5,390	5,210	227.9	251.5	62.3	1.28
Viet Nam	310.1	88.8	155.6	336.2	1,753	1,400	110.8	111.6	71.2	0.62
ASEAN	**4,326.1**	**617.7**	**2,327.0**	**3,602.0**	**3,767**	**3,603**	**1,249.6**	**1,235.9**	**53.7**	**7.00**
ASEAN-6	2,955.2	443.3	2,092.9	3,107.7	4,721	4,463	1,119.4	1,085.7	53.5	6.27
CLMV	1,370.9	174.3	234.1	494.3	1,343	1,415	130.2	150.2	55.6	0.73
Other Asian Economies										
HKG	1.0	7.2	263.3	365.6	36,676	36,560	443.1	504.7	168.3	2.48
India	2,973.2	1,227.2	1,841.7	4,715.6	1,501	1,530	297.3	490.4	16.1	1.66
Japan	364.5	127.6	5,960.3	4,575.5	46,707	47,870	798.6	886.0	13.4	4.47
PNG	452.9	6.826	15.1	18.7	2,217	1,790	11.8	8.9	78.0	0.07
PRC	9,327.5	1,354.0	8,221.0	12,261.3	6,071	5,680	2,050.1	1,817.3	24.9	11.48
Rep. of Korea	97.1	50.0	1,129.5	1,597.6	22,589	22,670	547.9	519.6	48.5	3.07
Taipei,China	36.0	23.3	474.1	894.3	20,336	17,738	301.2	270.5	63.5	1.69
Timor-Leste[g]	14.9	1.2	6.3	23.2	5,464	3,670	0.0	0.7	0.5	0.00
World	**129,710.3**	**7,046.0**	**72,216.4**	**83,193.4**	**10,249**	**10,012**	**17,854.8**	**18,414.3**	**24.7**	**100.00**

ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; Brunei Dar. = Brunei Darussalam; CLMV = Cambodia, Lao PDR, Myanmar, and Viet Nam; GNI = gross national income; HKG = Hong Kong, China; Lao PDR = Lao People's Democratic Republic; PPP = purchasing power parity; PRC = People's Republic of China.

Notes: [a] Population and GDP figures are estimates for 2012, exports and imports figures are actual data in 2012 for all economies except Timor-Leste, land area is from actual 2011 data; [b] thousand square kilometers; [c] million people; [d] current international $ billions for 2012; [e] GNI figures are for 2009; [f] GNI figures are for 2010; [g] trade figures are estimates for 2011, exports exclude oil.

Sources:

(i) Population and GDP figures are sourced from the International Monetary Fund, World Economic Outlook Database, October 2013. http://www.imf.org/external/pubs/ft/weo/2013/02/weodata/index.aspx (accessed October 2013).

(ii) Imports and exports figures are sourced from the International Monetary Fund, Direction of Trade Statistics (DOTS). http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=170921 (accessed October 2013).

(iii) GNI and land area data are sourced from World Bank, World Development Indicators Database. http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&SdmxSupported=Y&CNO=2&SET_BRANDING=YES (accessed October 2013).

(iv) Trade figures of Taipei,China are sourced from the Directorate-General of Budget, Accounting and Statistics, Executive Yuan, Taipei,China. http://eng.stat.gov.tw/ct.asp?xItem=25763&CtNode=5347&mp=5 (accessed October 2013).

(v) Trade figures of Timor-Leste are sourced from Central Intelligence Agency, The World Factbook. https://www.cia.gov/library/publications/the-world-factbook/index.html (accessed October 2013).

400,000 people is ASEAN's smallest member—yet it boasts a per capita income comparable to that of Western European countries.

Four ASEAN members—Indonesia, Malaysia, the Philippines, and Thailand—have held middle income status for some time (with per capita income ranging from $2,500 in the Philippines to more than $10,000 in Malaysia), while Viet Nam just achieved lower middle income status in 2012, with a per capita income above $1,500. ASEAN's other three members—Cambodia, the Lao PDR, and Myanmar—remain low income, underdeveloped, with major pockets of poverty, even as economic growth is accelerating with a rapid improvement in living standards.

ASEAN is also one of the most open economic regions in the world, with total merchandise exports over $1.2 trillion—nearly 54% of total ASEAN GDP and 7% of global exports. Diversity again underlies these aggregates—Singapore is the most open economy (with export/GDP ratios of well over 100%) followed by Malaysia and Viet Nam, while Myanmar, Indonesia, and the Philippines have the lowest export/GDP ratio (between 15%–20%).[15]

1.2.1 Global Macroeconomic Trends

A growing consensus among international economists and political experts is that the last 20 years have seen the center of global economic gravity shifting toward Asia. This trend is likely to continue over the coming decades. The 2008/09 global financial crisis and recent sovereign debt crisis in Europe have hastened this process—emerging Asia has thus far maintained growth momentum despite external shocks and disruptions. While advanced (especially European) economies experience a prolonged period of subdued growth as their economies restructure, emerging markets are likely to show robust expansion even as they remain vulnerable to external shocks and face the challenges of adopting more sustainable and inclusive development. With emerging market demand rising as a source of growth, Asia will likely be the driver of emerging market expansion, although the Middle East, Latin America, and Africa are expected to boost their own economic influence in an increasingly multipolar, globalized world (Kohli et al. 2011).

Until 2007, the world economy had seen a long period of robust expansion—interrupted by several shocks—fueled in part by abundant liquidity coming from oil exporters' excess savings, growth in East Asia's emerging economies, and a few advanced countries. Low interest rates and financial innovation led to unprecedented large consumption, particularly in the US and parts of Europe, and created housing bubbles in many advanced countries. Excessive leveraging and imprudent lending burst these bubbles, exposing

15 It should be noted that Viet Nam has experienced a dramatic increase in its degree of trade openness (total exports plus imports over GDP), from 24% in 1985 to 160% in 2012.

sharply increased household indebtedness and systemic financial weakness in advanced economies. This led to sudden bankruptcies and forced consolidation among the more fragile US and European financial institutions, with complex and widespread risk rapidly spreading through contagion, eventually leading to the global credit crunch and 2008/09 global financial crisis.

To keep the financial system running, governments and monetary authorities had to bail out troubled, systemically critical financial institutions—those "too big to fail"—significantly adding to government debt, further dampening growth prospects in advanced economies. Since 2010, global finance was further shaken by the mounting eurozone sovereign debt crisis. Sovereign borrowing costs rose sharply in several European countries. This crisis is still unfolding but seems to have emerged beyond its trough. Even with a successfully managed recovery, growth will likely remain sluggish in Europe over the next several years as austerity programs are forced upon governments seeking bailout funds.

To support advanced economies facing long-term sluggish growth or further recession, high unemployment, and debt restructuring, major central banks used unconventional monetary easing policies to spur economic activity. This resulted in another surge in global liquidity with potential spillover effects on emerging markets—including ASEAN—exposed to potential volatility and large swings in liquidity. High liquidity and low interest rates in advanced countries led to large "search-for-yield" high-risk capital outflows to emerging markets. Emerging markets are then exposed to possible overheating and excessive credit growth, together with exchange rate appreciation (hurting exporters), greater domestic bank loan exposures, and—in sum—weakening overall macroeconomic and financial stability.

To steady these financial foundations, macroprudential policy has become a critical, essential element in Asia's macroeconomic management. Countries have adopted an array of exchange rate policies and interventions that could distort price competitiveness and disrupt the underlying stability that is the foundation for smooth functioning production networks. Similar to the 1997/98 crisis aftermath, ASEAN members have largely pursued market-based exchange rate regimes, whereas the PRC yuan appreciation against the US dollar has been tightly managed. With current account surpluses and capital inflows, most ASEAN currencies may continue to appreciate both against the dollar and the yuan—thus weakening competitiveness against the PRC. Overall, continued sluggish export demand from advanced economies increases competitive pressure on ASEAN countries from the PRC—and increasingly India.

1.2.2 Asia's Regional Context

In addition to the changing global context, ASEAN also faces major changes within Asia. Japan will likely continue to play its role as a major ASEAN partner, partly as an export market, but more through production networks supported by FDI and as a partner in technological development. While Japanese FDI flows to the PRC have been larger than those to this past decade, the cumulative Japanese FDI stock in ASEAN remains higher than in the PRC. Given increasing competition from the PRC, ASEAN-based Japanese firms must cut costs and raise productivity. Their investment and production strategies will shift from being country-specific to ASEAN-based—to optimize production processes and achieve higher returns of scale (Sussangkarn 2003).

Removing all barriers to internal trade is vital to reduce production costs, enabling investors to compete with PRC-based companies. Creating a borderless ASEAN market also has the potential to strengthen trade and investment links with the Republic of Korea and Taipei,China, as these economies continue to advance and relocate production facilities. The growth in intermediate trade has been the glue for binding East Asian economies and linking them to international markets.

Indeed, the PRC and India benefit from huge—single—domestic markets. By 2030, economic size and purchasing power should increase dramatically with the emergence of a large middle class in both countries. Recent estimates suggest India's total population will reach 1.5 billion, with more than 70% at medium- or high- income levels, defined by World Bank standards. An estimated 85% of the PRC's 1.4 billion population by 2030 are expected to be at these income levels (ADB and ADBI 2014). Having such large markets at its doorstep is a huge opportunity for ASEAN. But it also raises an essential, major challenge of creating a truly borderless single market—a challenge which will require all members to ingrain the deep structural reforms needed to boost productivity and competitiveness.

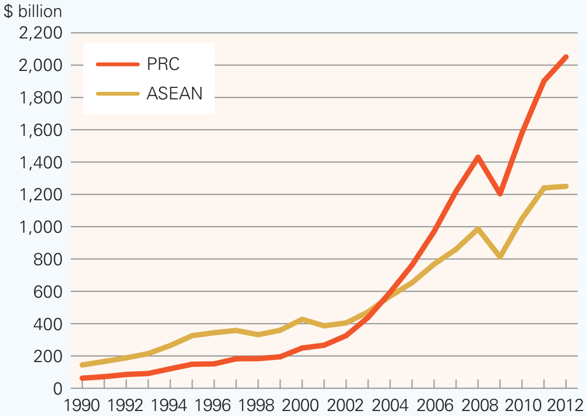
Given current global economic prospects, several regional export trends will likely accelerate. In particular, after the 1997/98 Asian financial crisis, PRC exports began to grow much more rapidly than ASEAN's. As a result, ASEAN's share in world trade stagnated—even if ASEAN benefited from its own increased exports to the PRC (Figure 1.3).

Slowing demand from advanced markets will substantially increase competition from vibrant emerging markets, risking further erosion of ASEAN's export share. A rapidly expanding PRC domestic market—combined with increased competition in export markets—could further deflect FDI toward the PRC, accelerating the trend since the mid-1990s. As mentioned, divergent exchange rate movements between ASEAN and the PRC could further cloud the outlook (Figure 1.4).

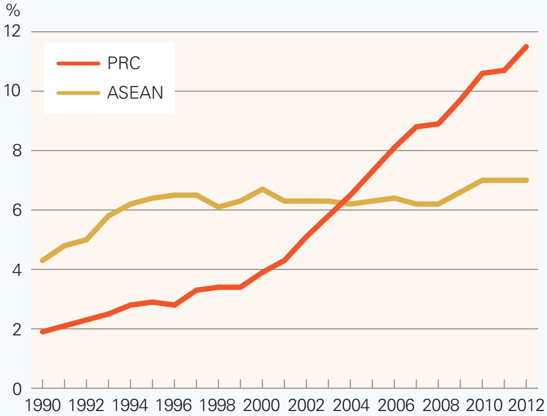
India has also grown rapidly over the past decades—with many local firms globally competitive and increasingly challenging ASEAN products in export markets. In response, ASEAN must urgently work to accelerate meeting AEC targets on its way toward creating an integrated single market—one that gives it critical market mass and allows productivity and innovation to keep it competitive. In other words, ASEAN must think and move beyond the AEC—by improving connectivity, eliminating remaining barriers to the cross-border flow of goods, reducing trade costs, liberalizing services, and integrating its financial systems.

Figure 1.3 ASEAN and PRC: Merchandise Exports and Shares in World Trade, 1990–2012

(a) Merchandise Exports ($ billion)



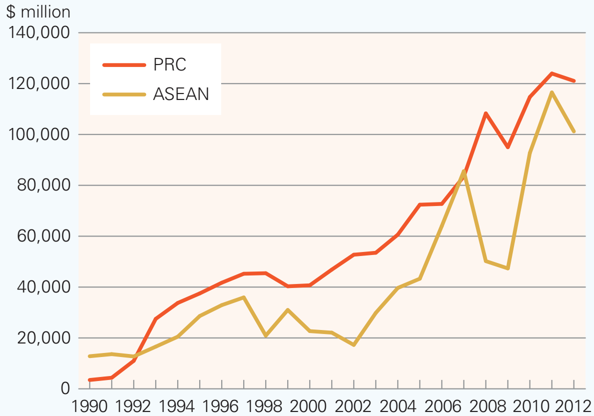
(b) Share of Total World Exports (%)



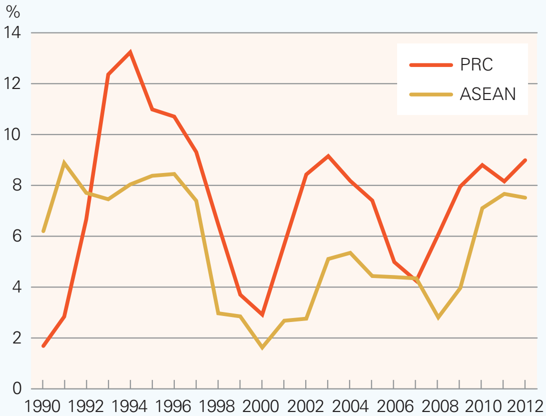
ASEAN = Association of Southeast Asian Nations; PRC = People's Republic of China.
Source: International Monetary Fund, various years. Direction of Trade Statistics.
http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=170921 (accessed September 2013).

Figure 1.4 Foreign Direct Investment to ASEAN and PRC, 1990–2012

(a) FDI Inflows ($ million)



(b) Share of World FDI Inflows (%)



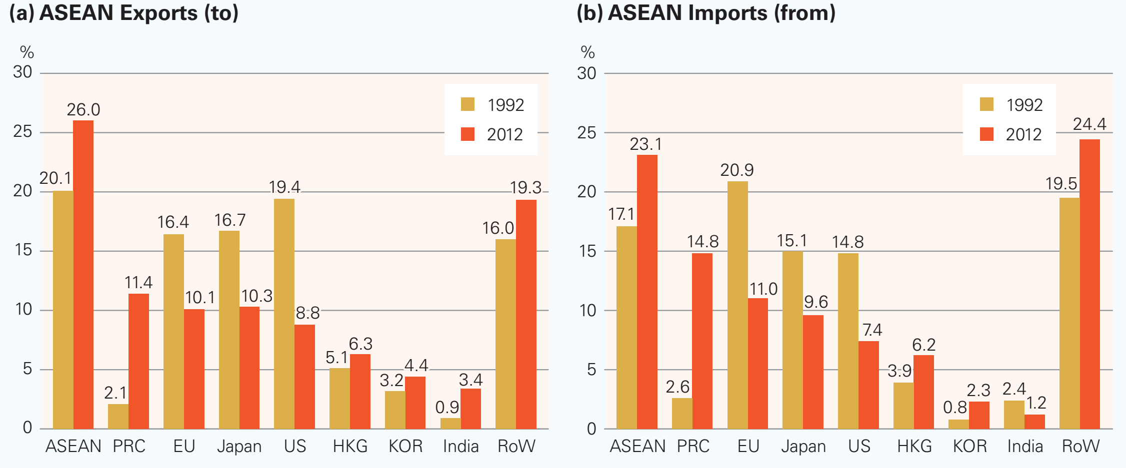
ASEAN = Association of Southeast Asian Nations; FDI = foreign direct investment; PRC = People's Republic of China.
Source: United Nations Conference on Trade and Development, Foreign Direct Investments Statistics Database.
http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx (accessed September 2013).

The AEC is a major step in the right direction. But much more will be required for ASEAN to cope with its future challenges.

In the years running up to 2030, ASEAN's economic opportunities will be enormous. First, an ASEAN market is large enough to bring economies of scale. Second, new domestic and regional demand—from the PRC, India, and other Asian economies—hold huge potential for increasing trade. Exports to the PRC steadily expanded from 2.1% of total ASEAN exports in 1992 to 11.4% in 2012. Exports to India remain well below potential—just 3.4% of total ASEAN exports in 2012, up from 0.9% in 1992. With better connectivity and fast income growth, India can also become a key ASEAN partner over the next two decades (Figure 1.5).

Beside manufactured exports, changing patterns of Asian consumerism should benefit resource and agriculturally rich ASEAN economies. Rapidly rising energy and food demand from the PRC, India, and the Asian region generally hold large potential gains. A competitive ASEAN will also increase its role as both exporter and importer to expanding emerging markets outside Asia, such as Latin America and Africa, increasing "South–South" trade.

Figure 1.5 ASEAN Trade by Economy and Region, 1992 and 2012
(% shares on total trade)



ASEAN = Association of Southeast Asian Nations; EU = European Union; HKG = Hong Kong, China; KOR = Republic of Korea; PRC = People's Republic of China; RoW = Rest of the World; US = United States.
Source: International Monetary Fund, Direction of Trade Statistics. http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=170921 (accessed October 2013).

1.2.3 Free Trade and Investment Agreements

Over the past few years, ASEAN members have proliferated FTAs and broader economic partnership agreements (EPAs) to facilitate trade and investment with key economic partners—and allow firms to boost competitiveness. By the end of 2013, a total of 90 FTAs involving ASEAN countries were either signed, being negotiated, or proposed (Table 1.2).[16] Most agreements came into being after 2000, with an increasing number involving non-ASEAN countries—an indication of ASEAN's open regionalism (ADB 2008b, 2010a; Plummer and Chia 2009).

Of the 40 signed FTAs, 29 were bilateral (between one ASEAN and one non-ASEAN country)[17] and 11 either plurilateral (between one ASEAN country and two or more non-ASEAN countries) or multilateral agreements (between two or more ASEAN countries and one or more non-ASEAN countries). These FTAs include the AFTA and five major ASEAN+1 agreements concluded with Australia-New Zealand, the PRC, India, Japan, and the Republic of Korea. The remaining 50 FTAs were under negotiation (29) or under study/proposed (21). Most of these agreements are expected to become effective by 2020 (see Table A1.1 in the appendix to this chapter for a detailed FTA list).

A main reason behind the exponential growth in FTAs derives from the difficulties in concluding the multilateral Doha Round of the World Trade Organization (WTO). While in December 2013 the WTO was able to make

Table 1.2 Status of ASEAN Free Trade Agreements
(as of July 2013)

Type	Signed	Under Negotiation	Proposed	Total
Multilateral	9	5	4	18
Plurilateral	2	10	3	15
Bilateral	29	14	14	57
Total	**40**	**29**	**21**	**90**

Bilateral—between two economies: one ASEAN and one non-ASEAN member (with the exception of the Lao PDR-Thailand Preferential Trading Agreement).
Multilateral—between two or more ASEAN members and one or more non-ASEAN members (includes ASEAN+1 agreements).
Plurilateral—between one ASEAN member and two or more non-ASEAN members.
Source: ADBI staff and Asian Development Bank. Asia Regional Integration Center. http://aric.adb.org/ftatrends.php (accessed September 2013).

16 The term FTA is used in a wide sense to cover also EPAs which include provisions not only related to liberalization and facilitation of goods and service trade, but also investment, capital, and labor movements.
17 With the exception of the FTA between the Lao PDR and Thailand, both ASEAN members.

some progress at a meeting in Bali after years of stalled negotiations, the reached agreement is still on relatively minor issues and may not substantially affect the trend started by Asian economies of embracing regionalism as the bottom–up response.

Although several trade experts see these myriad agreements eventually costing more than the benefits accrued — due to the so-called "spaghetti bowl" (Bhagwati 1995) or "Asian-noodle bowl" effect (ADB 2008b) — several countries have stayed on the FTA/EPA bandwagon for a variety of reasons, such as the simplification of trade negotiations with limited parties, or simple peer pressure — which creates a domino effect with self-sustaining dynamics (Baldwin 1996).[18] To untangle multiple agreements — partly due to this criticism and partly to affirm group relevance — several proposals over the past few years have tried to "consolidate" bilateral and plurilateral FTAs under wider regional arrangements. Welfare gains — which grow with agreement coverage — have also been a persuasive argument in favor of "consolidation" (Kawai and Wignaraja 2009).

A few months after the EAS was formed in December 2005, the Comprehensive Economic Partnership for East Asia (CEPEA) was proposed to create a regional block by the ASEAN+6. This proposal did not receive immediate attention, but it gained momentum after ASEAN+1 agreements were signed with Australia, New Zealand, and India in 2009. The creation of an East Asian Free Trade Area (EAFTA) focusing on ASEAN+3, eventually leading to a CEPEA, has also been considered, although progress in this direction is yet to be seen. The uncertain pace of negotiations for an FTA among the PRC, Japan, and the Republic of Korea (CJK) has however been a major hampering factor.[19]

Trans-Pacific Partnership

Following the creation in 2006 of a Trans-Pacific Strategic Economic Partnership Agreement among four small, very open Asia-Pacific economies (Brunei Darussalam, Chile, New Zealand, and Singapore), negotiations began in 2007 to establish a Trans-Pacific Partnership (TPP), broadening the process to a larger number of APEC economies.[20] The US joined negotiations in 2008, and since the emphasis placed by the Obama administration on the successful conclusion of the agreement, the TPP is being regarded as a US-led initiative.

18 The "spaghetti bowl" or "Asian-noodle bowl" derives from a multiplicity of FTAs, each with different structures, coverage, and rules of origins. FTA critics argue that managing this complex system of FTAs is very costly for everyone — government agencies as well as business entities. This could counter the *raison d'être* for FTAs in the first place, adding costs as firms wade through each FTA, assessing which is more beneficial.

19 ASEAN and the "Plus-Three" countries are the two blocs of the proposed EAFTA. As political factors and territorial disputes are slowing down negotiations for a proposed CJK FTA, the outcome is affecting progress toward the EAFTA creation.

20 A Free Trade Area of the Asia-Pacific (FTAAP) involving all 21 APEC members was proposed by APEC's Business Advisory Council in 2006.

Once realized, the TPP is expected to generate large income gains due to the opportunities offered to both emerging markets and advanced economies (Petri and Plummer 2012). Twelve APEC economies—four from ASEAN—are currently part of TPP official negotiations: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US, and Viet Nam. The Republic of Korea has also shown keen interest to join the group. The deadline to conclude negotiations was initially set for the end of 2013, but after failing to meet this target the negotiating parties did not announce any new expected date to finalize the TPP.

Based on the TPP Leaders Statement signed in Honolulu in 2011, this FTA would be a comprehensive "21st Century" agreement covering a number of sectors often excluded from similar deals, such as agriculture and the environment (Fergusson et al. 2013). The TPP addresses issues related to technical trade barriers, intellectual property rights, sanitary and phyto-sanitary measures, government procurement, trade in services (including financial services), competition policy, and investment. Thus, it is considered a "high standard" agreement, potentially moving FTA negotiations from a focus on quantity to one of quality. For now, however, several key Asian players—such as the PRC, Indonesia, and India—have decided to not participate in TPP negotiations.[21]

Regional Comprehensive Economic Partnership

Another major initiative introduced by ASEAN at the 19th Summit in Bali in November in 2011 with the goal of untangling the noodle bowl while maintaining "centrality" is the Regional Comprehensive Economic Partnership (RCEP)—an idea gaining rapid momentum. A product of the 18th ASEAN Economic Ministers' Retreat in February 2011, RCEP was likely conceived in response to the threat that the TPP could divide ASEAN member states between those joining and those remaining out of it (Box 1.1).

The agreement is designed to have a broader and deeper engagement among participating countries than the existing ASEAN+ FTAs, aiming in particular to be more comprehensive but less stringent on requirements than the TPP as it recognizes the diversified circumstances of member countries (i.e., allowing longer time for implementing liberalization schemes and adopting a more flexible approach for countries requiring temporary exclusion for sensible sectors, with some possible permanent exclusions as well). It pulls together all existing ASEAN+1 FTAs while

21 The fact that only four of the ten ASEAN members have decided (so far) to join TPP negotiations is often perceived as an issue for the group's cohesion, implying the desirability to see more countries participating in the future. As the four ASEAN members which are currently joining TPP negotiations (Brunei Darussalam, Malaysia, Singapore, and Viet Nam) are also the more "open" economies in the group (in terms of trade/GDP ratio) it is not surprising that considerable discussion has been ongoing in Thailand—the next "open" ASEAN economy—to take part in the group, while Indonesia has shown less interest. The other three ASEAN economies—Cambodia, the Lao PDR, and Myanmar—are, like India, not (yet) APEC members.

leaving the partnership open for any other member of bilateral or multilateral FTA to join, should those covered desire (Fukunaga and Isono 2013; Wang 2013).

The RCEP aims to rationalize rules of origin by using a simplified approach to their definition. It focuses on non-tariff barriers, streamlining and harmonizing custom procedures, and making them more consistent and predictable than in existing agreements. It covers trade in goods and services, investment, competition, intellectual property rights, dispute settlement mechanisms, the environment, as well as economic and technical cooperation—a component revealing its development orientation, which is not part of the TPP (Elms and Lim 2012).[22]

Once realized, the RCEP has the potential to generate large economic gains for ASEAN members and other participating countries. Numerical attempts to quantify its "income effect" suggest a possible significant increase in ASEAN+6 countries' GDP from a consolidation of existing ASEAN+1 FTAs (Kawai and Wignaraja 2009). Besides, a multiplier effect can also be created by the expansion of production networks and further gains can occur through the reduction of bilateral agreements' inefficiencies, or the spaghetti bowl effect. But RCEP countries will be facing a number of challenges to successfully conclude negotiations as they work to eliminate these inefficiencies toward the harmonization of different components of bilateral agreements. Existing ASEAN+1 FTAs, for example, vary considerably in terms of tariff elimination rates, with the ASEAN–Australia–New Zealand FTA showing the highest rate at 95.7% and the ASEAN–India FTA the lowest at 79.6%. They also differ substantially on the rules of origin that decide the eligibility of goods and services for preferential treatment (Baldwin and Kawai 2013).

Another key challenge to realize the RCEP is the absence of bilateral FTAs among some major negotiating parties, such as the PRC and Japan, Japan and the Republic of Korea, or the PRC and India—the "bucket" effect. Although talks for a CJK FTA were launched in 2013, the prospects to conclude such negotiations anytime soon are clouded by the presence of territorial disputes between these countries.

Currently ongoing RCEP negotiations are expected to be completed by 2015.[23] At the moment, the agreement involves all ASEAN+6 countries, overlapping with the proposed CEPEA membership (Figure 1.6). More countries, either from Asia or outside the region, can however be invited to join the RCEP in the future.

Moving Forward

A debate on the role of the TPP and RCEP—and their relationship—was recently started both at the national and regional level, focused on costs and benefits of membership and whether they are competing or complementary agreements (ADB

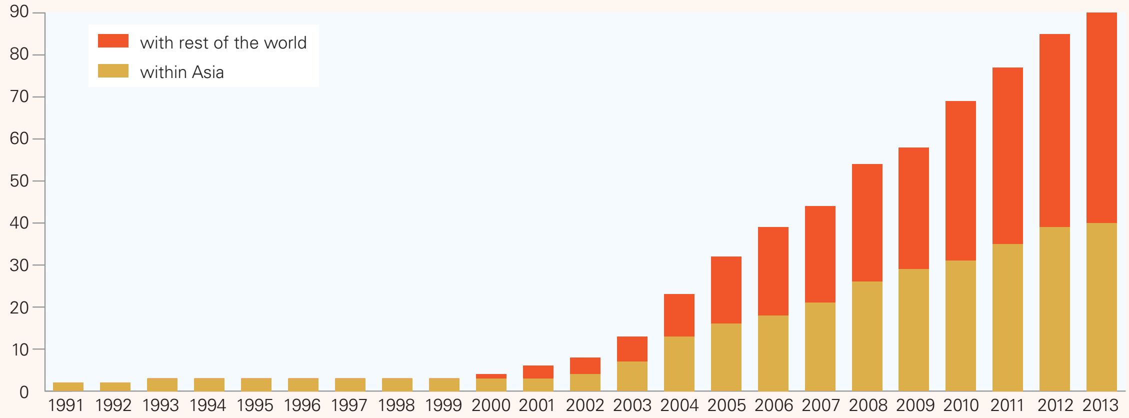
22 Negotiations also cover issues related to labor movements, government procurement, and SMEs.

23 The first two rounds of RCEP negotiations were held in 2013 in Brunei Darussalam (May) and in Australia (September). The third round was successfully concluded in January 2014 in Kuala Lumpur, Malaysia and a fourth round in April 2014 in the PRC.

Box 1.1 Streamlining ASEAN Free Trade and Investment Agreements: The RCEP

Since the early 2000s, members of the Association of Southeast Asian Nations (ASEAN) have been actively introducing trade and investment agreements with partners in Asia and elsewhere. While 90 agreements were in place by the end of 2013, the number was close to zero at the end of the 1990s (Figure B1.1).

Figure B1.1 Exponential Growth of ASEAN Trade and Investment Agreements, 1991–2013
(total number of agreements signed, under negotiation, or being proposed)



ASEAN = Association of Southeast Asian Nations.
Source: Asian Development Bank, Asia Regional Integration Center. http://aric.adb.org/ftatrends.php (accessed September 2013).

To streamline existing agreements under a wider umbrella, ASEAN introduced the Regional Comprehensive Economic Partnership (RCEP)—inviting trade and investment partners to join the initiative. The proposal, formulated in 2011, came at a time ASEAN was facing pressure to consolidate existing bilateral agreements under broader frameworks, while facing some internal divisions prompted by the plan to establish a Trans-Pacific Partnership (TPP) among a subset of Asia-Pacific Economic Cooperation (APEC) members—involving only four of ASEAN's 10 members.

The RCEP is potentially a very powerful initiative, accounting for about 30% of both global gross domestic product and trade. It focuses on building momentum among Asian economies by promoting closer trade and investment interdependence. It is designed to provide a broad framework to include existing agreements, enhancing their principles while deepening and widening coverage. If successful, the RCEP will greatly strengthen ASEAN's central role as the key institution for Asian integration (Table B1.1).

Some experts see the RCEP in competition with the TPP, suggesting the two processes will coexist with some rivalry (ADB 2013b; Wu and Mealy 2012). However, while the TPP sets high requirements for participation—requiring agreements on "gold standards"—the RCEP is far more flexible and pragmatic in approach, recognizing the different circumstances of highly diverse trade and investment partners and promoting economic and technical cooperation (Basu Das 2012b; Hawke 2012).

Table B1.1 RCEP's Structural Components

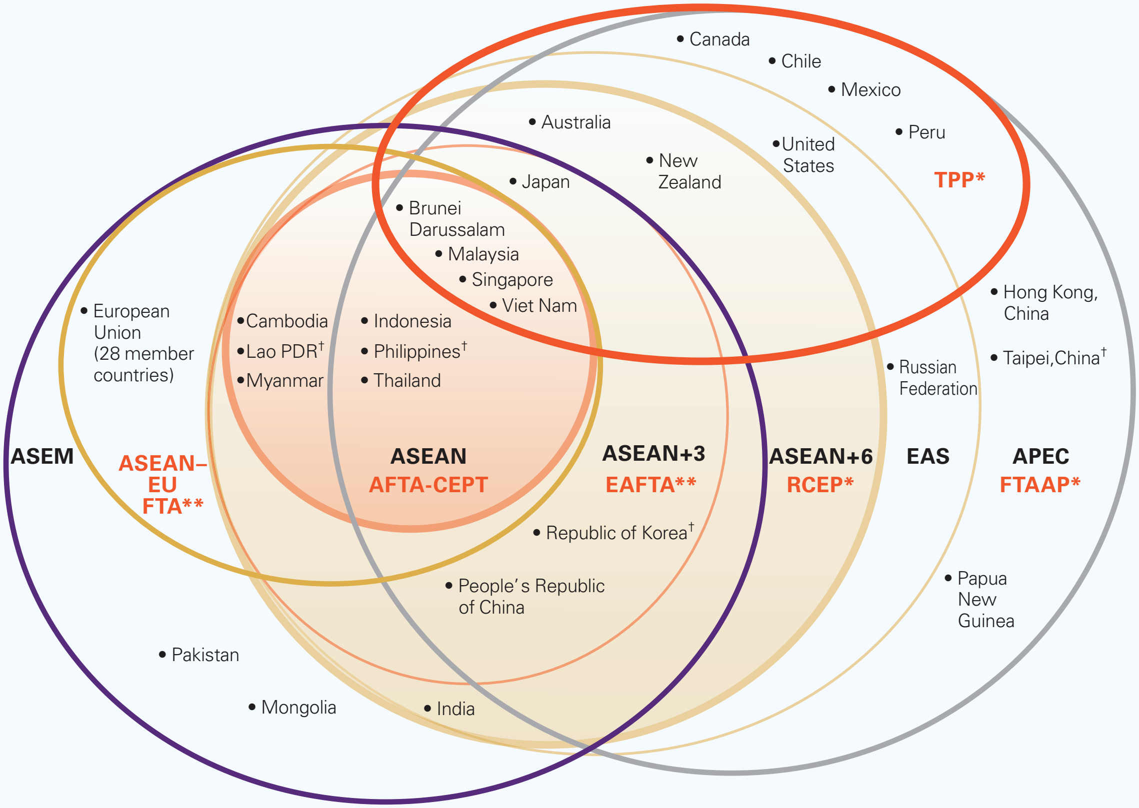
Objectives	Timeline
• Improve existing agreements through a wider coverage and level of commitment • Create broader opportunities for firms and consumers by lowering the impediments and other costs for business transactions • Maintain ASEAN central role in designing and implementing Asia's regional economic architecture	• Launched in Bali in November 2011 — first discussed in Nay Pyi Taw in April 2011 • Endorsed in Phnom Penh in November 2012 (internal agreement reached in Siem Reap in August 2012) • Negotiations started in early 2013 — expected to be completed by end 2015
Principles	**Components**
• **Rationalization of rules of origin** — using a simplified approach to their definition • **Special treatment granted to developing countries** — can delay commitments' implementation • **Open accession** — any ASEAN partner country of existing FTAs can choose to join negotiations • **Periodic review** of achievements for effective agreement's implementation • **Focus on non-tariff barriers** — streamline and harmonize customs procedures; make them more consistent and predictable • **Develop regional standards and common approaches** to testing methods and conformity assessments • **Consistency with WTO rules** — coverage of WTO-plus issues • **Promotion of domestic structural reforms** to implement liberalization and facilitation measures	• **Trade in goods** — elimination of tariff rates on a wider range of lines than those already agreed with existing partners (protection may be allowed through transitional safeguard mechanisms if imports cause injury to domestic industries) • **Trade in services** — adoption of a sector-wise liberalization, identifying areas with large potential to generate results (i.e. tourism) • **Investment** — emphasis on liberalization to facilitate investment flows • **Competition** — reduction of regulatory and administrative costs • **Intellectual property rights** — focus on protection and enforcement issues • **Dispute settlement mechanism** — to be embedded in the agreement • **Economic and technical cooperation** — to complement and support the agreement *[working groups have been created in each of the above seven components]*

ASEAN = Association of Southeast Asian Nations; FTA = free trade agreement; RCEP = Regional Comprehensive Economic Partnership; WTO = World Trade Organization.
Source: Authors, based on information from the ASEAN Secretariat and press reports, including the "ASEAN Framework for Regional Comprehensive Economic Partnership" (http://www.asean.org/news/item/asean-framework-for-regional-comprehensive-economic-partnership) and the "Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership" (http://www.meti.go.jp/press/2012/11/20121120003/20121120003-4.pdf).

By any account, the timely and successful conclusion of the RCEP—expected by the end of 2015—will offer great opportunities for ASEAN. But it also presents formidable challenges, given in particular the limited resources invested in the ASEAN Secretariat—which is leading negotiations—and national perspectives that may diverge over time. To overcome these challenges and bring RCEP success, ASEAN must speak with one voice and act as a single economic bloc. Thus, critically important is for the group to rapidly implement the ASEAN Economic Community and move beyond it. The RCEP has indeed the potential to become a key pillar in Asia's evolving economic architecture.

Source: Authors based on various ASEAN Secretariat's communiqués and press reports.

Figure 1.6 RCEP, TPP, and Other FTAs



AFTA = ASEAN Free Trade Area; APEC = Asia-Pacific Economic Cooperation; ASEM = Asia–Europe Meeting; ASEAN = Association of Southeast Asian Nations; CEPT = Common Effective Preferential Tariff; EAFTA = East Asian Free Trade Area; EAS = East Asia Summit; EU = European Union; FTA = free trade agreement; FTAAP = Free Trade Area of Asia and the Pacific; Lao PDR = Lao People's Democratic Republic; RCEP = Regional Comprehensive Economic Partnership; TPP = Trans-Pacific Partnership.
Notes: *under negotiation; **proposed; †expressed interest to join the TPP.
Source: Authors.

2013b; Cheong 2013). While proponents of the competitive view focus on the fact that the US is not part of the RCEP and that the PRC and India are excluded from the TPP, in reality both agreements are open to receive new members and should be regarded as complementary FTAs.[24] In particular, it is easier for developing countries which are ready for some degree of liberalization to join the RCEP, while economies

24 At the time this report went to press (June 2014), in addition to the Republic of Korea seriously discussing the possibility of joining TPP negotiations, Thailand and the Philippines have also expressed their keen interest. The PRC was also carefully considering its options, with a number of influential Chinese analysts suggesting the country should join negotiations as soon as possible (Wang 2013).

intending to undertake deeper liberalization can (also) aim to be TPP members. Eventually, the two FTAs could converge to form a wide and deep agreement, with large income gains for its members. As more ASEAN countries will be ready to join TPP negotiations, benefits for the region (and the world) are expected to increase.[25]

ASEAN countries could also largely benefit from signing FTAs with the EU. Currently, Malaysia, Singapore, Thailand, and Viet Nam are independently negotiating agreements with the EU, while individual discussions with other ASEAN member countries may also start soon.[26] An ASEAN–EU FTA has also been proposed. Although progress is currently slow, such an FTA would consolidate and replace individual country agreements and, if realized, generate large gains for its members. A successful conclusion of WTO negotiations on a broader range of issues than those agreed in Bali in December 2013 remains, however, the best possible outcome for ASEAN economies, also given their relatively high degree of openness to countries outside the region.

Ultimately, for ASEAN-based companies to take advantage of the RCEP, TPP, and other FTAs, ASEAN countries need to introduce productivity-enhancing domestic reforms and raise their competitiveness. Creating a truly borderless ASEAN economic community is vital to leveling the playing field with business firms in countries such as the PRC or India. For example, the ASEAN–PRC FTA allows ASEAN firms, particularly those food- and agriculture-based, to expand rapidly in the Chinese market. However, with PRC export growth to advanced economies slowing, PRC firms will likely be more active in exporting to neighboring Asian markets — closely competing with ASEAN firms. In this context, an RCEP that effectively unifies ASEAN+1 agreements will help maintain ASEAN's centrality in the regional economic architecture — giving the AEC more credence as a single integrated market. The TPP will also help to better integrate with Asia-Pacific economies.

ASEAN's regional and global relevance has steadily grown — through greater political and security cooperation, economic integration, and social cohesion. However, creating an ASEAN Community by 2015 also requires strong political-security and socio-cultural pillars. Thus the group will need to collectively address security and political issues such as those arising out of energy crises, territorial disputes, ethnic conflicts, and others.[27] Closer cooperation is a precondition for ASEAN to remain the driving force as an institution for Asian integration (ADB 2010a).

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25 It should be noted that similar tracks were supported by APEC as possible roads to the formation of an APEC-wide Free Trade Area of the Asia-Pacific (FTAAP) in the Yokohama Vision of 2010 (http://www.whitehouse.gov/the-press-office/2010/11/13/apec-leaders-declaration-yokohama-vision-bogor-and-beyond).

26 The negotiations for a Singapore–EU FTA were finalized in December 2012. While discussions on investment protection are still ongoing, both parties seem to be ready to sign the agreement very soon.

27 Competition for energy sources is geopolitical in nature and will likely intensify over the coming decades — growing demand from energy-deficient countries have already reignited friction over territorial disputes, such as the potentially energy-rich islands and atolls in the South China Sea.

1.3 Progress of the ASEAN Economic Community and Beyond

The blueprint for realizing the AEC is both comprehensive and ambitious to attain a single market and production base, allowing the free flow of goods, services, investments, and skilled labor, and the freer movement of capital across the ASEAN region. It aims to create a highly competitive region while ensuring growth is more equitable and inclusive. To monitor its progress, the four AEC pillars are broken down into 17 "core elements" of integration with 176 "targets" set over four sub-periods—ending in 2009, 2011, 2013, and 2015 (Figure 1.7). As an integration "project," its breadth and scope are arguably second only to the creation of the single market in the EU (Pushpanathan 2012).

Figure 1.7 ASEAN Economic Community: Structural Components

PILLARS	CORE ELEMENTS		
I. SINGLE MARKET AND PRODUCTION BASE	Free Flow of Goods	Free Flow of Skilled Labor	Priority Integration Sectors *Agro-based products; air travel; automotive; e-ASEAN; electronics; fisheries; healthcare; logistics; rubber-based products; textiles and apparel; tourism; wood-based products*
	Free Flow of Services	Free Flow of Investment	
	Freer Flow of Capital	Food, Agriculture, and Forestry	
II. COMPETITIVE ECONOMIC REGION	Competition Policy	Consumer Protection	Infrastructure Development *Transport; ICT* *Energy; mining* *Infrastructure financing*
	Taxation	Intellectual Property Rights	
	E-commerce		
III. EQUITABLE ECONOMIC DEVELOPMENT	Development of Small and Medium-Sized Enterprises		
	Initiative for ASEAN Integration		
IV. INTEGRATION INTO THE GLOBAL ECONOMY	Coherent Approach toward External Economic Relations *(includes FTAs and CEPs)*		
	Enhanced Participation in Global Supply Networks		

ASEAN = Association of Southeast Asian Nations, CEP = comprehensive economic partnership, FTA = free trade agreement, ICT = information and communication technology.
Source: ASEAN Secretariat and ADBI staff elaborations.

A single ASEAN production base should spur productivity, enhance the region's competitiveness, and boost income growth. A recent study estimates an approximate 5% gain in ASEAN's aggregate income once the AEC is in place (Petri et al. 2010). However, to reach this target, members must introduce deep structural reforms to their domestic systems. Completely removing trade and non-trade barriers on goods, services, and investment can indeed be a complicated affair which may require more time than initially thought. Countries will have in particular to undertake the significant regulatory harmonization that the AEC demands, agreeing on product and governance standards. Efficient infrastructure, transport and logistics, and competitive financial services must power trade efficiency. Fair and effective competition laws and policies, and consumer protection and ASEAN standards must be crafted. Efficiency in resource use is particularly important looking forward as the world likely has entered a period of "sustained high resource prices" (McKinsey 2011). A level playing field requires overcoming many hurdles — physical, technical, economic, institutional, political, and cultural. Bold decisions by ASEAN policymakers are needed and implementation needs close monitoring.

To track progress, the ASEAN Secretariat designed a detailed AEC Scorecard to monitor AEC Blueprint compliance. The usefulness of this scorecard is, however, limited, as the system neither offers nor enforces remedies when targets are missed. Also, there is no specific monitoring agency to consolidate members' reports on AEC target compliance. Nor is there any sanctioning for target delays — leaving the scorecard system severely limited. Without effective monitoring, it is difficult for assigned committees or expert meetings to tackle bottlenecks impeding progress. Still, while uneven, members are generally adhering to the AEC Blueprint and progress is being made (ASEAN 2012a). The ASEAN Secretariat estimates that between 2008 and 2011, 67.9% of the blueprint's deliverables were met (Table 1.3). To meet the end-2015 deadline, however, will require huge efforts if countries' are to comply fully with AEC commitments.

The problem is that, as required measures become more complex, compliance drags. While the accomplishment rate for Phase I (2008–2009) was 86.7%, the Phase II (2009–2011) rate fell to 54.6%. Phase III (2012–2013) and Phase IV (2014–2015) are more complex and demanding. Broadly, major delays come from (i) ratifying signed agreements and protocols — thus delaying effective implementation, (ii) completing specific country commitments, (iii) revising domestic laws, rules, and regulations to align them with AEC requirements, and (iv) implementing specific initiatives and measures. An assessment of current delays and their importance in meeting targets underlines the AEC challenge. This is what comes next.

Table 1.3 ASEAN Economic Community Implementation Progress
(as of December 2011)

ASEAN Scorecard System: Key Areas	Phase I (2008–2009)		Phase II (2010–2011)		Total Measures	
	Targeted	Fully implemented	Targeted	Fully implemented	Targeted	Fully implemented
	Pillar I: Single Market and Production Base					
Free Flow of Goods	9	9	47	23	56	32
Free Flow of Skilled Labor	0	0	1	1	1	1
Free Flow of Services	13	10	30	13	43	23
Free Flow of Investment	6	5	13	5	19	10
Freer Flow of Capital	1	1	5	5	6	6
Priority Integration Sectors	28	28	1	1	29	29
Food, Agriculture, and Forestry	8	8	11	5	19	13
Total Pillar I	65	61	108	53	173	114
Implementation Rate*	**93.8%**		**49.1%**		**65.9%**	
	Pillar II: Competitive Economic Region					
Competition Policy	2	2	2	2	4	4
Consumer Protection	2	2	9	5	11	7
Intellectual Property Rights	0	0	5	4	5	4
Transport	25	15	14	6	39	21
Energy	0	0	3	2	3	2
Mining	1	1	7	7	8	8
ICT	2	2	4	4	6	6
Taxation	0	0	1	0	1	0
E-commerce	0	0	1	1	1	1
Total Pillar II	32	22	46	31	78	53
Implementation Rate*	**68.8%**		**67.4%**		**67.9%**	
	Pillar III: Equitable Economic Development					
SME Development	1	1	7	4	8	5
Initiative for ASEAN Integration	2	2	2	1	4	3
Total Pillar III	*3*	*3*	*9*	*5*	*12*	*8*
Implementation Rate*	**100.0%**		**55.6%**		**66.7%**	
	Pillar IV: Integration into the Global Economy					
External Economic Relations**	5	5	9	7	14	12
Total Pillar IV	5	5	9	7	14	12
Implementation Rate*	**100.0%**		**77.8%**		**85.7%**	
	ASEAN Economic Community					
Total Measures in Four Pillars	**105**	**91**	**172**	**96**	**277**	**187**
Implementation Rate*	**86.7%**		**55.8%**		**67.5%**	

ASEAN = Association of Southeast Asian Nations; ICT = information and communication technology; SMEs = small and medium-sized enterprises.
Notes: *% of targets fully implemented; **includes ratification of various free trade agreements with the People's Republic of China, Japan, the Republic of Korea, Australia, New Zealand, and India.
Source: ASEAN Secretariat. 2012. ASEAN Economic Community Scorecard: Charting Progress Toward Regional Economic Integration - Phase I (2008-2009) and Phase II (2010-2011). Jakarta.

1.3.1 Pillar I — Single Market and Production Base

Early targets for creating a single market and production base were almost fully met — 93.8% of Phase I targets by 2009. But the Phase II rate was just below 50%, leaving the end-2011 rate at a rather disappointing 65.9%. Thus, even as progress continues, it appears many measures will not be fully in place by 2015. Creating a single market and production base is the "core" of the AEC: hence the overall prognosis for meeting the 2015 deadline is not good. Nonetheless, the liberalization process has been set, with some aspects already well-entrenched.

For example, tariffs on goods traded across ASEAN have by and large been eliminated. Rates are zero on 99.7% of ASEAN-6 tariff lines. CLMV countries, however, are moving slower, with 98.9% of tariff lines ranging from 0%–5%. Further progress in reducing CLMV tariff rates — needed to boost competitiveness — can be achieved by multilateralizing preferences (Box 1.2).

Still, while tariff liberalization has largely been completed, the free flow of goods remains hampered by many non-tariff barriers (NTBs) — or "behind-the-border" issues. Discriminatory practices and lack of policy and regulatory transparency are major impediments. NTBs are important in determining trade costs. Recently, ASEAN has refocused on reducing NTBs to allow the full benefits of tariff liberalization to be spread more evenly. Under the ATIGA, progress has been made on (i) harmonizing tariff nomenclature, (ii) simplifying and making "rules of origin" more trade-friendly, and (iii) implementing the ASEAN Single Window (ASW) and protocols for the ASEAN Framework Agreement on Facilitation of Goods in Transit. There has also been progress on claims for preferential tariff treatment through self-certification.

As harmonizing customs procedures has been slow, an ASW should help ease customs formalities. The private sector is urging authorities to prioritize national single windows (NSWs) and an ASW given the potentially large benefits. As of the end of 2013, three ASEAN members still lack NSWs — while the other seven are in the process of implementing a simplified ASW. The first step is to implement a region-wide ASW design and develop the necessary legal framework. In 2011, ASEAN members approved a 5-year work plan to introduce the ASW and related regulatory issues. Thus, missing the 2015 deadline is explicitly recognized, as the ASW is a key element in the AEC.

The private sector sees technical regulations and product standards as major sources of NTBs — including quality assurance, accreditation, and measurement. Creating mutual recognition arrangements (MRAs) by sector and harmonizing standards are underway, as well as regulatory regimes covering medical products and electrical and electronic equipment. Despite the ASEAN Protocol on Notification Procedures, lack of information from members remains a problem in removing NTBs. The ATIGA includes important commitments on NTBs, but it is not clear

Box 1.2 Multilateralizing CLMV Preferences for Tariff Reduction

By 2010, nearly all goods traded by countries of the Association of Southeast Asian Nations (ASEAN) were covered under the Common Effective Preferential Tariff (CEPT)—with tariff rates between 0% and 5% for almost all goods originating within ASEAN. Only a few “sensitive” products, such as rice and sugar, were part of an exclusion list not covered under the CEPT. ASEAN-6 countries (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) have already eliminated duties on all non-exclusion goods, quotas, and quantitative restrictions by the ASEAN Trade in Goods Agreement (ATIGA). Cambodia, the Lao People’s Democratic Republic (Lao PDR), Myanmar, and Viet Nam (CLMV countries) are granted up to 2015 to meet CEPT tariff reductions.

Unlike the European Union’s customs union approach, the ATIGA does not use a common external tariff on goods imported from non-members. Each ASEAN member may impose tariffs on non-ASEAN goods based on national preferences. ASEAN-6 countries have made significant progress in multilateralizing preferences, by granting non-ASEAN members the same CEPT rates without discrimination. They usually apply a unique tariff rate for ASEAN members and for non-members—in most cases zero—on almost all tariff lines. As a consequence, the ASEAN-6 countries have close-to-zero margins of preferences (MOPs)—the difference between applied tariff rates on imports and most-favored-nation rates—on CEPT rates for products outside the exclusion list.

The situation for CLMV countries is quite different. While they started reducing tariffs based on preferential CEPT schedules after joining ASEAN, for the most part they did not extend rate reductions to non-members. As a result, CLMV countries use a multitier tariff system—CEPT rates for ASEAN members and different rates for non-members. Estimates show that in 2007 MOPs were still 15% in Viet Nam and around 7%–8% in Cambodia and the Lao PDR.

Administering a multitier tariff system is costly—with separate rates for each tariff line depending on goods’ origin. Moreover, existing ASEAN+1 free trade and investment agreements complicate matters by stressing the already weak capacity of CLMV customs agencies. Besides, managing a tariff multitier system makes setting up an ASEAN Single Window and national single windows (NSWs) difficult.

For the creation of NSWs it is crucial to harmonize and to simplify customs procedures and processes with standardized documentation. But given the weak electronic connectivity between domestic agencies and the huge gaps in institutional capacity existing among ASEAN customs agencies, the task remains very challenging. The multitier CLMV tariff system creates other problems as well, adding several other non-tariff barriers—such as complex administrative procedures that vary largely across countries and further raise trade costs.

Policymakers in CLMV countries should seriously consider creating a level playing field by multilateralizing preferences under the CEPT scheme and unifying rates under the same tariff line. Although this may imply short-term costs, long-term gains remain very large and significantly outweigh welfare losses.

Source: ASEAN Secretariat website, Menon (2012), and Narjoko et al. (2011).

whether ASEAN members will have the necessary structural reforms required to be ready by 2015.

In services, some AFAS targets have been met, but progress is uneven and substantial delays have pushed AEC deadlines out of reach. Under the Coordinating Committee on Services, negotiations to remove restrictions on several priority sectors — air transport, e-commerce, healthcare, tourism, and logistics services — have started. While there is good progress in air transport and tourism — given the flexibility allowed under the "ASEAN minus" formula[28] — major restrictions remain in the others. Given the importance of efficiency in linking production networks, liberalizing logistics services, for example, should be a priority. Yet, despite the work thus far, protection remains high in services for all of ASEAN, except Singapore. Regulatory and business licensing procedures are cumbersome and restrictive. In many countries, state-owned service providers limit competition and hamper regional liberalization.

Results on skilled labor mobility are mixed. Although the scorecard does not monitor dynamics by subsector, MRAs for engineers and architects are in place and others have been signed for several types of business services, including information technology, healthcare, accounting, and surveying (Mikic 2009). A 2012 ASEAN Agreement on the Movement of Natural Persons allows temporary movement of skilled workers transferred from companies in one ASEAN country to other member countries. Although permanent relocation is not permitted, and the agreement is limited to temporary transfers of executives and professionals — covering business visitors, contractual services, and intra-company transferees — it is a precedent that should allow completion of all MRAs in professional services close to the 2015 deadline.

In Phases III and IV of the AEC, services liberalization should accelerate. However, it is unlikely targets will be met leaving much to be done beyond 2015 (Pushpanathan 2012). To accelerate the process, there are proposals to make the AFAS more comprehensive — similar to the ACIA or ATIGA. The AEC Blueprint is quite flexible on financial services — with targets to 2020 and beyond — allowing CLMV countries and Brunei Darussalam more time to liberalize. Central banks have been discussing an ASEAN Banking Framework to move the AEC beyond current targets for banking integration through harmonizing regulations, establishing financial stability infrastructure, and introducing capacity building for CLMV bank staff.

Investment flows are consolidated under the ACIA — covering investment liberalization, protection, facilitation, and promotion. In particular, private sector feedback suggests members could significantly gain from improving investment facilitation.[29] The World Bank's Doing Business Survey (World Bank 2013 — see

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28 Under this formula, any member — while approving an initiative — can opt-out from a scheme it feels ill-prepared for, though intends to join later.

29 Interestingly, private sector feedback shows a much stronger preference for investment facilitation than liberalization. ASEAN scores were widely diverse on facilitation (Urata and Okabe 2010).

section 3.3) shows modest or low scores for ASEAN (with the exception of Singapore, Thailand, and Malaysia), due to red tape, other bureaucratic procedures, regulations, and lack of transparency. These remain major hurdles for business, particularly SMEs. Major restrictions are related to market access (Myanmar, Thailand, Malaysia, and the Lao PDR), screening and appraisal (Indonesia, Cambodia, Myanmar, and the Lao PDR), and national treatment (Brunei Darussalam and Malaysia).

To promote "freer" capital flows, the AEC targets liberalizing financial services and capital accounts, while promoting capital market development. Some progress has been made, but much remains to be done—in particular creating an environment for financing ASEAN's huge infrastructure needs. The creation in 2012 of the ASEAN Infrastructure Fund (see section 4.1) is a positive step, although its capitalization is inadequate to contribute to any serious infrastructure financing over the coming decades.[30] Despite rapid growth, bond—especially corporate—markets remain too small to accommodate large infrastructure investments. A Credit Guarantee and Investment Facility has been established to help issuers tap local currency bond markets.[31] Improving rules and regulatory regimes for freer portfolio investment flows—and FDI—is being discussed in light of the ACIA. And the development of a regional capital market—covering integration of equity markets, provision for secondary listings, and governance and disclosure standards—is proceeding slowly. There has been progress in insurance and in promoting ASEAN as an "asset class."

Progress in deepening integration in AEC priority sectors—electronics and electrical goods, e-commerce, healthcare, wood-based products, automobiles, rubber-based products, textiles and apparel, agro-based products, fisheries, air travel, and tourism—is also mixed. Air travel and tourism got a boost in January 2012 when the ASEAN Tourism Marketing Strategy was endorsed, which aims to promote the region as a single tourist destination.[32] An ASEAN Automotive Industry Strategy and MRAs for telecommunications equipment are underway.

Finally, most progress in food, agriculture, and forestry has been in agricultural research and food security—a medium-term Strategic Plan of Action on ASEAN Food Security was also developed and is being implemented. To ensure the free flow of safe, quality food products—and to enhance their competitiveness on

30 The ASEAN Infrastructure Fund (AIF)—domiciled in Malaysia with initial equity of $485 million provided by ASEAN members ($335 million) and ADB $150 million)—is expected to finance about six projects a year, with a $75 million lending cap per project. Criteria for investments include the potential to reduce poverty, increase trade, and bolster investment. ADB, which administers the AIF, committed to providing additional co-financing for each project. See also sections 4.1 and 4.3.

31 The $700 million Credit Guarantee and Investment Facility provides guarantees on local currency-denominated bonds issued by companies in the region, making it easier for firms to issue local bonds with longer maturities.

32 See section 3.3 for a more detailed discussion of tourism.

international markets — ASEAN is considering adopting measures harmonizing national food product regulations. An ASEAN+3 Emergency Rice Reserve has already been established for food security and an agreement has been reached to mitigate the impact of climate change on ASEAN agriculture and forestry.

1.3.2 Pillar II — Competitive Economic Region

The second AEC pillar is designed to build a competitive economic region through the adoption of consumer protection, intellectual property rights, and competition policies. It also covers infrastructure development (including all modes of transport), information and communication technology (ICT), energy cooperation, e-commerce, and double taxation issues. While the AEC Blueprint recognizes the importance of these policies, it only outlines a quite open agenda of possible measures, citing regional guidelines based on country experience and international best practices. But it does also identify clear standards and targets — except for transport. Studies show these policies are highly diverse across ASEAN. Improving national policies, introducing best practices, and harmonizing them across member countries would bring substantial benefits to the region beyond those attributed to the AEC (Plummer and Chia 2009; Soeya and Sukma 2013).

Structural reforms harmonizing best practices in competition policies are beyond the AEC and very difficult to implement effectively. But they will eventually be required to create a seamless economic community among ASEAN countries by 2030. As shown by the EU, a state-of-the-art competition policy is critical for a well-functioning single market. Currently, however, not all ASEAN countries have a competition policy. All members are expected to have one by 2015, although how they will eventually be implemented and coordinated remains far from clear.[33] ASEAN has prepared Regional Guidelines on Competition Policy and a Handbook on Competition Policy and Laws, but they remain limited and largely theoretical. Some progress however has been made in intellectual property rights and patent examination, as well as on information exchange for consumer protection.[34] For now, institutional capacity and law enforcement remain major issues for most ASEAN countries.

Transport infrastructure is a salient prerequisite for any region to be competitive.[35] While remarkable progress has been made in air transport with ASEAN "open sky" policies, two key transport agreements — the ASEAN Framework Agreement on Multimodal Transport and the ASEAN Framework Agreement on the Facilitation of Goods in Transit — have been slow off the

33 See sections 3.3 and 4.4 for a more detailed discussion of competition policies.
34 An ASEAN Intellectual Property Rights Action Plan 2011–2015 was introduced in 2011 and it is currently being implemented.
35 See section 4.3 for a more detailed discussion of transport and regional connectivity.

mark. The proposal for an ASEAN Single Shipping Market — currently under study — will substantially eliminate the remaining restrictions. To be sure, there has been some progress on technical matters related to setting up an ASEAN Roll-On/Roll-Off shipping network (see section 4.3) and cross-border arrangements for railways. But much remains to be done on road transport and easing transit, due to the multitude of laws and regulations involved. Also, given the massive infrastructure investments needed, transport facilitation agreements and their enforcement are essential for creating a competitive single market.[36]

On energy, the implementation of the ASEAN Power Grid and the Trans-ASEAN Gas Pipeline are underway. Other priorities of the ASEAN Plan of Action on Energy Cooperation 2010–2015 include coal clean technology, renewable energy, civilian nuclear energy, and energy efficiency and conservation. But there has been little progress thus far. Discussions on technical and legal issues related to energy cooperation are at an early stage. On ICT, more progress is urgently needed, especially on creating regionally harmonized rules and regulations.

By December 2011, overall implementation under Pillar II was broadly similar to that of Phase I — an average success rate of 67.9% — still well below target.

1.3.3 Pillar III — Equitable Economic Development

One of the biggest challenges in building an AEC is the huge development gaps between and within member countries. In essence, this is the third AEC pillar, which also covers nurturing SMEs. Development gaps are not merely defined by divergent per capita incomes, but also — and perhaps more importantly — through institutional capacity and governance, which affect nearly every component of the AEC. In many instances, the AEC Blueprint provides CLMV countries more time to introduce rules, regulations, and structural reforms to comply with targets. It is not sure, however, that a few years delay will be enough for CLMV institutions to catch up with the ASEAN-6 countries, which are naturally also expected to improve.

Recognizing the need for strong impetus in reducing intraregional development gaps, leaders endorsed a new ASEAN Framework for Equitable Economic Development at the 19th Summit in Bali, Indonesia, in November 2011. Yet, a more systematic and coordinated approach is needed to create a more inclusive AEC development agenda. Such an approach would focus on geographically isolated provinces — also due to the archipelagic nature of Indonesia and the Philippines — and better coordination with subregional cooperation initiatives. Progress on reducing intraregional gaps needs to be closely monitored. New modalities for intra-ASEAN solidarity may also need to be examined.[37]

The AEC Blueprint recognizes the important role SMEs play in fostering equitable economic development. The definition of an ASEAN agenda to support

36 It should be noted that railways remain fairly underdeveloped in most ASEAN countries.
37 Section 3.2 discusses this need in greater detail.

SMEs is, however, still embryonic. The ASEAN Policy Blueprint for SME Development 2010–2015 outlines a regional agenda for promoting SMEs. An ASEAN SME Advisory Board was set up in 2011 and met for the first time during the 44th ASEAN Economic Ministers' Meeting in 2012—with its agenda covering SME financing, innovation, technology, and internationalization. To promote a culture of quality in SMEs, a multimedia self-reliance toolkit has been developed, while proposals are under study to integrate local SME service centers into an ASEAN-wide center. Importantly, a regional SME development fund is also being considered to help finance new projects.

The achievement rate of Pillar III fell dramatically from Phase I to II—by December 2011 it was 66.7%.

1.3.4 Pillar IV—Integration into the Global Economy

The fourth AEC pillar aims to better integrate ASEAN into the global economy. Although progress mainly relates to FTA implementation, it also covers adopting a coherent approach toward external economic relations and boosting participation in global supply networks. The implementation rate of this pillar has been the highest among the four—at an average 85.7%. As of November 2013, ASEAN member countries had signed a total of 40 FTAs, including comprehensive partnership agreements. An additional 50 agreements were either under negotiation or being proposed (see section 1.2). As discussed earlier, of the total, five important agreements were concluded as ASEAN+1 FTAs—with the PRC, the Republic of Korea, Japan, Australia and New Zealand, and India (Table 1.4).

Table 1.4 Summary of ASEAN+1 Comprehensive Economic Partnerships and Free Trade Agreements

Agreements \ Coverage	Trade in Goods		Trade in Services		Investment	
	Signed	Effective	Signed	Effective	Signed	Effective
ASEAN–People's Republic of China Comprehensive Economic Cooperation Agreement	2004	2005	2007	2008	2009	2010
ASEAN–Republic of Korea Comprehensive Economic Cooperation Agreement	2006	2007	2007	2009	2009	2009
ASEAN–Japan Comprehensive Economic Partnership Agreement	2008	2008	ongoing negotiations			
ASEAN–India Comprehensive Economic Cooperation Agreement	2009	2010	2013	2014*	2013	2014*
ASEAN–Australia and New Zealand Free Trade Agreement	2009	2010	2009	2010	2009	2010

ASEAN = Association of Southeast Asian Nations.
Note: *Expected date for the agreement to become effective.
Source: Authors.

Under the agreements with the PRC and the Republic of Korea—which became effective 1 January 2012—tariffs on more than 90% of the total value of trade between ASEAN-6 members and these two countries were eliminated (the so-called "Normal Track"). This has huge implications for competitiveness and trade flows. Also in January 2012, the FTA with Australia and New Zealand became effective for Indonesia, while other countries are expected to follow suit. At the end of 2013, however, several issues over liberalizing services were still pending under FTAs with Japan.

Tariffs under the various ASEAN+1 agreements distinguish between the Normal Track and the "Sensitive Track" or "Highly Sensitive Track". Most tariff rates included under the Normal Track should reach zero as agreements are implemented, while tariffs under the Sensitive and Highly Sensitive categories can remain substantial, although generally not exceeding 50%.[38] In some cases, goods can be also excluded from these lists and included in the Normal Track. Notably, the PRC agreement has no "exclusion list," making it one of the most comprehensive deals thus far signed by ASEAN members.

1.3.5 Bottlenecks and Constraints

The ASEAN Secretariat is expected to update its AEC implementation scorecard in early 2014, detailing progress made in Phase III (2012–2013). Although official data were unavailable at the time this report went to press, the Chairman's Statement issued at the 23rd ASEAN Summit in Brunei Darussalam suggests that by September 2013 about 80% of measures included in the AEC Blueprint had been implemented. Sources in the secretariat say that, while almost 90% of measures to be introduced in Phase I were already in place, the implementation rate for Phase II and Phase III measures was only slightly above 70% in both periods (ASEAN 2013a).

Notwithstanding the considerable progress made, major efforts must be made by ASEAN members to ensure AEC success. Realizing the AEC Blueprint remains critical to create a single market and production base (Pillar I) and to make ASEAN a competitive economic region (Pillar II). Each AEC agenda component is complex and requires meticulous negotiations before agreement is reached. Then regulations or laws must be introduced and aligned with members' respective political systems. Major legal and institutional changes in national systems are also needed, requiring bold structural reforms.

But ASEAN has no central institution that can objectively monitor progress on implementing the plethora of agreements and commitments made—the AEC Scorecard is based on information provided by each member state. Further, there

38 Realized tariffs for all products under the *Normal Track* and *Sensitive Track* will reach their lowest levels—or be totally eliminated—based on ATIGA commitments, mainly by ASEAN-6 and FTA partners. CLMV countries usually have longer periods to reduce tariffs.

is no enforcement mechanism or sanction for not adhering to commitments. Under ASEAN rules — and with barely any exceptions — one country's failure to implement a measure makes it nonbinding for the rest.

As mentioned earlier, major bottlenecks in implementing the AEC are due to the different systems used by member countries to ratify agreements and protocols — affecting their entry into force. So far, provisions related to the liberalization of services under the AFAS and to the transport sector (for example, facilitating the transit of goods and regulating air freight) have been subject to major delays. Diverse legal and constitutional systems, often requiring lengthy processes, also severely affect aligning regional initiatives with domestic laws and regulations. The process of standardization is indeed time-consuming.

Besides, in areas such as the free movement of skilled labor, the scorecard is unable to capture the depth of measures and regulations required by the AEC Blueprint, as it only includes a few milestone targets and reporting requirements. Slow progress in MRAs on job qualifications, in synchronization with immigration procedures, and in ASEAN-wide harmonization remain major impediments in reaching AEC targets.

Given the limited resources available at the ASEAN Secretariat, monitoring detailed implementation schedules nationally is another major issue that must urgently be resolved for an AEC to be meaningful — let alone lead eventually to a borderless economic community.

While several core elements will undoubtedly be in place by 2015, much will remain undone due to constitutional, legislative, and regulatory limitations blocking agreements — whether for intra- or extra-ASEAN commitments. By the end of 2015, although the AEC will likely remain a work in progress, its blueprint will surely be well underway. The key challenge to ASEAN members is to maintain momentum — to strengthen their regional commitments by applying structural reforms domestically.

1.3.6 Beyond the AEC

As mentioned in section 1.1, ASEAN leaders agreed at their 23rd Summit in October 2013 to form a high-level task force to define the group's post-2015 agenda for regional integration. While discussions are ongoing through separate groups under the three pillars, a final report is expected to be submitted by the ASEAN Coordinating Council for leaders' endorsement at the 27th Summit in October/November 2015. As far as the "economic" pillar of the ASEAN Community is concerned, preparation of the post-2015 agenda's recommendations is currently ongoing under the guidance of the High-Level Task Force on Economic Integration.

Key issues being discussed revolve around the appropriate direction of economic integration ASEAN should take going forward. In particular, a debate exists among policymakers and experts from government agencies, academia, and the private sector as to whether thinking about the next steps of integration the AEC should be seen as an already very ambitious target which may still require several years (even decades) to be accomplished, or whether it should be considered as a stepping stone toward the creation of a deeper and truly "borderless" economic community—as this report ultimately suggests.

The former view is based on the assumption that the impediments to fully realize the AEC by 2015 are far too deeply rooted in the region's economies to be removed in a short period of time. A more realistic approach would therefore suggest setting the creation of the ASEAN "single market" as a long-term goal. A post-2015 integration agenda, up to say, 2030, would then simply focus on strengthening the existing four AEC pillars, with only marginal expansion in their scope. On the other hand, the latter view suggests that while it may well take up to 2020 to fully realize the AEC Blueprint, a 2030 agenda should include a wide set of new and more ambitious targets for integration.[39]

In retrospect, the initial framework for overall ASEAN cooperation was introduced at the first Summit in 1976 with the Bali Concord I—its economic agenda covered food and energy, industrial cooperation, trade, and global cooperation. Two decades later, the ASEAN Vision 2020 introduced a long-term focus on stability, prosperity, and competitiveness. It was with the endorsement of the Bali Concord II in 2003 that the AEC was formally introduced. It affirmed the aim of reducing poverty and socio-economic disparities, promoting equitable development, enhancing competitiveness, and creating a single market and production base by allowing the free flow of goods, services, investment, and skilled labor, and a freer flow of capital. One year later, a detailed plan to implement the AEC was provided by the Vientiane Action Programme, which targeted reducing development gaps—within and across ASEAN members—and introduced a list of 11 priority integration sectors (agro-based products, air travel, automotive, electronics, ICT [e-ASEAN], fisheries, healthcare, rubber-based products, textiles and apparels, tourism, and wood-based products).[40] It also included "environmental sustainability" as a key goal under the ASEAN Socio-Cultural Community. Finally, in 2011 the Bali Concord III made explicit reference to achieving a people-centered ASEAN, to fully integrating the group within the global economy and maintaining its centrality in the regional architecture for cooperation.

The next steps for ASEAN economic integration will likely extend this past trajectory, aiming to build a prosperous community of nations focused on achieving macroeconomic stability, strengthening competitiveness, and reducing inequalities while protecting the environment and maintaining centrality. The

39 This study aims to contribute to defining such post-2015 agenda elaborating on ASEAN's long-term aspirations (chapter 2), challenges (chapter 3), growth-enabling factors (chapter 4), institutional architecture (chapter 5), and policy options (chapter 6).

40 Logistics was later added as the 12th priority sector.

ASEAN model for economic integration is built from the bottom up and aims at fulfilling people's aspirations. It does not follow a top–down approach such as the EU one, based on realizing a "grand plan" to ultimately create a political union moving up from a free trade area, to a customs union, a single market, and a single currency as part of a scheme for complete financial integration. Rather, the AEC model is built on four pillars where integration is to be deepened in parallel — single market and production base, competitive economic region, equitable economic development, and integration into the global economy. The issue is whether the AEC, as defined by its blueprint, is a good enough plan to ensure sustainable and prosperous development up to 2030.

This study takes the view that with rising competitive pressures from the PRC, India, and other emerging economies around the world, deeper integration is needed. ASEAN needs to create a truly borderless economic community moving beyond the AEC. The next chapters look at the region's aspirations, challenges, and enabling factors leading to policy options — including reforms of ASEAN's institutional architecture — to implement a post-2015 agenda.

Chapter 1: Appendix

Table A1.1 Status of ASEAN Free Trade Agreements (as of December 2013)

Name	Status	ASEAN Members	Non-ASEAN Members
Multilateral			
ASEAN Free Trade Area (AFTA)	Signed and in effect	All	None
ASEAN–Australia and New Zealand Free Trade Agreement	Signed and in effect	All	Australia, New Zealand
ASEAN–India Comprehensive Economic Cooperation Agreement	Signed and in effect	All	India
ASEAN–Japan Comprehensive Economic Partnership Agreement	Signed and in effect	All	Japan
ASEAN–Republic of Korea Comprehensive Economic Cooperation Agreement	Signed and in effect	All	Korea
ASEAN–People's Republic of China Comprehensive Economic Cooperation Agreement	Signed and in effect	All	PRC
Asia-Pacific Trade Agreement	Signed and in effect	Lao PDR	Bangladesh, PRC, India, Republic of Korea, Sri Lanka
Trans-Pacific Strategic Economic Partnership Agreement	Signed and in effect	Brunei Darussalam, Singapore	Chile, New Zealand
Preferential Tariff Arrangement-Group of Eight Developing Countries	Signed but not yet in effect	Indonesia, Malaysia	Bangladesh, Egypt, Iran, Nigeria, Pakistan, Turkey
Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area	Under negotiation*	Myanmar, Thailand	Bangladesh, Bhutan, India, Nepal, Sri Lanka
Trade Preferential System of the Organization of the Islamic Conference	Under negotiation*	Brunei Darussalam, Thailand	36 OIC members
Regional Comprehensive Economic Partnership (RCEP)	Under negotiation*	All	Australia, PRC, India, Japan, Republic of Korea, New Zealand
Trans-Pacific Partnership (TPP)	Under negotiation*	Brunei Darussalam, Malaysia, Singapore, Viet Nam	Australia, Canada, Chile, Japan, Mexico, New Zealand, Peru, United States
ASEAN–EU Free Trade Agreement	Under negotiation	All	28 EU members
ASEAN–Hong Kong, China Free Trade Agreement	Proposed/Under study	All	Hong Kong, China
ASEAN–Pakistan Free Trade Agreement	Proposed/Under study	All	Pakistan
Comprehensive Economic Partnership for East Asia (CEPEA)	Proposed/Under study	All	Australia, PRC, India, Japan, Republic of Korea, New Zealand
East Asia Free Trade Area (EAFTA)	Proposed/Under study	All	PRC, Japan, Republic of Korea
Plurilateral			
European Free Trade Association–Singapore Free Trade Agreement	Signed and in effect	Singapore	Liechtenstein, Iceland, Norway, Switzerland
Gulf Cooperation Council–Singapore Free Trade Agreement	Signed but not yet in effect	Singapore	6 GCC members
Indonesia–European Free Trade Association Free Trade Agreement	Under negotiation	Indonesia	Liechtenstein, Iceland, Norway, Switzerland

Name	Status	ASEAN Members	Non-ASEAN Members
Malaysia–European Free Trade Association Free Trade Agreement	Under negotiation	Malaysia	Liechtenstein, Iceland, Norway, Switzerland
Malaysia–European Union Free Trade Agreement	Under negotiation	Malaysia	28 EU members
Singapore–EU Free Trade Agreement	Under negotiation	Singapore	28 EU members
Thailand–European Free Trade Association Free Trade Agreement	Under negotiation	Thailand	Liechtenstein, Iceland, Norway, Switzerland
Thailand–EU Free Trade Agreement	Under negotiation	Thailand	28 EU members
Viet Nam–Customs Union of Russia, Belarus, and Kazakhstan Free Trade Agreement	Under negotiation	Viet Nam	Belarus, Kazakhstan, Russian Federation
Viet Nam–European Union Free Trade Agreement	Under negotiation	Viet Nam	28 EU members
Viet Nam–European Free Trade Association Free Trade Agreement	Under negotiation	Viet Nam	Liechtenstein, Iceland, Norway, Switzerland
Malaysia–Gulf Cooperation Council Free Trade Agreement	Proposed/Under study	Malaysia	6 GCC members
Philippines–EFTA Free Trade Agreement	Proposed/Under study	Philippines	Liechtenstein, Iceland, Norway, Switzerland
Thailand–MERCOSUR Free Trade Agreement	Proposed/Under study	Thailand	Argentina, Brazil, Paraguay, Uruguay
Bilateral			
Lao PDR–Thailand Preferential Trading Arrangement	Signed and in effect	Lao PDR, Thailand	
Japan–Brunei Darussalam Free Trade Agreement	Signed and in effect	Brunei Darussalam	Japan
Japan–Indonesia Economic Partnership Agreement	Signed and in effect	Indonesia	Japan
Japan–Malaysia Economic Partnership Agreement	Signed and in effect	Malaysia	Japan
Malaysia–Chile Free Trade Agreement	Signed and in effect	Malaysia	Chile
Malaysia–India Comprehensive Economic Cooperation Agreement	Signed and in effect	Malaysia	India
Malaysia–New Zealand Free Trade Agreement	Signed and in effect	Malaysia	New Zealand
Malaysia–Pakistan Closer Economic Partnership Agreement	Signed and in effect	Malaysia	Pakistan
Japan–Philippines Economic Partnership Agreement	Signed and in effect	Philippines	Japan
India–Singapore Comprehensive Economic Cooperation Agreement	Signed and in effect	Singapore	India
Japan–Singapore Economic Agreement for a New-Age Partnership	Signed and in effect	Singapore	Japan
Republic of Korea–Singapore Free Trade Agreement	Signed and in effect	Singapore	Republic of Korea
New Zealand–Singapore Closer Economic Partnership	Signed and in effect	Singapore	New Zealand
People's Republic of China–Singapore Free Trade Agreement	Signed and in effect	Singapore	PRC
Singapore–Australia Free Trade Agreement	Signed and in effect	Singapore	Australia
Singapore–Costa Rica Free Trade Agreement	Signed and in effect	Singapore	Costa Rica
Singapore–Jordan Free Trade Agreement	Signed and in effect	Singapore	Jordan
Singapore–Panama Free Trade Agreement	Signed and in effect	Singapore	Panama
Singapore–Peru Free Trade Agreement	Signed and in effect	Singapore	Peru
United States–Singapore Free Trade Agreement	Signed and in effect	Singapore	United States
Japan–Thailand Economic Partnership Agreement	Signed and in effect	Thailand	Japan
People's Republic of China–Thailand Free Trade Agreement	Signed and in effect	Thailand	PRC
Thailand–Australia Free Trade Agreement	Signed and in effect	Thailand	Australia
Thailand–New Zealand Closer Economic Partnership Agreement	Signed and in effect	Thailand	New Zealand
Thailand–Peru Free Trade Agreement	Signed and in effect	Thailand	Peru

Name	Status	ASEAN Members	Non-ASEAN Members
Chile–Viet Nam Free Trade Agreement	Signed and in effect	Viet Nam	Chile
Japan–Viet Nam Economic Partnership Agreement	Signed and in effect	Viet Nam	Japan
Pakistan–Indonesia Free Trade Agreement	Signed but not yet in effect	Indonesia	Pakistan
Malaysia–Australia Free Trade Agreement	Signed but not yet in effect	Malaysia	Australia
India–Thailand Free Trade Area	Under negotiation*	Thailand	India
Thailand–Bahrain Free Trade Agreement	Under negotiation*	Thailand	Bahrain
India–Indonesia Comprehensive Economic Cooperation Arrangement	Under negotiation	Indonesia	India
Indonesia–Australia Free Trade Agreement	Under negotiation	Indonesia	Australia
Republic of Korea–Indonesia Free Trade Agreement	Under negotiation	Indonesia	Republic of Korea
Malaysia–Turkey Free Trade Agreement	Under negotiation	Malaysia	Turkey
United States–Malaysia Free Trade Agreement	Under negotiation	Malaysia	United States
Canada–Singapore Free Trade Agreement	Under negotiation	Singapore	Canada
Pakistan–Singapore Free Trade Agreement	Under negotiation	Singapore	Pakistan
Singapore–Egypt Comprehensive Economic Cooperation Agreement	Under negotiation	Singapore	Egypt
Singapore–Mexico Free Trade Agreement	Under negotiation	Singapore	Mexico
Singapore–Ukraine Free Trade Agreement	Under negotiation	Singapore	Ukraine
Thailand–Chile Free Trade Agreement	Under negotiation	Thailand	Chile
United States–Thailand Free Trade Agreement	Under negotiation	Thailand	United States
Republic of Korea–Viet Nam Free Trade Agreement	Under negotiation	Viet Nam	Republic of Korea
Pakistan–Brunei Darussalam Free Trade Agreement	Proposed/Under study	Brunei Darussalam	Pakistan
United States–Brunei Darussalam Free Trade Agreement	Proposed/Under study	Brunei Darussalam	United States
Indonesia–Chile Free Trade Agreement	Proposed/Under study	Indonesia	Chile
United States–Indonesia Free Trade Agreement	Proposed/Under study	Indonesia	United States
Malaysia–Republic of Korea Free Trade Agreement	Proposed/Under study	Malaysia	Republic of Korea
Malaysia–Syria Free Trade Agreement	Proposed/Under study	Malaysia	Syria
Pakistan–Philippines Free Trade Agreement	Proposed/Under study	Philippines	Pakistan
Philippines–Taipei,China Economic Cooperation Agreement	Proposed/Under study	Philippines	Taipei,China
United States–Philippines Free Trade Agreement	Proposed/Under study	Philippines	United States
Comprehensive Economic Partnership Agreement between Singapore and Sri Lanka	Proposed/Under study	Singapore	Sri Lanka
Thailand–Canada Free Trade Agreement	Proposed/Under study	Thailand	Canada
Republic of Korea–Thailand Free Trade Agreement	Proposed/Under study	Thailand	Republic of Korea
Pakistan–Thailand Free Trade Agreement	Proposed/Under study	Thailand	Pakistan

ASEAN = Association of Southeast Asian Nations; EFTA = European Free Trade Association; EU = European Union; MERCOSUR = Common Market of the South; PRC= People's Republic of China.
Notes: *Parties have already signed a framework agreement.
(i) Bilateral—between two economies: one ASEAN and one non-ASEAN member (with the exception of the Lao PDR–Thailand Preferential Trading Agreement).
(ii) Multilateral—between two or more ASEAN members and one or more non-ASEAN members (includes ASEAN+1 agreements).
(iii) Plurilateral—between one ASEAN member and two or more non-ASEAN members.
(iv) Signed and in effect—free trade agreement provisions active.
(v) Signed but not yet effective—agreement signed, but not ratified by legislature or executive.
(vi) Under negotiation—parties have begun negotiations (with or without a framework agreement.
(vii) Proposed—parties considering a free trade agreement by establishing joint study groups, conducting feasibility studies, etc.
Source: ADBI staff and Asian Development Bank. Asia Regional Integration Center. http://aric.adb.org/ftatrends.php (accessed September 2013).

Chapter 2

Aspirations for a "RICH" ASEAN

2 Aspirations for a "RICH" ASEAN

Despite several decades of rapid development and progressive integration, ASEAN economies remain extremely diverse and marked by a generally low—albeit increasing—degree of convergence. Yet, in response to changing domestic and global dynamics, authorities face common risks and gravitate toward shaping a unified strategy to promote economic development in the region. For example, both the 1997/98 Asian financial crisis and the 2008/09 global financial crisis were the impetus for nearly all ASEAN countries to reformulate their long-term economic development plans to reflecting redefined priorities.

Local consultations and background papers on individual country development perspectives revealed today's ASEAN has reached a crossroads. Its members hold the opportunity to continue the large increase in average income levels. But they also confront the risk of significant growth deceleration due to the interplay of internal and external factors. In response to these opportunities and risks, ASEAN countries need to introduce the proper mix of domestic structural reforms and initiatives for strengthening regional integration. They need to move toward the creation of a truly borderless economic community by the year 2030—beyond the 2015 ASEAN Economic Community (AEC) Blueprint.

These national and regional policies complement and reinforce each other—and are central to meeting ASEAN members' long-term development aspirations. By implementing domestic reforms and amid stronger efforts to cooperate regionally, ASEAN countries can enter a high-growth scenario leading to a tripling of per capita incomes between 2010 and 2030. They can raise the quality of life to levels enjoyed today by members of the Organisation for Economic Co-operation and Development (OECD). However, if countries fail to introduce the appropriate policy mix and are unable to effectively manage events such as natural disasters, climate change, and potential political tensions, then a more pessimistic scenario is likely to emerge, leading to a slowdown in gross domestic product (GDP) growth to no more than an average 3% per year for the region, with many countries falling into the middle-income trap.

Aspirations identified for individual ASEAN members largely reflect their different levels of development, population size and composition, economic structure, geographical footprint, and quality of life. Although the very exercise of defining aspirations of a regional entity comprised of such a diverse set of nations is beset with difficulties, the study suggests that ASEAN economies collectively seek a region that is Resilient, Inclusive, Competitive, and Harmonious — ASEAN's overall aspiration is to become "RICH" by 2030.

This chapter outlines ASEAN's 2030 development aspirations — for individual economies and the region as a whole. After discussing ASEAN's key strengths, weaknesses, opportunities, and threats, it introduces the study's analytical framework. It defines two economic growth scenarios — one optimistic, the other pessimistic. It quantifies 2030 aspiration targets in terms of real per capita GDP levels on the basis of country-specific consultations and analyses. The chapter concludes by broadening the concept of development aspirations beyond GDP to include various quality of life indicators.

2.1 Strengths, Weaknesses, Opportunities, and Threats

While Asia continues to grow in the aftermath of the global financial crisis of 2008/09, what are the key opportunities and challenges facing ASEAN's economy? The background papers on individual ASEAN member countries prepared for this study included detailed "strengths–weaknesses–opportunities–threats" (SWOT) analyses to help identify internal and external factors critical to achieving 2030 aspirations. Internal factors were used to discuss existing strengths and weaknesses, while external factors helped define opportunities and threats. The identification of internal and external factors emerging from the SWOT analysis is a useful exercise to shaping national as well as regional policy agendas. An ASEAN SWOT diagram summarizing the results of individual country SWOT analyses is shown in Table 2.1.

2.1.1 Strengths

ASEAN countries' major strengths lie in sound macroeconomic fundamentals, a sizeable population — still relatively young and with a growing middle class of well over 100 million — and a good track record in economic growth.[41] ASEAN countries' collective growth in GDP from 1992 to 2012 shows a remarkable annual average of 5.7%, despite the decline induced by the 1997/98 Asian financial

41 ASEAN countries' macroeconomic fundamentals improved substantially since the financial crisis of 1997/98, due to the introduction of structural reforms (see section 3.1).

Table 2.1 ASEAN SWOT Diagram

Strengths	Weaknesses
1. Strong macroeconomic fundamentals and generally robust economic growth 2. Young, growing population and expanding middle class 3. Abundant natural resources, biodiversity, and wide-range of productive capabilities in agriculture, manufacturing, and services 4. Open and flexible economies with diversified export structures 5. Large inflow of foreign direct investment and articulated regional production networks 6. Growing and dynamic small and medium-sized enterprises 7. Ability to manage great diversity—economic, political, cultural 8. Solidifying ASEAN institutionalization	1. Huge development gaps and pronounced disparities in rule of law and governance 2. Absence of an effective regional fund to redistribute resources among ASEAN members 3. Increasing risk of falling in the "middle-income trap" 4. Low education attainment and large unskilled workforce 5. Lack of harmonized policies and standards to manage mobility of skilled and unskilled labor 6. Absence of a regional strategy to promote private sector investment in research and development 7. Weak ASEAN Secretariat due to insufficient resources and obsolete governance principles 8. Over-ambitious targets for accomplishing the ASEAN Economic Community and lack of a clear integration vision beyond 2015
Opportunities	**Threats**
1. Strategic location with huge market potential in neighboring economies 2. Strong historical and cultural links throughout Asia 3. Deep manufacturing and technology links with Northeast Asia 4. Potential to increase energy, water, and food production, and to play a pro-active role in responding to supply crises 5. Potential to develop regional economic hubs—in health, education, logistics, financial services, and tourism 6. Strong regional financial cooperation initiatives enabling to further strengthen members' macroeconomic resilience 7. Pivotal role to play in the regional economic architecture 8. Recognized role as honest broker between key Asian economies	1. Vulnerability to external shocks due to high degree of openness 2. Erosion of advantages in the export-driven growth model followed so far 3. Excessive focus on intra-regional competition and lack of internal cohesion to formulate a long-term regional development strategy 4. Loss of "centrality" in the regional economic and geopolitical context due to the rise of the People's Republic of China and India 5. Unresolved intra and extra regional territorial disputes and ethnic conflicts 6. Lack of unified ASEAN representation of members' interests in global forums 7. Inability to collectively manage climate change, energy security, and regional disasters 8. Weak links between ASEAN and subregional cooperation initiatives and programs

ASEAN = Association of Southeast Asian Nations; SWOT = strengths–weaknesses–opportunities–threats.
Source: Authors—based on findings of individual ASEAN countries' perspective background papers prepared for this study.

crisis, and the repercussions of the 2008/09 global financial and economic crisis together with the crisis in the eurozone (see Figure 1.2).

The region is blessed with abundant natural resources—including oil, gas, hydropower, and minerals—as well as a large biodiversity and a substantial agricultural base. Part of the region's success came through constructing a robust, highly competitive export sector built on ASEAN-based production networks and supply chains. These networks cover the wider East Asian region and have largely been linked to the substantial flows of foreign direct investment (FDI) ASEAN countries continue to attract. Economic openness, availability of low cost production inputs, and favorable conditions for foreign companies to relocate factories are all part of the reason. ASEAN member countries have also been able to develop vibrant small and medium-sized enterprises (SMEs)—often enjoying strong links with regional and global supply networks.[42]

ASEAN has one of the world's most impressive track records in regional cooperation—aside from the European Union (EU)—leading to significant progress in economic integration and growth. These achievements demonstrate how ASEAN has been able to deal with its great regional diversity—economic, political, and cultural. Increased institutionalization, such as the introduction of the ASEAN Charter, the roadmap for an ASEAN Community, and several master plans recently prepared to promote development in connectivity, tourism, and information communication and technology—among others—are path breaking components for deeper integration over the coming years.

2.1.2 Weaknesses

While ASEAN's internal strengths are no doubt remarkable, the group also presents several internal weaknesses that must be addressed. Major concerns lie in the presence of huge development gaps within and across countries, and pronounced disparities in governance systems and effective implementation of the rule of law. Development gaps are particularly wide between rural and urban areas, as well as archipelagic regions such as Luzon and Mindanao in the Philippines or the Western and Eastern provinces of Indonesia. Gaps also remain huge between Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam (CLMV) and the ASEAN-6 countries,[43] even excluding Singapore and Brunei Darussalam (which have already achieved a high income status).

To reach AEC Blueprint targets and effectively develop the concept of ASEAN as a family of nations, these gaps must narrow substantially. The Initiative for ASEAN Integration and the Framework for Equitable Economic Development recognize such need. But progress has been slow. A more determined and innovative

42 The devastating floods in Thailand toward the end of 2011 showed how important these production networks and ASEAN SMEs have become *globally*.
43 Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

approach is required to forge ASEAN as a socially responsible community that maintains its distinctive identity while increasing cohesion among its people. In this context, the absence of a politically acceptable financial mechanism to redistribute resources among ASEAN members remains a major weakness (see sections 3.2 and 4.4 for detailed discussions).

Today, half of ASEAN's members are lower- to upper-middle income countries. The next two decades will be critical for these economies to make the substantial leap to higher-income status. If they will be able to follow a development path similar to that of the Republic of Korea — for example — they may be able to avoid falling in the middle-income trap and join the group of countries driving global growth and prosperity.[44] One of the tenets central to bypassing the middle-income trap is to graduate from excessive reliance on foreign technologies by building a local business climate that promotes private investment in research and development (R&D) and creates incentives for innovation (Kohli et al. 2011). Without progress in these areas, it will be hard for ASEAN to become a highly competitive region, also given the generally low educational attainment and the relatively large proportion of unskilled labor in much of the region's workforce.

When it comes to labor mobility, different ASEAN countries face quite different problems. Brunei Darussalam, Malaysia, Singapore, and Thailand are net importers of (especially unskilled) labor; Indonesia, the Philippines, Myanmar and Viet Nam are large exporters. Cambodia and the Lao PDR are also net labor exporters, although to a lower degree due to the smaller labor force size. Labor migration issues in ASEAN — as in major regions worldwide — can be politically contentious. The AEC Blueprint includes provisions for the free movement of skilled labor, but does not address unskilled labor. The lack of harmonized policies to manage the movement of both skilled and unskilled labor creates problems in raising ASEAN economies' productivity to achieve higher levels of competitiveness.

Another shortcoming lies with the ASEAN Secretariat, which continues to lack sufficient human and financial resources. With the secretariat's responsibilities increasing, its current staffing is inadequate to properly fulfill assigned duties and provide quality and effective coordination. The secretariat's budget also needs to be greatly expanded, in part to lower dependency on funds provided by development partners — which often include some form of conditionality. Understaffing and underfunding the secretariat can be seen as a deliberate choice — defined by the reluctance to transfer sovereignty and to delegate power from national to regional authorities. While the lack of sovereignty transfer results in decision-making structured uniquely on consensus, the group still remains trapped in an approach to funding the secretariat's budget based on the principle of equal contribution,

44 Box 3.2 includes a detailed discussion on middle-income trap issues affecting ASEAN economies.

which today appears too rigid and inadequate given the complexity of ASEAN's external environment and the need to remain internationally competitive (see chapter 5 for a detailed discussion).

These weaknesses, combined with the presence of rigid principles for decision-making and financial contributions — along with the lack of a proper settlement mechanism to resolve internal disagreements — may significantly erode the central role played by ASEAN as a group in Asia's institutional architecture (Wihardja 2011). The need for a stronger secretariat is also reflected in its capacity to properly design and monitor AEC targets and their implementation — ensuring that national laws and regulations reflect commitments and priorities. Besides, while the region is facing long-term development challenges, ASEAN leaders have focused on accomplishing AEC targets without providing a clear sense of direction and vision for economic integration beyond 2015.[45]

2.1.3 Opportunities

ASEAN's overall population of 620 million with an advantageous age distribution makes it a globally attractive market. Yet, it also has a combined market of over 2.5 billion people on its borders: its strategic position in Asia offers the group opportunities to serve as a natural land bridge between East and South Asia — especially between the People's Republic of China (PRC) and India — two of the world's most dynamic economies. Thus far Myanmar has been the "missing link" in ASEAN's regional development. However, the opening of the country — which began in 2011 through a deep political and economic reform process — carries huge historical significance to enhance regional connectivity and create new impetus to the region's economic growth. Land and maritime routes also link ASEAN countries with South Asia, Central Asia, and the Pacific.

Aside from geography, ASEAN also holds a unique characteristic that favors international relations — its members hold deep historical, cultural, and trade links with the rest of Asia.[46] It is not surprising, therefore, that in recent decades ASEAN members were able to develop deep manufacturing and technological links through trade and production networks with Northeast Asian economies — Japan, the Republic of Korea, the PRC, and Taipei,China. At the same time, agriculturally rich Southeast Asia has become a major supplier of food and other agricultural products to Northeast Asia.

ASEAN also maintains vast potential to increase the production and export of energy, water, and food, which allows it to play an increasingly strategic role in

45 As discussed in section 1.1, at their 23rd Summit in Brunei Darussalam in October 2013 ASEAN leaders asked the "Coordinating Council" to prepare an ASEAN Community's Post-2015 Vision, which is expected to be endorsed at the 27th Summit in 2015.

46 Cultural linkages between Southeast and South Asian countries are deeply rooted. Many Southeast Asian languages and performing art find their origin in India — they were diffused throughout by region using the intense trade linkages established in the past by Indian merchant houses.

response to potential crises in their supply. And ASEAN also has large capacity to develop regional hubs for several high value-added services — such as education, logistics, health, finance, and tourism. Singapore is already a regional hub in all these sectors; Thailand has acquired status as a hub for tourism and medical services; Malaysia is aiming to become a regional center in finance, health, and education in the next few years. Overall, ASEAN has grown over the past four decades as a favored global tourist destination, and can further strengthen its attraction for travelers through increased transport connectivity and regional cooperation initiatives (see section 3.3, Box 3.6).

The creation of regional schemes for financial cooperation, such as the Asian Bond Markets Initiative and the Chiang Mai Initiative, began in response to the 1997/98 financial crisis. These initiatives have evolved into important platforms for further strengthening ASEAN's economic and financial resilience in response to shocks and crises. Post-crisis reforms and strong external markets helped ASEAN secure a sound macroeconomic foundation in much of the region when the 2008/09 global financial crisis hit. After ASEAN economies felt the crunch — especially through trade channels in its more open economies — financial stability quickly returned, allowing governments to launch stimulus packages aimed at sustaining growth and contributing to recovery.

Moreover, since the 1997/98 Asian financial crisis, ASEAN was able to play an increasingly pivotal role in shaping a new regional economic architecture. The formation of ASEAN-plus-One trade and investment agreements, the strengthening of the ASEAN Regional Forum, the establishment of the ASEAN+3 Finance Ministers and Central Bank Governors process, and creation of the East Asia Summit are examples of evolving regional dialogue. ASEAN's perception as a relatively benign hub of cooperation gives it the potential to strengthen the role of honest broker it has played in balancing competing regional interests between key partners — from Japan, to the PRC and India — on economic, political, and security issues.[47]

2.1.4 Threats

In defining and planning its future, ASEAN will need to carefully evaluate the threats it faces with geopolitical forces subject to dramatic shifts and economic development strategies undergoing profound change. The risk of contagion increases significantly as regional and global economic interdependence deepens. ASEAN remains vulnerable to external shocks, partly because it is one of the most open regions in the world. Intraregional trade, currently about one-fourth of total ASEAN trade, is insufficient to provide a cushion should the United States (US) and European Union (EU) continue to lower demand for ASEAN goods. Besides,

47 ASEAN countries have also traditionally strong economic and political relationships with the European Union and the United States.

a repeated slowdown in the PRC's and India's economic growth rates, as recently occurred, will also negatively affect ASEAN trade.

The threat of external shocks and contagion is compounded by the need to resolve global economic imbalances, requiring a review of export-oriented strategies toward adopting a more balanced approach that promotes internal demand and inclusive growth. ASEAN countries need to implement structural and institutional reforms for a smooth rebalancing and diversification of the sources of economic growth — a difficult but necessary strategy.[48] Competition from the PRC, India, and other countries will push for raising productivity and innovation. In facing external pressures, it will be also important to eliminate the currently excessive focus on intra-regional competition, which impedes the ability to attain a truly borderless economic community. Internal cohesion in formulating a long-term regional development strategy should also be enhanced.

One key issue — both a major threat and opportunity — relates to how ASEAN positions itself geopolitically. The Bali Concord III — adopted under the theme of an "ASEAN Community in a Global Community of Nations" — gives the right message in calling for a "…more coordinated, cohesive, and coherent ASEAN position on global issues of common interest and concern, based on an ASEAN shared global view." It also calls for a strengthened Secretariat to "…support the vision and development of the ASEAN Community in a global community of nations" (ASEAN 2011b). Determined political leadership will be needed to translate the Bali Concord III into reality. Cautious optimism prevails "….. but, its [ASEAN] continuous existence is not assured" (Soesastro 2000). In this respect, the successful consolidation of trade and investment agreements under the Regional Comprehensive Economic Partnership umbrella is expected to boost ASEAN "centrality" (see section 1.3).

Unresolved territorial and ethnic conflicts — within ASEAN and on its periphery — remain serious threats to regional unity and harmony. Managing and resolving these disputes will increasingly test the effectiveness of political mechanisms to maintain peace and security in the region.[49] For example, border crossing arrangements between Thailand and Cambodia remain problematic and highly inefficient — the missing railway connection between these two countries could take years to materialize. While there are other security issues on the borders between Myanmar and the PRC, and Myanmar and India, the overriding regional tension remains over territorial waters in the South China Sea. These have increased in severity and have intensified over the past several years. To a

48 It should be noted that "rebalancing" does not imply reducing trade, but just placing less focus on "net exports."

49 Peace and security in Southeast Asia has been based on a variety of regional agreements, such as the Treaty of Amity and Cooperation, the Declaration of Conduct of the South China Sea, the ASEAN Nuclear-Free Zone, the ASEAN Defence Ministers' Meeting, and the ASEAN Regional Forum.

large extent, these threats have roots steeped in history, and involve the untapped resource potential as much as the projection of power in rapidly advancing economies. While intraregional tensions have already become a challenge for ASEAN, as it strives to speak with a single voice in global forums, they could escalate in future geopolitical importance.

Related to the ability to speak with a unified voice is ASEAN's lack of power to represent its members' interests in global forums. Its institutional figures such as the Secretary-General or the ASEAN Chair have little scope to speak on behalf of the group. For example, both the ASEAN Secretary-General and Chair receive invitations to join the Group of Twenty (G20) meetings — since the first leaders' summit in 2008 following the outbreak of the global economic and financial crisis. Sadly, ASEAN's institutional leaders, even at the top, have no power to represent or speak on behalf of the group itself. Despite being participants in G20 (and similar) meetings, their role is often confined to note-taking and reporting to members' capitals: they have no power to articulate a strategy in the interest of ASEAN as an entity — or even lobby on behalf of individual countries (see chapter 6).

An additional threat lies in the ability to collectively manage common challenges such as climate change, energy security, food security, and natural disasters. While there has been successful cooperation in tackling health threats involving acquired immune deficiency syndrome, severe acute respiratory syndrome, and avian flu, for example, ASEAN needs to expand its preparedness in facing other longer-term challenges, including natural disasters, which are becoming more frequent than in the past. Over the last decade, ASEAN countries have suffered considerably from droughts, earthquakes, tsunamis, typhoons, floods, and volcanic eruptions. Aside from widespread human suffering and loss of life and livelihoods, natural disasters seriously disrupt supply chains and affect the regional economy.

Climate change and related issues, such as the trans-boundary haze seasonally affecting Sumatra, Malaysia, and Singapore, have become permanent regional features. Long-term projections also show that countries such as Viet Nam will be seriously affected by climate change; the Philippines and other areas are highly prone to typhoons and need to ramp up preparedness.[50] Several capitals — Bangkok, Jakarta, and Manila, for example — are increasingly exposed to severe flooding. Climate change could affect food security and disrupt energy supply as well. And while the impact of climate change is expected to grow over time, the next two decades will be critical for ASEAN to prepare and incorporate adaptation and mitigation measures in its development strategies (see section 3.4).

Finally, as Asia's economic interdependence continues to grow on a multi-track, multi-speed format, the region's institutional architecture increases in

50 The disaster caused by Typhoon Haiyan in November 2013 is a clear, unfortunate example.

complexity (ADB 2008b). Therefore, it is important for ASEAN to strengthen links with subregional cooperation initiatives and programs that promote members' development—such as the Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area, the Greater Mekong Subregion, the Indonesia-Malaysia-Thailand Growth Triangle, and various other bilateral initiatives promoted by Japan, the Republic of Korea, the PRC, the US, and several other development partners. Current institutional linkages with subregional programs remain, however, weak. ASEAN needs to establish an effective mechanism to link and monitor its own activities in relation to these programs and initiatives so as not to lose relevance within these subregions.

2.2 Ambitions and Pragmatism

While there are costs as well as benefits to regional integration, the general consensus is that, for ASEAN, the benefits largely outweigh costs. Regional integration helps generate faster economic growth through transmission channels such as mobilizing resources for investment, an expanding and increasingly mobile labor force, and overall improvements in total factor productivity due to technological change and innovation.

Economic projections combined with national and regional development aspirations suggest ASEAN countries hold tremendous potential for growth, such that by 2030, they could enjoy the average quality of life in OECD countries today. If, however, ASEAN countries fail to introduce domestic structural reforms and launch bold initiatives for regional cooperation, they could easily slip into a substantially slower growth scenario and fall prey to the middle-income trap.

To examine where the ASEAN economy might be in the year 2030, this study sequentially identifies economic aspirations, key development challenges, growth-enabling factors, ASEAN's institutional architecture, and the national and regional policy options available. Specifically, after a detailed analysis of each ASEAN country's domestic economy, a set of common aspirations and challenges emerged from a regional extrapolation exercise based on synergies and complementarities identified across countries.

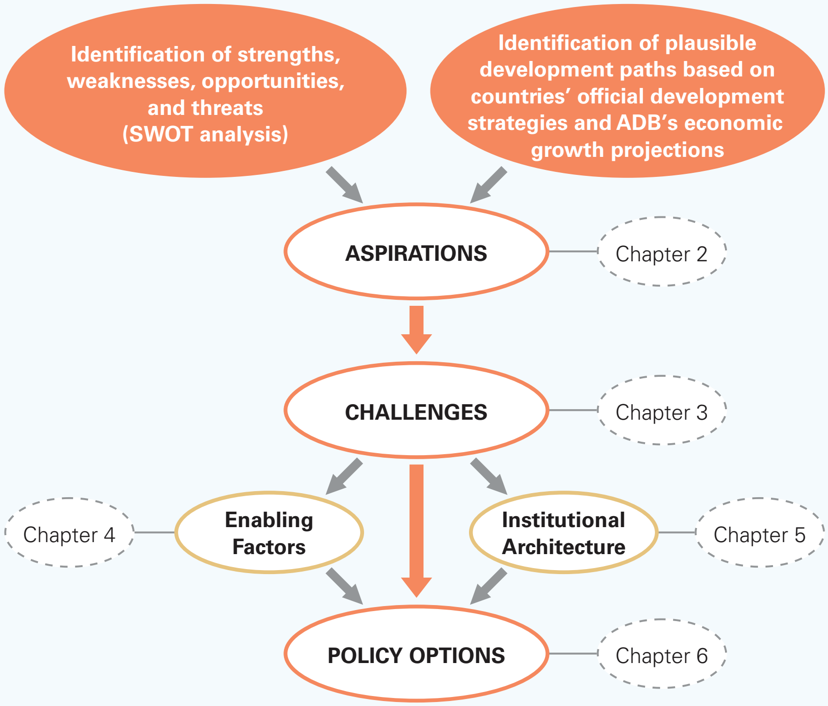
2.2.1 An Analytical Framework of Aspirations, Challenges, and Policy Options

Countries' economic aspirations can be seen as a broad concept based on various elements. Per capita GDP, as a measure of economic well-being, is the most important indicator. But it is by no means an exhaustive indicator of the quality of life. Yet, focusing on per capita GDP allows the possibility of setting quantifiable targets and conducting meaningful international comparisons. Nonetheless, defining aspiration targets in terms of per capita GDP remains a difficult exercise requiring a thoughtful approach.

Aspiration targets are quite different from economic projections. Projections are based on economic models constructed on the basis of conventional assumptions on the interplay of economic variables. Defining the long-term level of per capita GDP as a country's aspiration involves both ambition and pragmatism. Ambition drives the internal social, political, and economic system to best mobilize resources to achieve high and sustained output growth. At the same time, pragmatism is needed to ensure that development trajectories are plausible and attainable.

The analytical framework adopted in this study (Figure 2.1) combines long-term economic aspirations (analyzed in the remainder of this chapter), development challenges (chapter 3), growth-enabling factors (chapter 4), ASEAN's institutional architecture (chapter 5), and policy options (chapter 6). This type of bottom-up analytical framework can offer sensible recommendations in mapping out a propitious path of economic development through consultation and participation.

Figure 2.1 Aspirations-Challenges-Policy Options Analytical Framework



ADB = Asian Development Bank.
Source: Authors.

Setting aspiration targets for a country's long-term economic development was the first step in understanding where ASEAN economies, and the region as a whole, want to be by 2030. The second and third steps identify key development challenges and growth-enabling factors needed to fulfill aspirations. The fourth step examines ASEAN's institutional environment and how it should evolve if aspirations are to be met. Finally, the fifth step involves articulating a structured set of policy options — national and regional — to address the key challenges, drive the enabling factors forward, and enhance the regional institutional architecture.

2.2.2 2030 Growth Scenarios

ASEAN countries' per capita GDP aspiration targets for the year 2030 were formulated on the basis of in-depth background studies conducted by a team of ASEAN scholars in each country and a series of consultations organized in 2011 with local policy makers, think tanks, and experts from government, private firms, academia, and the media. Key background information to ensure the plausibility and attainability of suggested outcomes were sourced from development strategies issued by national government agencies and the results of projections prepared by the Economics and Research Department of the Asian Development Bank (ADB) — as part of the study "ASEAN, the PRC, and India: The Great Transformation," or ACI study (ADB and ADBI 2014).

During 1991–2010, ASEAN's aggregate GDP grew at a yearly average of 5.8%. This is an astonishing figure, given the Asian financial crisis that derailed several ASEAN economies in the late 1990s and the global economic and financial crisis that erupted a decade later. During the 20-year period, the yearly average GDP growth of CLMV economies was faster (7.4%) than the ASEAN-6 (5.1%). There are various reasons for this, including the lower starting base, the marginal effect of the 1997/98 Asian financial crisis on CLMV economies, and their relative isolation from external shocks (Figure 2.2).

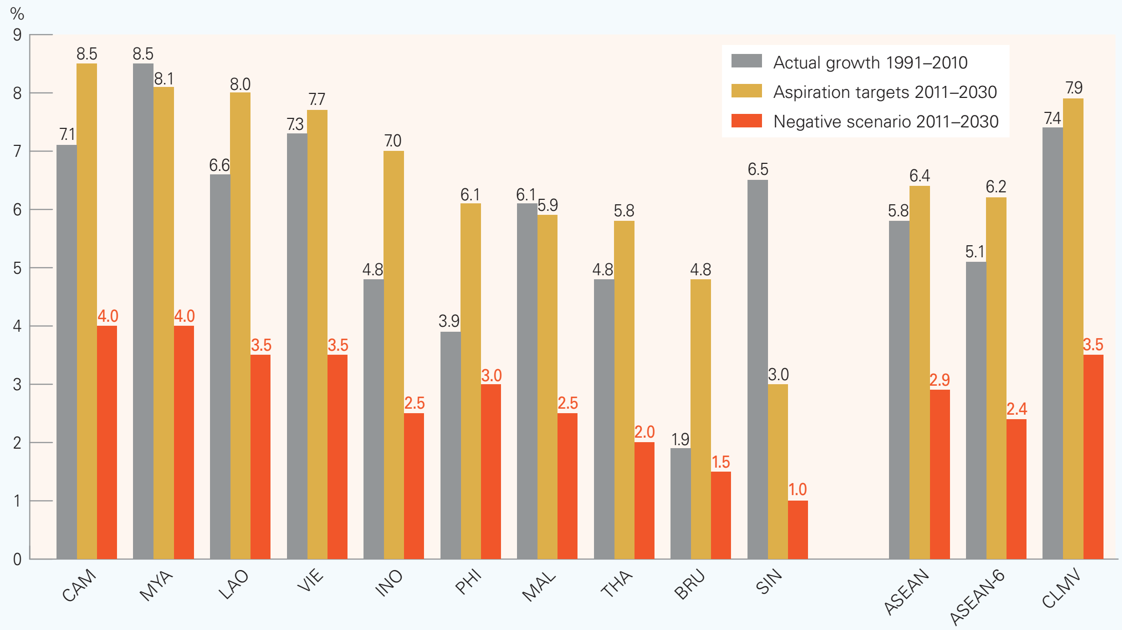
The aspiration GDP growth target calculated for ASEAN from 2011 to 2030 is a yearly average of 6.4%. The CLMV countries could grow an average 7.9% each year, with the ASEAN-6 averaging 6.2%. These aspiration targets are approximately one percentage point above the projections prepared by ADB for the ACI study for ASEAN as a whole — and a half percentage point higher for CLMV countries. These higher aspiration targets — as compared with economic projections — are due to both the ambition element and the economic multiplier effect induced by regional integration, which was not calculated in ADB's economic projections (Box 2.1).

The eurozone crisis and sluggish US growth in the years after the 2008/09 global financial crisis, combined with the volatility of natural resource prices and the PRC's growth moderation since 2010 may make it difficult for ASEAN as a whole to reach the ambitious 6.4% yearly average growth rate during 2010–2030. But, as discussed in the previous section, ASEAN can count on several factors that augur well for the region's economies to continue the sustained growth they have seen over the past two decades — and do even better the next 20 years.

In particular, as the ASEAN economy becomes increasingly borderless through enhanced regionalism, individual countries can increase growth by capturing larger economies of scale, playing a more significant role as regional industrial hubs in specific sectors or deepening value chains, and enhancing economic integration with the rest of the world. However, ASEAN countries need to take bold actions to ensure their development aspirations are fulfilled. Two necessary conditions must be met: (i) adopting domestic structural reforms to boost productivity, and (ii) strengthening initiatives for regional cooperation.

If these conditions are not met, ASEAN member countries will find it increasingly difficult to sustain economic growth and fulfill their development aspirations. Based on calculations done by the ACI study using computable

Figure 2.2 ASEAN GDP Growth to 2030: Aspirations vs. Negative Scenario
(actual 1991–2010 growth; aspiration targets and negative scenario for 2011–2030)



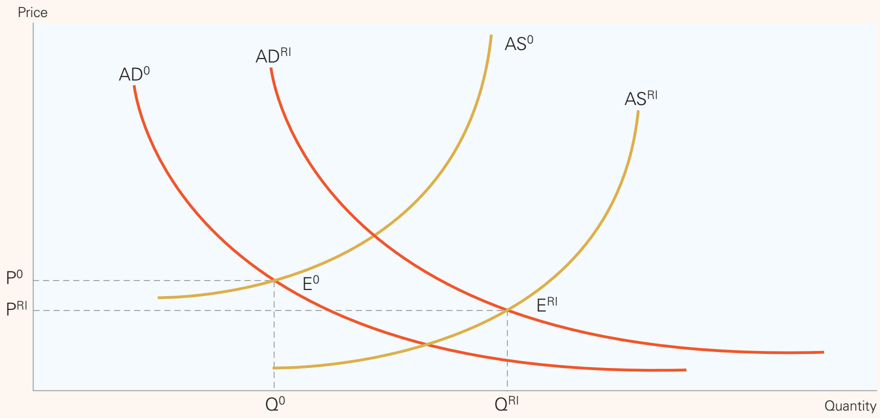
ASEAN = Association of Southeast Asian Nations; BRU = Brunei Darussalam; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; CAM = Cambodia; INO = Indonesia; CLMV = Cambodia, Lao PDR, Myanmar, and Viet Nam; LAO = Lao People's Democratic Republic; MAL = Malaysia; MYA = Myanmar; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Notes: Aspiration targets are based on country consultations and background papers prepared for this study. The "negative scenario" is based on simulations calculated for this study on the basis of projections prepared by the Economics and Research Department, Asian Development Bank.
Sources: 1991–2010 data are from the International Monetary Fund. World Economic Outlook, April 2012 Edition. http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx (accessed September 2013).

Box 2.1 Impact of Regional Economic Integration on Growth

Regional economic integration can be generally defined as the outcome of the elimination of barriers to trade, investment, and other forms of economic interdependence between two or more countries (negative integration) together with the creation of common structures aimed at governing the newly created markets (positive integration). Theoretical work associates increased regional economic integration with net positive effects on growth due to improved allocation efficiency and production agglomeration, which can eventually cause a permanent increase in the rate of growth (Baldwin and Venables 1995; Rivera-Batiz and Romer 1991).

The standard general equilibrium model helps clarify the impact of regional economic integration on growth. Before economic integration, a country's macroeconomic equilibrium is reached where the aggregate demand (AD^0) and aggregate supply (AS^0) meet (Figure B2.1). At the equilibrium point (E^0), the price level is set at P^0 and the quantity produced by the internal economic system at Q^0.

Figure B2.1 Effect of Economic Integration on Aggregate Demand and Supply



AD = aggregate demand; AS = aggregate supply; E = equilibrium point; P = price; Q = quantity; RI = regional integration.
Source: Authors.

general equilibrium models, ASEAN economies could face a much slower growth scenario with GDP growth averaging just 2.9% per annum over the two decades to 2030—less than half their potential.

Average yearly growth of the ASEAN-6 will only reach 2.4% with increased competition from the PRC, India, and other emerging markets. Indonesia, Malaysia, the Philippines, and Thailand would succumb to the middle-income trap as they fail to invest in research and development (R&D) and education.

CLMV countries will also face severe difficulties, with Myanmar unable to capitalize on its current momentum for reform, Cambodia and Lao PDR facing skilled-labor shortages and left outside regional production networks and supply chains, and Viet Nam unable to strengthening its private sector and adopt an effective macroeconomic policy framework (to manage the

Regional economic integration—with one or more countries—induces a shift toward the right of both the aggregate demand, from AD^0 to AD^{RI}, and the aggregate supply from AS^0 to AS^{RI}. This is due to the static effect of summing up domestic consumer markets at the regional level and the net dynamic effect of expanding production aiming to serve the increased total demand and the newly created regional market. In case aggregate supply increases proportionally more than demand, the final equilibrium point shifts from E^0 to E^{RI}, with a lower price (P^{RI}) and a higher quantity (Q^{RI}) than before integration, as shown in the diagram. If, however, the increase in aggregate supply is proportionally lower than demand, the new equilibrium price will be higher than before integration (not shown in the diagram).

Economists have been debating the relationship between regional economic integration and growth for some time. Studies focused on the European Union have shown that in the long-run countries which have joined the group (Greece, Ireland, or Italy) experienced a much higher average growth in their per capita gross domestic product than countries that decided to remain out—for example Switzerland (Aldcroft 1993; Artis and Lee 1997; Badinger 2001).

In line with these findings, Asian Development Bank (ADB) studies also find that regional economic integration in Asia helps eradicate poverty by fostering growth and improving the living conditions of millions of people (ADB 2008, 2010). This relationship is structured on four basic effects. First, increased regional economic integration enables countries to benefit from economies of scale due to the expanded market size, which allows for better resource allocation and enhanced factor productivity. Second, integrating economies benefit from internalizing positive spillovers generated by removing barriers to the free flow of goods, services, and production factors. Third, closer economic interdependence and integration helps narrow the development gap existing across countries in the region by connecting the peripheries with the centers of economic growth—benefits that accrue especially to low-income and landlocked areas/countries. Fourth, enhanced economic integration allows late comers to join regional production networks and supply chains, offering opportunities for local firms—especially small and medium enterprises—to grow as providers of parts, components, and services to intermediate and final goods' producers.

Source: Authors.

shift from lower- to upper-middle income levels). As a result, under the slow growth scenario, CLMV countries would only grow an average 3.5% annually during 2011–2030. This scenario is also defined by ASEAN's inability to manage pressing challenges posed by climate change and more frequent natural disasters, and to solve mounting political tensions, both within and across countries.[51]

51 The ACI study (ADB and ADBI 2014) conducted separate exercises to estimate the impact of several shocks on the 2011–2030 economic growth path of ASEAN economies—as well as the People's Republic of China (PRC) and India. They include (i) a major slowdown in productivity growth, (ii) rising food and energy prices, (iii) worsening environmental conditions, (iv) emerging distributional concerns due to increasing income inequalities, and (v) increasing protectionism due to economic recession in major export markets.

While the long-term GDP aspirations identified in this study from background papers and detailed country consultations are usually in line with government development plans, achieving 2030 quantitative targets is a positive, high-growth scenario against the baseline projections provided by ADB. In contrast, the low-growth scenario occurs as several external and internal shocks hit the region, and as ASEAN countries will be unable to introduce domestic structural reforms and adopt bold measures to enhance regional economic integration — by creating a truly borderless economic community beyond the AEC. Under the pessimistic scenario, fulfilling ASEAN members' development aspirations will be inevitably delayed.

2.2.3 2030 Aspiration Targets: National Perspectives

As discussed, defining development aspirations requires identifying plausible development paths based on official development strategies as well as economic growth projections. This section reviews individual development strategies adopted by the governments of each ASEAN member as well as economic growth projections prepared by the ADB for individual country development to 2030.

Brunei Darussalam

Brunei Darussalam's key 2030 aspiration is to diversify its economy by improving the local business environment and promoting private sector investment. Diversifying the economy has been a primary goal of government for several decades and has been included in the country's vision to 2035 (Department of Economic Planning and Development, Brunei Darussalam 2007). Yet the economy has been unable to make significant progress in this direction thus far. Although Brunei Darussalam has reached very high per capita income — due mainly to the availability of large oil and gas resources — its industrial structure remains poorly developed as a result of low economic diversification and the limited role played by the private sector. Oil and gas earnings have been used to create generous employment opportunities in the public sector (also as an indirect redistributive mechanism of government funds), discouraging the private sector from starting businesses due to the generalized increase in real wage rates implied by such policy (Green and Tamit 2013).[52]

The growth aspiration for Brunei Darussalam produced by this study is to double its real per capita GDP during the next two decades to close to $60,000 by 2030, which corresponds to an average GDP growth of 4.8% per annum (Table 2.2). This is indeed ambitious, especially compared with ADB's growth projection of 3.7% annually over the two decades, and against the pessimistic scenario implying a

52 Brunei Darussalam has often been cited in economic literature as affected by the resource curse syndrome—or suffering the "Dutch disease"—where large earnings generated by natural resource exports flow abroad rather than being re-invested to promote economic development. This pattern, discourages growth of local industries, in particular non-oil and gas tradable goods (see Rosser 2006; Sy and Tabarraei 2009; Gelb 2011).

1.5% average yearly GDP growth rate during 2011–2030.[53] Oil and gas production is expected to increase about 5% yearly during this period — although if energy prices rise faster than expected, much faster growth is possible.

To fulfill its 2030 aspirations, Brunei Darussalam's economy needs to undergo a structural transformation promoted by government measures that unlock the potential for decisive growth in the private sector, promote SME development, expand port facilities, as well as invest in downstream energy sectors. Under this scenario, the public sector's share of GDP will need to shrink — relative to other sectors — from its current 20% to about 10% of the economy by 2030 (Green and Tamit 2012).

Cambodia

Leaving decades of conflict behind, from 1994 to 2011 Cambodia's GDP grew at a yearly average of more than 7%. It underwent substantial opening and a deep transformation from an agrarian economy to a more diversified and balanced mix of agriculture, industry, and services. Per capita income surged 3.5 times in real terms, from $248 in 1994 to $852 in 2011.

Through structural reforms and policies promoting poverty reduction and sustainable socio-economic development, by the year 2030 Cambodia can come close to reaching upper-middle income status, after graduating from its least developed country (LDC) rank, entering the lower-income group around 2015 (Strange et al. 2013).[54] This target is in line with ongoing discussions among government agencies — at the time the ASEAN 2030 report was being finalized — in preparing the country's new 2030 development strategy. But it requires even stronger focus and effort than those made in the past (Ministry of Planning of Cambodia 2010). Reaching this aspiration target will require an average 8.5% annual GDP growth — implying a further 4.5 times increase in real per capita GDP over 2010–2030. ADB's projections are somewhat less optimistic, estimating an annual average economic growth of 7.9% over the same period (Table 2.2), while Cambodia's economy is expected to grow only at 4% annually on average during the same period.

Rapid economic growth and diversification need to be strengthened considerably in key sectors like agriculture, light manufacturing, and tourism. Investing earnings from the exploitation of oil and gas resources into viable projects will help diversify the economy — also to avoid the "resource curse"

53 The pessimistic growth scenario and related GDP growth rates for all individual ASEAN countries analyzed in this section were borrowed from the ACI study (see above discussion).

54 The World Bank classifies economies according to their level of gross national income (GNI) per capita. In 2013, economies with a per capita GNI lower than $1,035 were classified as low income; those with a per capita GNI between $1,036 and $4,085 as lower-middle income; and those with a per capita GNI between $4,086 and $12,615 as upper-middle income. Economies with a per capita GNI above $12,616 are classified as high income.

Table 2.2 ASEAN 2030 Projections and Aspiration Targets

Countries	Population		Gross Domestic Product (GDP)				
	Million people		$ billion			Average annual growth (%)	
	Actuals (2010)	Projections (2030)	Actuals (2010)	Projections (2030)	Aspiration Targets (2030)	Projections (2030)	Aspiration Targets (2030)
BRU	0.414	0.542	12.371	25.768	32.378	3.7	4.8
CAM	14.953	18.363	11.255	54.797	61.627	7.9	8.5
INO	237.641	277.059	708.352	2,121.335	2,890.468	5.5	7.0
LAO	6.437	8.049	6.461	30.114	32.315	7.7	8.0
MAL	28.251	37.069	237.803	694.737	780.067	5.4	5.9
MYA	61.187	69.310	45.380	225.259	231.322	8.0	8.1
PHI	94.010	127.336	199.591	663.418	675.859	6.0	6.1
SIN	5.184	6.093	227.382	397.842	427.615	2.8	3.0
THA	63.878	67.759	318.908	823.663	1,014.845	4.7	5.8
VIE	88.257	101.955	103.575	439.449	478.602	7.2	7.7
ASEAN	**600.212**	**713.535**	**1,871.078**	**5,476.382**	**6,625.100**	**5.4**	**6.4**
ASEAN-6	429.378	515.857	1,704.407	4,726.762	5,821.233	5.1	6.2
CLMV	170.834	197.678	166.671	749.620	803.867	7.5	7.9

ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; BRU = Brunei Darussalam; CAM = Cambodia; INO = Indonesia; CLMV = Cambodia, Lao People's Democratic Republic, Myanmar, and Viet Nam; LAO = Lao People's Democratic Republic; MAL = Malaysia; MYA = Myanmar; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Note: Projections are from the Economics and Research Department, Asian Development Bank. Aspiration targets are based on country consultations and background papers prepared for this study.

spiral. It will also require improving economic infrastructure for providing affordable energy and modern transport services throughout the country. And Cambodia must strengthen institutions and governance systems. It goes without saying that achieving sustainable development also requires greater investment in social sectors such as health care, access to (high quality) education, and creation of development opportunities for youth, together with broader human security and social protection (Strange et al. 2013).

Indonesia

With an expected population close to 280 million, by 2030 Indonesia will be the fifth most populous country in the world and a much more decentralized nation than it is today—with a large part of its economy still relying on domestic markets (Abimanyu and Santoso 2013). Its recently adopted long-term development

Per Capita GDP				
$			No. times of increase over 2010–2030	
Actuals (2010)	Projections (2030)	Aspiration Targets (2030)	Projections (2030)	Aspiration Targets (2030)
29,882	47,561	59,763	1.6	2.0
753	2,984	3,356	4.0	4.5
2,981	7,657	10,433	2.6	3.5
1,004	3,741	4,015	3.7	4.0
8,418	18,742	21,044	2.2	2.5
742	3,250	3,337	4.4	4.5
2,123	5,210	5,308	2.5	2.5
43,862	65,293	70,180	1.5	1.6
4,992	12,156	14,977	2.4	3.0
1,174	4,310	4,285	3.7	4.0
3,117	**7,675**	**9,435**	**2.5**	**3.0**
3,969	9,163	11,285	2.3	2.8
976	3,792	4,067	3.9	4.2

Sources: 2010 data are from the International Monetary Fund. World Economic Outlook, April 2012 Edition. http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx (accessed September 2013). Aspiration targets for 2030 are from background papers on individual ASEAN countries prepared for this study.

strategy suggests the country will be among the world’s top 10 largest economies by 2025, rising to join the top six economies by 2050 (Coordinating Ministry for Economic Affairs of Indonesia 2011).

Indonesia’s overall aspiration is to reach an income level above of $10,000 by 2030, preparing to reach high-income status in the following 5 years. Achieving this ambitious target implies a 3.5 times increase in real per capita GDP from the 2010 level ($2,981). In turn, it would require the economy to expand by an average 7% annually over the two decades. This is considerably above ADB’s projected 5.5% annual GDP growth for the same period, but in line with development plans included in Indonesia’s long-term strategy (see Table 2.2). In case Indonesia will be unable to meet its development challenges and it will enter a low-growth scenario, the economy is expected to expand only by 2.5% on average every year during the period 2011–2030.

Investment will have to grow considerably from the current level of 30% of GDP, supported by a sustained increase in economic activity — especially in the tertiary sector — following an expansion in trade, transportation, communication, and services related to expected deepening in the financial sector and tourism. While industrial production will likely continue growing over the next two decades, the contribution of the tertiary sector to GDP is expected to overtake manufacturing, in relative terms, by 2018.

Following Indonesia's policy to ensure environmental protection, mining is expected to play a decreasing role in the economy — in relative terms — reaching about 5% of GDP by 2030. Overall, the relative contribution of public administration to GDP will shrink due to decentralization and an expected increase in the efficiency of public service delivery (Abimanyu and Santoso 2013).[55]

Reaching Indonesia's aspiration targets will require strong determination from both public and private sectors, which will have to work closely together. The country needs to further strengthen macroeconomic management, build economic infrastructure to better connect its vast archipelago, and create development opportunities for the poor. As natural disasters have unfortunately been increasing over the past decade, the government will also have to improve the management of its natural resources to prevent and mitigate the emergence of food and energy crises, which could seriously compromise development prospects.

Lao PDR

The government development strategy for 2011–2015 includes a yearly average GDP growth target of 8% (or more) to graduate from the United Nations' LDC status by 2020 (Ministry of Planning and Investment of Lao PDR 2010). While Lao PDR has already entered the World Bank's group of lower middle-income countries in 2011, moving out of LDC status will require wide and intensive effort — as it implies not only decisive growth in per capita gross national income (GNI), but also on other development indicators related to human capital and its economic vulnerability to external shocks.[56]

The aspiration target for the Lao PDR is to extend by another decade the 8% annual GDP growth set by the government to graduate from LDC status

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55 Indonesia's growth is expected to remain centered on Java and Bali, especially with regard to trade and financial services. But the role played by other islands such as Kalimantan and Sumatra will substantially increase due to opportunities in exploiting natural resources and increasing agricultural production. The provinces and Nusa Tenggara, Maluku, and Papua are also expected to enjoy an economic growth trend.

56 The United Nations sets three criteria to assess the LDC status: (i) income, based on a 3-year average of per capita GNI, calculated by the World Bank using the Atlas method—average GNI must be above $1,190 to graduate; (ii) a Human Assets Index, based on indicators of nutrition, health, and education; and (iii) an Economic Vulnerability Index, based on indicators of population size, remoteness, merchandise export concentration, the primary sector's share of GDP, and four other indicators of economic instability (see http://www.unohrlls.org/en/ldc/164/).

and enter, by 2030, the upper-middle income group. Meeting this target would require raising the 2010 per capita GDP level by a factor of 4 (see Table 2.2). In the manufacturing sector, the Lao PDR can increase production of intermediate goods in garments and information technology goods. Achieving this high level of growth will not be easy for the Lao PDR, given its low degree of human capital development, poor economic infrastructure, and scarcity of domestic financial resources. However, literacy is increasing and with better transport infrastructure strengthening regional connectivity, the country can more fully participate in production networks and supply chains (Leebouapao and Kyophilavong 2013).

By introducing focused structural reforms, the Lao PDR is expected to continue growing rapidly, given its large factor endowments and the political stability enjoyed so far — ADB's projections indicate an average GDP growth of 7.7% over the period. Under a pessimistic scenario, however, with the inability to implement structural reforms, to enhance skills of the workforce, and to join regional production networks, the economy will only grow at an average yearly rate of 3.5% over the 2011–2030 period.

Malaysia

Malaysia is expected to become a fully developed, high-income country by the year 2020, or possibly earlier. The country's new long-term development strategy — the New Economic Model (NEM) launched in 2010 — suggests the economy will be able to grow an average of around 6.5% until 2020, settling to around 5% GDP growth during the following decade (National Economic Advisory Council of Malaysia 2010). The aspiration for Malaysia's per capita GDP is to increase 2.5 times between 2010 and 2030 from a level of $8,418 in 2010 to $21,044 in 2030. Reaching this target will require average GDP growth of 5.9% per annum — which is in line with the NEM (see Table 2.2).

Fulfilling this aspiration is indeed very ambitious for Malaysia, considering that the country is showing signs of succumbing somewhat to the middle-income trap — where growth is moderate, prices rise faster than per capita income, and private investment remains low — with insufficient technological upgrading and sluggish productivity growth (Abidin 2013). Against this backdrop, ADB's projections suggest that Malaysian GDP should grow an average 5.4% per year during 2011–2030. However, if the country can capitalize on its distinct strengths — including sound macroeconomic management, policy flexibility, the large availability of natural resources, and ample financial liquidity (which can effectively translate high savings rates into investment and consumption) — the 2030 aspiration targets can be met. On the other hand, if Malaysia enters a low-growth scenario during the two decades leading to 2030 its GDP will be only growing at an average 2.5% yearly.

Besides reaching high income status, the NEM aspires for development to be inclusive and sustainable. Efforts to promote better inclusiveness are focused on improving income distribution between rural and urban areas, and reducing poverty in remote regions — especially in the Eastern states — where poverty incidence remains high. In addition, the NEM addresses both economic and environmental sustainability, with the former focused on maintaining prudent macroeconomic policies, low inflation, and fiscal discipline, and the latter promoting green growth and the importance to capitalize on the country's biodiversity — while maintaining Malaysia's proactive stance in managing climate change (Abidin 2013).

Myanmar

The process of structural political and economic reforms started in 2011 offers a completely new perspective for the economic development of Myanmar — far from the trend seen over the past several decades. If this process is successful, by 2030 the country can graduate from its current low-income status and achieve — or get close to achieving — upper-middle income status. The country, although still suffering from structurally weak macroeconomic management and low levels of human capital development, is extremely rich in natural resources and is strategically located between the two giant markets of the PRC and India.

With the reform process continuing and positively affecting many aspects of the country's political, social, and economic development, Myanmar's ambitious target is to increase its per capita GDP of Myanmar 4.5 times over the next two decades — from $742 in 2010 to $3,337 in 2030. Meeting this target implies an annual average GDP growth of 8.1% (see Table 2.2) — slightly higher than the 8% per annum GDP growth projected by ADB.

Actually, rapid development of new production technologies in various industries and smooth integration of Myanmar's economy with the region could push average GDP growth higher — close to yearly averages of 10%–11% (Verbiest and Naing 2013). Reaching a high growth scenario would require, however, major and rapid reform of current institutional and governance systems. In contrast, in case reforms do not push through as expected or if Myanmar will be unable to manage the transition, the economy will only expand by an average 4% annually during the period 2011–2030.

Philippines

While the Philippines had lower growth vis-à-vis the other ASEAN-6 economies in the 1990s and early 2000s, the past few years has seen renewed economic strength, with encouraging results on a broad range of development indicators.

Based on this performance, the 2030 aspiration target for the Philippines is to increase its 2010 per capita GDP by 2.5 times to reach over $5,300 by 2030 — entering upper middle-income status by 2020.[57] Achieving this target

57 This assumption implies that GDP will grow faster in the first than second decade—a trend generally applicable to the region.

implies average annual GDP growth of 6.1% over the two decades — close to ADB's projections of 6% (see Table 2.2). To be sure, the government adopted a Medium-Term Development Plan from 2011 to 2016, which assumes an average yearly GDP growth of 7.2%–7.7% for the period — a strategy which includes medium-term goals of equalizing access to development opportunities and creating effective development support systems (National Economic and Development Authority of the Philippines 2011). If, however, the country will enter a pessimistic scenario, GDP will only expand at an average 3% annually.

The Philippine economy is characterized by a relatively small manufacturing sector, low investment, and the presence of several imbalances. Uneven productivity across sectors, huge output gaps between large corporations and SMEs, and unbalanced geographical distribution of income all need to be corrected to achieve sustained growth in the long run.

Poverty incidence in the country is among the highest in Southeast Asia, with income concentrated in a small share of the population — creating serious challenges to following an effective inclusive growth strategy. Moreover, prospects for environmental sustainability have worsened in recent years due to progressive deforestation and increasing urban pollution. On the other hand, the country can not only count on the large availability of natural resources, but also on a well-educated labor force, English language proficiency, and a vibrant service sector. There has also been an encouraging record of macroeconomic stability in recent years (Yap and Majuca 2013). These factors support the country's ability to fulfill its 2030 per capita GDP growth aspirations.

Singapore

The Singapore government's objective for the decade to 2020 is for the economy to achieve an average yearly GDP growth rate of 3%–5%, and falling to 2%-3% between 2021 and 2030. Given the severe land and labor constraints and rising trends in real wages and income levels, the only way to sustain such economic expansion and remain internationally competitive is to focus on improving labor and other factors' productivity. While productivity growth was somewhat subdued at a 1%–2% yearly average in 2001–2010, the government aims to increase productivity growth to an average 2%–3% per annum in 2011–2020 (Ministry of Finance of Singapore 2010).

The aspiration for Singapore is to increase 1.6 times its current real per capita GDP and to reach over $70,000 by 2030 — confirming its status as one of the world's richest countries. Fulfilling this target implies an average 3.0% annual GDP growth over 2011–2030, slightly higher than ADB projections of 2.8% (see Table 2.2). Singapore can sustain its economic dynamism by increasing R&D investment to further developing biotech sciences and strengthening or creating hubs in areas such as education, healthcare, financial services, transportation and tourism. This, in turn, will help the country strengthen its position as one of Asia's most innovative economies and retain its global competitiveness — leading in a number of market niches through the operation of locally-based multinational corporations and indigenous corporations succeeding by means of new design, products, and services (Chia 2012). But if major external shocks will hit the economy, Singapore may enter a very low growth path, with GDP increasing only at 1% yearly, on average, during 2011–2030.

Reflecting its high income level, Singapore's 2030 development aspirations are also focused on improving citizens' quality of life and becoming a distinctive, vibrant and green global city, able to attract highly skilled professionals and to enhance its cultural and social base. Some key constraints — which will continue to affect development — are Singapore's vulnerability to regional and international shocks, dependency on importing natural resources, limited land area, small population, and a low fertility rate. To achieve its 2030 development aspiration targets the country will have to introduce policies to overcome or manage these constraints (Chia 2012).

Thailand

Based on sustained growth over the past five decades, Thailand's aspiration target is to become an advanced economy, enjoying high income with per capita GDP of approximately $15,000 by 2030. This requires tripling 2010 per capita GDP, which implies an average 5.8% annual GDP growth between 2011 and 2030 (see Table 2.2). To realize this ambitious target — about one percentage point above ADB projections — Thailand will need to take full advantage of its strategic location between East and South Asia, retain its competitive edge as a center for production networks in industries such as automobiles and electronics, and grow as a hub in industries such as tourism, finance, and medical services (Jitsuchon 2013).

It should be noted, however, that while Thailand grew at an average 6.3% between 1961 and 2011, GDP expanded at a 7.7% annual average in the first three decades, and only at 4.3% annually between 1991 and 2011 as a result of the Asian financial crisis and the global financial crisis. If the country will be unable to successfully overcome its development challenges it could enter a low-growth scenario with the GDP expanding at a reduced pace of only 2% yearly on average over the period 2011–2030.

The economy needs to rebalance away from an almost exclusive reliance on export as the engine of growth and increase the role of domestic demand, particularly investment, which has declined substantially in relation to GDP since the Asian financial crisis of 1997/98. It will also need to expand in line with the government's medium- and long-term plans to promote green and knowledge-based development (National Economic and Social Development Board of Thailand 2009, 2011).

To reach these high development levels, Thailand also needs to move away from a model focusing on input accumulation and promote innovation and technological progress through investment in R&D and education, with the aim of increasing its human capital. Given the relatively slow pace of factor productivity growth the country has seen since the 1997/98 Asian financial crisis, achieving a sustained expansion of GDP will be difficult, also in view of the rapidly ageing population. Thailand is also facing the risk of falling into the middle-income trap and needs appropriate policies that promote innovation and a better quality of higher education, among others.

As Thailand's economy and society mature, the country's development aspirations will have to increasingly focus on improving equality and inclusiveness. Enhancing access to public services and establishing a comprehensive, universal welfare system, including the creation of formal safety nets to ensure social protection for all citizens, are important objectives for the next two decades to foster greater social cohesion (Jitsuchon 2013).

Viet Nam

The 2011–2020 socio-economic development strategy prepared by Viet Nam's government sets annual GDP growth at an average 7%–8%, implying reaching a per capita GDP close to $3,000 by 2020 (Government of Viet Nam 2011). This development strategy stresses the importance of maintaining macroeconomic stability and achieving a modern and efficient economic structure by increasing the share of manufacturing and services in total output The plan sets a 35% target contribution of total factor productivity to economic growth, marking a clear shift toward paying greater attention to the quality of growth, rather than just its speed (Vo and Nguyen 2013).

This study adopts an aspiration target for Viet Nam to increase its 2010 per capita GDP level four times to reach close to $4,700 by 2030 — making the country reach the World Bank's upper-middle income group. Achieving this ambitious target implies sustaining an average GDP growth rate of 7.7% annually, slightly higher than the ADB-projected 7.2% pace over the same period (see Table 2.2).[58] One key factor affecting the ability of Viet Nam to achieve high economic growth in the next two decades lies in the capacity to manage its increased economic interdependence with other Asian countries and the rest of the world.

Closer integration with Asian economies is an opportunity for Viet Nam to exploit an expanding regional market. At the same time, however, it also generates sources of macroeconomic instability due to problems in managing and absorbing expanding capital flows, as domestic financial markets remain largely undeveloped. In the scenario that the macroeconomic framework remains weak, and the private sector is unable to flourish in the absence of structural reforms,

58 During 1991–2010, Viet Nam's GDP growth rate reached an average 7.3% per annum: the highest among ASEAN economies after Myanmar (which, however, suffered from a low degree of statistical accuracy).

Viet Nam's GDP can face a low-growth scenario and expand by an average on only 3.5% yearly during the period 2011–2030.

To maintain high economic growth, Viet Nam will have to focus on establishing efficient markets for capital and other production factors, improving efficiency of public investment and state-owned enterprises, and promoting innovation and technological improvements through R&D investment. This is particularly important in order to avoid falling in the middle-income trap, an imminent threat to the country. As Viet Nam's income level increases, other key 2030 development aspirations include achieving an equitable and sustainable growth with a focus on protecting the environment, improving governance, developing infrastructure, fostering human capital, and enhancing democracy (Vo and Nguyen 2013).

2.3 Region-Wide Aspirations

Economic research suggests that countries set economic development aspirations on the basis of a wide range of factors and ambitions related to improving the quality of life.[59] However, one initial problem encountered in defining collective aspirations lies in the need to generalize individual preferences—as people attribute different values to intangibles. Another problem is in the availability of quantifiable indicators. While GDP is one of the most widely-used economic indicators, it alone cannot capture the breath of factors defining quality of life. Although GDP reflects material well-being and explains a great deal of an individual's satisfaction with life, it cannot cover aspects of physical security, justice, social interaction, working conditions, or quality of the environment—all important factors in setting development aspiration targets.

International organizations such as the United Nations Development Programme (UNDP), the World Bank, and the OECD have attempted to overcome these problems by constructing various methods of measuring quality of life. While alternative approaches suggest the need to use different sets of indicators, per capita GDP is generally recognized as the most important. A survey conducted by the Economist Intelligence Unit in 2005 suggests, for example, that per capita GDP explains more than 50% of the inter-country variation in life satisfaction (EIU 2005).

In addition to setting aspiration targets focused on GDP per capita, background papers on individual ASEAN members' 2030 development perspectives stressed the importance of policies that improve people's quality of life. Although per

59 Important contributions were made by Alkire (2008), Fleurbaey (2009), and Stiglitz et al. (2009). An early seminal study was edited in the 1970s by Appley (1971), while a recent contribution by Niimi and Zhuang (2012) discussed quality of life indicators for Asian economies.

capita GDP remains the most important and widely-used economic indicator to define long-term development targets, people tend to assess how their quality of life improves using a much wider set of indicators.

2.3.1 Improving People's Quality of Life

Countries have started to adopt a broader set of concepts and measures to set their long-term vision and aspiration targets rather than merely looking at per capita income. The case of Bhutan is interesting—in 1972 it introduced the concept of gross national "happiness" as superior to a purely material well-being indicator as measured by GDP.[60] Among ASEAN members, Malaysia has already developed a quality of life index that includes 11 elements: income and distribution; work-life; transport and communication; health; education; housing; environment; family life; social participation; public safety; and culture and leisure. Other ASEAN countries are discussing the possibility of adopting similar indexes in creating long-term development strategies.

Identifying suitable quality of life indicators is not easy. The UNDP has been working on the concept of "human development," which goes beyond economic well-being, including indicators on health and education. Based on this concept, since 1980 the UNDP has published a Human Development Index (HDI) as an average of per capita GDP, calculated in purchasing power parity terms, life expectancy at birth—used as a proxy for health—and years of schooling, average and expected—as an indicator of educational attainment (Figure 2.3).

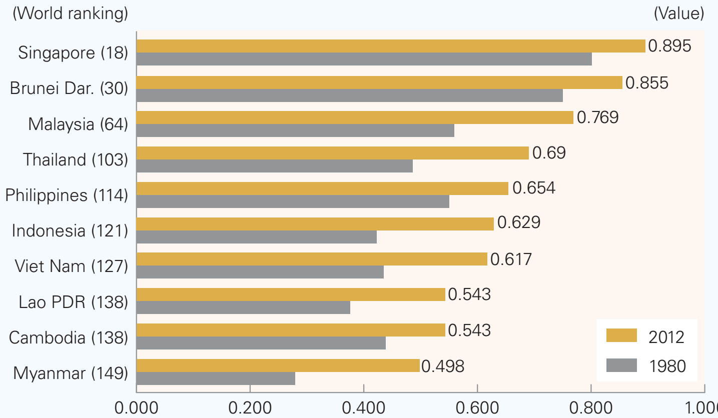
HDI rankings in 2012 among ASEAN economies mimicked per capita GDP rankings with the exception of the Philippines.[61] Global rankings reveal, however, that besides Singapore and Brunei Darussalam, which have high income levels, ASEAN members tend to perform better on the HDI than other countries in the world—their rankings are higher on average than those in per capita GDP (in purchasing power parity terms). This is partially due to improvements in health and education in some countries.

Although "human development" as measured by HDI offers a better approximation of quality of life than per capita GDP alone, the index still leaves out important factors, especially the non-monetary aspects of people's lives. One approach to measuring the overall quality of life is to assess resources available to individuals, implying the use of monetary indicators of income and consumption, and non-monetary indicators to measure resources used to develop infrastructure and social services (Fleurbaey 2009). However, as individual preferences differ and people do not price resources equally, it is

60 In addition to economic well-being, national happiness in Bhutan is determined by environmental, physical, mental, workplace-related, social, and political wellness.

61 The Philippines performed better than Indonesia, while Indonesia had higher per capita GDP (see Table 1.1).

Figure 2.3 Human Development Index in ASEAN Countries



ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Notes: (i) The earlier available data for Lao PDR and Viet Nam are 1985 and Cambodia and Singapore 1990; (ii) Values in parenthesis refer to the country's rank in 2012.
Source: United Nations Development Programme. http://hdr.undp.org/en/statistics/data/ (accessed November 2013).

difficult to use these indicators to conduct sensible economic analyses and cross-country comparisons.

A different approach, which has gained popularity in recent years despite measurement problems, is to focus on subjective assessments of well-being (Stiglitz et al. 2009). Quality of life indicators are used to reflect individual preferences and include life satisfaction and measures of hedonic experiences, such as happiness and positive feelings. However, as surveys and opinion polls are commonly used to assess individual preferences, it remains difficult to define a set of indicators that effectively compare results over time and across countries and income groups. Finally, a third approach to measuring quality of life focuses on achievements based on individuals' ability to form societies incorporating multiple dimensions—reflecting the extent of people's opportunities and choices (Alkire 2008).

Based on the insights from economic literature, a comprehensive approach to measuring quality of life for Asia has been developed by creating indicators aimed at capturing the extent of inclusive growth (Niimi and Zhuang 2012). This approach, which combines several dimensions of individual capabilities, preferences, and resources, uses eight dimensions to measure quality of life and identifies 24 indicators to assess where Asian countries stand (Table 2.3).

Unfortunately, for ASEAN members, many of these indicators cannot properly measure the various dimensions of quality of life—as they are either limited in coverage, unavailable for some countries, or not systematically collected by national and international agencies. For example, NOx emissions calculated as CO_2 equivalent per capita show extraordinarily high values for Brunei Darussalam (50% higher than the US and more than double the OECD average) and Myanmar, with very low values for Singapore and the Philippines. This suggests the possibility that different metrics are used to collect national data.

A similar problem occurs for indicators such as the unemployment rate and labor force participation ratio. Moreover, surveys that aim to measure financial satisfaction of households or the share of formal to total employment are conducted irregularly and do not cover all ASEAN members. Unless national and international agencies decide to systematically develop indicators through

Table 2.3 Dimensions and Indicators of Quality of Life

Dimensions	Indicators
(i) Material well-being	1. GDP per capita (2005 PPP$) 2. Satisfaction with financial situation of household (subjective)
(ii) Job opportunity and working conditions	3. Labor force participation rate (% of total population aged 15+) 4. Unemployment rate (%) 5. Share of informal to total employment (%)
(iii) Health	6. Life expectancy at birth (years) 7. Infant mortality rate (per 1,000 live births) 8. Undernourished population (%) 9. State of health (subjective)
(iv) Education	10. Net primary school enrollment rate (%) 11. Average years of schooling (years)
(v) Social inclusion or equity	12. Poverty rate (% of population below $2 (PPP) a day) 13. Gini coefficient 14. Ratio of female to male primary school enrollment (%) 15. Sense of belonging to local community (subjective)
(vi) Economic and physical insecurity	16. Perception of safety (subjective, %) 17. Homicide rate (per 100,0000 people) 18. Social protection index
(vii) Environment and living conditions	19. NOx emissions (metric tons of CO_2 equivalent per capita) 20. Access to improved water source (%) 21. Access to improved sanitation facilities (%) 22. Slum population (% of urban population)
(viii) Governance	23. Rule of law index 24. Government effectiveness index

CO_2 = carbon dioxide; PPP = purchasing power parity.
Note: NOx is a generic term for mono-nitrogen oxides NO and NO_2 (nitric oxide and nitrogen dioxide).
Source: Zhuang and Ali (2010).

specific and sustainable effort, it will be difficult to capture the complex factors underlying various quality of life dimensions in one number.

But progress is being made in some areas. For example, the World Bank has developed a set of indicators to assess governance — an opportunity to expand the HDI by including a proxy to accommodate this dimension. Although this does not allow for preparing a composite quality of life index, due to issues in assigning proper weights for each component, it remains quite useful to compare ASEAN members' results.

Thus, one can combine four selected indicators of quality of life across ASEAN countries (Figure 2.4). These include the three HDI components — (i) per capita GDP used as a measure of people's economic well-being, (ii) life expectancy at birth as a proxy for health, and (iii) average number years of schooling for education) — together with the World Bank's rule of law index used to measure governance.

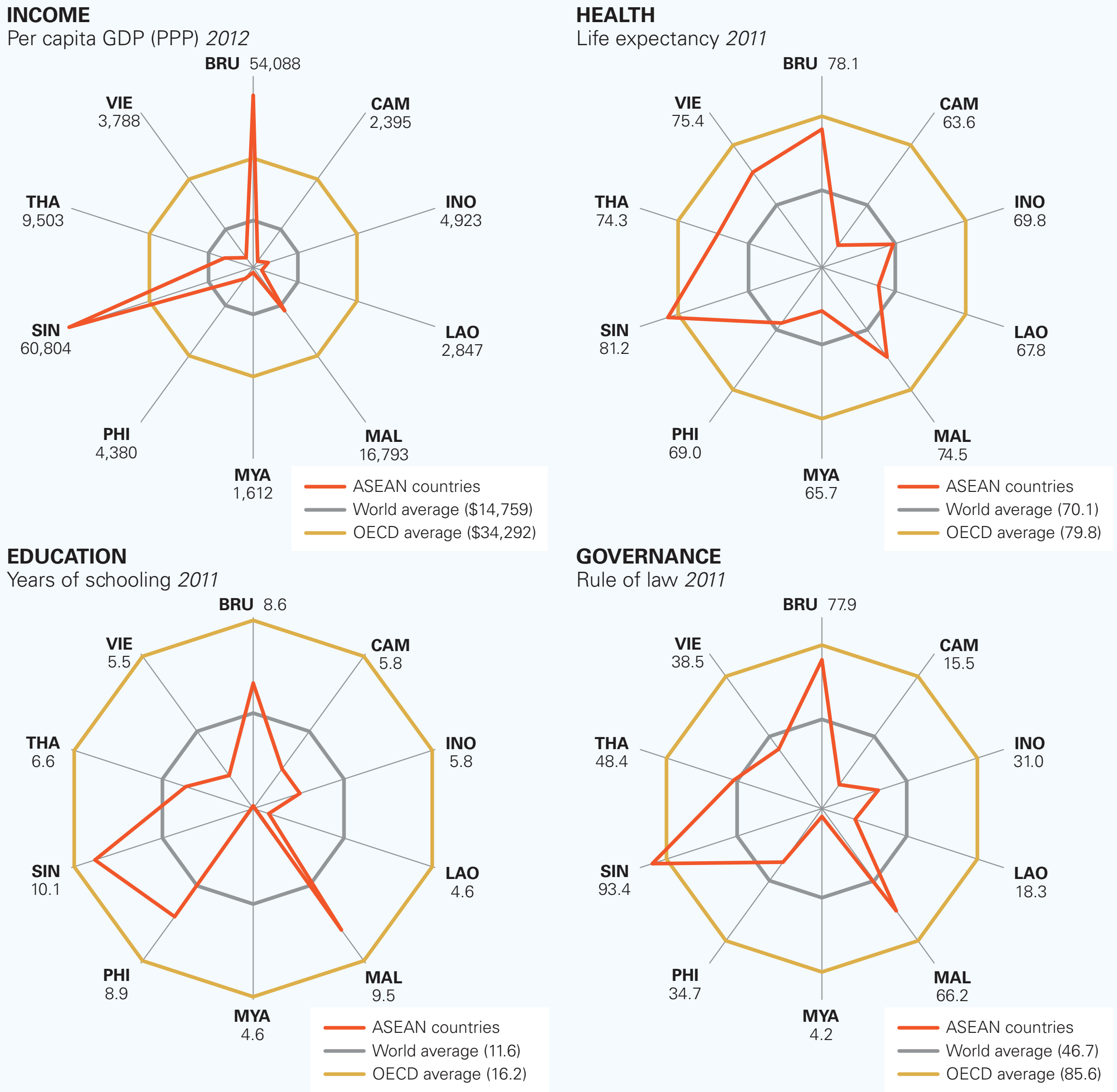
Values for ASEAN countries are compared with World and OECD averages. GDP per capita aspirations for ASEAN economies moving toward 2030 have already been discussed (see section 2.2). The OECD average for 2011 is used as a rough comparator for ASEAN members' 2030 aspiration targets in quality of life dimensions such as health, education, and governance. While the huge differences in income levels across ASEAN are reflected in the first panel — showing how Singapore and Brunei Darussalam are outliers — the other three panels help focus on non-monetary dimensions where there remains room for improvement.

While it is clear that CLMV countries significantly lag behind other members, Viet Nam shows relatively good performance in all areas. This suggests that Cambodia, the Lao PDR, and Myanmar could learn from the structural reforms and other policies Viet Nam introduced to pursue inclusive development during the last two decades. Among the ASEAN-6, Indonesia requires bold improvement, especially in governance and education, while Malaysia performs relatively well, with indicators for health, governance, and education already close to the OECD average.[62]

In summary, this analysis shows that the distance between ASEAN countries and the OECD average remains huge, and suggests that higher income status ASEAN economies pursue toward 2030 must be accompanied by structural reforms and polices that ensure commensurate improvement in the quality of life of their people and overall social progress. Achieving inclusive and sustainable development requires a holistic approach in defining aspiration targets: one that includes a broad set of indicators in addition to per capita GDP.

62 The education index is also high for the Philippines. In assessing education results, however, one has to consider that metrics used (years of education) do not properly include educational quality. This may also explain why—despite good performance in Malaysia, the Philippines, and Viet Nam—fostering human capital remains a key challenge for all these countries.

Figure 2.4 Selected Indicators of Quality of Life for ASEAN Countries



ASEAN = Association of Southeast Asian Nations; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic; OECD = Organisation for Economic Co-operation and Development; PPP = purchasing power parity.

Sources: Author's elaboration on data from the following sources: (i) Per capita GDP (PPP) is from International Monetary Fund, World Economic Outlook Database, April 2013 Edition. http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/index.aspx (accessed November 2013); (ii) The "Life Expectancy at Birth" and "Average Years of Schooling" indexes are from United Nations Development Programme, Human Development Report 2013. http://hdr.undp.org/en/media/HDR_2013_EN_Table1.pdf (accessed November 2013); (iii) The "Rule of Law" index is from The World Justice Project, Rule of Law Index, 2011. http://worldjusticeproject.org/sites/default/files/WJP_Rule_of_Law_Index_2011_Report.pdf?bcsi_scan_97e98328e2b67804=0&bcsi_scan_filename=WJP_Rule_of_Law_Index_2011_Report.pdf (accessed November 2013).

2.3.2 Achieving a "RICH" ASEAN by 2030

The final step in defining 2030 development aspirations for ASEAN as a whole is to extrapolate from country-specific results to identify a region-wide approach. This exercise requires a certain degree of abstraction from individual member conditions to set a higher level of priorities for the region. Eventually, defining ASEAN-wide aspiration targets for 2030 will help identify the key challenges and policy options for the entire group.

Aggregating individual country per capita GDP aspirations for 2030 suggests that ASEAN as a whole aims at increasing its average per capita GDP by a factor of three, from $3,117 in 2010 to $9,285 by 2030 (see Table 2.2). As CLMV countries are expected to grow more rapidly than the ASEAN-6, the income gap measured by the ratio of the per capita GDP average of CLMV countries over the ASEAN-6 average is estimated to improve from 24.6% in 2010 to 41.4% in 2030.

In addition to setting quantitative targets in per capita GDP, four key priorities—overarching economic growth aspirations—emerge for ASEAN as a group from analyzing specific country situations, and on the basis of the country-level consultations conducted in 2011. Despite pronounced diversity across countries, there is substantial convergence among experts who prepared the country background papers and those who participated in the consultation exercises on the urgency to improving *competitiveness* vis-à-vis the PRC, India, and other emerging markets. A second key aspiration is maintaining stable macroeconomic and financial conditions and ensuring *resilience* to shocks. The third key priority is related to pursuing an inclusive and sustainable development path, reducing development gaps across and within countries. Given the overall objective of achieving a people-centered ASEAN, inclusiveness and sustainability are required to reduce inequalities, improve participation, and provide equal opportunities for all. Last, but not least, the fourth aspiration relates to growing in harmony with the rest of the world by maintaining peaceful relations internally with regional neighbors and the rest of the world, while protecting the environment and properly managing natural resources.

Long-term development strategies of individual ASEAN governments typically touch on all these four priorities, although their emphasis may differ across countries and other priorities are of equal or greater importance for some countries. Formulating ASEAN 2030 aspirations based on the above four priorities is an important exercise that not only allows aligning country-specific strategies with a regional strategy: it also ensures individual countries find benefits in joining regional initiatives—as they will eventually converge toward similar goals.

In summary, the region's key development priorities can be structured along the following four 2030 aspirations: (i) resilience; (ii) inclusiveness; (iii) competitiveness; and (iv) harmony. While not intended to define a new road map for the region, these ASEAN-wide aspirations provide a window to an ambitious, yet pragmatic future. They help shape the idea of creating a Resilient, Inclusive, Competitive, and Harmonious region—a “RICH” ASEAN by 2030 (Table 2.4).

Resilience refers to the capacity of handling volatilities and shocks that may occur within or outside the region, reducing the likelihood of economic crises. Ensuring resilience implies solid macroeconomic policies to provide financial stability. It also requires the presence of highly educated civil servants, capable of managing effective policy frameworks, assess risks, and take action when needed. To capture the benefits from enhanced regional interdependence, creating a resilient ASEAN also requires strengthening the regional framework for macroeconomic cooperation by introducing common initiatives and effective institution-building.

Inclusiveness is designed to reduce poverty and narrow development gaps—within and across countries—by allowing people’s participation in decision-making and providing equal opportunities for all, without excluding anyone due to gender, sexual orientation, ethnicity, age, disability, or individual preference. Making economic development equitable and closing development gaps is a necessary condition to improve people’s quality of life—in both income and non-income dimensions.

Competitiveness refers to the ability to increase productivity and compete economically in global markets with major players—particularly large emerging Asian economies like the PRC and India—by developing a specific set of institutions, policies, and other factors linked to innovation and market efficiency. Key factors include the ability to forge efficient markets and firms

Table 2.4 ASEAN “RICH” Concept

Resilience	Capacity to handle volatilities and shocks through solid macroeconomic policies and effective policy frameworks ensuring financial stability also by strengthening initiatives for regional cooperation.
Inclusiveness	Ability to narrow development gaps within and across countries, reduce poverty, provide equal opportunities, follow a participatory approach in decision making, and ultimately improving people’s quality of life.
Competitiveness	Ability to increase productivity and compete with major players in global markets by developing a specific set of institutions, policies, and other factors linked with innovation capability and market efficiency.
Harmony	Condition of living in peace with members of national and international communities, working together to resolve common problems, sharing prosperity with others, and respecting and protecting the environment.

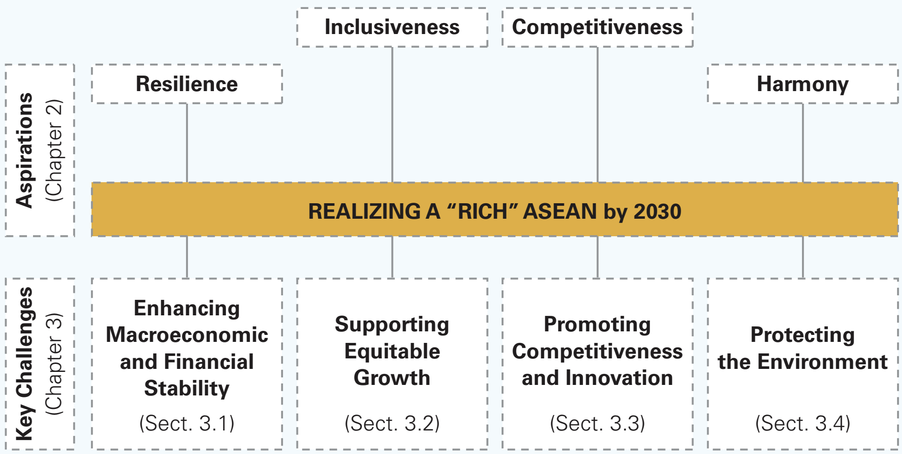
ASEAN = Association of Southeast Asian Nations.
Source: Authors.

through sound national and regional regulatory frameworks—those that promote entrepreneurship and R&D investment to be at the technological frontier in key sectors. Regionally, it implies harnessing the advantage of size and economies of scale by moving toward a truly borderless regional economic community.

Finally, the concept of *harmony* emphasizes that economic and social development should be sustainable and congruent with nature. It refers to people living in peace with other national, regional, and international communities, working together to resolve common problems by assuaging them before confrontation erupts, sharing prosperity, and respecting and protecting the environment, with proper consideration of the need to mitigate and adapt to climate change. A focus on reaching a harmonious ASEAN by 2030 implies forging the group's identity as a family of nations through closer economic, social, cultural, security, and political contact.

The linkages between ASEAN countries' 2030 economic development aspirations and key challenges (chapter 3) can be mapped (Figure 2.5). Enhancing macroeconomic and financial stability is the key challenge linked with the aspiration of improving resilience, while supporting equitable growth is the challenge connected with the aspiration of realizing inclusive development by the year 2030. Promoting competitiveness and innovation is the challenge ASEAN countries face as they build a more competitive region, while protecting the environment (and properly managing natural resources) is the key challenge related to the ASEAN aspiration to grow in harmony with the environment and their neighbors.

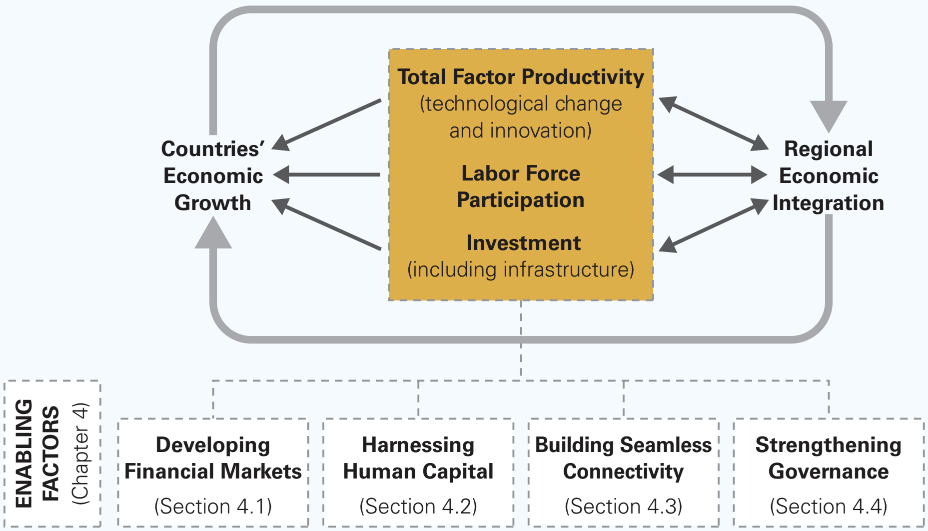
Figure 2.5 Linkages between Aspirations and Challenges



RICH = Resilient, Inclusive, Competitive, and Harmonious.
Source: Authors.

As mentioned above, although regional integration involves costs as well as benefits for participating economies, as ASEAN economic interdependence progresses, the benefits of integration tend to largely outweigh costs (Capannelli 2011b; see Box 2.1). In particular, as efficiency of production factors increases, growth-enabling factors become more evident, such as developing financial markets, boosting human capital, expanding regional infrastructure and spearheading good governance (chapter 4). In turn, increased efficiency of production factors induces closer regional integration, creating a two-way reinforcing relationship with economic growth (Figure 2.6).

Figure 2.6 Effect of Economic Integration on Growth: Transmission Channels



Source: Authors.

Fulfilling ASEAN 2030 development aspirations and overcoming key challenges requires facilitating trade and travel across borders and ensure the free flow of information through a seamless communications network, on the capacity to work toward better and more efficient management of economic resources, and to bring institutions that affect economic activity closer together (chapters 3 and 4). Reaching ASEAN's 2030 aspirations will involve seismic shifts in policy direction—domestic and regional—predicated on peace and stability.

Chapter 3

Key 2030 Challenges

3 Key 2030 Challenges

Achieving a resilient, inclusive, competitive, and harmonious (RICH) ASEAN by 2030 is an ambitious goal for individual members and the association as a whole. Becoming "RICH" holds great potential. As discussed in chapter 2, ASEAN's average per capita gross domestic product (GDP) could expand by a factor of three between 2010 and 2030. People's quality of life could also rise to average Organisation for Economic Co-operation and Development (OECD) levels, today. To fulfill these aspirations, however, ASEAN faces daunting challenges — nationally and regionally. Deep domestic structural reforms are needed to transform individual economies and sustain growth and development. Regional cooperation initiatives are also necessary for ASEAN to affirm its centrality in the wider Asian context and strengthen its competitive position globally.

This study used a bottom–up approach to identify the key 2030 challenges ASEAN countries are facing in fulfilling their aspirations. Local consultations were conducted with relevant institutions and experts. Background papers were commissioned to well-known scholars from ASEAN countries. Three primary and secondary challenges to meet growth and development aspirations in each ASEAN country were identified through this process (Table 3.1). The selection of six challenges is meant to keep the number manageable, as they are later associated with specific policy options for individual countries, and the region as a whole (see chapter 6).[63]

Human capital development is the most frequent challenge identified by seven of ASEAN's ten member countries. Other common challenges are related to strengthening governance and institutions and improving environmental protection and natural resource management (identified by six countries), developing economic infrastructure, enhancing macroeconomic management, and reducing inequalities and improving social cohesion (identified by five countries). Four countries also mentioned the need to promote economic diversification. All in all, a total of 24 different challenges were identified at the country level. By pooling results, the highest common denominators were selected as the most pressing region-wide challenges underpinning the "RICH" ASEAN 2030 concept.

63 It is important to stress that the division between primary and secondary challenges is only made for convenience of exposition and does not necessarily imply any order of priority or urgency.

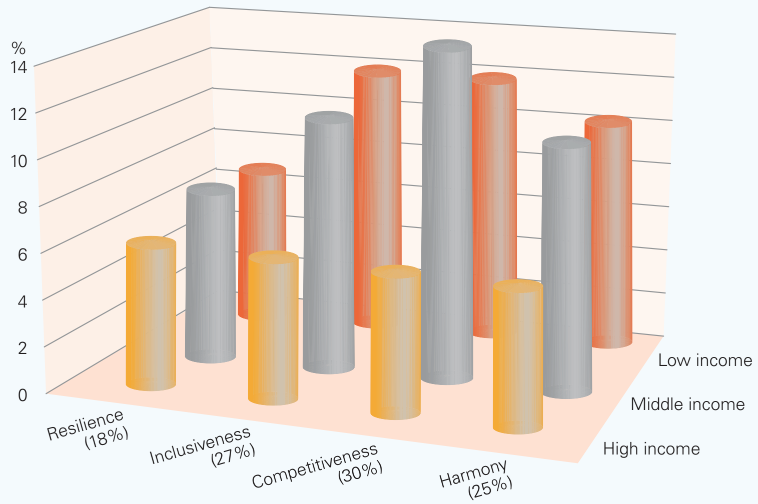
Table 3.1 ASEAN 2030 Challenges by Country

	Primary Challenges			Secondary Challenges		
Brunei Dar.	Diversify the economy	Improve the business and investment climate	Develop human capital	Improve environmental protection and natural resource management	Promote financial deepening	Improve quality of life
Cambodia	Develop human capital	Diversify the economy	Reduce poverty	Improve environmental protection and natural resource management	Strengthen governance and institutions	Enhance macroeconomic management
Indonesia	Enhance macroeconomic management	Develop economic infrastructure	Improve environmental protection and natural resource management	Reduce inequality and improve social cohesion	Strengthen governance and institutions	Diversify the economy
Lao PDR	Diversify the economy	Develop human capital	Improve environmental protection and natural resource management	Develop economic infrastructure	Enhance macroeconomic management	Develop sustainable social safety nets
Malaysia	Make the economy more competitive	Develop human capital	Cultivate technology and innovation capabilities	Increase labor productivity	Reduce inequality and improve social cohesion	Improve environmental protection and natural resource management
Myanmar	Strengthen governance and institutions	Enhance macroeconomic management	Strengthen agriculture	Develop human capital	Strengthen the industrial base	Develop economic infrastructure
Philippines	Improve the business and investment climate	Develop economic infrastructure	Strengthen governance and institutions	Strengthen the industrial base	Reduce inequality and improve social cohesion	Improve fiscal management
Singapore	Manage limited resources	Address demographic and labor constraints	Cultivate technology and innovation capabilities	Identify new drivers of growth	Reduce inequality and improve social cohesion	Manage urbanization and the environment
Thailand	Develop human capital	Reduce inequalities and improve social cohesion	Enhance macroeconomic management	Identify new drivers of growth	Strengthen governance and institutions	Ensure energy security
Viet Nam	Strengthen governance and institutions	Develop economic infrastructure	Develop human capital	Improve urbanization management	Improve environmental protection and natural resource management	Develop sustainable social safety nets

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Note: Primary and secondary challenges were identified through background papers on individual countries' 2030 perspectives and local consultations. Challenges are classified according to the type of aspiration (Resilience, Inclusiveness, Competitiveness, Harmony) they mainly belong to, although several challenges relate to more than one aspiration. The division between primary and secondary challenges is purely instrumental to facilitate the identification of the key issues countries need to address to fulfill their 2030 aspirations and do not imply prioritization.
The color scheme is as follows: Resilience Inclusiveness Competitiveness Harmony
Source: Authors.

By showing their distribution by income group, one can get a sense of the relative importance of these challenges for ASEAN countries (Figure 3.1).[64] The view that ASEAN members need to focus on strengthening competitiveness is widespread, regardless of income level. High-income countries (Brunei

Figure 3.1 Distribution of ASEAN 2030 Challenges by Income Group
(% share of response by type of aspiration)



Aspirations	High Income	Middle Income	Low Income	Total ASEAN
Resilience (18%)	5.0	6.7	6.7	18.3
Inclusiveness (27%)	5.0	10.0	11.7	26.7
Competitiveness (30%)	5.0	13.3	11.7	30.0
Harmony (25%)	5.0	10.0	10.0	25.0
Total	20.0	40.0	40.0	100.0

ASEAN = Association of Southeast Asian Nations.
Notes: (i) Values were calculated on the basis of the key challenges identified from the study's background papers on countries' perspectives and shown in Table 3.1. Challenges were classified by type of aspiration following the "RICH" concept (Resilience, Inclusiveness, Competitiveness, Harmony). Percent shares refer to total number of challenges identified by each country for different aspirations; (ii) High-income countries include Brunei Darussalam and Singapore; middle-income countries include Indonesia, Malaysia, the Philippines, and Thailand; low-income countries include Cambodia, the Lao People's Democratic Republic, Myanmar, and Viet Nam.
Source: Authors.

64 The figure summarizes the 2030 challenges identified in this study by country income groups (high, middle, and low income) and type of challenge following the resilience, inclusiveness, competitiveness, harmony (RICH) nomenclature. The sum of all 12 bars equals 100%. Bars suggest the distribution of challenges by income group.

Darussalam and Singapore), middle-income countries (Indonesia, Malaysia, the Philippines, and Thailand), as well as the lower-income countries of Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam (CLMV countries) all rank challenges related to increasing competitiveness as most important. Challenges of inclusiveness—considered particularly urgent for CLMV countries—rank second in importance, while challenges related to harmony and resilience rank respectively in third and fourth, with their distribution mostly determined by middle- and low-income countries' preferences.

This chapter identifies and analyses ASEAN's key 2030 challenges. The first section, associated with resilience to economic and financial shocks, discusses the importance of enhancing macroeconomic and financial stability. The second section, associated with the challenges related to achieving equitable growth and inclusive development, focuses on ways to promote economic convergence, narrow inequalities, improve social cohesion, and ultimately avoid falling into the middle-income trap. The third section, associated with challenges related to competitiveness and innovation, analyzes ASEAN's research and development (R&D) strategies, and suggests ways to enhance productivity. Finally, the fourth section, associated with environmental protection, looks at sustainable development issues related to natural resource management, energy policy, and urbanization.

3.1 Enhancing Macroeconomic and Financial Stability

Prudent and coherent macroeconomic policies are instrumental in balancing the need to both sustain economic expansion and ensure overall economic and financial stability. Past crises, including the 1997/98 Asian financial crisis, underscore how much damage inconsistent and unsustainable macroeconomic policies may cause on overall economic performance. One important lesson is that policy frameworks overly designed for rapid growth can destabilize financial markets.[65]

During the early stages of liberalization, major ASEAN economies saw the absence of appropriate sequencing and consistent macroeconomic policies behind the distortions that eventually created financial sector instability and economic crisis. The rapid contagion during the 1997/98 crisis showed that East Asian economies were far more interdependent than previously thought. Not only did the crisis highlight the need for better national macroeconomic management, it also exposed the lack of tacit—let alone formal—mechanisms for regional cooperation and coordination. It left the region speeding along a development highway with no spare tire.

65 This section draws partly from Siregar (2012) and Nijathaworn (2012).

3.1.1 Increasing Economic Integration

The degree of trade integration within ASEAN members and between ASEAN and other East Asian economies has continued to increase over the past decades.[66] In 2010, close to half of ASEAN+3[67] merchandise exports and 56% of its merchandise imports were traded intraregionally (Table 3.2).

Table 3.2 ASEAN Trade with Selected Countries and Regions

ASEAN Exports to	$ billion			Share of Total Exports (%)		
	1990	2000	2010	1990	2000	2010
ASEAN+3	**62.1**	**187.5**	**524.0**	**43.0**	**43.9**	**49.9**
ASEAN	**27.4**	**98.1**	**262.2**	**18.9**	**23.0**	**25.0**
PRC	2.6	16.4	113.6	1.8	3.8	10.8
Japan	27.3	57.4	103.2	18.9	13.4	9.8
Republic of Korea	4.8	15.7	45.0	3.3	3.7	4.3
India	1.8	6.8	36.8	1.2	1.6	3.5
European Union	23.2	64.0	115.5	16.0	15.0	11.0
United States	28.0	81.0	100.3	19.4	19.0	9.6
Other countries	29.4	87.6	272.9	20.4	20.5	26.0
Total World	**144.5**	**426.8**	**1049.5**	**100.0**	**100.0**	**100.0**

ASEAN Imports from	$ billion			Share of Total Imports (%)		
	1990	2000	2010	1990	2000	2010
ASEAN+3	**72.5**	**189.6**	**535.2**	**44.4**	**51.4**	**56.0**
ASEAN	**24.8**	**82.9**	**231.1**	**15.2**	**22.5**	**24.2**
PRC	4.8	18.7	129.9	2.9	5.1	13.6
Japan	37.8	70.4	116.9	23.1	19.1	12.2
Republic of Korea	5.1	17.7	57.4	3.1	4.8	6.0
India	1.4	3.4	20.0	0.8	0.9	2.1
European Union	25.6	40.9	131.1	15.7	11.1	13.7
United States	23.6	51.6	83.4	14.4	14.0	8.7
Other countries	40.2	83.5	186.4	24.6	22.6	19.5
Total World	**163.3**	**369.0**	**956.1**	**100.0**	**100.0**	**100.0**

ASEAN = Association of Southeast Asian Nations; ASEAN+3 = ASEAN plus the PRC, Japan, and the Republic of Korea; PRC = People's Republic of China.
Source: International Monetary Fund, Direction of Trade Statistics Database. http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=170921 (accessed September 2013).

66 However, as shown by the impact through the trade channel during the 2008/09 global financial crisis, much of the demand for final products produced in East Asia remains dependent on demand from the European Union and the United States; see Athukorala and Kohpaiboon (2009). Moreover, it should be noted that the extent of intraregional trade integration tends to decline quite substantially if measured in terms of value added, as production networks explain a large share of total intra-ASEAN trade. See also the recently developed Trade in Value Added (TiVA) database created by the International Monetary Fund and the OECD (http://www.oecd.org/industry/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm).
67 ASEAN plus the People's Republic of China (PRC), Japan, and the Republic of Korea.

Intra-ASEAN foreign direct investment (FDI) has also been growing in importance. Between 1996 and 2012, cumulative FDI inflows to ASEAN totaled about $880 billion. The European Union (EU) led on the investors' side (about one fourth of total) with ASEAN second. Intraregional FDI inflows clearly increased over the decade, though the share remains low compared with the EU's, another indication that ASEAN economies hold much potential to strengthen linkages with each other (Table 3.3).

Portfolio investments (assets and liabilities) of Indonesia, Malaysia, the Philippines, Singapore, and Thailand (ASEAN-5) have grown relative to the size of these economies during 2001–2010, increasing from about 19%–21% of their aggregated nominal GDP in 2001 to about 28%–30% in 2010 (Table 3.4). Intra-ASEAN-5 portfolio assets and liabilities have remained fairly steady as a ratio of total inward and outward portfolio assets at about 11%–12% over the decade, and as a result intra-ASEAN-5 portfolio assets and liabilities have also increased in relation to economic size—from 2.3% of the total in 2001 to 3.3% in 2010.[68]

Although ASEAN banks have little presence in each other's domestic markets, ASEAN will likely see greater banking integration in the near future. Integration

Table 3.3 Foreign Direct Investment to ASEAN, 1996–2012
($ million from selected countries and regions)

	Flows			Cumulated Flows	
	1996	2005	2012	$ million	% share
Total FDI	**30,178**	**39,386**	**108,214**	**879,003**	**100.0**
from:					
ASEAN	**4,265**	**3,517**	**20,037**	**125,228**	**14.2**
Japan	5,276	5,765	20,772	119,642	13.6
PRC	118	743	4,101	23,561	2.7
Republic of Korea	505	888	1,893	19,460	2.2
India	69	80	2,624	10,202	1.2
Australia	325	588	1,851	12,229	1.4
European Union	7,352	11,435	23,466	218,480	24.9
United States	5,178	4,344	6,924	93,074	10.6
Others	7,091	12,028	26,545	257,126	29.3

ASEAN = Association of Southeast Asian Nations; FDI = foreign direct investment; PRC = People's Republic of China.
Source: ASEAN Secretariat, various years. Foreign Direct Investment Statistics. http://www.aseansec.org/stat/Table26.pdf (accessed October 2013).

68 Portfolio flows for other ASEAN economies remain of relatively minor importance, with the exception of Viet Nam (with $5.6 billion total portfolio inflows in 2010, of which about 10% came from other ASEAN countries).

Table 3.4 ASEAN-5 Countries' Total Portfolio Investment

	$ million		Share of Total Portfolio Investment (%)		Share of Nominal GDP (%)	
	2001	2010	2001	2010	2001	2010
Total Assets (outflows)	**111,198**	**469,986**	**100.0**	**100.0**	**20.9**	**27.9**
to ASEAN-5	12,194	56,163	11.0	11.9	2.3	3.3
to Japan	10,582	25,738	9.5	5.5	2.0	1.5
to PRC	1,459	36,764	1.3	7.8	0.3	2.2
to United States	20,604	79,251	18.5	16.9	3.9	4.7
Total Liabilities (inflows)	**103,588**	**501,073**	**100.0**	**100.0**	**19.4**	**29.7**
from ASEAN-5	12,194	56,163	11.8	11.2	2.3	3.3
from Japan	7,426	29,740	7.2	5.9	1.4	1.8
from PRC	37	429	0.0	0.1	0.0	0.0
from United States	35,630	170,545	34.4	34.0	6.7	10.1

ASEAN = Association of Southeast Asian Nations; ASEAN-5 = Indonesia, Malaysia, Philippines, Singapore, and Thailand; PRC = People's Republic of China.
Source: International Monetary Fund, Coordinated Portfolio Investment Survey Database. http://elibrary-data.imf.org/QueryBuilder.aspx?s=321&key=1445290&f=1&ts=1&ys=2002&ye=2011&ms=1&me=12&ds=1&de=31&did=323&id=46 (accessed September 2013).

with global banks has already begun through increased presence, particularly after the Asian financial crisis (Siregar 2012). Further ASEAN banking integration is expected to bring efficiency gains through economies of scale (see section 4.1).

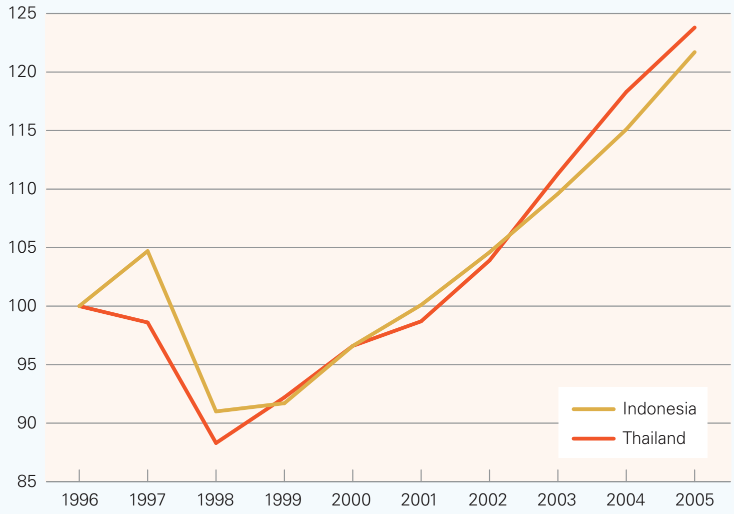
With greater economic and financial integration comes the risk of contagion from shocks or crises. Therefore, the formulation of national and regional strategies to prevent economic and financial crises becomes an even more important than in the past (see section 6.1). This is also true for ASEAN+3 countries as they increasingly integrate.

3.1.2 Policy Goals

It took about 5 years following the 1997/98 crisis for real GDP to return to pre-crisis levels in both Indonesia and Thailand—the two most severely affected ASEAN countries (Figure 3.2). Any future major economic or financial crisis in an ASEAN country may lead to a similar set back in their prospective growth trajectories and derail aspirations to meet the 2030 per capita GDP targets discussed in chapter 2.

Maintaining macroeconomic and financial stability is primarily a national goal—to bolster resilience against domestic and external shocks. Since the Asian financial crisis, most ASEAN countries have performed reasonably well in terms of their macroeconomic policies, as evidenced by ASEAN's relative resilience

Figure 3.2 Real GDP Growth Index: Indonesia and Thailand (1996=100)



GDP = gross domestic product.
Source: Computed from International Monetary Fund, World Economic Outlook Database. http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/weorept.aspx?pr.x=29&pr.y=3&sy=1996&ey=2005&scsm=1&ssd=1&sort=country&ds=.&br=1&c=578%2C536%2C548&s=NGDP_R&grp=0&a= (accessed August 2013).

to the 2008/09 global financial crisis. A critical issue to the proper formulation of macroeconomic policies is to ensure risks and vulnerabilities are accurately assessed (Sussangkarn 2012a).

In the aftermath of the Asian financial crisis, many ASEAN countries shifted from pegged to flexible (managed) exchange rates with inflation targeting explicitly or implicitly guiding monetary policy. However, CLMV countries, which are also largely exposed to dollarization—or the multiple currency phenomenon (Capannelli and Menon 2010)—still maintain different exchange rate regimes. While these countries were less exposed to the Asian financial crisis, they still need to build the technical and institutional capacity to make macroeconomic management more effective.

Currently, ASEAN economies are exposed to different levels of macroeconomic vulnerabilities (Table 3.5). In general, macroeconomic conditions in ASEAN-6 economies (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand) are relatively robust, with current account surpluses in all countries except Indonesia, relatively strong external reserve positions,[69] low to moderate public debt,

69 Though reserves also need to cover other short-term foreign currency obligations.

and relatively healthy banking sectors in terms of capital adequacy and nonperforming loans. CLMV economies, on the other hand, show greater vulnerability via high external and fiscal deficits, with moderate to low gross official reserves.

Fiscal sustainability is a potential policy issue for several ASEAN economies given their high public deficits. There is also a challenge in managing the risk of asset bubbles — given rapid monetary growth in much of ASEAN countries. Going forward, data indicate that Viet Nam, Cambodia, and the Lao PDR should carefully monitor macroeconomic developments; while Malaysia, the Philippines, and Thailand may face a medium-term fiscal challenge given their relatively high deficits (see section 6.1).

Table 3.5 Vulnerability Indicators for ASEAN Countries

	Current Account Balance (% of GDP)	**Gross Reserves** (no. months of imports)	**Public Debt** (overall balance; % of GDP)	**Fiscal Balance** (overall balance; % of GDP)	**Monetary Growth** (M2 year-on-year % growth)	**Capital Adequacy Ratio**[a, b]	**Non-Performing Loans**[b] (% of total loans)
ASEAN-6							
Brunei Darussalam	52.4 [c]	12.2 [c]	na	17.5	0.9	19.4	5.4
Indonesia	-2.8	7.5	24.5	-1.8	14.9	17.5	1.8
Malaysia	6.4	9.0	55.5	-4.5	9.0	14.3	2.0
Philippines	2.8	16.4	41.9	-2.3	10.9	17.8	3.1
Singapore	18.6	8.3	111.0	9.5 [c]	7.2	16.3	0.9
Thailand	0.7	10.0	45.4	-2.3	10.4	16.3	2.4
CLMV							
Cambodia	-8.6	7.4	28.8	-2.3	20.9	28.8	2.2
Lao PDR	2.3	3.8 [c]	52.8	-1.4	31.0	21.6	2.2
Myanmar	-1.0	10.7	48.0	-3.2	55.0	na	na
Viet Nam	5.8	1.7 [c]	51.3	-4.0	12.6	8.2	3.0

CLMV = Cambodia, Lao PDR, Myanmar, and Viet Nam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic; na = not available.

Notes: Data as of 2012 or latest available; [a] The capital adequacy ratio is calculated as "regulatory capital to risk-weighted assets" (%). [b] Data for ASEAN-6 are most updated 2013 figures, except for Thailand (2012); data for CLMV are latest available data from International Monetary Fund Country Reports Article IV Consultation; the capital adequacy ratio for Viet Nam, is calculated using non risk-weighted assets; [c] 2011 data.

Sources: (i) "Current Account Balance," "Gross Reserves," and "Fiscal Balance" data are sourced from Asian Development Bank. 2013. *Key Indicators for Asia and the Pacific.* Manila. http://www.adb.org/sites/default/files/pub/2013/ki2013_0.pdf (accessed October 2013); (ii) "Public Debt" is sourced from International Monetary Fund (IMF) 2013. *Fiscal Monitor October 2013.* Washington, DC. http://fsi.imf.org/docs/GFSR/GFSR-FSITables-October2013.pdf (accessed October 2013); (iii) "Capital Adequacy Ratio" and "Non-Performing Loans" data are sourced from various issues of IMF Article IV Country Reports and the Financial Soundness Indicators in October 2013. http://www.imf.org/External/Pubs/FT/GFSR/2013/02/pdf/text.pdf (accessed October 2013).

3.1.3 Regional Cooperation Issues

Regional cooperation is an important tool to help boost macroeconomic and financial stability — both for individual countries and ASEAN as a whole. The 1997/98 crisis provided impetus for several East Asian financial cooperation initiatives. Many countries felt that, given the region's abundant financial resources, the crisis could have been avoided had there been closer financial cooperation — or at least crisis resolution mechanisms would have been less painful, and conditionality imposed by the International Monetary Fund (IMF) less harsh.

The start of ASEAN financial and monetary cooperation dates back to the 1970s. The ASEAN Swap Arrangement (ASA) was established by the five original ASEAN central banks in 1977 — to provide short-term (1–6 month) liquidity assistance to members with temporary international liquidity problems. Its initial size was $100 million. Each member contributed $20 million and could request up to twice its contribution.[70] The swap facility was subsequently renewed and doubled in 1987.

Chiang Mai Initiative and its Multilateralization

In May 2000, in response to the 1997/98 crisis, ASEAN+3 countries built on the ASA to create the Chiang Mai Initiative (CMI), which supplemented the ASA with bilateral swap agreements between each of the ASEAN-5 economies and each "Plus-Three" country.[71] This network was naturally cumbersome due to the presence of many separate contracts denominated in different currencies and with diverse terms and conditions. To improve the efficiency of the CMI, ASEAN+3 countries agreed in May 2007 on the principle of developing a self-managed reserve pooling mechanism governed by a single contractual agreement among participating countries (Sussangkarn 2012a). This agreement became known as the Chiang Mai Initiative Multilateralization (CMIM), which came into effect on 24 March 2010 and included all 13 ASEAN+3 countries (Box 3.1).

ASEAN+3 Macroeconomic Research Office

An ASEAN Surveillance Process has been in place since 1999 supporting regional policy dialogue, economic review, and economic and financial integration. A high-level Macroeconomic and Finance Surveillance Office (MFSO) was established at the ASEAN Secretariat to strengthen regional surveillance capacity. Despite

70 The ASA was used immediately following the second oil shock (1979–1981) by Indonesia (1979), Malaysia (1980), Thailand (1980), and the Philippines (1981).

71 "Plus-Three" countries (the PRC, Japan, and the Republic of Korea) had also established bilateral swap agreements among themselves.

these developments, given the quite limited resources available to ASEAN as a group, ASEAN countries must leverage regional surveillance initiatives at the ASEAN+3 level (see chapter 6), particularly through the ASEAN+3 Macroeconomic Research Office (AMRO).

Established in Singapore in April 2011, AMRO is an independent macroeconomic and financial surveillance agency, supporting the CMIM by monitoring and analyzing regional economies and contributing to CMIM decision-making. Currently, AMRO produces a quarterly Regional Economic Monitoring Report and biannual individual country assessments, which are submitted to the ASEAN+3 Finance Deputies, and presented at the ASEAN+3 Finance Deputies Meetings in April and November, and the ASEAN+3 Finance Ministers and Central Bank Governors' Meeting in May. AMRO also carries out thematic research to strengthen surveillance capabilities. To benefit from its insights, ASEAN Finance Ministers have agreed to invite AMRO representatives to their regular meetings to brief the group on the regional macroeconomic and financial conditions (ASEAN 2012b).

Financial Market Deepening and Integration

Finally, another area for regional cooperation among ASEAN countries involves initiatives aimed to develop and deepen capital markets — such as the Asian Bond Markets Initiative (ABMI), Asian Bond Fund (ABF), and the Credit Guarantee and Investment Facility (CGIF).[72] Generally, these initiatives (to be discussed in greater detail in section 4.1) aim to increase recycling of the region's large savings into long-term regional development financing and lessen the need for countries to rely on short-term foreign borrowings — as happened prior to the 1997/98 crisis. ASEAN countries appreciate the importance of deepening and liberalizing their regional financial markets. Capital market development, financial services liberalization, and capital account liberalization are being addressed as part of the ASEAN Economic Community (AEC) Blueprint through the "Roadmap for Monetary and Financial Integration of ASEAN (RIA-Fin)."

Exchange Rate Volatility

ASEAN-6 and CLMV countries' exchange rates against the US dollar show several trends (Figures 3.3 and 3.4). Currencies such as the Indonesian rupiah and the Philippine peso show pronounced volatility against the dollar and need to be closely monitored by monetary authorities. At the same time, the trend of CLMV countries' exchange rates is peculiar compared with ASEAN-6 due to the large dollarization discussed earlier.[73]

72 For a review of ABMI, ABF, and CGIF see ADB (2008b, 2010a).

73 The jump in the US dollar–kyat value occurred after the Central Bank of Myanmar unified exchange rates and introduced a managed float system in April 2012.

Box 3.1 Increasing the Effectiveness of the Chiang Mai Initiative Multilateralization

The Chiang Mai Initiative Multilateralization (CMIM) is ASEAN+3's regional crisis prevention and resolution mechanism—a swap facility (local currencies for US dollars) providing foreign exchange liquidity to countries in need. Agreeing on CMIM contribution shares, purchasing multiples, voting weights, and decision rules were a milestone in ASEAN+3 cooperation (Table B3.1).

Table B3.1 CMIM Financial Contributions, Borrowing Arrangements, and Voting Power

Members	Financial Contributions		Borrowing Arrangements		Voting Power			
	$ billion	% share	multiplier	quota ($ billion)	no. of basic votes	no. of votes based on contributions	total no. of votes	% share
PRC (including HKG)	76.8	32.00					40.00	28.41
PRC	68.4	28.50	0.5	34.20	1.60	34.20	35.80	25.43
HKG	8.4	3.50	2.5	21.00	0.00	4.20	4.20	2.98
Japan	76.8	32.00	0.5	38.40	1.60	38.40	40.00	28.41
Republic of Korea	38.4	16.00	1.0	38.40	1.60	19.20	20.80	14.77
"Plus Three" Countries	**192.0**	**80.00**			**4.80**	**96.00**	**100.80**	**71.59**
Brunei Darussalam	0.1	0.03	5.0	0.30	1.60	0.03	1.63	1.16
Cambodia	0.2	0.10	5.0	1.20	1.60	0.12	1.72	1.22
Indonesia	9.1	3.79	2.5	22.75	1.60	4.55	6.15	4.37
Lao PDR	0.1	0.03	5.0	0.30	1.60	0.03	1.63	1.16
Malaysia	9.1	3.79	2.5	22.75	1.60	4.55	6.15	4.37
Myanmar	0.1	0.05	5.0	0.60	1.60	0.06	1.66	1.18
Philippines	9.1	3.79	2.5	22.75	1.60	4.55	6.15	4.37
Singapore	9.1	3.79	2.5	22.75	1.60	4.55	6.15	4.37
Thailand	9.1	3.79	2.5	22.75	1.60	4.55	6.15	4.37
Viet Nam	2.0	0.83	5.0	10.00	1.60	1.00	2.60	1.85
ASEAN	**48.0**	**20.00**			**16.00**	**24.00**	**40.00**	**28.41**
ASEAN+3	**240.0**	**100.00**			**20.80**	**120.00**	**140.80**	**100.00**

	Issues	Rule of Decision Making
Fundamental Issues	Review (size, contribution, and borrowing multiples), re-admission, membership, terms of lending, etc.	Consensus
Lending Issues	Lending, renewal, default	2/3 weighted majority

ASEAN = Association of Southeast Asian Nations; CMIM = Chiang Mai Initiative Multilateralization; HKG = Hong Kong, China; Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.

Notes: Financial contributions refer to the amount of foreign reserves committed to swap by each country. Borrowing arrangements indicate the maximum amount (quota in $ billion) that each country can borrow based on the multiplier applied to its financial contribution. Voting power shows the distribution of the percent share and total number of votes calculated as the sum of basic votes (equal for each member) and the number of votes based on financial contributions.

Source: ASEAN Secretariat and ASEAN+3 Macroeconomics Research Office.

In recent years, policy makers, scholars, and other experts have been debating whether the CMIM would really be effective, focusing on issues such as its governance structure, membership enlargement, terms and conditions for fund mobilization, its link with International Monetary Fund (IMF) programs, size, and decision-making rules (AMRO 2012; Azis 2012; Capannelli 2011a; Henning 2011; Hill and Menon 2012; Lamberte and Morgan 2012):

- ***Relationship with the IMF.*** Currently, any amount exceeding 30% of an economy's swap quota (contribution times purchasing multiple) can only be drawn if linked to an IMF-supervised program. This provision includes, however, an intrinsic contradiction as the CMIM can only be effective if it provides greater value to borrowing economies than what the IMF can already offer—by playing a complementary role. Therefore, the automatic IMF link has raised great concern among several experts who advocate not only for its reduction, but eventually its complete elimination (Sussangkarn 2012a; Kawai 2010).
- ***Size.*** The current IMF unlinked portion is too small to be useful for crisis prevention or resolution. For example, Thailand's and Indonesia's IMF unlinked portion is $6.828 billion each—tiny compared with the $17.2 billion IMF 1997 package for Thailand, its $40 billion Indonesian package, or the $30 billion swap the Republic of Korea received from the US Federal Reserve to tie it over during the 2008/09 global financial crisis. It is obvious that an acute foreign exchange liquidity shortage or a foreign exchange crisis would still force a country like Thailand or Indonesia to seek IMF help to access sufficient funds. In sum, the current CMIM size offers no value-added in a situation like the 1997 crisis.

  If a crisis occurs, IMF involvement in its resolution remains unavoidable, especially where conditionality is needed. However, for temporary foreign exchange shortages (not crises), the IMF unlinked portion should be large enough to be useful. The unlinked portion is planned to be increased to 40% in 2014. However, this remains insufficient. Unless the unlinked portion is sufficiently large—or CMIM access fully unlinked to the IMF for a specified period of temporary liquidity shortages (such as occurred following the Lehman Brothers bankruptcy)—ASEAN countries will likely avoid using the CMIM and vie for bilateral swaps with countries that have large foreign reserves such as the US, the People's Republic of China, and Japan.

  A good international comparison is offered by the operations of the Latin American Reserve Fund (Fondo Latino Americano de Reservas—FLAR). While the size of FLAR is much smaller than CMIM's, with seven member countries and paid-in capital of about $2 billion, it has no operational link to the IMF and member countries frequently borrow from it—totaling about $10 billion throughout its 30-year history. There is no conditionality, yet no country has ever defaulted on its loans from FLAR (more details on FLAR are available at https://www.flar.net/ingles/contenido/default.aspx).
- ***Decision-making and voting powers.*** Currently, "Plus-Three" countries hold 71.59% of the voting shares—above the two-thirds majority required for decisions on operational issues such as swap approvals and conditionality. Thus, "Plus-Three" countries can de facto make operational decisions once they agree among themselves, even if all ASEAN members disagree. To avoid future intraregional friction, it would be better to keep total "Plus-Three" voting weights below two-thirds—say about 60%—so that support of at least two ASEAN members may be needed for reaching a two-thirds majority (see section 6.1). Introducing this kind of change in the decision-making mechanism may require much discussion and time; however, it will help strengthen CMIM unity, as ASEAN+3 financial and monetary cooperation moves toward 2030.

Source: Authors, ASEAN Secretariat, ASEAN+3 Macroeconomic Research Office.

Figure 3.3 Trends of ASEAN-6 Countries' Exchange Rates
(1 January 2008–1 January 2014)

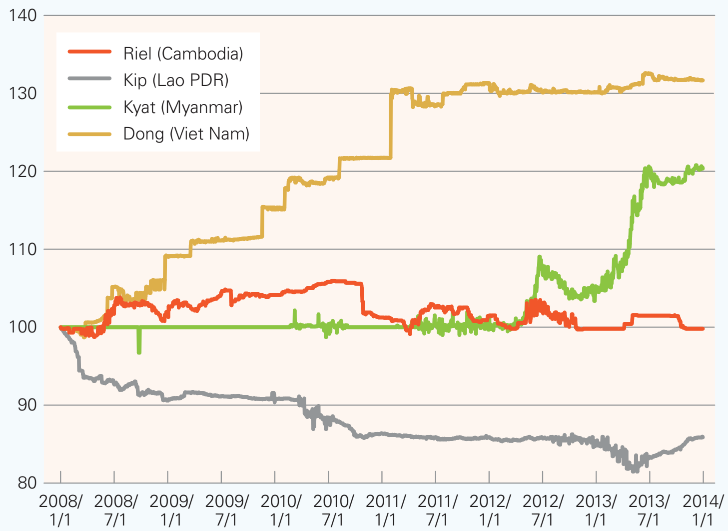
ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; B$ = Brunei dollar; S$ = Singapore dollar.
Notes: (i) The chart shows daily exchange rate indices from 1 January 2008 to 1 January 2014, based on 1/1/2008 = 100; (ii) An upward trend indicates an appreciation vis-à-vis the US dollar.
Source: Bloomberg (accessed January 2014).

Excessive intraregional exchange rate volatility in ASEAN increases costs of cross-border business and hampers bilateral and intraregional trade. The local currency value of business contracts can change quickly if exchange rates are too volatile—a costly effect for contracting parties that may hamper cross-border trade and investment, considering that local markets are not sophisticated or deep enough to provide hedging. Therefore, there is merit for ASEAN monetary authorities to cooperate in limiting exchange rate volatility (see section 6.1).

Short-Term Capital Flows

While the tools to manage macroeconomic stability in the context of volatile short-term capital flows lie mainly with national authorities, there are also important regional and global dimensions that need to be assessed. Short-term capital flows are affected by the use of quantitative easing (QE) policies introduced by major central banks such as the US Federal Reserve, the Bank of Japan, and the Bank of England to boost economic growth. The European Central Bank may also explicitly use a similar policy in the future. While some of the liquidity created will stay in the US, Japan, and Europe, much of it is likely to flow abroad in search of higher

Figure 3.4 Trends of CLMV Countries' Exchange Rates
(1 January 2008–1 January 2014)



CLMV = Cambodia, Lao PDR, Myanmar, and Viet Nam; Lao PDR = Lao People's Democratic Republic.
Notes: (i) The figure shows daily exchange rate indices from 1 January 2008 to 1 January 2014, based on 1/1/2008 = 100; (ii) An upward trend indicates an appreciation vis-à-vis the US dollar.
Source: Bloomberg (accessed January 2014).

returns. ASEAN countries will likely continue to be major recipients, with rapid capital inflows challenging monetary authorities' ability to manage exchange rates, meet the cost of sterilization, and protect against capital flow reversals.

The usual policy tool kits—exchange rate intervention, accumulation of reserves, sterilization, interest rates, and various macro- and micro-prudential measures—may be insufficient and need to be supplemented by capital control measures. In 2006, Thailand faced a situation where rapid short-term capital inflows fuelled currency appreciation. Monetary authorities decided to introduce capital controls. But these were poorly designed and were eventually abolished after a short period of time due to the negative financial market reaction (Box 3.2).

Fiscal Sustainability

Fiscal policy is part of the national governments' domain. It would be unrealistic to expect any kind of "fiscal compact" among ASEAN economies to emerge by 2030—it has been elusive even in the eurozone. As discussed in chapter 2, there is pronounced diversity across ASEAN countries in economic structure, level of development, balance of payments position, reserve level, and social priorities that

Box 3.2 The Thai Experience with Capital Controls

In late 2006, Thailand faced a situation where rapid and sustained portfolio capital inflows led to significant baht appreciation despite large exchange rate intervention by the Bank of Thailand. The increasing value of the baht threatened to stifle Thai exports—its main source of growth since the 1997/98 crisis. Eventually, capital controls were introduced in December 2006 by way of a 30% unremunerated reserve requirement and imposition of a 1-year minimum maturity on portfolio inflows, with a 10% penalty on the capital amount for earlier withdrawals.

Because there were no guidelines on how best to introduce capital controls, Thailand simply borrowed from a 20-year old Chilean model—with some local adaptation. But given the vastly different financial environment in 2006 compared with the early 1990s, markets reacted quickly, particularly to the requirement that inflows be kept in the country for at least 1 year. The Thai stock market crashed 15% the day after capital controls were imposed, and within 24 hours, authorities lifted the controls on inflows to the stock market, which basically sapped the effectiveness of the overall package.

Source: Sussangkarn (2012b).

determine fiscal policy.[74] Nonetheless, fiscal sustainability is essential in avoiding fiscal crisis contagion and is critical in realizing a "RICH" ASEAN by 2030.

For the moment ASEAN has no plans for regional tax harmonization related to either value added taxes or corporate income tax — which raises concerns over double taxation and tax competition.[75] Most ASEAN countries impose general corporate income tax at rates that are within a few points of the 23% Asian regional average rate. However, the Philippines' 30% corporate income tax rate is almost double Singapore's 17%.

3.2 Supporting Equitable Growth

Realizing a "RICH" ASEAN requires an economic growth path which is not only rapid and sustainable, but also inclusive and equitable. The region's development process needs to ensure convergence in people's incomes and quality of life both across and within countries. Coupled with social and demographic

74 Increasingly, while monetary policy in Southeast Asia is often done within the halls of a central bank, fiscal policy involves a wide range of decision-makers working with the full participation of democratic, legislative institutions. This suggests that different regional collaborative mechanisms must be established, perhaps bringing legislative bodies together in consultative exercises. This may better fall under the ASEAN Political-Security Community or the ASEAN Socio-Cultural Community as much as within the AEC.

75 A good possible future reference for ASEAN can be found in the EU's mechanisms for addressing double taxation among member countries, as well as tax competition and harmonization.

transformations, inequality is one of the most difficult challenges ASEAN countries face—collectively and individually.

So far, development policies have brought a tremendous reduction in poverty and a large improvement in ASEAN living standards. Yet, many people in the region continue to live on less than $2 a day. Besides, over recent decades, the rich on average tended to benefit more from growth than the poor. But islands of prosperity cannot survive in a sea of growing inequality. ASEAN needs to enter a path toward more equitable growth. Failure to reduce income disparity risks building a society where citizens face unequal opportunities. From an economic viewpoint, the more unequal the distribution of income, the less "pro-poor" growth is. Increasing inequality is neither politically acceptable nor sustainable—it undermines the very notion of an inclusive society and the idea of ASEAN as a family of nations.[76]

Many of the issues related to realizing an equitable and inclusive development are dealt with in the ASEAN Socio-Cultural Community (ASCC) Blueprint (see chapters 1 and 5), which lays down the plan for a people-centered and socially-responsible community. It covers human capital development, education, labor protection, social welfare, the environment, and urbanization—among other issues. Some of the themes related to inclusiveness and equity are discussed in this section (development gaps and policies to sustain growth, the middle-income trap, and subregional programs). Other issues, such as those related to environmental protection and human capital development are discussed in sections 3.4 and 4.2, respectively, while indicators of financial inclusion are presented in section 4.1.

3.2.1 Inequality and Development Gaps

One prominent set of inequality measures track income and development gaps between two groups of countries: the upper- and middle-income ASEAN-6 and the lower-income CLMV. The development gap existing between these two groups is an important touchstone reflecting the nature of ASEAN inequality. Assuming current trends continue, faster economic growth in the CLMV would considerably reduce the existing gap with ASEAN-6 countries by 2030.

Asia is often cited as a successful example of the fight against poverty. ADB estimates that between 1990 and 2010 the number of poor people living on less than $1.25 a day in Asia and the Pacific halved from approximately 1.5 billion to 750 million, with Southeast Asia contributing much to this success story (ADB 2012c). Rapid economic growth has been one of the key factors in reducing poverty: during the two decades from 1990 to 2010, ASEAN countries posted an average yearly GDP growth of 5.8%—against the world average of 3.4%.

As a result of the reduction in poverty incidence, a new middle class has emerged in most ASEAN countries and continues to grow rapidly. This is testimony to sound economic growth policies, particularly those encouraging trade

76 This section draws from Habito (2012).

and openness. However, inequality, measured by a host of indexes, both income and non-income, has in fact increased within several ASEAN countries (ADB 2012a). In addition to widening income disparity, there remain stark differences in the quality of life—testimony to unequal division of development benefits.[77] Geographically, there appears to be growing urban/rural income disparity. The worsening regional and class differences are in some cases wider than those in comparable country groups in Europe, Latin America, North Africa, and even other parts of Asia (UNDP 2005).

The presence of widespread income inequality across ASEAN countries is a severe impediment to realizing the AEC. The creation of a common market and single production base requires quantitative and qualitative development gaps among member countries to be substantially reduced—also to ensure cooperation initiatives will effectively work as a partnership for shared prosperity. Even excluding high-income Singapore and Brunei Darussalam, the next richest country, Malaysia, had a per capita GDP 11.9 times higher than Myanmar in 2012, and 2.7 times the regional average (Table 3.6).

Fulfilling the 2030 GDP growth aspiration targets presented in chapter 2 implies income convergence around the ASEAN average—greatly narrowing development gaps. In 1990, average per capita GDP in ASEAN-6 was approximately 11 times that of the CLMV countries. In 2012, the gap was reduced to 3.5 times and, if 2030 aspiration targets will be met, the gap will further decline to 2.8 times by 2030. But if ASEAN countries are unable to introduce structural reforms domestically and embrace regional cooperation initiatives for creating a truly borderless economic community, they will fall into a low-growth scenario, where income gaps may increase, inverting the current trend.

Even with the impressive results in recent decades, many in CLMV countries continue to remain poor (Figure 3.5). For example, 66.0% of the population in the Lao PDR in 2008 and 49.5% of Cambodia's population in 2010 lived below the $2 a day poverty line. At the same time, the still high poverty incidence in Indonesia and the Philippines shows that reaching (lower) middle-income status is no panacea for reducing poverty. Conversely, Viet Nam's dramatic poverty reduction (where the share of population living below the $2 a day threshold fell from 75.2% in 1993 to 43.4% in 2008) shows that pro-poor growth policies can have a significant, positive impact.

Poverty is closely related to broader inequality. While trends may shift over time, the picture for ASEAN countries is one of generally stubborn, if not increasing inequality. Since the 1990s, the Gini coefficient—a commonly used measure of income gaps—consistently declined only in the case of Thailand (Figure 3.6). In countries such as Cambodia, the Philippines, and Viet Nam, coefficients increased

77 Quality of life differences are apparent in the continued failure to meet the Millennium Development Goals related to health and provision of safe water and sanitation, for example.

Table 3.6 ASEAN Income Gaps
(countries' gaps with lowest (A) and average (B) per capita GDP levels)

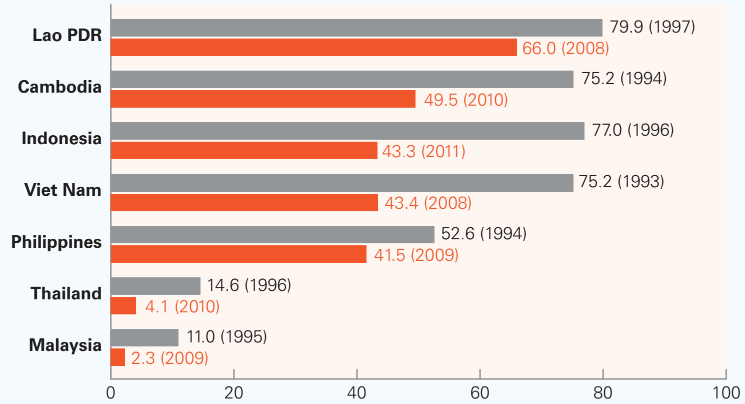
Countries	Income Gap (A)		Income Gap (B)	
	2012	2030	2012	2030
Brunei Darussalam	48.8	17.9	11.2	6.4
Cambodia	1.1	1.0	0.2	0.4
Indonesia	4.1	3.1	1.0	1.1
Lao PDR	1.6	1.2	0.4	0.4
Malaysia	11.9	6.3	2.7	2.2
Myanmar	1.0	1.0	0.2	0.4
Philippines	3.0	1.6	0.7	0.6
Singapore	60.0	23.7	13.8	8.4
Thailand	6.2	4.5	1.4	1.6
Viet Nam	2.0	1.4	0.5	0.5
ASEAN	**4.3**	**2.8**	**1.0**	**1.0**
ASEAN-6	5.4	1.2	1.3	0.4
CLMV	1.5	3.4	0.4	1.2

ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; CLMV = Cambodia, Lao PDR, Myanmar, and Viet Nam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic.
Notes: Income gaps refer to per capita GDP values. Per capita GDP values for 2012 are taken from Table 1.1, while 2030 values refer to "aspiration" targets from Table 2.1. Income Gap (A) refers to the ratio of the country's per capita GDP to the lowest per capita GDP country in that year. (Myanmar in 2012 and Cambodia—expected—in 2030). Income Gap (B) refers to the ratio of the country's per capita GDP to the ASEAN average per capita GDP in that year.
Sources: World Bank, World Development Indicators Database. http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&SdmxSupported=Y&CNO=2&SET_BRANDING=YES (accessed October 2013). Aspiration targets for 2030 are taken from background papers on individual ASEAN countries prepared for this study.

in the early 2000s and, although they more recently decreased, currently it is little changed from two decades ago. In Malaysia, income inequality first decreased, but during the last decade it rose to levels similar to those of the 1990s. Gini coefficients increased significantly in Indonesia and the Lao PDR over the last 20 years (Box 3.3). In other words, during the 1990s and 2000s, ASEAN's richer segments have benefited relatively more from growth and development than the poor (ADB 2012c).

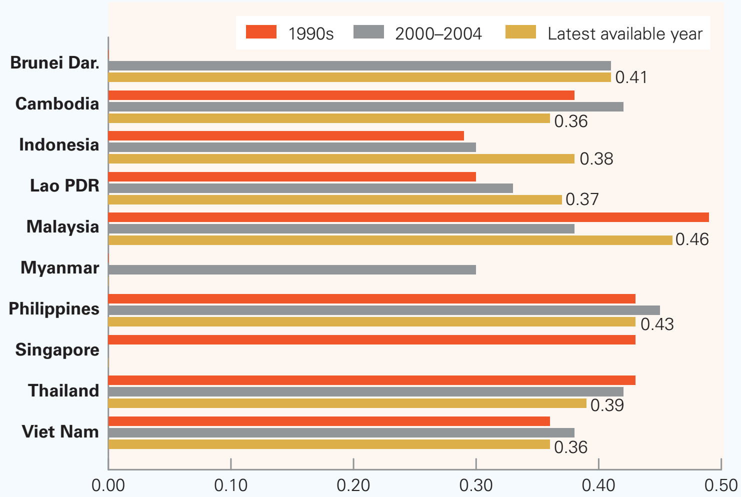
For broader, non-income measures of development, the Human Development Index (HDI) is a useful metric (see Figure 2.3 in chapter 2). Along with income, the HDI measures levels of health and education. The 2012 HDI country rankings

Figure 3.5 Reduction of Poverty in ASEAN
(% share of population living below $2 a day in purchasing power parity terms)



ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.
Source: Asian Development Bank. 2013. *Key Indicators for Asia and the Pacific*. Manila. http://www.adb.org/sites/default/files/pub/2013/ki2013.pdf (accessed November 2013).

Figure 3.6 Evolution of Inequality in ASEAN
(trend of the Gini coefficient since the 1990s)



ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Sources: (i) World Bank, World Development Indicators Database. http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&SdmxSupported=Y&CNO=2&SET_BRANDING=YES (accessed September 2012); (ii) ASEAN Secretariat, ASEAN Community in Figures 2011. http://www.aseansec.org/documents/ASEAN%20community%20in%20figures.pdf (accessed October 2013).

illustrate the poor performance of CLMV countries in comparison with the ASEAN-6, highlighting the need for greater investment in human capital, education, and health to help provide better access to development opportunities.

Analysis of the progress toward meeting the Millennium Development Goals (MDGs) offers another measure of inequality. Again, there is huge diversity across countries — some surpassing targets, while others showing little progress or even slippage (Table 3.7). Each ASEAN country faces its own difficulties in meeting the MDGs, but most countries are having problems with health-related goals, especially those of reducing infant and maternal mortality. Indonesia and the Philippines, given their large populations and the geographic challenge of reaching thousands of islands, are encountering difficulties with providing access to sanitation. Besides, the Philippines and Thailand are showing little progress — even regression — in meeting some of the education-related targets.

If MDGs and the broader goals for inclusive development are to be met, ASEAN governments must spend more on social sectors such as education and health. But mobilizing financial resources is often insufficient to ensure

Box 3.3 Measuring Inequality: The Gini Coefficient

The Gini coefficient, named after the Italian statistician and sociologist Corrado Gini who first introduced the concept in 1912, measures the difference of a country's (or region's) distribution of income (or consumption expenditure) with a situation of perfect equality. The Gini coefficient typically ranges between 0 (perfect equality) and 1 (perfect inequality)—lower values indicate a more equal distribution of income (or consumption expenditure). For example, in a situation of perfect income equality across population quintiles, the poorest 20% and the richest 20% of the population both hold 20% of total income (the difference is equal to 0). A situation of perfect inequality occurs when the richest quintile holds 100% of income.

Globally, the Gini coefficient generally increased from 1990 to 2010, suggesting worsening economic inequality worldwide. While Gini coefficients for Asian countries have generally increased over the period, they range between 0.28 and 0.51, indicating overall more equal income distribution than in Sub-Saharan Africa (where coefficients range between 0.30 and 0.65) or Latin America and the Caribbean (0.45–0.60 range). Yet, other regions have performed better than Asia during the two decades from 1990 in terms of trends for inequality measures.

Asian economic growth has been characterized by widening inequality. The main factors behind this trend are the very drivers of the region's productivity increases and rapid economic growth: technological change, globalization, and market-oriented reforms. These forces: *"…tend to favor owners of capital over labor, high-skilled over low-skilled workers, and urban and coastal areas over rural and inland regions"* (ADB 2012c, p. 38). But growth and inequality are not inexorably linked: one conclusion is that addressing institutional weaknesses, market distortions, and social exclusion, can combat inequality by improving economic opportunity.

Source: ADB (2012c).

inclusiveness; the right policy mix must be in place (see section 6.2). Malaysia devotes considerable fiscal resources to health and education, as do Thailand and Viet Nam. But Cambodia, the Philippines, and Indonesia still have large room for improvement, while Myanmar is clearly lagging behind (Table 3.8).

Battling inequality requires policies aimed at achieving strong growth and a development path where the benefits are spread across the population through improved access to economic opportunity.[78] In this respect, ASEAN's

Table 3.7 Status of Millennium Development Goals Attainments in ASEAN Countries, 2013

<table>
<tr><th></th><th>Halve the proportion of population living on $1.25/day</th><th>Net enrollment ratio of at least 95% in primary education</th><th>95% of children finishing primary education</th><th>Female-male participation ratio of .95 in primary school</th><th>Reduce by two-thirds the under-5 mortality rate</th><th>Reduce by two-thirds the infant mortality rate</th><th>Reduce maternal mortality rate by three-quarters</th><th>Halve the proportion of people without sustainable access to safe drinking water</th><th>Halve the proportion of people without sustainable access to sanitation</th></tr>
<tr><td>Brunei Dar.</td><td></td><td rowspan="5">Very fast</td><td>Very fast</td><td rowspan="3">Very fast</td><td rowspan="2">Slow</td><td rowspan="3">Slow</td><td>Slow</td><td></td><td></td></tr>
<tr><td>Cambodia</td><td>Very fast</td><td rowspan="3">Slow</td><td>On track</td><td>Very fast</td><td rowspan="2">Slow</td></tr>
<tr><td>Indonesia</td><td>Very fast</td><td>On track</td><td>Slow</td><td>On track</td></tr>
<tr><td>Lao PDR</td><td>On track</td><td>On track</td><td>Very fast</td><td>Very fast</td><td>On track</td><td rowspan="3">Very fast</td><td rowspan="2">Very fast</td></tr>
<tr><td>Malaysia</td><td>Very fast</td><td>Very fast</td><td rowspan="3">Very fast</td><td>On track</td><td>On track</td><td rowspan="5">Slow</td></tr>
<tr><td>Myanmar</td><td></td><td></td><td rowspan="2">Slow</td><td rowspan="2">Slow</td><td rowspan="2">Slow</td><td>On track</td></tr>
<tr><td>Philippines</td><td>Slow</td><td>Regression</td><td>On track</td><td>Slow</td></tr>
<tr><td>Singapore</td><td></td><td></td><td rowspan="2"></td><td></td><td rowspan="2">On track</td><td>Very fast</td><td rowspan="3">Very fast</td><td rowspan="3">Very fast</td></tr>
<tr><td>Thailand</td><td rowspan="2">Very fast</td><td>Regression</td><td>Very fast</td><td>On track</td></tr>
<tr><td>Viet Nam</td><td>Very fast</td><td>On track</td><td>On track</td><td>Slow</td><td>Slow</td><td>Very fast</td></tr>
</table>

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Note: Explanation about colors and degrees of attainment of Millennium Development Goals:
Very fast—Countries that have already reached the target.
On track—Countries that are expected to meet the target in (or before) 2015.
Slow—Countries that are expected to meet the target only after 2015.
No progress/Regression—Countries that have made no progress since 1990 or have slipped backwards.
No information—Countries did not report on this issue.
Source: Processed from Part II: Millennium Development Goals of Asian Development Bank. 2013. *Key Indicators for Asia and the Pacific.* Manila. http://www.adb.org/sites/default/files/pub/2013/ki2013_0.pdf (accessed November 2013).

78 Indicators of access to financial services are shown in chapter 4, Table 4.1.

Table 3.8 Expenditures on Education and Health, 2011
(government expenditures as % of GDP)

	Education	Health
Brunei Darussalam	3.7	2.1
Cambodia	2.6*	1.3
Indonesia	2.8	0.9
Lao PDR	3.3*	1.4
Malaysia	5.1*	1.6
Myanmar	0.8	0.3
Philippines	2.8	1.4
Singapore	3.2	1.4
Thailand	5.8	3.1
Viet Nam	6.6	2.7
ASEAN	**4.0**	**1.7**
PRC	3.5	2.9
India	3.3*	1.2
Japan	3.8*	7.4
Republic of Korea	3.3	4.1

ASEAN = Association of Southeast Asian Nations; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.
Notes: * 2010 data; ASEAN average was computed using GDP shares as weights.
Sources: (i) Asian Development Bank. 2013. *Key Indicators for Asia and the Pacific*. Manila. http://www.adb.org/sites/default/files/pub/2013/ki2013_0.pdf (accessed November 2013); (ii) World Bank, World Development Indicators Database. http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&SdmxSupported=Y&CNO=2&SET_BRANDING=YES (accessed November 2013).

pronounced diversity is simultaneously a strength and weakness. Intraregional diversity becomes a strength in that, if well integrated, the wide variety of factor and resource endowments across the region can promote economic growth by exploiting different countries' comparative advantages. At the same time, however, diversity is a weakness when huge income differences make it difficult for ASEAN members to agree on a common development agenda—and in carving out a region-wide, effective, growth strategy. Diversity also complicates attempts to ensure changes in relative prices and trade patterns do not hurt the poor.

3.2.2 Avoiding the Middle-Income Trap

In 2013, about 86% of ASEAN's population was living in middle-income countries, with significant income differences between the lower-middle income Lao PDR, Viet Nam, Philippines, and Indonesia, and the upper-middle income Thailand and Malaysia.[79] Income gaps were also acute internally in each of these countries, between rural and urban areas, and among different regions. Another 13% of the ASEAN population used was living in low-income Cambodia and Myanmar, also marked by substantial in-country inequality and high poverty incidence compared to the rest of the group. The remaining 1% was living in high-income Brunei Darussalam and Singapore. From a regional perspective, the extent of equity improvements which can be achieved through targeted development policies will be determined by the ability of progressively closing national and regional gaps. ASEAN as a group is promoting equitable and inclusive economic development setting a path for the CLMV to grow faster than the rest of the group.

Given the current development status of ASEAN economies, it is important that not only ASEAN-4 countries (Indonesia, Malaysia, the Philippines, and Thailand) but also Viet Nam and the Lao PDR follow a growth strategy that escapes or avoids the middle-income trap (Box 3.4). Growth and development are neither smooth nor uniform processes. Success, for instance, in generating growth to overcome mass poverty does not guarantee a country can move beyond middle-income status afterward. Over the past four decades in East Asia, only Japan, the Republic of Korea, and a few small economies have steadily converged into high-income status (Tran 2013). In contrast, ASEAN's middle-income members have generally had lower growth rates since those prior to the 1997/98 Asian financial crisis.

A strategy that can break free from the middle-income trap includes enhancing capital and skilled labor mobility—nationally and regionally—away from sectors with low productivity growth, increasing R&D investment, promoting the development of knowledge-intensive sectors, and generating new business in areas with higher growth potential (see section 6.2). This strategy underscores the need to shift from a mainly investment-led to an increasingly innovation-led growth strategy.

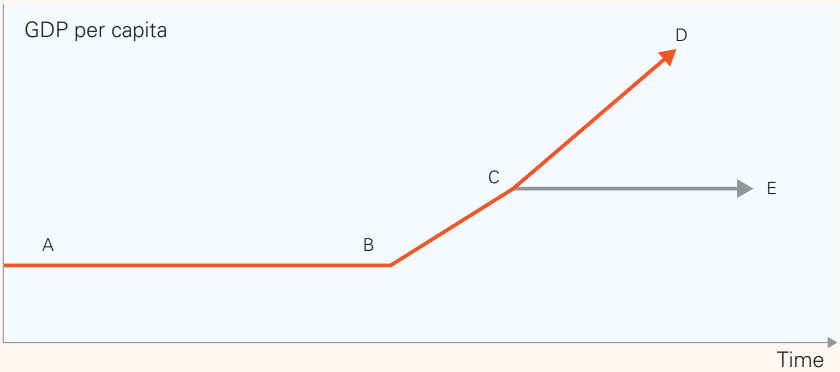
So far, ASEAN-4 countries and Viet Nam have generally been able to absorb technology developed elsewhere. Coupled with robust investment, this enabled them to reach middle-income status. Since the 1997/98 Asian financial crisis, however, investment levels in these countries have failed to reach pre-crisis levels. To deal with this structural change, policies are needed that encourage ASEAN firms to rely more on technological innovation, as Singapore, the Republic of Korea, and Taipei,China have been doing.

79 In 2012, the World Bank classified "low-income" economies those with a per capita GDP of $1,025 or less; "lower-middle income" economies those with a per capita GDP between $1,026 and $4,035; "upper-middle income" economies those with a per capita GDP between $4,036 and $12,475; and "high-income" economies those with a per capita GDP of $12,476 or more.

Box 3.4 Growing Middle-Income Economies

When countries stagnate after reaching middle-income status, they risk becoming stuck in the "middle-income trap." The typical development path has four distinct segments (Figure B3.1): AB corresponds to a traditional society marked by underdevelopment—a poverty trap. BC is the initial development stage where the poverty trap is overcome and markets are increasingly developed, allowing attainment of C—the middle-income level. CD represents sustaining growth to high-income level D, while CE is an alternative path marked by stagnation or low growth—the middle-income trap.

Figure B3.1 Development Stages of an Economy



GDP = gross domestic product.
Source: Adapted from Tran (2013).

C is reached from B through a long process typically transforming a country from an agricultural to industrial economy with rising shares of manufacturing and services in total output and employment. This trend is accompanied by structural changes in factor markets, technology, and comparative advantage. The more developed ASEAN members have essentially passed through this stage at varying speeds and degrees of success. Beyond C, however, four types of changes can occur: (i) a shift from an economy characterized by unskilled or lowly-skilled labor to one based on skilled-intensive activities providing for higher labor income; (ii) a shift from input-driven growth to total factor productivity-based growth—raising general income; (iii) shifts in the structure of comparative advantage—necessitating factor mobility; and (iv) changes in the institutional system—especially encouraging entrepreneurial growth. These changes typically are the major challenges a country must overcome to accomplish a successfully transition to high-income status. Deliberate measures can be designed to ensure these changes occur in a way that provides for inclusive and sustainable growth.

Can Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam avoid the trap? An answer to this question can be found by reviewing the economic growth path followed by the Republic of Korea—a country that successfully overcame the middle-income trap. The key factors that allowed the Republic of Korea to enter the high-income status in 1985 are related to considerable investment in research and development, and great enhancements of innovation, labor productivity, and quality of institutions. Japan's successful development story is based on similar factors. Middle-income ASEAN countries should therefore take these experiences to heart when strategizing their transition from middle- to high-income levels.

Source: Tran (2013).

3.2.3 Regional Initiatives to Bridge Development Gaps

Formulating policies to break free of the middle-income trap should not obscure the continuing challenge for CLMV countries, especially Cambodia and Myanmar, to escape the poverty trap—raising incomes and providing basic needs for those below the poverty line. In these countries, a growth strategy that promotes rural development and agricultural productivity, while focusing on investment growth along with successful technology adaptation, will remain relevant for some time yet. However, as incomes rise and countries reach middle-income status, development strategies will need to increasingly focus on knowledge creation and innovation to sustain growth.[80]

Closer coordination of ASEAN-6 initiatives promoted to help CLMV development and channel external development assistance in support of the ASEAN Framework for Equitable Economic Development (AFEED) will improve economic convergence. The AFEED, adopted in 2011, emphasizes equitable, inclusive, and sustainable growth through improved connectivity and cooperation. Implementing the AFEED naturally requires financial resources. ASEAN leaders at their 2000 Summit introduced the Initiative for ASEAN Integration (IAI), focusing on channeling assistance to CLMV countries.[81]

Technical assistance from ASEAN-6 to CLMV countries to administer single-window customs procedures—under regulations matching regional standards and international best practices—is one example of an IAI project. The IAI is wide ranging, but lacks the resources for success: its first work program (2002–2008) listed 134 projects, but with an expected cost only slightly above $200 million—less than many national assistance programs in CLMV countries funded by international financial institutions. Actual secured funding through 2005 was considerably smaller than the work program envisaged and only a tiny fraction of the assistance provided by ASEAN-6 outside the IAI framework (Table 3.9).

3.2.4 Subregional Programs

ASEAN-centered subregional cooperation programs (and institutions) help bridge the development divide within and across member countries, redressing lagging growth in mainland as well as archipelagic regions (ADB 2010a). These programs typically help developing infrastructure or introducing policy reform, while building the capacity of people and local governments. To date, several of these

80 An open question is how CLMV countries can learn from the experiences of their neighbors, both in overcoming the poverty trap and in avoiding the middle-income trap. This will require targeted national policies, but also increased regional cooperation to allow lessons learned to be institutionalized across ASEAN.
81 See ASEAN Secretariat website, Initiative for ASEAN Integration Strategic Framework and IAI Work Plan 2 (2009–2015).

Table 3.9 ODA from ASEAN-6 to CLMV Countries
(as of September 2012)

	No. of Projects	Funding ($)
Brunei Darussalam	12	1,475,332
Indonesia	34	1,768,668
Malaysia	65	5,314,065
Philippines	2	30,932
Singapore	59	24,462,263
Thailand	14	481,902
Total	**186**	**$33,533,162**

ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; CLMV = Cambodia, Lao People's Democratic Republic, Myanmar, and Viet Nam; ODA = official development assistance.
Source: ASEAN Secretariat, Status Update of the IAI Workplan I (2002–2008). http://www.asean.org/images/2012/Economic/IAI/IAI%20Work%20Plan%20I.pdf (accessed November 2013).

programs have created transport corridors, which should now be transformed into more inclusive "development corridors," drawing in peripheral islands and border areas that have thus far seen less of the benefits. Examples include the Greater Mekong Subregion (GMS), the Brunei Darussalam–Malaysia–The Philippines East ASEAN Growth Area (BIMP-EAGA), the Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT), and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC).

Greater Mekong Subregion (GMS)

The GMS is undoubtedly the most successful of these subregional programs, serving as a model in Southeast Asia and across the world. It covers Cambodia, the Lao PDR, Myanmar, Thailand, Viet Nam, and the People's Republic of China (PRC), participating through Yunnan Province and Guangxi Zhuang Autonomous Region. Coordinated by ADB since its inception in 1992, the GMS program has so far mobilized funds for more than $10 billion in investments, focusing on both hard and soft infrastructure. It facilitates the introduction of policies that ensure public and private investments are effective in opening borders to trade and improving people's living standards.

All-weather roads have been built along with bridges, airports, railroads, and related facilities as part of the GMS program, with tremendous contribution to improving subregional connectivity (see section 4.3). Until the early 1990s only Thailand had developed a significant transport network: other countries simply lacked physical infrastructure and the related software to transport goods and people. By 2005, however, major GMS urban centers were connected by roads, in turn bolstering the economic development process. While transport infrastructure accounts for the bulk of GMS investments, there have also been important projects in sectors such as electricity transmission lines, which have allowed the Lao PDR, for example, to develop and export hydroelectric power to Thailand. These lines, together with coordinated investment in underlying hydroelectric power generating facilities, have boosted growth in the Lao PDR through an expansion of electricity trade, balancing supply and demand across GMS countries—helping narrowing income and broader development gaps with other ASEAN countries.

Myanmar had been the missing link until 2011, when the country introduced economic and political reform in favor of liberalization and democratization. Today, GMS projects are focused on Myanmar to help close remaining connectivity gaps, not just within mainland Southeast Asia but also with the PRC, India, and Bangladesh. With the PRC targeting growth and development of its inner southern regions, there is considerable potential for GMS success to continue. Fortifying GMS links also offer new economic opportunities for CLMV economies and help accelerate development, supporting ASEAN's drive for more inclusive growth.

Brunei–Indonesia–Malaysia–The Philippines East ASEAN Growth Area (BIMP-EAGA)

BIMP-EAGA covers the islands of Borneo (shared by Malaysia and Indonesia), Mindanao (Philippines), and Sulawesi (Indonesia), which historically lagged in economic development. BIMP-EAGA targets maritime connectivity and the opportunities generated by the subregion's vast biodiversity. But it aims to expand roads and air links through physical infrastructure and improving trade-related policies and institutions.

Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT)

IMT-GT is a private sector-led initiative aimed to better link Peninsular Malaysia to Sumatra (Indonesia) and southern Thailand. It focuses on trade-supporting policies promoting investment from business enterprises.

Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)

BIMSTEC links Myanmar and Thailand to Bangladesh, Bhutan, India, Nepal, and Sri Lanka through land and maritime routes. It has broad sectoral coverage: its main growth and development opportunity lies in connecting Southeast to South Asia, two regions with largely unrealized economic potential.

3.3 Promoting Competitiveness and Innovation

Marked by rapid progress in transportation and communication technology, globalization has changed the way the economy, politics, and societies work. Ever more efficient logistic systems are restructuring the conceptualization, production, and distribution of goods and services. With competitiveness and innovation driving globalization, the progressive reduction and elimination of barriers to trade, capital flows, labor mobility, and information flows has become a critical factor in ensuring a country's economic progress. The liberalization process behind Asia's economic transformation is indeed one of the main reasons trade and investment continue to be attracted to the region. As discussed in chapter 2, the rise of the PRC and India in the global economy increasingly challenges ASEAN countries to enhance their competitiveness—globally, regionally, and nationally. Over the coming decades, competitive pressures will not only come from within Asia, but also more distant economies such as the Russian Federation, Brazil, South Africa and Turkey—to name a few.

What makes a region or country competitive? Scholars have forged a variety of growth and development theories on how emerging economies move up the ladder and narrow the productivity gap with high-income countries. Some use a flexible framework to analyze what builds countries' and firms' competitive advantages, using production factors (land, labor, capital) and other locally-available resources most effectively. Findings suggest that the macroeconomic environment (institutions, macroeconomic policy, social infrastructure) and microeconomic conditions (business climate, corporate operations and strategies, cluster development, among others) both matter (Porter et al. 2008; Wong et al. 2011).

Recent work on new structural economics also suggests that each stage of development must contend with given and endogenous factor endowments—a mix of natural resources, human development, and physical capital. This analytical framework associates stages of development with their optimal industrial structures. It concludes that well-functioning markets, backed by government policy, are important for an economy to find its "current" comparative advantage, maximize efficiency and competitiveness, and help the transition to a higher development stage (Lin 2012).

3.3.1 Competitiveness Fundamentals

Measuring competitiveness is a complex exercise bound to have both conceptual and empirical limitations. The World Economic Forum's Global Competitiveness Report is frequently used as a key reference. It ranks 12 cornerstones of the macroeconomic and microeconomic foundation of a country's competiveness. Countries are categorized in three stages. Stage I refers to factor-driven economies, where key competitiveness pillars are institutions, infrastructure, the macroeconomic environment, and the provision of basic services, such as health and primary education. Stage II covers economies where competition is driven by efficiency factors, including higher education and training, financial market development, technological readiness, and market size and efficiency. In stage III, competitiveness is mostly driven by innovation and business sophistication (World Economic Forum 2013b). Scholars have also developed an index for ASEAN economies based on Global Competitiveness Report criteria (Wong et al. 2011).

ASEAN competitiveness rankings show great intraregional diversity. For example, the 2013–2014 Global Competitiveness Report ranked Singapore as the most competitive country in Asia and the second most competitive country globally. In contrast, Myanmar was Asia's least competitive country and ranked 139 of the 148 countries surveyed. Malaysia was ranked 24 and Indonesia 38 worldwide. The diversity extends to stages of development and "pillars" of competitiveness (Table 3.10).

Historically, ASEAN competitiveness has been spotty. Over a range of indicators, ASEAN lost competitiveness after the 1997 Asian financial crisis. Labor productivity remains far behind more advanced countries and has been below the PRC's since 2009. Growth in labor productivity relies heavily on efficient use of information and communication technology (ICT) and growth in total factor productivity (TFP). ASEAN is weak on innovation, while endogenous entrepreneurship remains limited. ASEAN countries, both individually and as a group, have a long way to go to meet their 2030 aspirations.

With the exception of Singapore, competitiveness must drastically improve in all ASEAN countries. Similarities in areas where competitiveness must strengthen include innovation, technological readiness, infrastructure, and business sophistication. For technological readiness—which measures how well an economy exploits ICT to improve productivity—several ASEAN countries score low on internet usage, bandwidth, and even fixed telephone line penetration. Myanmar, Cambodia, and Indonesia are examples where logistics is holding back competitiveness. The Philippines chronically lacks infrastructure. ASEAN countries' domestic institutions, except those of Singapore and Brunei Darussalam rank below what will be needed by 2030. Especially poor are indicators such as corruption and high business costs related to threats of terrorism and crime. While market efficiency is not a major weakness, several "doing business" indicators—such as procedures and days required to start a business, and customs procedures—rank quite low among ASEAN members. Problems related to administrative procedures are highest in Brunei Darussalam, Indonesia, the Philippines, and Viet Nam.

But there are also relative strengths common to ASEAN countries. These lie in "pillars" covering institutions and primary education, the macroeconomic environment, and labor market development. In particular, when compared with other countries at the same level of development, internationally, all ASEAN countries, except Viet Nam and Cambodia, score above average in macroeconomic environment at their projected 2030 stage of development. This is due to relatively high gross national savings as a percentage of GDP and, in some cases, moderate inflation and sound fiscal balances. Several ASEAN countries are relatively competitive when it comes to industrial clusters. Firms rank well on organizational practice, internationalization, strategy, and operational effectiveness (Wong et al. 2011).

Large market size helps increasing productivity due to economies of scale. Countries with relatively favorable domestic market size now and by 2030 — large populations and rising per capita income — are Indonesia, the Philippines, Thailand, Viet Nam, and Myanmar. In contrast, Brunei Darussalam, the Lao PDR, and Singapore are handicapped by their small populations. The diversity in market size merely underscores the importance of creating a borderless ASEAN economic community to better compete globally.

3.3.2 R&D Investment and the Innovation Challenge

Prompted by technological change, innovation that sustains productivity growth is one of the most important drivers of competitiveness. ASEAN countries are lagging behind in indicators measuring both technological readiness and innovation (see Table 3.10). In emerging economies, technological development evolves incrementally and cumulatively. It starts by adopting existing, mature technologies created in developed countries, moving on to incremental innovation by acquiring increasingly sophisticated technological capabilities while learning and imitating processes — eventually joining the ranks of world innovators.

The United Nations Development Programme (UNDP) developed a Technology Achievement Index (TAI) to assess countries' technological level — (i) creating new technology; (ii) using recent innovations; (iii) employing older innovations; and (iv) building the human skill base to adopt, adapt, and create technology. The index focuses on results — how well a country participates in creating and using technology — rather than the number of scientists, R&D expenditures, or the policy environment.[82]

The first dimension — new technology — is measured by per capita patents and receipts of royalties and license fees from abroad. The application of recent innovations is measured by the number of internet hosts per capita and the share of high- and medium-technology intensive exports in total goods' exports. The extent to which older innovations are being used is measured by the number of per capita telephones (landline and cellular) and electricity consumption.

82 The TAI does not include data on R&D spending, which is relatively low for ASEAN countries. In ASEAN, only Singapore devotes sizable resources to R&D relative to GDP. See Figure 6.1.

Finally, the degree of human skill is measured by mean years of schooling for those aged 15 and above and the gross tertiary science enrollment ratio. These eight indicators are then averaged (unweighted) to obtain the TAI. A modified TAI by Hu (2011) is used to show the different levels of technological development in Asia, including ASEAN and other countries. The top tier includes Japan, the Republic of Korea, and Singapore, with the Republic of Korea catching up with Japan. The rest of ASEAN — along with the PRC and India — remain far behind (Figure 3.7).

Table 3.10 ASEAN Competitiveness Fundamentals, 2013

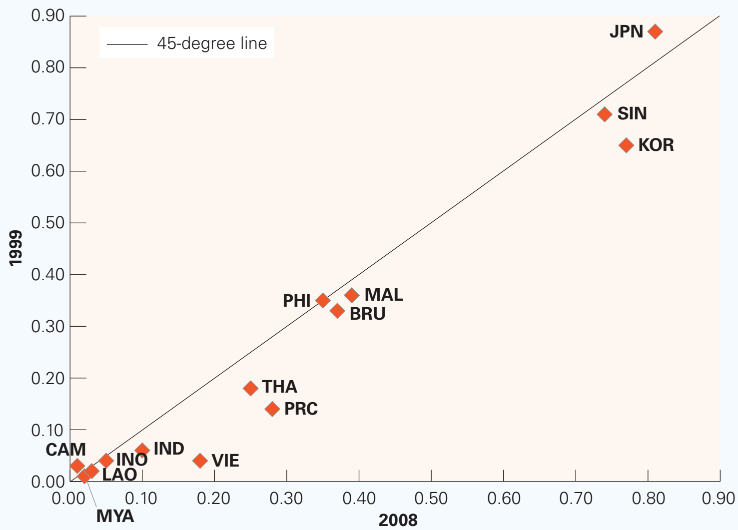
	Singapore	Malaysia	Brunei Dar.	Thailand	Indonesia
Rankings and Scores					
Global rank (148 economies)	2	24	26	37	38
Global score (1–7)	5.61	5.03	4.95	4.54	4.53
Stages of Development					
In 2013	III	from II to III	from I to II	II	II
In 2030 (expected)	III	III	from II to III	III	from II to III
Pillars of Competitiveness					
Institutions	6.04	4.85	4.96	3.79	3.97
Infrastructure	**6.41**	5.19	4.29	4.53	4.17
Macroeconomic environment	6.01	5.35	**7.00**	**5.61**	**5.75**
Health and primary education	**6.72**	**6.10**	**6.33**	**5.52**	**5.71**
Higher education and training	5.91	4.68	4.52	4.29	4.30
Goods market development	5.59	5.23	4.52	4.67	4.40
Labor market development	5.77	4.79	5.06	4.35	4.04
Financial market development	5.82	**5.45**	4.29	4.61	4.18
Technological readiness	6.01	**4.17**	3.75	**3.56**	**3.66**
Market size	4.66	4.87	**2.42**	5.10	5.32
Business sophistication	**5.08**	5.02	4.23	4.42	4.44
Innovation	5.19	**4.39**	**3.38**	**3.24**	**3.82**

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Notes: (i) Ranking and scores are given by the 2013–2014 Global Competitiveness Report of the World Economic Forum. Higher rankings and scores indicate stronger competitiveness; (ii) Stage of development "I" refers to a situation where countries' key competitiveness pillars are factor-driven (institutions, infrastructure, macroeconomic environment, health, and primary education); stage of development "II" is when the key competitiveness pillars focus on efficiency factors (higher education and training, goods market development, financial market development, technological readiness, and market size; stage of development "III" is when countries' key pillars for competitiveness are based on innovation and business sophistication. Top two pillars Lowest two pillars
Source: Authors' elaborations from World Economic Forum (2013b).

While many ASEAN countries remain product and process imitators, by 2030 most of them should move on to reach the technological frontier and be able to innovate. Looking ahead, ASEAN countries should develop national and region-wide innovation strategies built on strengthening existing comparative advantage and develop new ones in strategic sectors (see section 6.3). Once again, ASEAN's pronounced diversity represents both its strength and weakness. As globalization increases the importance of multipolar development, in the long run the region should be able to leverage its diversity.

	Philippines	Viet Nam	Lao PDR	Cambodia	Myanmar
	59	70	81	88	139
	4.29	4.18	4.08	4.01	3.23
	from I to II	I	I	I	I
	from II to III	from II to III	II	II	II
	3.76	3.54	4.00	3.61	2.80
	3.40	3.69	3.66	3.26	2.01
	5.34	4.44	4.41	4.53	3.74
	5.33	**5.78**	**5.56**	**5.32**	**5.05**
	4.28	3.69	3.31	3.12	2.52
	4.19	4.25	4.36	4.35	3.57
	4.08	4.40	**4.55**	**4.76**	**4.09**
	4.41	3.76	3.77	4.04	2.41
	3.58	**3.14**	**2.98**	**3.22**	**2.03**
	4.66	**4.64**	**2.63**	3.23	3.57
	4.29	3.68	3.86	3.83	2.87
	3.21	**3.14**	3.22	**3.05**	2.24

Figure 3.7 Technology Achievement Index in Asia, 1999 and 2008



BRU = Brunei Darussalam; CAM = Cambodia; IND = India; INO = Indonesia; JPN = Japan; KOR = Republic of Korea; LAO = Lao People's Democratic Republic; MAL = Malaysia; MYA = Myanmar; PHI = Philippines; PRC = People's Republic of China; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Source: Adapted from Hu (2012).

3.3.3 Agricultural Productivity and Food Security

Except for Brunei Darussalam and Singapore, agriculture is a key sector for all ASEAN countries—and its importance is destined to remain highly strategic. As incomes grow, an increasingly quality-oriented and diversified demand for agricultural products will offer huge development opportunities. ASEAN's central role in Asia's food security is also destined to rise. Agriculture has been core to innovation and R&D, as the "green revolution" started in the late 1960s continues to evolve new varieties and genetic diversity.

ASEAN's agriculture R&D and innovation covers several tropical vegetables and fruit on the production side, and helps broadening end-uses for rubber, palm oil, and sugarcane—some of its major agricultural products beside rice. The region has a marked competitive advantage in tropical agriculture, and in genetically adapting temperate crops to grow in tropical climes. To achieve a "RICH" ASEAN by 2030, it must strengthen this advantage by raising productivity while preserving natural resources such as forests, land, and water (see section 6.3)

As a major producer of food and industrial crops, in order to increase competitiveness in agriculture, ASEAN should regionally map areas with comparative advantage in perennial tree crops (rubber, palm oil, cocoa, coconuts, and coffee) and areas better suited for field or annual crops (rice, corn, pulses, and beans). After incorporating factors of production such as land, water, fertilizer, and others, productivity growth can be examined from a holistic agribusiness approach integrating supply chains with trading networks, eventually resulting in dynamic agricultural production networks (Wong 2007).

ASEAN has a huge potential to raise agricultural value-added and productivity by tapping the rapid progress underway in agri-biotechnology and "green" biotechnology. Genetic engineering, microbiology and diagnostics, bio-farming, bio-pharming, bio-fuels, bio-plastics, and bio-remediation are often cited as the 21st century's "green revolution." At the same time, the region is facing the impelling challenge not to degrade its ecosystems from overusing yield-boosting chemical fertilizers and pesticides. It must also reduce pollution generated from agricultural waste in production and processing (such as in rubber factories and palm oil mills). Ecosystems must be treated as "public goods," and engineered accordingly.

Productivity increases encompass the entire value chain—processing, storage, logistics, distribution, retail, and consumption. Supply chains link agriculture to manufacturing and services, creating a broad agribusiness framework. Often production networks are driven by distribution networks. For example, supermarkets are transforming ASEAN agri-food supply chains. They are able to quickly adopt new technology, monitor food safety and traceability, and can directly link producers to consumer preferences and shifting demand. Some supermarket chains are also traders, wholesalers, and retailers for certain supply chains in agribusiness (Wong 2012).

ASEAN has an important role to play in ensuring Asia-wide food security—a task which has recently become quite complex, moving beyond its traditional aspects related to food availability, accessibility, distribution, and utilization. Promoting food safety and traceability has also become part of regional food security. ASEAN's food security is focused on rice, and emergency stocks can be organized under the ASEAN plus Three Emergency Rice Reserve, also in coordination with the ASEAN Food Security Information System.

3.3.4 Production Networks and Industrial Clusters

As discussed in chapter 1, the ASEAN Free Trade Area (AFTA) was established in 1992 to increase the region's competitive edge as a global production base and to attract FDI. Intraregional trade further benefited from regional free trade and investment agreements, which have proliferated in Asia since the early 2000s—particularly as their use began to grow. The AEC, even if not fully met by 2015, will continue to pressure ASEAN countries to focus on competitiveness and their capacity to attract investment as part of regional and global production networks.

Regional (and global) production networks are complex structures where final goods are formed by many parts and components, and whose production processes can be fragmented into segments and spread across countries. Usually, multinational firms that commercialize final products decide the production location of each part and component — and assembly lines — based on countries' comparative advantages, including labor cost, the availability of infrastructure, the business environment, institutional frameworks, and the presence of a local supporting industry for example, with efficiency and cost-saving processes as the basic drivers of production fragmentation. FDI by multinational corporations can be important in coordinating investment, production, and trade — especially in industries that have long value chains — such as electronics and electrical appliances, computers, automobiles, machinery, textiles, and garments.

Production networks can lead to industrial clusters — geographically concentrated areas of interconnected production firms, specialized suppliers, service providers, and associated institutions in one industry. Proximity and economies of scale in clusters help increasing productivity and competitiveness. Developing and upgrading these clusters has grown in importance for governments and the private sector. Singapore is an inspiring example for several countries (Box 3.5). Industrial clusters are also important means to develop competitive small and medium-sized enterprises (SMEs), critical as supporting industries. Scholars have shown that

Box 3.5 Singapore's Industrial Clusters—The *Biopolis*

Developing industrial clusters has been part of Singapore's industrial policy since the 1990s. To enhance competitiveness of both industry and services, the National Science and Technology Board was established in 1991 to make Singapore a center of excellence in specified areas of science and technology. An ambitious biotechnology cluster brought the state, industry, and academia together to encourage innovation and entrepreneurship.

Drawing universities into private sector innovation, enterprise development, and the formation of entrepreneurship skills was one of Singapore's key economic success factors. Research parks and institutes were built. The government consciously created an environment conducive to the biomedical industry—to attract experts and ensure intellectual property protection. Singapore advertised its comparative advantage for companies seeking to improve research and development aimed at developing innovative medical devices. More than 50 leading firms in pharmaceuticals, biotechnology, and medical technology established commercial facilities and continue to work today with the government to sustain manufacturing and process development, along with targeting suppliers' abilities to cover niche markets.

An inspiring example of a high-tech industrial cluster is Singapore's *Biopolis*—a 3-year construction project completed in 2006—designed as a center of excellence in international biomedical sciences that spans the entire value chain. Major pharmaceutical firms are located with world-class (A*STAR) research institutes and work toward building public–private partnerships. Since its establishment, many biotech companies have used this integrated research network to accelerate new drug development—an example that illustrates how clustering could help other ASEAN members innovate and remain competitive.

Source: Authors.

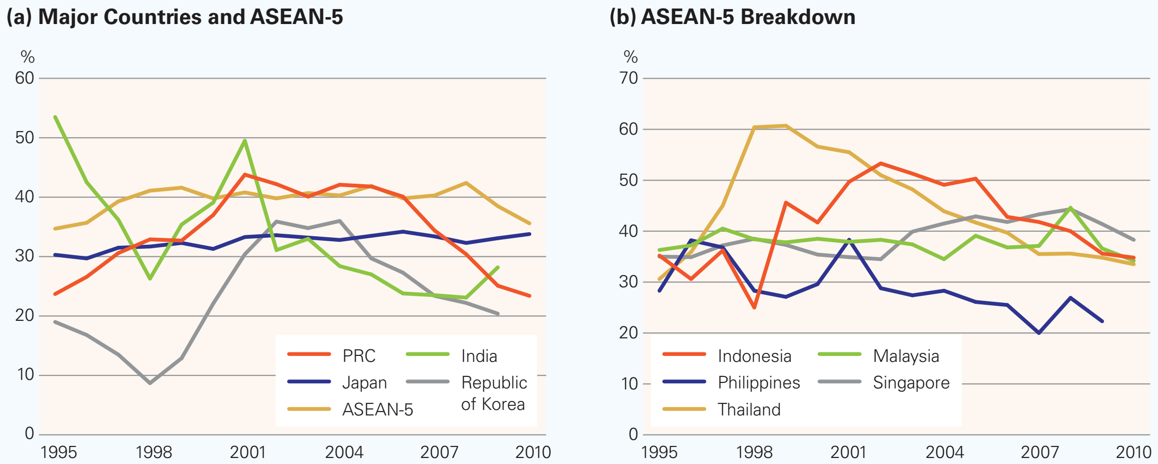
clusters can improve competition by increasing productivity of the firms based in the area, by driving the direction and pace of innovation, and by stimulating new business to be developed within the cluster (Porter 1998).

Production networks and industrial clustering have greatly helped East Asia build global comparative advantage in manufacturing. This is due to several factors, including (i) a widely diverse wage and labor productivity offering a wide choice of competitive cost locations for different parts of the value chain, (ii) trade and investment liberalizations, (iii) the availability of efficient site-specific infrastructure reducing production and logistics costs, (iv) the presence of local supporting industries, (v) multinational firms which ensure strong intraregional and international links, and (vi) adeptness at transferring and absorbing new production technologies (Athukorala 2010).

The PRC is Asia's major assembly base and a large producer of parts and components. Singapore, Thailand, and Malaysia have some of the highest parts and components trade to GDP ratios in the world, making specialized niches of comparative advantage especially important for these countries (Figure 3.8). Their success is largely due to policies that welcome FDI, encourage technological upgrading, and build strong connections with world markets, along with Asian neighbors following similar strategies (Chayodom and Cheewatrakoolpong 2012).

As business environments evolve, regional production networks will undoubtedly reshape themselves. Provided policy reforms succeed, Myanmar's

Figure 3.8 Share of Parts and Components in Total Machinery and Parts Exports, 1995–2010
(from selected countries to ASEAN)



ASEAN-5 = Indonesia, Malaysia, Philippines, Singapore, and Thailand; PRC = People's Republic of China.
Note: ASEAN-5 countries' values are averaged in panel (a), while their individual trends are shown in panel (b).
Source: United Nations Commodity Trade Statistics Database. http://comtrade.un.org/db/default.aspx (accessed October 2013).

greater participation in the ASEAN economy could substantially alter some existing production networks. Myanmar could become an important component in enhancing ASEAN competitiveness. Building on competitive strength in intermediate industrial production includes diversifying economic structures to produce more final goods within manufacturing and services more generally.

So far, ASEAN has not been particularly good at "branding" its products. In the next two decades, the region must begin creating and marketing the "ASEAN brand," particularly in manufacturing (see section 6.3).

3.3.5 Service Sector

Strengthening competitiveness and innovation requires an expanding service sector as a source of growth. Education, finance, and R&D outputs (i.e., in engineering) directly affect growth and foster innovation. Business strategies that establish firms at the cutting edge of global technology accelerate an economy's shift from middle- to high-income status. Advanced and efficient services are essential for these dynamics to take place.

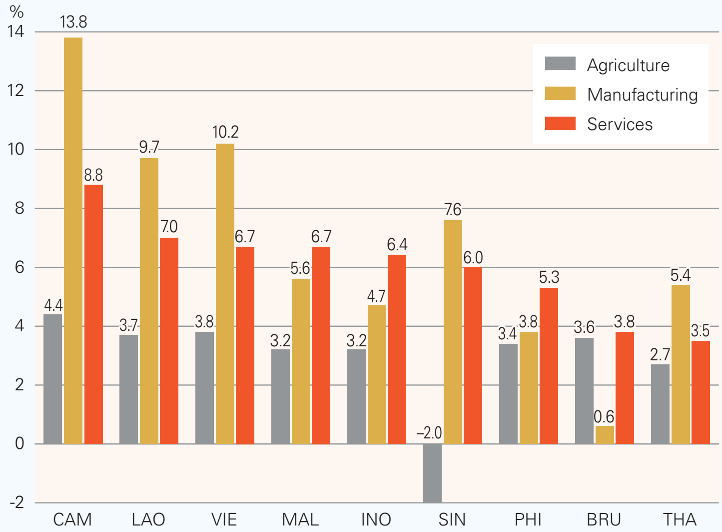
As economies develop, services usually assume a greater share in the GDP, boosting growth, productivity, and per capita income. Expanding services fosters inclusive growth as well. Although development policies have often focused on manufacturing as the prime source for creating employment, evidence shows labor productivity growth can be rapid in services as well. In several ASEAN countries the growth of the service sector has been impressive and almost the same as that of the manufacturing sector, on average (Figure 3.9).

Services provide crucial links to other economic sectors. Input–output tables show services are used extensively as inputs in manufacturing. Improvements in services offer a positive technology shock. They bring downstream increases in productivity, and products tend to become more competitive in international markets thanks to their contribution. Backbone services such as finance, telecommunications, and transport facilitate business for nearly all companies. Policy reforms in banking, insurance, transport, and telecommunications, for example, contribute to boosting manufacturing productivity (Arnold et al. 2008).

Developing an efficient and productive service sector is obviously an important component of national competitiveness strategies. Several studies suggest that large gains in export manufacturing often come from improved efficiency in transport and communication services (Arvis et al. 2010; Shepherd 2012). Countries that can offer better logistics services (as measured by the logistics performance index) than others tend also to trade relatively more parts and components, due to high the correlation existing between them, boosting the efficiency of production networks (Figure 3.10).

Data suggest that since the early 2000s, ASEAN countries have largely expanded trade in services, with most countries showing a two- or even a three-fold increase. Yet, there is much room for improvement on intra-ASEAN trade

Figure 3.9 Average Annualized Growth in Value Added by Sector, 1999–2011
(selected ASEAN countries)



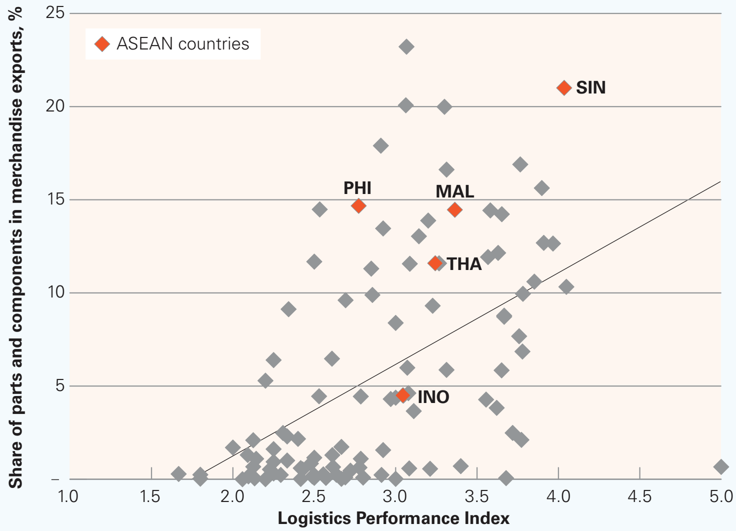
ASEAN = Association of Southeast Asian Nations; BRU = Brunei Darussalam; CAM = Cambodia; INO = Indonesia; LAO = Lao People's Democratic Republic; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Source: World Bank, World Development Indicators Database. http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&SdmxSupported=Y&CNO=2&SET_BRANDING=YES (accessed November 2013).

in services, also considering that the starting points a decade ago were very low. National and regional policies can greatly help. An index developed by the World Bank on barriers to trade in services shows that ASEAN countries still lag behind in service policy reform (Gootiiz and Mattoo 2009).

Moreover, while ASEAN countries have a high share of utilities (water, electricity, power), construction, and social services (education, health) in their domestic economies, trade in these service sectors remains low. Most ASEAN economies discriminate against foreign service providers.[83] Over the coming decades, pressures will likely increase to liberalize these sectors, making prices more competitive and reaping efficiency gains. Logistics — an AEC priority — is a useful example in helping define the challenges policymakers face in reforming services. The results of a recent exercise to construct restrictiveness indexes for logistics services show the presence of considerable protectionism across the region — with Singapore the least restricted (Hollweg and Wong 2009).

83 In professional services, only architecture and engineering show significant trade.

Figure 3.10 Participation in Production Networks vs. Logistics Performance Index, 2007



ASEAN = Association of Southeast Asian Nations: INO = Indonesia; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand.

Note: The Logistics Performance Index ranges from 1 to 5, with 5 being the best performance. It is an average of scores in efficiency of customs clearance process, quality of trade and transport-related infrastructure, ease of arranging competitively priced shipments, timeliness of shipments, ability to track and trace consignments, and quality and competence of logistics services and personnel.

Sources: (i) United Nations Commodity Trade Statistics Database. http://comtrade.un.org/db/default.aspx (accessed September 2013). (ii) World Bank. 2007. *Connecting to Compete: Trade Logistics in the Global Economy*. Washington, DC. http://siteresources.worldbank.org/INTTLF/Resources/lpireport.pdf (accessed September 2013).

Travel and transport account for the largest share of ASEAN's service trade. In contrast, their GDP share is much smaller. Tourism is one area where ASEAN has great, natural comparative advantage compared with other regions or countries. Competition in tourism among individual ASEAN members is obvious but also healthy—today almost all ASEAN countries have developed their own slogans and advertising campaigns. Yet, there is also plenty of room in ASEAN for developing a common strategy to promote tourism regionally, while maintaining individual countries' specific areas of comparative advantage.

Among ASEAN-wide developments adopted to promote tourism, an important initiative is the ASEAN Tourism Agreement of 2002, which helped coordinating national strategies at the regional level and facilitating travel in the region. Furthermore, a Roadmap for the Integration of the Tourism Sector for 2004–2010 was followed by the ASEAN Tourism Strategic Plan 2011–2015. A blueprint for tourism initiatives among member countries, this plan is being developed by national tourism organizations to promote ASEAN as a single tourism destination and become a strong competitor globally. The positive results achieved so far show joint tourism promotion of the entire ASEAN region can be a win–win strategy as it complements individual national plans. By promoting competitiveness and deepening social and cultural understanding in the region, the plan supports the AEC, ultimately boosting growth and integration of the region's tourism sector.

Overall, the number of regional initiatives already underway to make tourism competitive is quite large. However, progress in several areas has been slower than expected. On visas, for example, some ASEAN member countries are constrained by technology, security, or sovereignty concerns. Bureaucratic procedures are also proving to be major impediments. Similarly, the progress made with ASEAN Open Sky agreements face cumbersome ratification processes in many countries, which inevitably lower their potential benefits. Policy initiatives need to address these bottlenecks to allow economic gains to be fully exploited by ASEAN countries (see section 6.3).

ASEAN is no exception to positive links between regulatory reform and trade liberalization. The AEC Blueprint provides the core agenda for the integration of regional service markets through 2015 (Box 3.6). However, experience from other regions — particularly Europe — suggests integrating service markets may take several years. The AEC Blueprint will no doubt continue its relevance to expand ASEAN's service markets through 2030 and beyond. Regulatory reforms that promote productivity growth — and the resulting trade liberalization process — will remain key issues for policymakers in the years to come.

3.4 Protecting the Environment

Protecting the environment and improving natural resource management are prerequisites for achieving sustainable development in harmony with nature and neighboring countries. It leads to a better quality of life on the path toward realizing the 2030 aspirations for a "RICH" ASEAN. The concept of harmonious development relates to five issues closely interrelated with environmental protection. First is how to balance rapid growth while ensuring environmental stewardship. Second is how to manage energy supply and demand. Third is how to handle urbanization and the expansion of the middle class — with rising demand for a healthier life. Fourth is how to properly design regional cooperation initiatives, as natural resource management in one country can affect its neighbors' environment. And fifth is how to maintain peace and security within and across countries — in the region and beyond.

While the last is a fundamentally important aspect of harmonious development, this study analyzes only the first four issues as they focus on the region's economy. Issues related to politics, security, and peace are briefly covered in the analysis of the ASEAN Political-Security Community in chapter 5. It should be stressed,

Box 3.6 Services Liberalization under the ASEAN Economic Community

ASEAN's basic approach to service sector's liberalization and facilitation is provided by the ASEAN Framework Agreement for Services (AFAS) signed in 1995. So far, member countries have undergone eight successive rounds of AFAS negotiations which have been included as part of the ASEAN Economic Community (AEC) Blueprint to be realized by the end of 2015. Measures to liberalize and facilitate regional service trade refer to a total of 12 sectors: air transport; business services; construction; distribution; education; environment; financial services; health care; logistics; e-ASEAN (telecommunications); transport; and tourism.

The AEC Blueprint includes four priority service sectors for integration by 2010—air transport, e-ASEAN, health care, and tourism, with logistics to be liberalized by 2013. For other sectors, liberalization is expected to occur progressively through 2015. Within this general framework, a certain degree of flexibility is allowed for different subgroups to proceed at different speeds using the "ASEAN-minus-X" formula. The AEC Blueprint addresses financial services separately, suggesting that the pace and scope of financial liberalization may not proceed at the same speed in every country, given how liberalization may affect different member countries' financial stability.

AEC liberalization plans are based on the World Trade Organization's General Agreement on Trade in Services (GATS) related to cross-border trade, consumption abroad, and commercial presence (modes 1–3), as well as movement of natural persons (mode 4). Measures include specific guidelines on the removal of restrictions on cross-border trade, foreign ownership, and equity.

For example, in the four priority sectors, foreign equity limits were raised to 70% across ASEAN by 2010; with the same level for logistics by 2013. For non-priority sectors, foreign equity limits are supposed to reach 51% by 2010, rising to 70% by 2015 for non-financial services. To date, substantial restrictions on foreign ownership remain in Thailand, the Philippines, and Indonesia, suggesting the gap between AEC commitments and actual implementation remains wide. Progress in relaxing foreign ownership limits in other service sectors such as banking, air transport, maritime services, and telecommunications has been mixed, but remains overall below target (Dee 2010a).

The AEC Scorecard results for the AEC phases one and two (2008–2011) shown in Chapter 1 illustrates the difficulties in complying with services reform (see Table 1.3). Also important for ASEAN regional integration are links with important developing markets, such as the People's Republic of China (PRC), and India. Although agreements for trade in goods have been concluded with both countries, a services agreement remains under negotiation with India, while an agreement for trade in services was signed with the PRC in 2007 (see Table 1.4).

Looking ahead, it is important for policymakers to continue leveraging regional integration as a force for broad-based regulatory services reform. In the long term, the agenda will steadily shift from one driven primarily by market access in GATS' modes 1 and 3 to two more challenging areas. The first is regulatory reform and harmonization of behind-the-border barriers, which deeply affect production costs. The second relates to allowing the free movement of labor (GATS mode 4), including the mutual recognition of professional services to be fully integrated with measures for market access to foreign service providers, such as immigration procedures to obtaining working visas (see section 4.2).

Source: Authors, based on Shepherd (2012).

however, that achieving ASEAN growth and development aspirations can only be realized through a strong commitment to peace and regional security. In the past, although sporadic conflicts have erupted between ASEAN members, problems were resolved relatively quickly. And while political tensions, ethnic and religious conflicts, territorial disputes, and diplomatic disagreements cannot be ruled out, the resurgence of military conflict among ASEAN countries is today an increasingly remote possibility.

3.4.1 Balancing Environmental Stewardship with Growth

Ensuring proper environmental stewardship — managing the natural resource endowment by balancing protection and exploitation — is an extremely difficult, multi-faceted challenge. As many natural resources deplete over time, their use reduces national wealth. Accordingly, their mobilization and sale must be carefully weighed against economic and social costs. Market prices not always reflect full social costs, and similarly corporate balance sheets rarely account for the inevitable environmental or social costs. Renewable resources are technically and politically challenging. Biofuels, for instance, compete with agricultural crops for the use of arable land. Encouraging their efficient use must be done within a regulatory structure that allows for the development of appropriate market institutions, infrastructure, and human skills. Rapidly expanding urban centers challenge governments to develop, enforce, and maintain "green" strategies and policies. Urbanization is associated with a high concentration of manufacturing production in relatively small areas and with high population density — often resulting in air and water pollution. Aside from health problems, pollution imposes costs on the very production processes that underpin economic success.

While ASEAN economies are generally endowed with abundant natural resources (forests, fresh water, and maritime resources amid considerable biodiversity), proper resource management has become an increasingly important priority. Unfortunately, as a result of past policies, the resource base of forests, rivers, and seas have fallen prey to increasing pressures from unsustainable practices. The growing middle class will increasingly demand clean air and safe water. One clear worry is the deterioration of fresh water systems in ASEAN countries (Table 3.11).

Without immediate — and bold — action, clean water will be in short supply by 2030 in several parts of the region. ASEAN's strategic action plan on water resource management stresses decentralized wastewater management, giving local governments increasing responsibility. Usage charges for water (and other utilities) must cover costs. However, many countries have historically tried to keep water service fees artificially low, especially in urban areas. This discourages conservation and limits availability of financial resources — a "lose-lose" situation. Charging fees to cover real resource costs, coupled with provisions for subsidizing the poorest households, would go a long way to ensuring sustainable water supplies (see section 6.4). The challenges are particularly acute for the CLMV countries, which will require technical and financial support both from ASEAN-6 countries and other development partners.

Forests are one of the region's most abundant resources, yet they face similar challenges (Table 3.12). Forests capture carbon dioxide, diminish greenhouse gas build-up, and reduce global warming. They provide for watersheds, crucial to fresh water supplies, produce resources for a host of industries, and are often the primary source of livelihood for the poor, especially indigenous people. The disappearance of mangrove forests damages ocean fisheries, as they shelter a multitude of sea creatures in their early life cycle. It reduces fish stocks, livelihoods, primary food, and income sources, especially in poor coastal communities. The rapid destruction of forest cover in Southeast Asia has also had worldwide impact on global warming. Between 1990 and 2010 ASEAN's total forest area shrunk by about 2% (Figure 3.11).

ASEAN has repeatedly shown a keen interest in reversing global warming. The extensive mainland coastline and the huge combined archipelagos of more than 24,000 islands are particularly vulnerable to rising sea levels. Along with tidal and storm surges, flooding threatens wide areas in many countries, including urban centers. Countries like the Philippines and Viet Nam have already felt the increasing intensity and frequency of large storms or typhoons. All of Southeast Asia faces unpredictable climate shifts, exposing their large agricultural sectors to a variety of unknown and unpredictable risks.

ASEAN's average annual increase of greenhouse gas emissions—the main cause of global warming—is modest compared with other parts of the world and is actually slowing. For example, the average annual increases in nitrogen dioxide (N_2O) and methane (CH_4) in 2010 were lower than in previous years (Table 3.13

Table 3.11 Water Quality Status in Selected ASEAN Countries
(available years)

Country	Year	Water Quality Status
Indonesia	2008	54% of the 33 rivers monitored are heavily polluted
Philippines	2008	14%–28% of rivers has exceeded the BOD discharge limit
Thailand	2008	48% of river with poor quality in 2007 as compared to 29% in 2005
Viet Nam	1996–2001	BOD level in rivers exceed national standards by 2–3.8 times

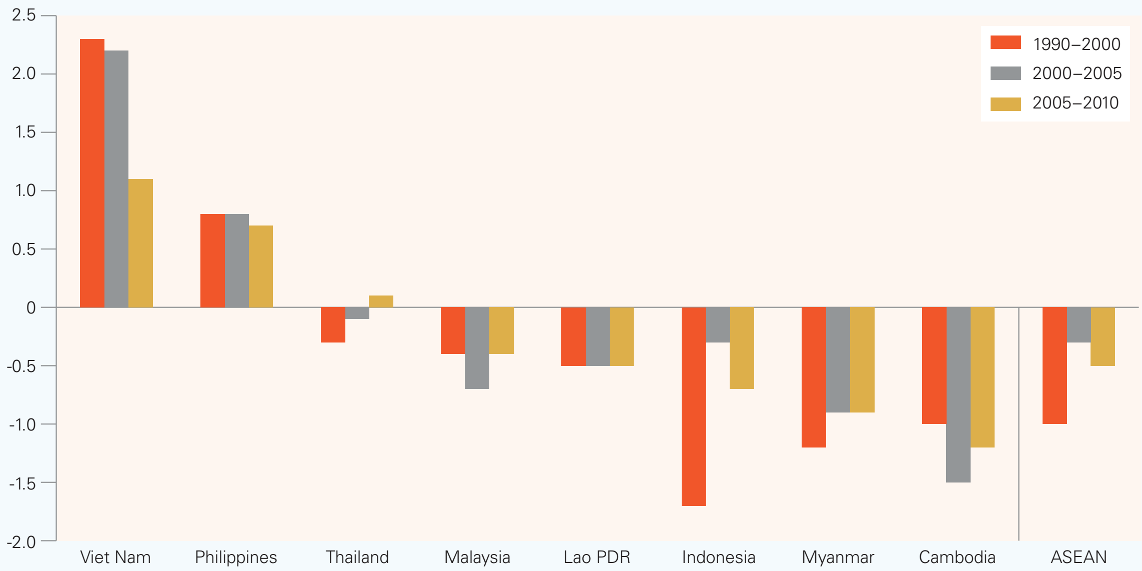
ASEAN = Association of Southeast Asian Nations; BOD = biochemical oxygen demand.
Note: BOD is the amount of dissolved oxygen needed by aerobic biological organisms in a body of water to break down organic material present in a given water sample at certain temperature over a specific time period. The BOD value is often used as a robust surrogate of the degree of organic pollution of water.
Sources: (i) ASEAN Secretariat. 2009. ASEAN Fourth ASEAN State of the Environment Report. http://www.aseansec.org/publications/SoER4-Report.pdf; (ii) Asian Development Bank. 2007. *Asian Water Development Outlook 2007*. Manila. http://www.adb.org/publications/asian-water-development-outlook-2007; (iii) World Health Organization (WHO) and United Nations Children's Fund. 2010. *Progress on Sanitation and Drinking Water Report.* Geneva: WHO. http://www.unicef.org/eapro/JMP-2010Final.pdf (accessed November 2013).

Table 3.12 ASEAN Forest and Wooded Land Area

	Forest	Other Wooded Land	Total Forest and other Wooded Land	
	'000 hectares	'000 hectares	'000 hectares	cover % share
Cambodia	10,094	133	10,227	57.9
Indonesia	94,432	21,003	115,435	63.7
Lao PDR	15,751	4,834	20,585	89.2
Malaysia	20,456	0	20,456	62.3
Myanmar	31,773	20,113	51,886	79.4
Philippines	7,665	10,128	17,793	59.7
Thailand	18,972	0	18,972	37.1
Viet Nam	13,797	1,124	14,921	48.1
ASEAN	**214,064**	**57,385**	**271,449**	**62.7**

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.
Note: The cover percent share refers to the country's total land area.
Source: Food and Agriculture Organization of the United Nations. 2010. *Global Forest Resources Assessment*. Rome. http://www.fao.org/docrep/013/i1757e/i1757e.pdf (accessed November 2013).

Figure 3.11 Change in Forest Areas in ASEAN, 1990–2010
(annual % change)



ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.
Source: Food and Agriculture Organization of the United Nations. 2010. *Global Forest Resources Assessment*. Rome. http://www.fao.org/docrep/013/i1757e/i1757e.pdf (accessed November 2013).

and Table A3.1 in the Appendix to this chapter). However, the only solution to global warming will be if emissions fall elsewhere as well. Air pollution, another major environmental threat, typically tracks closely with economic growth and comes from a variety of sources—from home cooking to vehicles, power generation, industrial processes, and clearing land for agriculture. Air quality varies considerably across ASEAN's megacities. In 2008, for example, the air was several times more polluted in Ho Chi Minh City than in Singapore.

Many ASEAN cities are shrouded in haze—largely particulate pollution that threatens health. On a few occasions, haze has become a regional issue especially for Indonesia, Malaysia, and Singapore. Transboundary haze results from vast areas of forests or fields burning as they are newly cleared for planting, especially in Sumatra and Borneo. The pollution has been so great that it heavily restricts visibility, affects air transport, and can cause a variety of health problems across the region (Haq and Schwela 2008). ASEAN has been working for several years to combat this haze. The signing of the Agreement on Transboundary Haze in 2002 paved the way for other efforts, including establishing an ASEAN Coordinating Centre for Transboundary Haze Pollution Control.

Environmental concerns are not new to ASEAN. But in previous decades, with the need to confront widespread poverty, there was scant attention given to air and water pollution or the disposal of solid waste. Many governments in Southeast Asia, as in most developing regions of the world, tended to tip the scale toward GDP growth at the expense of the environment and natural resource protection. While there is a short-term trade-off between environmental protection and business costs, economies will lose competitiveness without proper long-term management. Pollution imposes costs that must be paid at some point. A lack of fresh water resources limits industry and agriculture and clearly reduces living standards. Air pollution not only carries higher health costs, it also increases production costs

Table 3.13 Greenhouse Gas Emissions in ASEAN

Air Pollutants Emission		1995	2000	2005	2010
N_2O	Thousands metric tons CO_2 equivalent	163,130	180,290	202,290	206,336
	Average annual increase since previous period (%)		2.1	2.4	2.0
CH_4	Thousands metric tons CO_2 equivalent	481,350	517,670	527,670	530,308
	Average annual increase since previous period (%)		1.5	0.4	0.1
CFCs	Ozone depleting potential metric tons	21,944	14,318	1,037	1,025
	Average annual increase since previous period (%)		-7.0	-18.6	-0.2

ASEAN = Association of Southeast Asian Nations; CFC = chlorofluorocarbon; CH_4 = methane; CO_2 = carbon dioxide; N_2O = nitrogen dioxide.
Source: Intergovernmental Panel on Climate Change. 2007. *Climate Change 2007: Synthesis Report*. Geneva. http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr.pdf (accessed October 2013).

for many industries. Improper solid waste disposal compounds the problems of providing clean water and air, contributing to massive drainage problems in urban areas. Improper environmental practices impose special burdens on the poor — those most at risk from unsafe water, flooding, and loss of livelihood.

Understanding that a cleaner environment is a public good can encourage better development strategies, ones that provide for sustainable and competitive business practices. For example, products and business processes that limit pollution and solid waste can meet the increasing demand for "green" products. Currently these are niche markets for ASEAN. But they offer tremendous growth potential; to serve not only the US and Europe but also an expanding East Asian middle class demanding more environmentally friendly products and services. Thailand's "eco-car" project, for example, has led to the development of new automobile models for the domestic market. And they will likely be exported globally.[84] The ability to penetrate new markets requires policy initiatives aimed at developing "green" technological innovations, from R&D to new products, and the diffusion of new technologies (see section 6.4).

3.4.2 Managing Energy Resources

Appropriately managing energy sources, including power generation and use, is an essential feature of responsible environmental stewardship. Sustained economic growth depends on the proper allocation and care in using existing energy supplies and developing their more efficient use. Regional authorities also need to properly manage an increasing competition among Asian countries for the ever more scarce energy sources, not only within ASEAN but also the PRC, India, and others. ASEAN will have to act closely as a group to avoid potential conflicts among its members and neighboring countries.[85]

Managing the production, trade, and consumption of energy is a major factor in ensuring a country's rapid and sustainable economic development. Energy powers production, trade, and distribution. It is the backbone of public utilities — especially household electricity — and other services. Typical energy sources in ASEAN include fossil fuels (coal, crude oil, natural gas) and renewables (biofuels, geothermal, hydropower, solar, and wind power).[86]

Overall, fossil fuels continue to dominate the energy mix in ASEAN. Total energy usage has been constantly increasing over time as population and GDP expands. It rises in tandem with the increase in per capita income and the emergence of the region's middle class. In ASEAN, total energy usage more

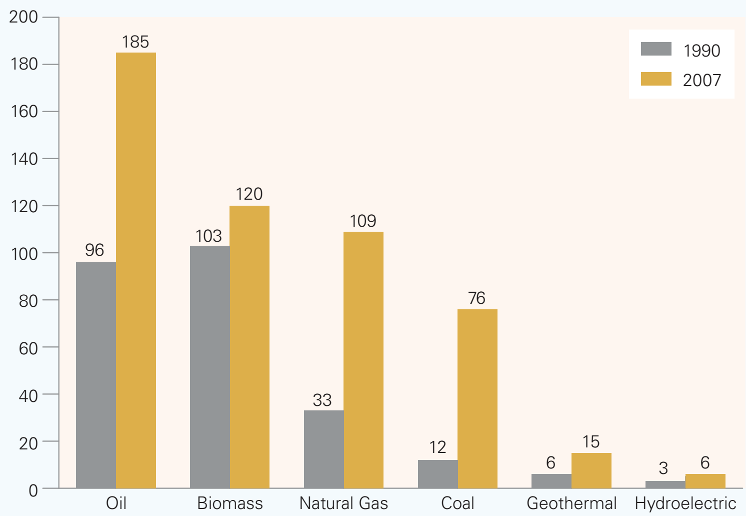
84 Thailand provided tax and other incentives for the development of small, fuel-efficient automobiles. Partly as a result, the country is exporting cars to other countries including Australia, Malaysia, and the Philippines.
85 This section draws heavily upon Achayuthakan and Ongsakul (2012).
86 Commercial nuclear power is currently unavailable in ASEAN, although it may be used as a future energy supply.

than doubled between 1990 and 2007, from 253 million to 511 million tons of oil equivalent. The fossil fuel share rose from 55.7% of total energy demand in 1990 to 72.4% in 2007, due to the relative jump in coal usage and natural gas. Oil's share has been nearly constant. Over the same period, the use of non-fossil fuels has fallen. The share of biomass fuels (generally forest and farm residues) declined from 40.7% in 1990 to 23.5% in 2007 as commercial fuels displaced traditional energy use (Figure 3.12).

One fundamental issue is the availability of infrastructure that supplies electricity. Economic growth and rising living standards demand ever-increasing power supply. Investments are needed to expand electrification into rural areas, and to ASEAN's least developed countries and provinces. In 2010, the regional electrification rate was above 90% in urban areas, but only 55% in the countryside. In Cambodia, however, rates dropped to 66% in urban areas and 12.5% in rural areas (Low 2012). There is also the need to expand existing power grids—to provide adequate, reliable, and properly managed systems that will keep pace with expected patterns of development.

Expansion in commercial energy has fueled economic growth and poverty reduction. Yet it has brought with it growing dependency on fossil fuels—contributing

Figure 3.12 ASEAN Primary Energy Mix
(million tons of oil equivalent)



ASEAN = Association of Southeast Asian Nations.
Note: Oil-equivalent tons measure the amount of energy released by burning approximately 1 ton of crude oil.
Source: Chira Achayuthakan and Weerakorn Ongsakul. 2012. Energy Needs toward ASEAN 2030. Background paper prepared for the ASEAN 2030 Study.

to global warming and increasing the region's exposure to volatile world oil prices. The last few decades witnessed several oil price spikes, adding large costs for consumers and delaying development. Part of the reason is the burgeoning demand from Asian countries, despite weak demand from advanced markets. It is unlikely that oil prices will be any less volatile going forward. High oil and gas prices may be good for Brunei Darussalam and Malaysia — the two ASEAN countries that are net petroleum product exporters — but not for the bulk of Southeast Asian countries. For ASEAN as a whole, imports have outpaced exports — they accounted for 42.5% of total consumption on a net basis in 2009.

Unfortunately, several governments subsidize retail oil prices, creating unsustainable fiscal burdens and reducing the pressure on businesses and households to conserve energy. In mid-2008, for example, the relatively energy-efficient economies of Hong Kong, China; the Republic of Korea; and Singapore saw gasoline prices range from $1.56–$1.94 per liter and diesel prices from $1.65–$2.20 (ADB 2008a). By comparison, in ASEAN (excluding Singapore), the highest prices were in Cambodia ($1.34 per liter for gasoline and $1.36 per liter for diesel). Indonesia was at the very low end ($0.61 and $0.67, respectively). Although policymakers have reduced subsidies over time, it is best to shift to completely market-based fuel pricing in the long run (see section 6.4).

High prices for oil and other fossil fuels create incentives to produce more renewable energy, particularly biofuels, geothermal, hydropower, and solar and wind power. ASEAN holds significantly undeveloped hydropower endowments, especially in archipelagic areas. Resources range from small, run-of-river systems that can help the development of isolated areas or islands, to the huge hydropower dams in countries like the Lao PDR (along the Mekong River).

Biofuels are another alternative to excessive dependency on fossil fuels (Box 3.7). As liquid chemicals produced from plants, animal fats, or plant sugars, biofuels can substitute or blend with traditional petroleum-based fuels and have captured the imagination of energy planners in many countries. Biofuels, for instance, have the potential to generate better livelihoods in rural communities. However, they also consume resources in competition with other uses, especially agriculture. To work efficiently as substitute fuels, they require considerable public investment to develop the institutions, policies, and infrastructure needed for markets to develop in a sustainable, yet competitive fashion.

There is an array of biofuel programs across ASEAN. In 2005, for instance, the Philippines began building the nation's first manufacturing facility for bioethanol in San Carlos, Negros Occidental — a traditional sugar-growing region. The aim was to replace up to 10% of imported gasoline with domestically produced ethanol, although one underlying problem is that sugar costs are relatively high. More recently, the government started a pilot project in the same region to better test and understand the commercial potential of Jatropha curcas in producing biodiesel.

While good policies encourage the use of renewable energy sources, it takes time to change public attitudes and ongoing practices. Existing technologies, transport systems, and market institutions still overwhelmingly encourage the use of fossil fuels. For instance, linking renewable power stations to baseline national grids are technically complex and expensive operations. Recent projections prepared by the Institute of Energy Economics (2011) suggest that, even under an optimistic "alternative policy scenario" with effective energy-saving initiatives, fossil fuels will still increase their share of ASEAN's total primary energy use to 77.4% in 2030, up from 72.4% in 2010. Coal, despite its many environmental drawbacks, is expected to annually grow 6.2% on average from 2007 to 2030 (Table 3.14).

Among renewables, hydropower and geothermal energy are expected to grow respectively by 7.1% and 5.1% on average each year during the same period, while biofuels will likely grow at a much lower rate of 1.1%. A more environmental

Box 3.7 The Promise of Biofuels

Biofuels are liquid energy forms that can be blended with, or substitute for, gasoline or diesel fuel for use in industry, households, or transportation. They are produced from a variety of different sources (biomass)—plants, oil seeds, animal fats, and waste materials.

Over the years to 2030, ASEAN will have several options for countries to develop a vigorous biofuels industry. The two main broad categories include the following:

- Biodiesel, which can be used wherever petroleum-based diesel is found. Most frequently it is used in conventional diesel engines for transport or industry. In ASEAN, biodiesel can be produced by processing palm or coconut oil, expanding markets for these traditional crops. It can also be obtained from the oil seeds of Jatropha curcas, which can be cultivated on marginal land and require little water, potentially expanding land that can be brought into commercial cultivation.
- Bioethanol, which can be blended with, or be a substitute for, gasoline. It is a renewable fuel that can reduce petroleum dependency for transport. Chemically, bioethanol derives from ethanol (or ethyl alcohol) and is typically produced from plants such as sugar cane, sugar beets, or other sugar- or starch-based feedstock. Aside from transport, bioethanol can be used in several industrial processes, including the production of alcoholic beverages.

Biofuels reduce dependency upon imported petroleum—improving the balance of payments. They also reduce greenhouse gas emissions, which they absorb as crops in their growth cycle. However, energy is needed for cultivation, harvest, and processing. Different crops related to different growing and processing techniques can have varying net impacts on the environment.

As biofuels compete with food crops, a balance must be found for land, water, labor, and other agricultural inputs. Unless technological innovation will bring in new opportunities, competition between encouraging energy security through biofuel development and food security will likely intensify in the years to 2030.

Source: Authors based on Achayuthakan and Ongsakul (2012).

Table 3.14 Primary Energy Forms in ASEAN, 2007 and 2030

Primary Energy	2007		2030		Annual average growth rate
	oil-equivalent million tons	% share	oil-equivalent million tons	% share	
Coal	76.0	14.9	300.1	26.0	6.2%
Oil	185.0	36.2	408.1	35.4	3.5%
Natural Gas	109.0	21.3	183.3	15.9	2.3%
Nuclear	0.0	0.0	30.4	2.6	–
Hydro	6.0	1.2	29.0	2.5	7.1%
Geothermal	15.0	2.9	47.4	4.1	5.1%
Others	120.0	23.5	154.2	13.4	1.1%
Total	**511.0**	**100.0**	**1,152.5**	**100.0**	**3.6%**

ASEAN = Association of Southeast Asian Nations.
Notes: (i) Oil-equivalent tons measure the amount of energy released by burning approximately 1 ton of crude oil; (ii) Other sources of energy include the traditional use of biomass—the gleaning of fields and forests.
Source: Chira Achayuthakan and Weerakorn Ongsakul. 2012. Energy Needs toward ASEAN 2030. Background paper prepared for the ASEAN 2030 Study.

unfriendly "business-as-usual" scenario (not shown in Table 3.14) suggests, however, that by 2030 the fossil fuel share of primary energy may increase to more than 80% of the total, with the share of coal growing to 30%.[87]

3.4.3 The Impact of Urbanization

Rapid urbanization across ASEAN over the last few decades adds to the challenge of good environmental management. According to United Nations estimates, by 2030 about 53% of ASEAN's population will live in urban areas, up from 42% in 2010 (Figure 3.13). This will impact both large countries such as Indonesia, or medium-sized Malaysia as well as the smaller, less developed members such as the Lao PDR and Cambodia. ASEAN's urbanization is primarily driven by the migration of agricultural workers to industry and services.[88]

The past few decades have seen the growth of megacities worldwide, particularly in Asia, and thus ASEAN. The growth of urban centers was spurred by lower transportation costs, increased productivity due to revolutionary changes in information technology and finance, and the ensuing development of supply chains and production networks. FDI often brought with it links to global production chains, creating economic incentives for rural-urban migration. Economic zones,

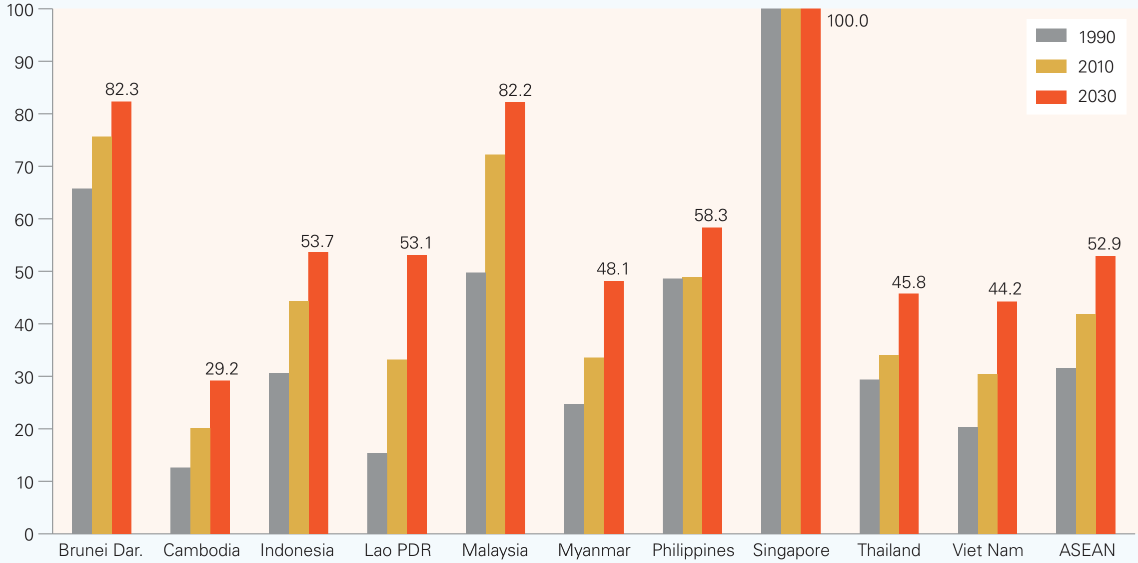
87 Under this scenario, ASEAN's total energy demand in 2030 will be about 25% higher than under the alternative policy scenario.
88 This section draws from Wong (2012).

especially near capital cities, took on new dimensions, characterized by urban cores hosting both modern businesses and growing slums. Urban sprawl brought middle-class regions on the urban periphery.

But rapid growth came at the expense of energy efficiency, and overburdened public utility systems, including water and sanitation. Roads too frequently service automobiles rather than public transport. Megacities are slowly strangling themselves as economic centers. Nonetheless, they dominate national economies. ASEAN therefore needs to undertake a deep, strategic process of urban restructuring in an ecologically sound, energy-efficient fashion (Wong 2012).

While Singapore, and to a lesser extent Bandar Seri Begawan and Kuala Lumpur, have invested in developing eco-friendly urban infrastructure — with adequate resources to maintain them in the future — many other ASEAN cities have seen limited progress. Increasing bouts of flooding in Bangkok and Manila and traffic congestion in Jakarta are testimony to the urgent challenges requiring urgent action (see section 6.4). As megacities proliferate toward 2030, they can either become bastions of economic productivity or, on the contrary, aggravate inequality and create political instability.

Figure 3.13 Urban Population Shares in ASEAN, 1990, 2010, and 2030



ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Source: United Nations Population Division, World Population Prospects: The 2008 Revision and World Urbanization Prospects: The 2009 Revision. http://esa.un.org/wup2009/unup/ (accessed December 2013).

3.4.4 Regional Cooperation on the Environment

Natural resource management and environmental stewardship are the responsibility of national governments. However, collective dialogue, planning, and cooperation also create opportunities for positive change. This is particularly true for cross-border issues, including transboundary haze and the unsustainable exploitation of ocean resources through overfishing. ASEAN countries have joined forces in several ways, in different subgroupings and organizational structures, to address common problems. Two of the more notable subregional efforts are the Coral Triangle Initiative and the Heart of Borneo Initiative.[89]

The Coral Triangle Initiative unites six countries from Southeast Asia and the Pacific (Indonesia, Malaysia, Papua New Guinea, the Philippines, Solomon Islands, and Timor-Leste) to work collectively to address ongoing degradation of ocean resources. It has received considerable international support and coordinates with BIMP-EAGA (see section 3.2 and Masli 2010). Preserving maritime resources requires international cooperation. Fish and other sea creatures need no passport—yet the destruction of their spawning habitats or overfishing can disrupt fish stocks in far distant regions. ASEAN's huge archipelagos are poorly policed. Over the coming decades, national agencies must take a cooperative and unified stance to protect these resources (see section 6.4).

The Heart of Borneo Initiative is different. It unites the three countries sharing the island of Borneo (Brunei Darussalam, Indonesia, and Malaysia) and aims to reverse unsustainable exploitation of Borneo's primary forests. Balancing the urgent need to fight illegal logging and preserving forestlands against the demand to expand and develop agriculture (e.g., through expanding plantations) is a daunting task. Empowering indigenous people, allowing them to participate in decision-making, and supporting appropriate community development and cultural preservation is part of the initiative. While local in nature, the impact of the Heart of Borneo Initiative is global. Borneo's rainforest is itself an important part of the global ecosystem—for example, in reducing greenhouse gases.

ASEAN environmental cooperation has a long history. A Ministerial Meeting on the Environment—started in 1981 and now part of the ASEAN Socio-Cultural Community—introduced a blueprint in 2010 comprising 10 priorities to protect the environment:

(i) addressing global environmental issues;
(ii) managing and preventing transboundary pollution (haze pollution and movement of hazardous wastes);
(iii) promoting sustainable development through education and public participation;

89 Further discussion on these two initiatives can be found in ADB (2010a). See the Coral Triangle Initiative website (http://www.coraltriangleinitiative.org/) and the Heart of Borneo Initiative website (http://www.hobgreeneconomy.org/en/about/).

(iv) promoting environmentally sound technology;
(v) promoting quality living standards in urban areas;
(vi) harmonizing environmental policies and databases;
(vii) promoting sustainable use of the coastal and marine environment;
(viii) promoting effective management of natural resources and biodiversity;
(ix) sustaining freshwater resources; and
(x) responding to climate change and addressing its impact.

Such a broad agenda will undoubtedly absorb huge resources — human and financial — but will also require the implementation of national policies and strong political determination (see section 6.4). ASEAN authorities will need to balance national and regional growth strategies with environmental stewardship as an essential component for sustained and harmonious economic development. ASEAN's path toward a truly borderless economic community by 2030 must embrace environmental protection.

Chapter 3: Appendix

Table A3.1 Greenhouse Gas Emissions in Selected Countries

Nitrogen dioxide (N_2O)
Thousand metric tons CO_2 equivalent

	1995	2000	2005	2010
Brunei Dar.	70	360	370	377
Cambodia	4,350	3,490	3,820	3,896
Indonesia	66,640	69,130	69,910	71,308
Malaysia	12,410	9,350	9,920	10,118
Myanmar	15,850	22,050	25,900	26,418
Philippines	18,520	16,890	18,940	19,319
Singapore	1,140	5,880	7,970	8,129
Thailand	23,650	26,030	27,990	28,550
Viet Nam	20,500	27,110	37,470	38,219

Methane (CH_4)
Thousand metric tons CO_2 equivalent

	1995	2000	2005	2010
Brunei Dar.	2,010	2,070	2,060	2,070
Cambodia	12,800	13,350	14,890	14,964
Indonesia	214,710	223,140	224,330	225,452
Malaysia	24,360	25,320	25,510	25,638
Myanmar	49,640	59,270	60,840	61,144
Philippines	44,490	44,630	44,860	45,084
Singapore	1,120	1,260	1,260	1,266
Thailand	73,090	77,070	78,840	79,234
Viet Nam	59,130	71,560	75,080	75,455

Chlorofluorocarbon (CFC)
Ozone depleting potential metric tons

	1995	2000	2007	2010
Brunei Dar.	59	47	10	10
Cambodia	94	94	12	12
Indonesia	5,249	5,411	203	200
Lao PDR	4	45	6	6
Malaysia	3,384	1,980	234	232
Myanmar	16	26	–	
Philippines	2,981	2,905	143	142
Singapore	3,167	22	–	
Thailand	6,660	3,568	322	319
Viet Nam	330	220	38	38

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; CO_2 = carbon dioxide; Lao PDR = Lao People's Democratic Republic.
Source: Intergovernmental Panel on Climate Change.2007. *Climate Change 2007: Synthesis Report.* Geneva. http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr.pdf

Chapter 4
Enabling Factors

4 Enabling Factors

As ASEAN member countries strive to achieve their development aspirations, they need to consider a broad set of issues that will allow targets to be met. The challenges identified through country consultations and background papers were discussed in chapter 3. The approach adopted in this study also suggests the presence of four growth-enabling factors, or prerequisites to realize the "RICH" ASEAN aspirations: (i) developing financial markets; (ii) harnessing human capital; (iii) building seamless connectivity; and (iv) strengthening governance. Without sufficient progress in the above strategic areas, it will be difficult to create an ASEAN borderless economic community by 2030.

This chapter analyzes these key growth-enabling factors. They more or less directly affect each of the aspirations and challenges discussed in the two earlier chapters—and they are interconnected. Deepening and widening financial markets, which is discussed in section 4.1, is important not only to ensure resilience, but also inclusiveness, competitiveness, and harmony. As are the quality of human capital and an efficient ASEAN labor market (section 4.2), the extent of domestic and regional connectivity (section 4.3), as well as the presence of sound institutions based on solid governance principles and practices (section 4.4).

The discussion on the institutional framework carried on included in this chapter will focus on national structures, while the wider set of issues related to the regional institutional architecture is dealt with in chapter 5.

4.1 Developing Financial Markets

Empirical evidence shows that countries with more developed financial systems tend to grow faster over the long term than countries were financial systems lag behind (Rajan and Zingales 1998; Beck, Levine, and Loayza 2000; Levine 2005). The presence of a high-quality financial system—efficient banks and other financial institutions working alongside deep and integrated capital markets—is a main growth-enabling factor for ASEAN countries to achieve their 2030 "RICH" aspirations.

To maintain rapid and sustainable economic growth, ASEAN countries are struggling to efficiently mobilize regional savings and make them available for productive use and for development purposes—including long-term infrastructure financing. Another important issue for ASEAN financial systems relates to ensuring inclusion and expanding access to credit of small and medium-sized enterprises (SMEs) and the millions of people still outside the formal system—especially the unbanked. Indeed, an efficient financial system is a central tool for inclusive growth.

Key steps to further develop financial markets and promote financial integration are being taken as part of the ASEAN Economic Community (AEC) Blueprint, which aims to "transform ASEAN into a region with free movement of goods, services, investment, and skilled labor, and freer movement of capital." Deepening and widening financial markets is an important factor not only to enable the AEC, but also to move beyond it, toward the creation of a truly borderless economic community by 2030.[90]

4.1.1 ASEAN Financial Landscape

ASEAN's financial landscape remains extremely diverse from country to country. The ratio of total financial assets[91] to gross domestic product (GDP) varies greatly across the region. Malaysia, Singapore, and Thailand compare favorably with the European Union (EU), while Viet Nam, the Philippines, and Indonesia fall within the range of their international peers, as defined by per capita income.[92] In contrast, Brunei Darussalam, Myanmar, Cambodia, and the Lao People's Democratic Republic (Lao PDR) show minimal financial development (Figure 4.1).

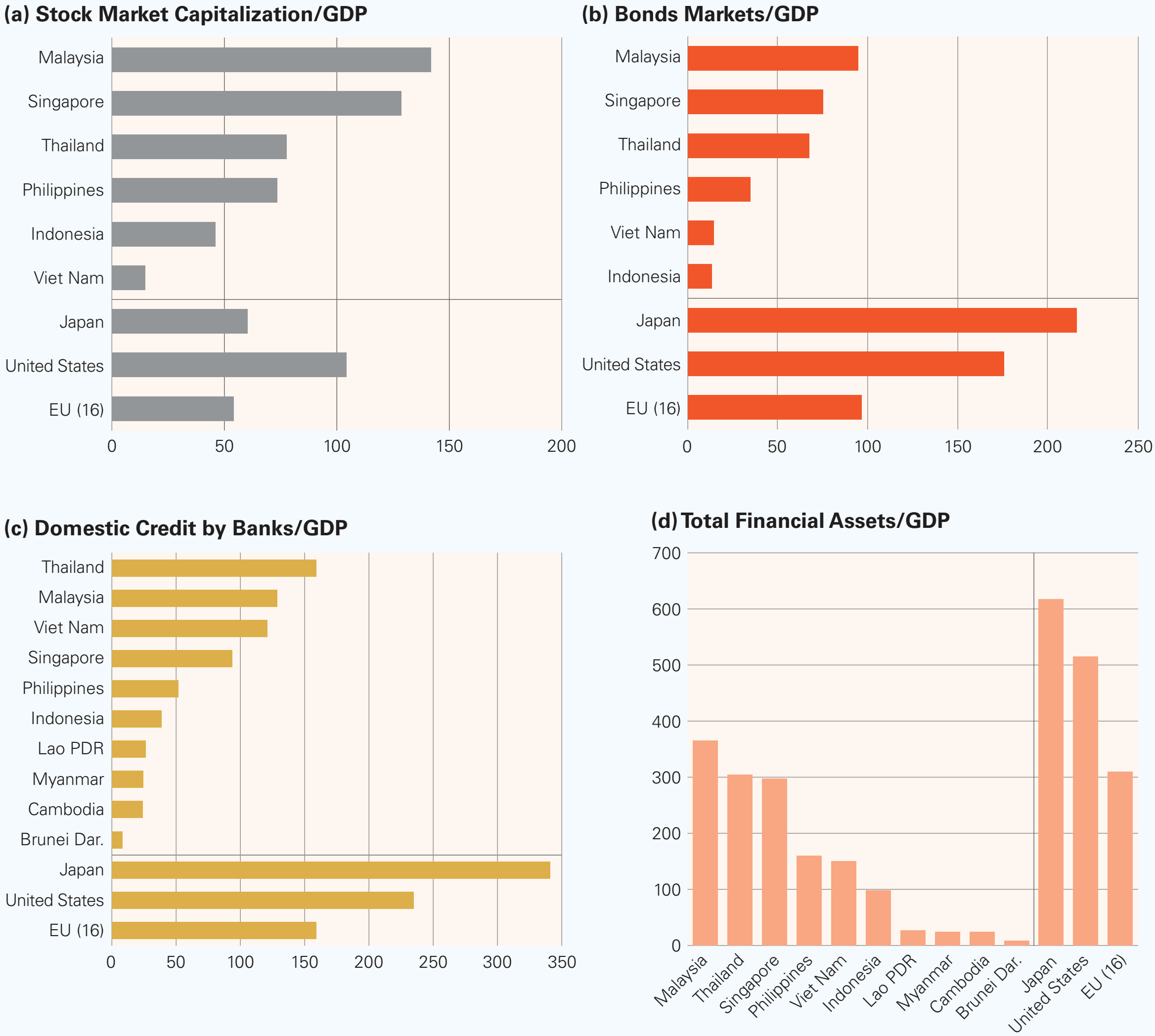
Apart from the diverse size of ASEAN banking systems, and their role in providing domestic credit, significant differences exist in size as well as quality of equity and bond markets—which continue to be absent in Brunei Darussalam, Cambodia, the Lao PDR, and Myanmar.

Accessibility to banking and overall indicators of financial inclusion also varies widely across the region. Limited opportunities for small business to access credit and for the poor to receive a wider range of financial services constrain development. The number of deposit and loan accounts, bank branches, and ATMs per adult roughly indicate the extent of accessibility to financial services (Table 4.1).

Singapore and Malaysia top the list for deposit accounts per 1,000 adults with figures comparing favorably with the United States (US) and high-income Europe. Cambodia and the Lao PDR, however, are below the average for even low-income sub-Saharan Africa (not shown in the figure). In terms of loan accounts per 1,000 adults, Singapore is above high-income Europe, while Indonesia, Malaysia, and Thailand have relatively equal shares at about one fourth of Singapore's ratio. The Lao PDR lags considerably behind—as does, most likely, Myanmar, for which comparable data are unavailable.

90 This section draws largely from Lee and Takagi (2012).
91 The sum of total domestic credit from banks plus equity and bond market investment.
92 International comparisons use the World Bank definition of income groups (see chapter 2).

Figure 4.1 Development of Financial Markets in ASEAN, 2011
(total financial assets as % of GDP)



ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; EU = European Union; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic.

Notes: (i) Latest available data for Myanmar and the Lao PDR are 2004 and 2010, respectively; (ii) Bond market data refer to local currency bonds outstanding (government and corporate); (iii) EU (16) ratio of domestic credit to GDP was computed using GDP as weights; (iv) EU (16) data refer to the following countries: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Poland, Portugal, Spain, Sweden, and United Kingdom.

Sources: (i) Asian Development Bank, Asian Bonds Online Database. asianbondsonline.adb.org/regional/data.php#bond_market_indicators (accessed November 2013); (ii) World Bank, World Development Indicators Database. http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&SdmxSupported=Y&CNO=2&SET_BRANDING=YES (accessed August 2012); (iii) Bank for International Settlements (BIS) Statistics online. http://www.bis.org/statistics/secstats.htm (accessed November 2013).

Table 4.1 Features of the Commercial Banking Sector

	Deposits	Loans	Outreach	
	no. of accounts per 1,000 adults	no. of accounts per 1,000 adults	no. of bank branches per 100,000 adults	no. of ATMs per 100,000 adults
Cambodia	108.0	28.9	4.0	5.1
Indonesia	504.7	274.8	8.3	13.4
Lao PDR	44.3	4.0	2.6	4.3
Malaysia	1,619.9	284.1	10.5	56.2
Myanmar	na	na	na	na
Philippines	487.8	na	7.7	14.9
Singapore	2,134.3	967.7	10.3	58.6
Thailand	1,119.9	237.0	11.2	77.7
Viet Nam	na	na	3.3	17.6
Japan	7,169.0	171.0	34.0	133.0
High-income Europe	2,022.0	701.0	32.0	94.0
US	2,021.9	na	35.7	173.8
South Asia	317.0	38.0	7.0	4.0
Sub-Saharan Africa	163.0	28.0	3.0	5.0

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic; na = not available; US = United States.
Note: All data are as of 2010, except for the number of loan accounts per 1,000 for Japan and number of ATMs per 100,000 adults for Japan and the US, which are 2009 figures.
Source: Consultative Group to Assist the Poor and The World Bank Group. 2010. *Financial Access 2010*. Washington, DC. International Monetary Fund, Financial Access Survey. http://fas.imf.org/ (accessed November 2013).

Indonesia, Malaysia, the Philippines, Singapore, and Thailand show comparable figures on the number of bank branches per 100,000 adults. They are, however, about a third of the level of advanced economies. Cambodia, the Lao PDR, and Viet Nam are similar to low-income sub-Saharan Africa. Thailand, Singapore, and Malaysia top the number of ATMs per 100,000 adults, while Cambodia and the Lao PDR are about the level of low-income sub-Saharan Africa and South Asia. Still, most ASEAN countries need to broaden access to domestic banking services.

Public access to insurance is more limited. Though widely diverse across ASEAN, the average population covered per life insurance office is above 300,000 and nearly 200,000 for non-life insurance—suggesting the difficulty ASEAN citizens have just to visit an insurance office nearby. Accessibility is most inadequate in low-income countries. Given the low level of institutional development, the insurance "safety net" is a high priority for ASEAN, as public demand for insurance tends to increase together with income. Likewise, insurance companies, acting as institutional investors, are important in developing domestic capital markets and promoting regional integration.

ASEAN financial systems remain largely bank-based, with Singapore and Malaysia as exceptions. Notably, the ratio of stock market capitalization to GDP in 2011 was about 140% for Malaysia and 130% for Singapore, well above the 104% US level and 54% in the EU. Though smaller by comparison, well-developed capital markets also exist in Indonesia, the Philippines, and Thailand. Following the Asian financial crisis, local currency bond markets grew significantly across Indonesia, Malaysia, the Philippines, Singapore, and Thailand as government bond issuance soared — although corporate bond issues remain limited in many of these countries, even if they have been rising recently. In contrast, capital markets remain in their infancy (if they exist at all) in Cambodia, the Lao PDR, Myanmar, and Viet Nam (CLMV countries), with Viet Nam being the most developed among them.

Despite significant deepening in some countries and overall growth, capital markets in the ASEAN region are generally small when compared with mature markets globally. Small market size creates a cost disadvantage where economies of scale are important. For example, ASEAN's largest bond market, Malaysia, is less than 0.4% of the world total — and the value of all ASEAN bond markets combined barely reached 1% of the global total in 2011.

Although ASEAN equity markets are more developed than those of bonds, none of the regional exchanges — with the exception of Singapore — are among the world's 20 largest markets in terms of either trading value or capitalization. ASEAN equity markets offer limited depth and liquidity to global investors, leaving them highly sensitive to global capital flow volatility when foreign investors are attracted to the region. It may be that the size of local currency markets are bound to mimic the size of the economies they support. One possible long-term solution to benefit from economies of scale may be in the direction of consolidation — forging an ASEAN-wide market for all locally issued securities (see section 6.5).

Opportunities to develop the banking system in Myanmar are enormous. Eventually, as CLMV countries move into (lower) middle-income status, capital market development will proceed at a faster speed, as happened with the more developed ASEAN economies. In middle-income ASEAN countries, equity markets, as well as government bond markets, saw a remarkable increase in depth and liquidity over the past decade. Ways to increase market size and efficiency include widening the issuer and investor base, building confidence in market infrastructure, as well as standardizing and harmonizing accounting practices and payment settlement systems.

A key challenge for middle-income ASEAN countries is to deepen capital markets without undue exposure to potentially damaging external shocks. These countries have made great strides since the 1997/98 Asian financial crisis. Their banking systems are now far more resilient than in the past—as indicated by the relatively minor, direct impact from the global financial crisis of 2008/09 (Box 4.1).

Strengthening financial resilience has become indeed one of the key issues discussed at global level to promote regulatory reforms of domestic financial systems. In particular, the Financial Stability Board is promoting several initiatives to facilitate the implementation of Basel II and Basel III accords in ASEAN countries, including regulations addressing the capacity to absorb losses (in terms of both quantity and quality of capital that banks must hold) and to

Box 4.1 ASEAN Financial Systems and Recent Crises

The 1997/98 Asian financial crisis exposed several important structural weaknesses within ASEAN financial systems. First, it showed the limitations of a bank-centric approach to finance. As many large banks were closely aligned with domestic conglomerates and the size of bond and equity markets was generally small, there was little margin to respond to the initial currency crisis, and to the ensuing banking crisis.

Second, ASEAN countries tended to borrow excessively short-term—and in foreign currencies (mostly US dollars)—assuming rollovers and new borrowing for longer-term projects would continue and exchange rates would remain stable in line with the pegged exchange rate regimes. But as funds were largely invested in long-term infrastructure projects in local currencies, the maturity and currency mismatches exacerbated the crisis when liquidity became tight. And the absence of viable debt markets, as alternative sources of finance, became very clear—expanding options through deep and liquid local currency bond markets.

In the crisis aftermath, affected countries grappled with restructuring and consolidating their banking systems. And this required a response to the third weakness—the presence of an inappropriate regulatory environment. In the process of cleaning up balance sheets and introducing better monitoring and surveillance mechanisms, national regulatory regimes were also rationalized.

The adoption of structural reforms, introducing more stringent supervision and increasing corporate governance standards, led to a much more conservative and resilient financial system. As a consequence, ASEAN banks had limited exposure to the subprime assets that led to the 2008/09 global financial crisis. While the region was indirectly affected through the trade channel, the impact of the crisis was relatively contained, as ASEAN economies recovered quickly in 2010.

Nevertheless, ASEAN monetary and financial authorities will face new challenges posed by the global financial and economic crisis—fueled by the evolving eurozone crisis—and various regulatory reforms pursued in the Group of Twenty and Asia-Pacific Economic Cooperation processes. With the trend of further financial liberalization, financial services and business activities are expected to become more sophisticated and complex, posing additional challenges.

Source: Authors based on Kawai (2011).

introduce liquidity buffers. Areas where financial systems need improvement are macroprudential regulations, capital adequacy ratios, liquidity standards, and the extent of transparency on financial derivate products (ADB and ASEAN 2013).

The pronounced differences existing across the region in terms of development of financial markets create several challenges to ensure a consistent implementation of international standards and rules (such as those introduced by Basel III), with possible negative implications in terms of both trade finance as well as long-term finance to promote regional infrastructure development (Wihardja 2013).

4.1.2 Regional Financial Integration and Cooperation

As noted in previous chapters, ASEAN countries have become more economically integrated — within themselves and with other East Asian economies, especially Japan, the People's Republic of China (PRC), Taipei,China, and the Republic of Korea. Economic integration is particularly pronounced in trade and foreign direct investment (FDI), with ASEAN constituting an important part of regional production networks. However, financial integration has advanced much more slowly than real market integration. Although intraregional portfolio investment flows have increased over the years relative to economic size, there remains much potential for growth (ADB 2008b, 2010b).

Achieving ASEAN 2030 aspirations requires greater progress in regional financial integration. Regional integration is critical because size matters in financial markets — ASEAN economies are too small individually to emerge as global players in banking or capital markets. An effective economic community indeed presupposes lowering financial borders and creating well integrated financial markets. As is clear from the European experience, economic integration requires deepening and widening of regional financial markets to support real cross-border activity.

Initiatives to promote ASEAN financial integration have been guided by the Roadmap for Monetary and Financial Integration (RIA-Fin) — endorsed by ASEAN Finance Ministers in 2003 in Manila and later subsumed under the AEC Blueprint. RIA-Fin covers four areas for regional cooperation: (i) capital market development; (ii) financial services liberalization; (iii) capital account liberalization; and (iv) monetary (currency) cooperation. Considerable progress has been made under the first three areas, but not in the area of currency cooperation — not surprisingly given the eurozone crisis.[93]

Financial Services Liberalization

ASEAN banking and insurance integration has been limited as measured by intraregional transactions across locally based financial institutions. For example, no ASEAN-based commercial bank has a branch or subsidiary in each member country (Table 4.2). ASEAN's three most internationally active

93 See section 3.1 for a more detailed discussion on regional monetary cooperation.

banks—Malaysia's Maybank, Thailand's Bangkok Bank, and Singapore's United Overseas Bank (UOB)—have subsidiaries in six of the ten ASEAN countries and a branch in one country. In contrast, the presence of global institutions is far more pervasive. Standard Chartered has subsidiaries in seven countries and representative offices in three. HSBC and Citibank each have subsidiaries in seven ASEAN countries.

The lack of significant banking integration in part reflects the presence of local controls over foreign bank entry and discriminatory restrictions on foreign bank

Table 4.2 Branches and Subsidiaries of Selected Commercial Banks in ASEAN

		Brunei Darussalam	Cambodia	Indonesia	Lao PDR
Global banks	HSBC	•		•	
	Standard Chartered	•	Rep	•	Rep
	Citibank	•		•	
from Japan	SMBC		Rep	•	
	Mizuho Financial Group		•	•	
	Bank of Tokyo-Mitsubishi UFJ			•	
from Indonesia	Mandiri			•	
	BCA			•	
	BNI			•	
from Malaysia	Maybank	•	•	•	
	Public Bank		•		•
	CIMB	•	•	•	
from the Philippines	Metrobank				
	BDO				
	BPI				
from Singapore	DBS			•	
	UOB	•		•	
	OCBC	Off-shore		•	
from Thailand	SCB		•		•
	Bangkok Bank			•	•
	B. Ayudhya				•

ASEAN = Association of Southeast Asian Nations; BCA = Bank Central Asia; BDO = Banco de Oro; BNI = Bank Negara Indonesia; BPI = Bank of the Philippine Islands; CIMB = Commerce International Merchant Bankers; DBS = Development Bank of Singapore; JV = joint venture; OCBC = Overseas Chinese Banking Corporation; Rep = representative office; SCB = Siam Commercial Bank; SMBC = Sumitomo-Mitsui Banking Corporation; UOB = United Overseas Bank.

operations within domestic markets. This often discourages regional activities of ASEAN-based banks in favor of large global institutions. Greater banking integration offers substantial benefits. First, an integrated banking market reduces costs through enhanced competition and gains from economies of scale—a larger customer base improves efficiency. More integrated ASEAN banks could mobilize more savings through their networks and allocate them at lower cost for more productive investment. This in turn would increase total factor productivity and thus accelerate growth. Second, greater integration improves ASEAN banking stability,

	Malaysia	Myanmar	Philippines	Singapore	Thailand	Viet Nam
	•		•	•	•	•
	•	Rep	•	•	•	•
	•		•	•	•	•
	•	Rep	Rep	•	•	•
	•		•	•	•	•
	•		•	•	•	•
				•		
				•		
	•	Rep	•	•	•	•
	•	Rep				•
	•	Rep		•	•	•
			•	Rep		
			•			
			•			
	•	Rep	Rep	•	Rep	Rep
	•	Rep	•	•	•	•
	•	Rep		•	•	•
				•	•	JV
	•	Rep	•	•	•	•
					•	

Note: A check mark implies the presence of the respective commercial bank in the country. Data refer to the end of 2011.
Source: Official websites of respective commercial banks.

as the emergence of globally competitive ASEAN banks enhances resiliency, enabling them to respond more promptly and efficiently to external shocks.

Insurance is more open to foreign ownership than banking, with foreign companies or foreign-controlled companies constituting almost 40% of the combined ASEAN market (Table 4.3) in 2010. This figure is slightly higher for non-life than life insurance companies. In CLMV countries, foreign-owned and foreign-controlled insurance companies dominate the market. There are no domestically-owned insurance companies in the Lao PDR, and in 2010 the share of foreign-owned and foreign-controlled insurance companies reached 57% in Cambodia and 53% in Viet Nam. Singapore has the second highest share of foreign-owned or controlled companies (84%) among ASEAN countries.

The high share of foreign-owned and foreign-controlled insurance companies in ASEAN may give the impression the insurance sector is well integrated. However, this is not the case, as the most active foreign insurance companies are from outside the region. ASEAN insurance companies with operations in neighboring Southeast Asian economies are limited. Thus, just as in banking, further integration of insurance markets is needed.

Several rounds of negotiations have been completed among ASEAN financial authorities in the area of banking and insurance liberalization, which falls under the broader ASEAN Framework Agreement on Services (AFAS) introduced in

Table 4.3 Insurance Companies by Ownership (as of 2010)

	No. of Insurance Companies				Foreign Share of Total (%)
	domestic	foreign controlled	100% foreign-owned	Total	
Brunei Darussalam	12	1	5	**18**	33.3
Cambodia	3	4	0	**7**	57.1
Indonesia	88	38	0	**126**	30.2
Lao PDR	0	10	0	**10**	100.0
Malaysia	26	0	17	**43**	39.5
Philippines	123	13	4	**140**	12.1
Singapore	24	76	50	**150**	84.0
Thailand	88	0	6	**94**	6.4
Viet Nam	20	4	19	**43**	53.5
ASEAN	**384**	**146**	**101**	**631**	**39.1**

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.
Notes: (i) Data for Myanmar are not available; (ii) "Foreign controlled" refers to companies of which more than 50% of capital is owned by foreign capital; (iii) "Foreign share of total" refers to the sum of the share of foreign-controlled and 100% foreign-owned companies of the total.
Source: ASEAN Secretariat. 2010. ASEAN Insurance Database.

1995 (see chapter 1). These negotiations led to a detailed schedule of commitments using a positive list approach, where ASEAN countries declare the modes they intend to follow to liberalize various subsectors. While progress in this area has been notable, especially since the adoption of the AEC Blueprint, its pace remains slow and ASEAN as a region remains a long way from full liberalization and from exploiting the full benefits of financial integration (ADB and ASEAN 2013).

Capital Market Development

Prior to the 1997/98 Asian financial crisis, many countries relied excessively on short-term foreign borrowing to finance growth. In Thailand, Indonesia, and the Republic of Korea, short-term foreign debt grew above foreign reserve levels. So when capital flows reversed, these countries became insolvent and had to accept harsh International Monetary Fund (IMF) programs to obtain emergency liquidity injections. With East Asia a savings surplus region, if more of the surplus can be recycled to finance investment within the region, then dependence on short-term foreign borrowing can be avoided.

Since the crisis, there have been several initiatives for developing mechanisms to "recycle" savings within East Asia and generate private sector finance, as the public sector can normally raise long-term financing on domestic or international markets. The ASEAN+3 Asian Bond Markets Initiative (ABMI), started in 2002, has helped drive this effort. As part of the ABMI roadmap, a Credit Guarantee and Investment Facility (CGIF) was established in May 2010 as a $700 million trust fund — the Asian Development Bank (ADB) contributed $130 million as paid-in capital.[94] The main CGIF function is to provide credit enhancement allowing marginal issuers to issue local currency bonds and larger issuers to issue internationally at lower rates.

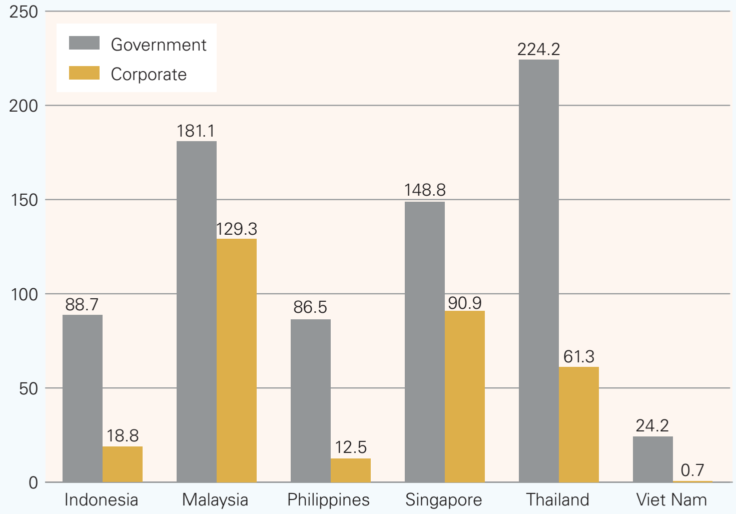
These initiatives are meant to help create an efficient regional government bond market to serve as a long-term private sector financing source.[95] With some exceptions, however, ASEAN corporate bond markets remain shallow and illiquid. As of September 2013, about 70% of outstanding bonds in ASEAN were sovereign (Figure 4.2). Corporate bond markets were particularly underdeveloped in the Philippines and Indonesia — as well as in Viet Nam; the largest corporate market is Malaysia, with close to $130 billion in bonds outstanding, or about 40% the total ASEAN market. Singapore and Thailand follow. But even in these three larger markets, average annual corporate bond growth between 2000 and 2012 only reached 24%, lower than the 30% annual growth in government bonds.[96]

94 The CGIF became operational in early 2012.

95 The importance of developing a regional corporate bond market is discussed in Gochoco-Bautista and Remolona (2011).

96 Growth rates are not shown in Figure 4.2.

Figure 4.2 Outstanding Government and Corporate Bonds in Selected ASEAN Countries
(as of September 2013)



Source: Asian Development Bank, AsianBondsOnline. http://asianbondsonline.adb.org/ (accessed January 2014).

Size is indeed very important in developing corporate bond markets. One major barrier to expand market size is the limited number of qualified issuers and potential buyers.[97] Theoretically, a critical mass (or size) threshold triggers a market's viable depth and liquidity. If ASEAN's—and more broadly Asia's—corporate bond markets are to be alternative sources of finance and intermediate savings within the region instead of relying on external markets, a regional approach to development makes sense.[98]

Capital Account Liberalization

Individual ASEAN countries' capital account policy helps explain the scope and pattern of intraregional financial flows. Based on a *de jure* (derived, in theory, from regulations) index of financial openness (Chinn and Ito 2009), Singapore is the only country with a virtually fully open capital account, followed by

97 McCauley and Remolona (2000) and Ma and Remolona (2005) emphasize the importance of market size in developing deep and liquid financial markets. The lack of reliable yield curves is another problem caused by the relative absence of liquid sovereign markets.

98 The ASEAN Secretariat has developed a "Bond Market Development Scorecard" to identify gaps across ASEAN bond markets and assess progress toward the realization of RIA-Fin in the context of achieving the AEC by the end of 2015 (ADB 2013b).

Cambodia and Indonesia.[99] The *de jure* capital account openness of countries like Thailand, the Lao PDR, Viet Nam, and even Malaysia, not to mention Myanmar, is low — implying the presence of extensive capital controls.

Indeed, according to the IMF Annual Report on Exchange Arrangements and Exchange Restrictions (IMF 2013), most ASEAN countries still apply extensive capital controls. While substantially allowing direct investment and portfolio inflows by nonresident purchases of domestic securities, they continue to control residents' ability to invest abroad. As a consequence, the region's inflow bias has discouraged intra-ASEAN capital inflows while encouraging inflows from external sources — thereby making capital inflow management more difficult (see section 3.1).

In a bank-based financial system, regional financial integration requires banks to conduct business freely. ASEAN's capital account limitations are consistent with the lack of two-way private capital flows and reduce the potential for regional financial integration. ASEAN countries should proceed to further liberalize their capital accounts, but with prudence, as reversals in short-term capital flows may cause serious damage, as shown by the Asian financial crisis of 1997/98 and other past episodes focused on individual ASEAN economies.

4.2 Harnessing Human Capital

A second growth-enabling factor to achieve a "RICH" ASEAN is the capacity to harness human capital — introducing proper policies reflecting population and labor market dynamics — to generate social gains to the economy as well as benefits to the individual. Investing in human capital is central to avoiding the middle-income trap. As discussed in chapter 2, there are many dimensions related to improving quality of life — from ensuring sufficient infrastructure for delivering services such as electricity, sanitation, and safe water, to providing access to quality education and good health. These are all aspects related to human capital development, which directly affect countries' competitiveness and inclusiveness, while providing needed skills to people.[100]

While each country faces diverse challenges, there are common issues across the region. Enormous demographic changes — affecting educational institutions, labor supply, and health providers — are common to all ASEAN economies. Education must evolve with these changes and more broadly provide the investment

99 No index is reported for Brunei Darussalam which, as part of the common monetary area with Singapore, is also believed to be virtually fully open.

100 The ASEAN Socio-Cultural Community (ASCC) Blueprint (see section 6.2) deals with improving human development by providing equal access to opportunities through investment in formal education, training and capacity building activities, innovation and entrepreneurship, and building a strong local civil service.

in human capital needed to build a more innovative, productive society. A high value-added growth pattern, melded with an inclusive and harmonious society promotes more equal employment opportunities for all.[101]

4.2.1 ASEAN's Demographic Change

The most striking aspect of Southeast Asia's demographic change is the dramatic deceleration in population growth. It began in the late 1970s—a feature found across much of Asia—largely as a result of declining fertility rates. Average population growth in Southeast Asia decelerated from about 2.5% annually in the early 1970s to below 2% in the mid-1990s. It was barely 1.2% during 2005–2010 and projections suggest this will continue to drop to a scant 0.7% annual increase during the 5 years leading to 2030 (Figure 4.3).

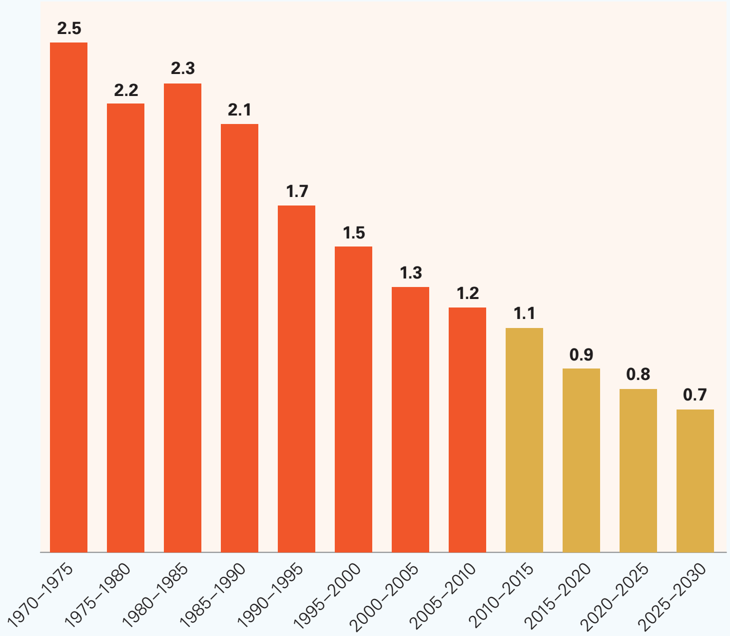
While all ASEAN members show a decline in population growth rates, there are marked differences between countries and underlying—critically important—fertility rates. Experts estimate that Brunei Darussalam, Myanmar, Singapore, Thailand, and Viet Nam have total fertility rates below 2.1%—the level necessary to achieve long-term population stability.[102] Though dropping, the Philippines has the highest fertility rate in the region.

While population growth rates are slowing radically, the constantly rising base means the absolute number of people added each year remains large. Between 2010 and 2030, ASEAN's population is expected to grow 18%—from about 600 million to over 700 million. Southeast Asia's labor supply will continue to rise and with it the challenge of creating new jobs and providing the skills new workers need to ensure more inclusive and sustainable growth. Educational and technical training institutions will have to evolve and expand.

Two important aspects of population dynamics, which reflect the quality of life, are infant and maternal mortality. There are fewer better development indicators than a country's ability to provide safeguards for a woman giving birth and an infant's chance to survive and stay healthy. In general, infant and maternal mortality ratios are falling across the region.[103] Once again, there are huge, stark differences across ASEAN countries (Table 4.4). Brunei Darussalam, Malaysia, and Singapore have relatively low maternal and child mortality rates, but other members have much higher ones. Viet Nam has more than twice Malaysia's maternal mortality rate; the Philippines' rate is almost four times greater; and Indonesia's is seven times as high. Maternal mortality stems from many deficiencies; it tends

101 This section draws on Canlas (2012) and Jones (2012).
102 The total fertility rate estimates the number of children that would be born to each woman throughout her childbearing years. A total fertility rate of 2.1 children per woman is necessary to ensure broad population stability as it allows for replacement of the child's generating couple plus a small factor to allow for infant mortality.
103 Jones (2012) reports that infant deaths per 1,000 live births in Southeast Asia fell from 5.5 in 1985–1990 to 2.7 in 2005–2010.

Figure 4.3 ASEAN Population Growth, 1970–2030
(average annual growth rate in %)



	1975–1980	1985–1990	1995–2000	2005–2010	2015–2020	2025–2030
Brunei Dar.	3.8	2.8	2.4	1.9	1.4	1.1
Cambodia	-1.7	3.7	2.2	1.1	1.1	0.8
Indonesia	2.3	1.8	1.4	1.1	0.8	0.6
Lao PDR	1.2	2.8	2.1	1.5	1.2	0.9
Malaysia	2.3	2.9	2.4	1.7	1.4	1.1
Myanmar	2.1	1.7	1.3	0.7	0.7	0.4
Philippines	2.8	2.6	2.2	1.7	1.6	1.3
Singapore	1.3	2.2	2.4	3.5	0.8	0.6
Thailand	2.3	1.7	1.1	0.7	0.3	0.1
Viet Nam	1.6	2.1	1.2	1.1	0.8	0.4

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Note: Data from 2010 to 2030 are United Nations Population Division projections.
Source: United Nations Population Division, World Population Prospects: The 2010 Revision. http://esa.un.org/wpp/Excel-Data/population.htm (accessed October 2013).

to be higher in isolated or rural communities, where health systems are less capable to deal with problem pregnancies and where transportation systems are inadequate. Child health indicators are similarly affected.

While richer countries typically have lower maternal and child mortality rates, much depends on how development is directed. Viet Nam shows it is not simply income or even public sector resource allocation that determines health quality. Often results are driven by policy priorities. Although Viet Nam's income just reached lower middle-income status in the early 2010s, its achievements in health care shame some of its richer middle-income neighbors. Improvements in health services, supported by better transport infrastructure—especially in rural areas—go a long way toward building more inclusive social development. ASEAN officials have the perspective to help national agencies learn lessons from their regional peers: ASEAN-wide efforts can make a difference.

In contrast to falling birth rates and infant mortality, ASEAN societies are aging. Aging is most apparent in Singapore and Thailand, where in 2010 more than 8% of the population was above 65 years of age. While these two countries stand out compared with the rest of ASEAN, the region will generally see a rapid

Table 4.4 Selected Social Indicators in ASEAN

	Under-5 Mortality Rate[a] (per 1,000 live births)	**Maternal Mortality Ratio**[b] (per 100,000 live births)	**Population Aged 65 Years and Over**[c] (% of total population)
Brunei Darussalam	7	24	3.8
Cambodia	43	250	5.1
Indonesia	32	220	5.1
Lao PDR	42	470	3.7
Malaysia	7	29	5.0
Myanmar	62	200	5.1
Philippines	25	99	3.8
Singapore	3	3	9.3
Thailand	12	48	9.1
Viet Nam	22	59	6.5
ASEAN	**30**	**157**	**5.5**

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.
Notes: [a] Data refer to 2011; [b] Data refer to 2010 and are sourced from the United Nations Statistics Division, Millennium Indicators Database, 2013; [c] Data refer to 2011 projections prepared by the United Nations Population Division.
Source: Asian Development Bank. 2013. *Key Indicators for Asia and the Pacific*. Manila. http://www.adb.org/sites/default/files/pub/2013/ki2013_0.pdf (accessed November 2013).

increase in proportion of the population older than 65 in the coming years. By 2030, an estimated 10.8% of the ASEAN population will be above 65, well above the 6.8% in 2010. Thus, while no ASEAN member is yet at Japan's levels — where nearly one-fourth of the population is already over 65 — Singapore and Thailand will near this mark by 2030.

The aging of society will be reflected in changing "dependency ratios," comparing the share of the "dependent" population — those too young or too old to work — with the working population. High ratios imply that societies would struggle to support large numbers of the young or elderly. The dependency ratio in ASEAN countries has been generally declining. For instance, in the Lao PDR, the dependency ratio fell from 90.3 in 1990 to 60.3 in 2011.[104] When populations age, the support system becomes overburdened, adding pressure on the working age population (Figure 4.4).

Declining fertility ratios and falling dependency ratios have provided ASEAN with a "demographic dividend" — a youthful workforce, unencumbered by large numbers of dependents. In most countries, the demographic dividend will end over the next few decades — by 2030 ASEAN will be characterized by increasing dependency ratios. There will be a need to complement support for the aged through existing informal, family- or community-based arrangements with formal social security systems. ASEAN's formal systems are generally weak. With the exceptions of Brunei Darussalam and Singapore, most countries devote less than 1% of GDP for social security and welfare, relying upon extended families to support themselves.[105]

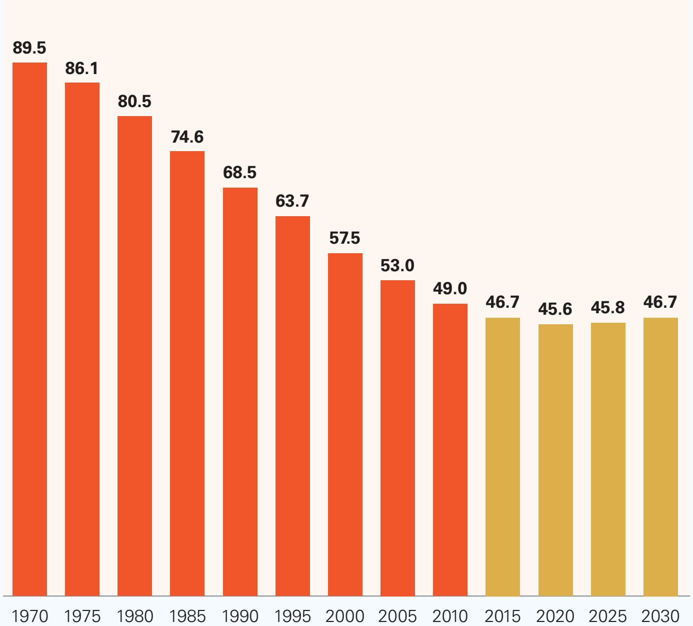
Beyond aging, the demographic picture must account for the evolving workforce itself — the nature of work in a country moving through middle-income status changes with its economic structure. Productivity will rely less on physical labor and more on intellectual skills. ASEAN will need fewer laborers in the field and more at the desk. The age at which a person provides useful, more relevant productive labor is rising just as population is aging. Labor markets must become more flexible involving the elderly, ensuring that their skills are not wasted. The challenge lies in preparing people for these shifts ahead of time. Education systems must evolve and provide lifelong learning that allows people to shift careers due to changing labor demand as well as their own life cycles.

4.2.2 Education and Labor Market Disparities

Arguably, if ASEAN citizens were asked what was most important to prepare for fulfilling the region's aspiration to achieve a "RICH" ASEAN in 2030, many would say "education." Education is the seed for developing human capital, for molding individual potential to contribute to social and economic development.

104 See ADB (2012a, Table 1.7, p. 140).
105 Comparable data are scarce. Nonetheless, see ADB (2012a, Table 7.7, p. 277).

Figure 4.4 Population Dependency Ratios in ASEAN, 1970–2030
(ratio of population aged 0–14 and 65+ per 100 population aged 15–64)



	1980	1990	2000	2010	2020	2030
Brunei Dar.	71.3	61.8	49.8	42.4	40.8	41.8
Cambodia	72.1	87.4	80.5	55.5	48.6	43.9
Indonesia	80.7	67.3	54.7	48.3	43.8	44.2
Lao PDR	90.3	89.7	85.0	62.3	49.1	44.4
Malaysia	74.1	68.6	59.1	54.1	50.1	52.4
Myanmar	79.6	67.7	55.2	44.4	41.1	42.0
Philippines	86.9	79.5	71.5	64.1	57.3	54.9
Singapore	46.6	37.1	40.5	35.9	41.1	60.8
Thailand	75.6	53.2	44.7	41.7	41.8	48.6
Viet Nam	84.0	75.5	60.5	42.1	41.6	43.1
ASEAN	**80.5**	**68.5**	**57.5**	**49.0**	**45.6**	**46.7**

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Note: Data from 2010 to 2030 are United Nations Population Division projections.
Source: United Nations Population Division, World Population Prospects: The 2010 Revision. http://esa.un.org/wpp/Excel-Data/population.htm (accessed October 2013)

An innovative ASEAN can only flow from educated citizens. Partly considered a public good, investment in education, especially at the primary level, has traditionally been the responsibility of government.

ASEAN has made considerable progress, even in the region's less developed countries, in ensuring that all children receive at least primary education. Together, 89% of ASEAN's primary school age children are enrolled.[106] However, many of the poor are still outside the system and several countries show only marginal progress in meeting the Millennium Development Goals (MDGs) related to primary education (ADB 2013d).

Equally important, an innovative economy requires skilled workers, trained for the jobs of the future. Here, many ASEAN education systems have far to go. Although Singapore and Brunei Darussalam have close to universal secondary education, only a minority of other ASEAN children are enrolled in secondary and tertiary institutions. In Cambodia and the Lao PDR, for example, only slightly more than one-third of those eligible for secondary education are enrolled (Table 4.5).

The presence of a gender gap in education is another feature of ASEAN countries. In some cases, such as Cambodia and the Lao PDR, many more

Table 4.5 Educational Attainment in Selected ASEAN Countries
(% share of total population, latest available year)

	Secondary Education Net Enrollment Rate	Tertiary Education Gross Enrollment Rate
Brunei Darussalam	99.0 (2011)	19.6 (2011)
Cambodia	37.6 (2008)	14.5 (2011)
Indonesia	74.4 (2011)	24.9 (2011)
Lao PDR	40.7 (2011)	17.7 (2011)
Malaysia	68.6 (2010)	42.3 (2010)
Myanmar	50.8 (2010)	14.8 (2011)
Philippines	61.6 (2009)	28.2 (2009)
Thailand	74.1 (2011)	47.7 (2011)
Viet Nam	64.9 (2002)*	24.4 (2011)

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic.
Note: * Further updated data for Viet Nam are not available from the World Bank dataset. The Millennium Development Goals' 2010 National Report published by the Government of Viet Nam reports that the "lower" secondary education net enrollment rate was 83.1% in 2009.
Source: World Bank, World Development Indicators Database. http://databank.worldbank.org/data/views/variableSelection/selectvariables.aspx?source=world-development-indicators; Government of Viet Nam. 2010. Millennium Development Goals 2010 National Report. http://www.undp.org/content/dam/vietnam/docs/Publications/24255_Full_version_English2.pdf (accessed November 2013).

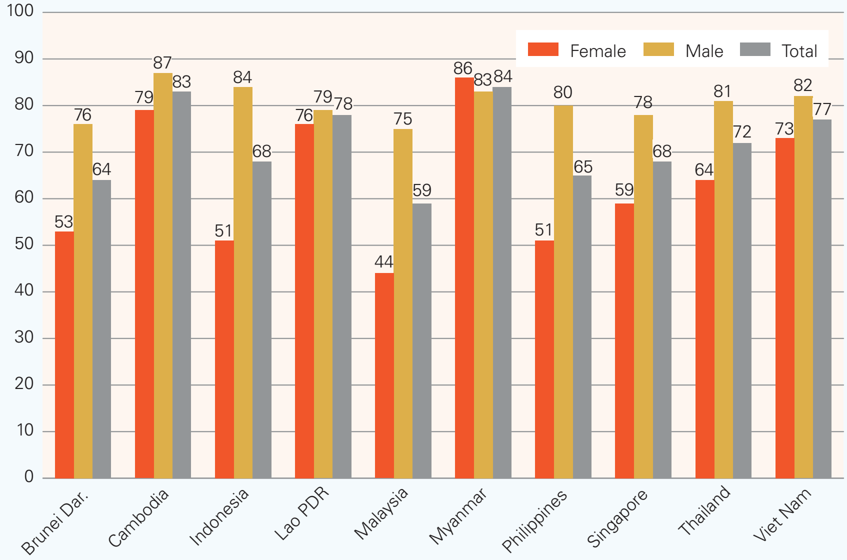
106 See ADB (2012a, Table 2.1, p. 67).

males enroll in secondary education than females. In other countries, however, female student enrollment outpaces that of their male counterparts, like in Brunei Darussalam, Malaysia, the Philippines, and Thailand.[107]

The labor market is another area where male and female conditions are strikingly different across the region. While male labor force participation surpasses that of females in every ASEAN country, in some of them the gender divide is quite extreme. Brunei Darussalam, for instance, is struggling to create a flexible labor force to diversify its economy and build a strong private sector base, but it faces considerable challenges, as only 53% of its women were in the labor force in 2012, against 76% of males. The situation in Malaysia, Indonesia, and the Philippines appears to be worse (Figure 4.5).

Beyond low labor force participation, ASEAN women are often shunted aside into less productive, less remunerative work than men's. In many cases

Figure 4.5 Labor Force Participation Rates, 2012
(population in the labor force as % share of working-age population by gender and total)



ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Note: The labor force participation rate is generally defined as the proportion of the population aged 15 and older that is economically active. Country statistics usually include in the labor force all people up to the age of 65 who supplied labor for the production of goods and services in the referred year (including those who are employed and those who are actively seeking for a job).
Source: World Bank, World Development Indicators Database. http://data.worldbank.org/indicator/SL.TLF.CACT.MA.ZS/countries (accessed November 2013).

107 See World Bank data (http://data.worldbank.org/topic/education).

they are restricted to marginal work with low job security — often categorized as "vulnerable."[108] Female workers are also disproportionally affected by economic crises, especially those that impact agriculture (ADB and ILO 2011). Within the formal sector, the share of female corporate board members — or executive members — in ASEAN countries remains a small fraction of that in the US or Europe (McKinsey 2012).[109] Reforms are urgently needed in ASEAN countries to improve female working conditions (see section 6.6).

4.2.3 The ASEAN Regional Labor Market

ASEAN's cooperation on labor issues has a long history, with the first ASEAN Labour Ministers Meeting (ALMM) held in 1975 and frequent meetings of "senior labor officials." The policy dialogue is currently organized under a 2010–2015 work program whose aim is to improve quality of life, promote productive employment, and ensure social protection. Initiatives are focused on enhancing competitiveness, labor productivity, education and skills training (mainly in rural areas), safety and health standards, youth unemployment, and the protection of migrant workers' rights.

The spectrum of labor-related areas covered under the creation of the ASEAN community is quite large and involves all three pillars. Issues related to human trafficking are part of the political-security pillar, while those pertaining to employment practices and social progress, human resource and skill development, as well as the protection of migrant workers fall under the socio-cultural pillar, where the ALMM also takes place. The AEC Blueprint covers issues more directly related to the development and functioning of the regional labor market, including the introduction of mutual recognition agreements (MRAs) on job qualifications and the issuance of visas and other permits to allow the relocation of foreign workers (Table 4.6).

Labor-related MRAs are often part of packages included in FTAs and/or comprehensive economic partnerships aiming to liberalize and facilitate service trade. Currently, MRAs are already in place for seven job qualifications: accountants, architects, dentists, engineers, medical practitioners, nurses, and surveyors. MRAs have also been signed as part of the AFAS for tourism professionals and for a few providers of business-related services.[110]

As discussed in chapter 1, the AEC introduced the free movement of skilled labor as a one of the core elements to create a single market and production base (see Figure 1.7). While the AEC targets freer capital flows within ASEAN, it limits

108 "Vulnerable employment … is a newly defined measure of persons who are employed under relatively precarious circumstances…." (ADB and ILO 2011, p. 7).
109 McKinsey (2012, p. 1). The report further notes that women are underrepresented at all levels of corporate responsibility.
110 All AFTA and AEC-related MRAs for professional services are expected to be ready by 2015.

Table 4.6 ASEAN Community Pillars and Labor Issues

ASEAN Community Pillar	Labor-Related Issues Included in the ASEAN Community Blueprints
Political-Security	Strengthening criminal justice responses to trafficking in persons
	Protecting victims of trafficking
Economic	Issuing visas and employment passes of business persons and skilled labor
	Working toward the recognition of professional qualifications
	Negotiating and implementing mutual recognition arrangements
	Strengthening human resource development and capacity building by: - developing core competencies and qualifications in priority areas - promoting effective national labor market programs in member states
Socio-Cultural	Facilitating investment in human resource development (with a focus on improving entrepreneurial skills)
	Promoting the application of labor standards and decent work regulations
	Promoting the introduction of comprehensive domestic welfare systems (including protection mechanisms against the negative effects of globalization)
	Protecting and promoting the rights of migrant workers

ASEAN = Association of Southeast Asian Nations.
Source: Authors based on information available from the ASEAN Secretariat website (www.asean.org).

cross-border movement to skilled labor. Although current dialogue is not covering the facilitation of unskilled labor migration, moving beyond the AEC, policymakers would need to discuss more structurally the pros and cons of managing broader intraregional labor mobility. Freer movement of labor will help accelerate economic convergence among member countries also by helping people in the CLMV and other poorer areas of middle-income ASEAN countries to benefit from regional growth in a more equitable and inclusive way (see section 6.6).

An important aspect of ongoing ASEAN initiatives to promote the formation of a regional labor market concerns the creation of "national skills frameworks" in each member country, which is expected to greatly facilitate the mutual recognition of job qualifications and skills across the region, as countries still use still very different regulatory systems as well as standards for labor skills' certification. Authorities are focusing their efforts to ensure that such frameworks are timely and effectively established in all member countries and used to facilitate regional labor migration, as part of the AEC Blueprint.[111]

In 2012, ASEAN economic ministers signed an "Agreement on the Movement of Natural Persons" allowing for the temporary movement of skilled workers across companies within member countries. This agreement, which follows the World Trade Organization's General Agreement on Trade in Services Mode 4, focuses on executives and professionals such as business visitors, contractual services, as well as intra-company transferees. However, permanent residence is still not contemplated under this agreement, de facto limiting the potential for intra-ASEAN skilled labor migration.

To be sure, regardless of regional labor cooperation agreements, millions of unskilled laborers already travel across ASEAN, often undocumented, in search of work. A large number of Indonesians and Filipinos from poor islands work in Malaysia and Brunei Darussalam. People from Cambodia, the Lao PDR, and especially Myanmar cross into Thailand for jobs. As in other parts of the world, they work in factories and fields, in the retail sector, as well as in homes as domestic laborers, taking jobs that better-off citizens usually would not. Many currently work illegally — as undocumented labor migrants — and face exploitation with little legal protection in labor-importing countries (ADB 2013c; Pasadilla 2011).

In 2010, four countries were net labor importers: Singapore, Brunei Darussalam, Malaysia, and Thailand, with the first two showing very high ratios of migrant workers to the total labor force — above 70% (Table 4.7). At the same time, workers in the Lao PDR, Philippines, Viet Nam, and Cambodia show a high propensity to work abroad. Intra-ASEAN labor flows are close to 60% of the total for inflows and 40% for outflows. Ratios are particularly high for Malaysia (around 80% of total migration for both inflows and outflows of labor), while the largest majority of workers from the Philippines (92%), Viet Nam (90%), Cambodia (85%), and the Lao PDR (77%) decide to migrate outside ASEAN. While these official figures do not capture the actual extent of the phenomenon, they are useful in providing a general overview of the differences across countries.[112]

Greater mobility can benefit the economies of both labor-exporting and labor-importing countries. The advantages to labor exporting countries are often clear — people migrate for higher paying jobs elsewhere and contribute

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111 The ASEAN–Australia–New Zealand FTA provides capacity building for ASEAN countries' government officials to introduce national qualification frameworks (NQFs) a means to enhance education and training governance. In particular a multi-sectorial Working Group was established in 2012 to design an ASEAN Qualifications Reference Framework. Although not all member countries have already created their NQFs a flexible approach allows latecomers to adopt the regional standard once they are ready.

112 Some experts and unofficial surveys suggest that, in 2012, there were more than 3 million workers from Myanmar in Thailand, largely employed in construction, farming, and the retail sector. A survey conducted for the Greater Mekong Subregion program shows that, in 2008, more than 2 million labor migrants from Myanmar were employed in Thailand (ADB 2013c).

to their countries' economy through remittances. Through migration, they also usually improve their skills by means of formal education or on-the-job training offered by their employees. But benefits accrue to importing countries as well. Brunei Darussalam provides a clear example. The Brunei Darussalam economy is far too small to maintain the labor needed for either public or private sectors to respond quickly to changing conditions or opportunities. To create a diversified economy that rests on a globally competitive private sector, the country must maintain both skilled and unskilled labor flexibly. Institutionally structured liberalization of regional labor migration — a goal for the AEC — may be politically sensitive, but would benefit the entire region (ADBI and OECD 2013).

An essential part of regional labor markets is the establishment and strengthening of institutions in labor surplus countries to better match skills with those needed in labor deficit countries. The Philippines has made considerable efforts in providing world labor markets with skilled workers (Remo 2011). The Philippine central bank estimates that the millions of overseas Filipino workers

Table 4.7 Labor Migration Statistics in ASEAN, 2010

Country	Population ('000)	Labor Force ('000)	Outward Labor Migration ('000)		Inward Labor Migration ('000)	
			Total World	Intra-ASEAN	Total World	Intra-ASEAN
Net Labor-Importing Countries						
Singapore	5,184	2,632	297	122	1,967	1,163
Brunei Dar.	414	202	24	9	148	121
Malaysia	28,251	12,250	1,481	1,196	2,358	1,883
Thailand	63,878	38,977	811	263	1,157	448
Net Labor-Exporting Countries						
Cambodia	14,953	8,050	350	54	336	321
Myanmar	61,187	27,337	515	321	98	1
Indonesia	237,641	117,578	2,504	1,519	397	158
Viet Nam	88,257	47,936	2,226	222	69	22
Philippines	94,010	39,639	4,276	335	435	9
Lao PDR	6,437	3,179	367	83	19	10
ASEAN	**600,212**	**297,780**	**10,626**	**3,902**	**6,915**	**4,114**

( ) = negative; ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic.
Source: World Bank, Bilateral Estimates of Bilateral Migrant Stocks in 2010. http://data.worldbank.org/indicator/SM.POP.TOTL (accessed November 2013).

account for approximately 10%–15% of Philippine GDP through remittance flows. These workers are deployed with the support of specialized government and private sector institutions, with particular success in meeting world demand for medical, maritime workers, as well as domestic helpers. Better institutional support in labor-exporting countries would allow people to better find work and help reduce the incentives driving illegal labor migration.

Migrant (especially unskilled) workers are too often subject to discrimination and offered unequal conditions compared with domestic workers. Signing the "ASEAN Declaration on the Protection and Promotion of the Right of Migrant Workers" by ASEAN Heads of States in Cebu in 2007 was a major step forward to achieve a better and more equal treatment of migrant workers, avoiding their exploitation and mistreatment and improving occupational safety. The declaration defines general principles for protection of migrant workers as well as member countries' obligations and commitments, including specific mechanisms for cooperation to resolve cases of undocumented migrant workers. Moving forward, ASEAN policymakers should move beyond the AEC provisions to free skilled

Net Labor Migration Stock ('000)	Net Labor Migration Stock/Total Population (%)	Net Labor Migration Stock/Labor Force (%)	Outward Labor Migrants/ Population (%)	Inward Labor Migrants/ Labor Force (%)
1,670	32.2	63.4	5.7	74.7
124	29.9	61.3	5.9	73.3
876	3.1	7.2	5.2	19.2
346	0.5	0.9	1.3	3.0
(15)	(0.1)	(0.2)	2.3	4.2
(417)	(0.7)	(1.5)	0.8	0.4
(2,107)	(0.9)	(1.8)	1.1	0.3
(2,157)	(2.4)	(4.5)	2.5	0.1
(3,840)	(4.1)	(9.7)	4.5	1.1
(348)	(5.4)	(10.9)	5.7	0.6
(3,710)	**(0.6)**	**(1.2)**	**1.8**	**2.3**

labor movement and tackle more broadly the complex issue of managing migration flows of unskilled workers (see section 6.6).

4.3 Building Seamless Connectivity

Building seamless connectivity is a priority to create the AEC, fostering inclusiveness and competition. The improved ability to travel, transit, and trade across the region is important to connect the centers with peripheries of economic growth and to better exploit ASEAN members' strategic location next to their giant neighbors — the PRC and India. Domestic connectivity allows remote areas to unlock their development potential and provide public services — electricity, water, sanitation, and telecommunications — where they are needed. At the same time, regional connectivity has become more promising than before as Myanmar's deep process of political and economic reform has brought the country back to the international scene, opening up unique opportunities to connect East Asia with South Asia. By reducing the cost of physical movement and trade flows, connectivity is also crucial for improving competitiveness of ASEAN-based companies in almost all aspects of economic activity, including participation in production networks and agriculture-related supply chains. Efficient connectivity is as well important to ensure region-wide food security.

Due to the presence of network externalities, benefits tend to be larger when more areas are connected. Transportation infrastructure represents both the skeletal backbone of physical connectivity and the circulatory system for moving goods and people. But connectivity is also needed for providing energy, communication, and information services. Power transmission lines must meet utility demand, bringing energy to homes and industry. So does broadband connectivity, as the information technology revolution has made efficient communication central to economic and social life. Related "software," i.e. systems, markets, institutions, and legal frameworks, is an ever growing part of the equation needed to enhance and better facilitate domestic and regional connectivity, enabling the growth and development needed to achieve a "RICH" ASEAN by 2030.

4.3.1 Need for Infrastructure

Infrastructure investment for construction and maintenance is one of the most important components of a country's economic development. As in so many other areas, there are huge gaps among ASEAN countries in the amount and quality of the available infrastructure needed to support efficient economies (Table 4.8). Singapore, with world-class connections through air and seaports, competes at the highest levels globally in providing services for trade and travel. Thailand and Malaysia follow close behind. The CLMV countries are clearly more disadvantaged. So are many of the poorer islands of Indonesia and the Philippines.

Table 4.8 Infrastructure Index for ASEAN Countries
(ranking and score for the *Global Competitiveness Report 2013–2014*)

	Rank	Score
Singapore	2	6.41
Malaysia	29	5.19
Thailand	47	4.53
Brunei Darussalam	58	4.29
Indonesia	61	4.17
Viet Nam	82	3.69
Lao PDR	84	3.66
Philippines	96	3.40
Cambodia	101	3.26
Myanmar	141	2.01

Lao PDR = Lao People's Democratic Republic.
Note: Rank is based on a sample of 148 economies and score ranges from 1 to 7, with the latter indicating highest efficiency.
Source: World Economic Forum. 2013. *The Global Competitiveness Report 2013–2014*. Geneva. http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf (accessed October 2013).

Closing the region's infrastructure gaps will be expensive. A study by the Asian Development Bank Institute (ADBI) suggests that Asia's overall investment requirement for infrastructure between 2010 and 2020 is approximately $8 trillion—with ASEAN countries covering a considerable share of the total (ADB and ADBI 2009). While about half the total infrastructure needed is for providing electricity, transportation (mostly roads) covers about 30% of the total, telecommunications 13%, with the rest needed for water and sanitation.

In Southeast Asia, available financial resources have been stretched thin to meet the most urgent infrastructure needs. The ASEAN Infrastructure Fund (AIF) will certainly provide some additional support, but given its current—relatively limited—size, it will be important for the region's authorities to prioritize the most urgent connectivity projects to be funded under this facility (see Sections 1.2 and 5.7).[113]

113 The enormous need for infrastructure finance underscores the importance of utilizing all possible funding mechanisms, including public-private partnerships. The AIF, created with an initial capital of $485 million, is expected to directly finance approximately 30% of each approved infrastructure project, with ADB and other co-financing partners covering the remainder. The actual lending target of for the first year (2012) is for $300 million, to be increased by 10% each year up to 2020. This implies actual lending will total up to $4 billion by 2020, leveraging more than $13 billion in infrastructure financing over 2012–2020.

The Master Plan on ASEAN Connectivity (MPAC), adopted in October 2010, stresses the importance and multi-faceted nature of connectivity. Long-term targets were introduced in three areas:

(i) **Physical infrastructure**, including the concrete and steel structures that provide for the movement of goods, services, and people — airports, railways, roadways, and (river and maritime) ports. MPAC calls for the expansion and upgrading of existing infrastructure and logistics facilities, and the creation of new ones. It also emphasizes the importance of creating multimodal transport systems, disseminating information and communication technology, and improving regional energy security.

(ii) **Institutional connectivity**, focusing on soft infrastructure — the policy regime that helps improve "hard" infrastructure systems. If customs, immigration, quarantine, and security procedures are too costly or cumbersome, especially where corruption lurks, trade suffers as vehicles avoid tainted border crossings. The MPAC targets removing institutional barriers to the smooth passage of vehicles, and the goods they carry or the services they help provide. It focuses on non-tariff barriers, harmonization of national regulatory standards, and the abatement of other institutional barriers to trade and investment.[114]

(iii) **People-to-people connectivity**, recognizing the critical importance of regional identity for community building. MPAC supports, in particular, social and cultural exchange, increasingly important as migration grows and regional production networks knit economies closer together.

4.3.2 Economic Corridors

As mentioned, transport infrastructure is the backbone of connectivity. But its benefits are not always distributed equitably. A high-speed road or railway connecting two urban areas may benefit cities, but unless transport systems are designed to support the areas they pass through, the overall impact will be suboptimal. An economic corridor is a concept aimed at developing transit zones surrounding key transport infrastructure connecting regions and subregions.

The Greater Mekong Subregion (GMS) program is one example where transport corridors are being transformed into economic corridors, to ensure that the roads leading from Bangkok through the Lao PDR to southern PRC, for example, provide development impetus to the countryside as well as its end-points. The early success of the GMS in roadway construction was not always accompanied by improved standards of living for residents along these highways, and did not stimulate enough economic activity nearby. In response, GMS developed a new approach combining hardware and software, involving several stakeholders on planning and implementation — including local authorities, businesses, national

114 A World Economic Forum (2013a) study notes that the lack of an appropriate policy environment particularly damages SME development.

planning authorities, and line agencies — to coordinate efforts that maximize the benefits of infrastructure on economic development (Wiemer 2009).

The Brunei Darussalam–Indonesia–Malaysia–The Philippines–East ASEAN Growth Area (BIMP-EAGA) and the Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT) are two other subregional cooperation initiatives committed to developing economic corridors. However, the archipelagic nature of the areas involved makes the challenge of logistics more difficult to overcome. As these initiatives mostly focus on cooperation between islands, the corridor concept must be modified to focus on areas surrounding ports.

4.3.3 Public–Private Partnerships for Infrastructure Development

Public–private partnerships (PPPs) are an important means of funding and implementing infrastructure projects. Successful PPPs operate in many sectors and countries. For example, PPPs allowed the Lao PDR to exploit hydroelectric resources and export power, Indonesia to build toll roads, the Philippines to construct air terminals and renovate urban water systems, and for a host of other countries to set up and operate export-processing zones. However, not all PPP projects have succeeded. Indeed, many PPP proposals fail to leave the drawing boards. Failures are often a result of complications of cross-country negotiations and problems within the policy environment (or soft infrastructure).

In general, infrastructure projects are more expensive than what ASEAN governments — especially the CLMV — can afford. Bringing the private sector in to participate and contribute a portion of required financing eases the fiscal drain and provides technical expertise. But private sector participation comes at a significant cost, particularly when projects are one-of-a-kind, where there is little institutional experience with similar projects. Improving a country's access to international financial markets (particularly bond markets) will lower these costs and help ensure projects yield commensurate benefits.

Typically, large projects involve considerable risk for private sector partners. Governance issues, including corruption, discourage both local and foreign participants. Regulatory and legal institutions must be of sufficient quality to ensure transparency and predictability in decision making — critically important to encourage private firms to accept these risks. Initial agreements must be fair to both sides (private and public); and they must be able to withstand political change, as some ASEAN countries with evolving democratic institutions did not always honor agreements made by previous governments — disrupting projects and driving away potential investors.

4.3.4 Coordination and Connectivity

Melding together rapid, sustained, and inclusive growth depends in part on improving connectivity. ASEAN economies base much of their development strategies on providing sites for the production and trading of parts and components in electronics, garments, and household and consumer goods. This strategy has been very successful in raising incomes and fostering economic growth, supporting employment and technology transfer. Intermediate products are often assembled in the PRC or other Asian countries, including several in ASEAN. These production networks—which also tend to form industrial clusters—are usually organized through processing centers, in which several firms are linked through logistics systems to provide internationally competitive goods and services, linked to international markets (see section 3.3).

The trade structure emerging from production networks differs from the classic pattern of swapping finished goods based on inherent comparative advantage. Intermediate production sharing is not necessarily dependent on natural resources, as it exploits advantages available in local environments, which includes the policy framework, labor supply and wages, agglomeration opportunities, transport costs, and organizational skills. Trade costs (transport, logistics, and border crossing) play a very important role in attracting intermediate production centers (Elek 2013).[115]

Geography is crucial. For example, being land-locked or having few natural resources can severely limit growth potential. Singapore's natural harbor helped make it an early regional entrepôt. Conversely, being land-locked reduced growth and development potential in the Lao PDR. Another important element of smooth connectivity is establishing economically viable transport links in the archipelagos of Indonesia and the Philippines. The lack of development in islands distant from core areas (Java and central Luzon) partly reflects the difficulty in building low-cost, reliable transport infrastructure.[116]

Efficient connectivity requires regionally coordinated investment in infrastructure, such as cross-border roads and railroads, world-class ports and airports, telecommunications, and systems that diversify energy supply and lower its costs. The most needed investments are usually the most expensive, with high demand for human skills and institutional capacity. They require long-term planning, development programs, and policies—and often need to be built in anticipation of future demand and require follow-up support.

4.3.5 Maritime Transport

Sea transport overwhelmingly dominates international trade in goods. The United Nations (UN 2012) reports that maritime transport accounts for over 80% of the world trade volume and 70% of its value. Historically, Southeast Asia has been

115 A World Economic Forum (2013a) report suggests that reducing transport costs can potentially offer up to six times the benefits of simply eliminating tariffs. See http://www.eastasiaforum.org/2013/10/21/apec-paves-the-way-for-greater-regional-connectivity/

116 But geography need not define destiny. Japan is an example of an archipelago not obviously hindered by island geography. The relatively recent development of small-scale roll-on/roll-off (Ro-Ro) ferries in the Philippines better links less-developed islands to world markets—an initiative that needs to be explored and exploited throughout ASEAN (see section 4.3).

central to Asia's overall trade. Specialized large vessels transport bulk cargo worldwide (Green 2009). Oil and natural gas flow from Southeast Asia to world markets. The region is an important global maritime transit zone. The Straits of Malacca alone saw an estimated 60,000 vessels pass through in 2011, with many carrying crude or refined petroleum, flowing from the Middle East to East Asia and the eastern Pacific (US EIA, 2012).

To support increasing trade volumes and improve transportation efficiency, infrastructure related to ASEAN maritime transport must expand using updated strategies that encourage multi-modal investment (see section 6.7). Although Singapore and some Malaysian ports offer highly efficient services by international standards, many other Southeast Asian ports, especially in the poorer, isolated islands in Indonesia and the Philippines, remain highly inefficient (USAID 2008, page 5).

Investment is needed not only to improve infrastructure for high-volume transport — where technological development is more advanced — but also to provide good facilities for small trading vessels. One way to encourage small-scale trade is through roll-on/roll-off (Ro-Ro) ferries, which can load cars, trucks, and buses, eliminating the need to shift cargo between vessels, reducing handling and other costs. Recently, the Philippines developed a nautical highway using Ro-Ro vessels that allows small businesses to trade efficiently and reliably. In some instances, transport costs have fallen as much as 40% (Asia Foundation 2010). Besides the Philippines, Ro-Ro shipping could be used between countries across Southeast Asia and with the PRC, although many issues such as international recognition of vehicle registration and insurance need to be addressed (Figure 4.6). In the near future, Myanmar's ports could be used to enhance Ro-Ro connections with South Asia and the rest of the world.[117]

4.3.6 Roads and Railways

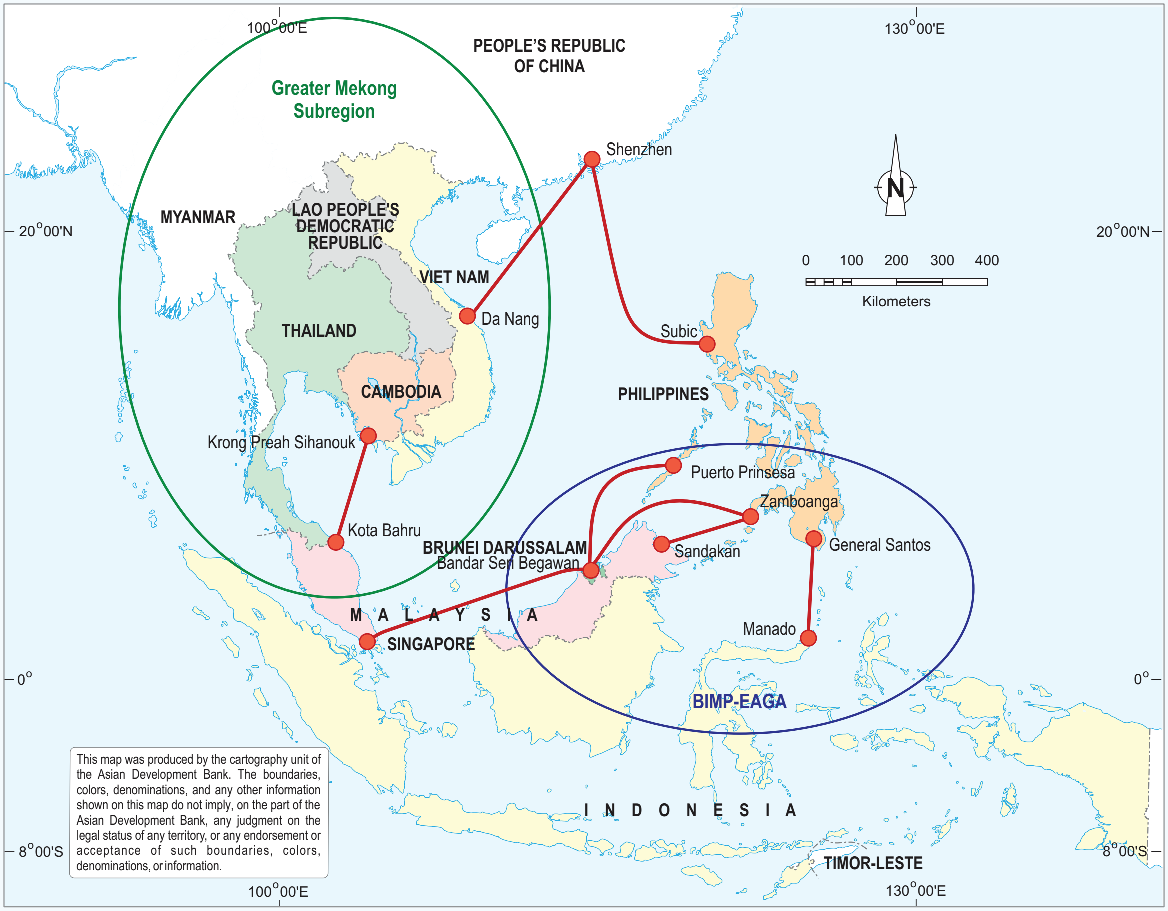
Much ASEAN trade moves over land, including both long-haul transport linking economic centers and short-haul transport connecting homes and factories to markets or transit points. Again, there is huge diversity: Malaysia's roads are well developed, while Cambodia remains far behind.[118] The lack of all-weather roads deters private sector development as firms will not invest where goods cannot be shipped economically. Conversely, once road transport investments are made, they can become catalysts for transforming entire regions — as shown by the GMS program. For example, the Cambodia–Viet Nam border crossing at Moc Bai–Bavet saw trade rise 40% annually between 2003 and 2006 after completion of a major highway connecting the two countries (Green 2009).

117 Supporting Ro-Ro is a clearly stated goal in MPAC. See ASEAN website (www.asean.org) and ASEAN (2011c).
118 In 2004, only 6.4% of Cambodia's road network was paved (Masuda 2012).

Reliable transport not only helps create business and offers opportunities for economic development in remote areas. Bad roads and other transport difficulties in getting women with problem pregnancies to proper facilities are major contributors to maternal mortality. Transport systems are also tied to investments in other sectors; irrigation has more impact when paired with rural roads. The relationship is two-way—rural roads yield larger returns when the surrounding population has the human capital to exploit expanded opportunities.

Traditionally, railways in Southeast Asian were not a priority, either for transporting goods or people. The archipelagic nature of Indonesia and the

Figure 4.6 Potential Roll-on/Roll-off Links in ASEAN



ASEAN = Association of Southeast Asian Nations; BIMP–EAGA = Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area.

Source: Adapted from Asia Foundation (2010).

Philippines naturally discourages widespread rail use. Even on mainland Southeast Asia, the absence of regional markets generated scant interest in large-scale railway development. Creating the AEC has drastically changed this view, as goods trade between Bangkok and Ho Chi Minh City or other cities in the GMS, including to southern PRC is now most economical by rail. Lowering transportation costs is part of the rationale behind the ambitious proposal for a Singapore–Kunming Rail Link (SKRL), which will upgrade and interconnect existing rail lines and fill remaining gaps across mainland Southeast Asia and Peninsular Malaysia. Large railway systems are expensive and the SKRL is no exception—its proposed 5,000-kilometer length is estimated to cost about $15 billion, with new lines needed for 431 kilometers in sections of Cambodia, the Lao PDR, and Viet Nam. It is a challenging project, involving ADB support to the PRC, Malaysia, and Thailand. The project aims to enhance the AEC by helping build a seamlessly connected region with lower transport and logistics costs.[119]

4.3.7 Air Transport

Air travel and transport are important for maintaining competitiveness for ASEAN's core economic zones, for promoting tourism, and also for bridging regional development gaps. Air transport is vital for high-tech industries, allowing "just-in-time" inventory management. It is a key cost factor to growing industries that depend on seasonal delivery and sales, including garments, and for products like high-value foodstuffs (such as live fish, for example) where immediate transit to markets is vital.

Open-sky policies encourage entry of low-cost international air carriers in routes previously dominated by inefficient national carriers. These policies have progressively lowered costs for passengers and cargo. Between 2003 and 2008, the price of airline services dropped by more than half from important airline hubs in ASEAN, just as the price of oil was surging (Table 4.9). This trend is expected to continue as policy barriers to new carriers are falling, and subsidies for old inefficient ones are being eliminated.

The ASEAN Single Aviation Market, which will liberalize air travel between member states by 2015, has already been approved by ASEAN Transport Ministers. However, to date, progress has been slower than planned—implying ASEAN-based carriers will be disadvantaged compared with airlines from the PRC and other Asian countries. ASEAN policymakers need to be more decisive to complete the AEC (see section 6.7).

119 The SKRL is a flagship project of the ASEAN Mekong Basin Development Cooperation—comprising ASEAN members and the PRC. See ASEAN Secretariat, Basic Framework for ASEAN Mekong Basin Development Cooperation (1996).

Table 4.9 Oil Prices and Travel Cost in Selected ASEAN Cities
(indexes of airline travel prices)

	2003	2008
Oil Price Index		
In euro	1.0	2.6
In US dollar	1.0	3.3
Travel Cost Index by City		
Bangkok	2.3	1.0
Kuala Lumpur	2.4	0.9
Manila	1.0	0.4
Singapore	1.9	1.0

ASEAN = Association of Southeast Asian Nations.
Notes: Oil prices are based on Brent crude oil one-month future in euros, with 2003 = 100. The dollar oil price is based on the average annual United States domestic crude oil price, with 2003 = 100. Airline travel prices are in revenue per seat-kilometer, indexed to the Manila data point in 2003.
Sources: (i) Trace et al. (2009); (ii) European Central Bank, Statistical Data Warehouse. http://sdw.ecb.europa.eu/browse.do?node=2120782 (accessed October 2012); (iii) InflationData.com Database. http://inflationdata.com/Inflation/Inflation_Rate/Historical_Oil_Prices_Table.asp (accessed October 2013).

4.4 Strengthening Governance

Good governance is a key enabling factor for achieving a "RICH" ASEAN by 2030. Several studies suggest that the quality of governance—defined in a broad sense—has a huge impact on economic development, with institutions playing a large role in shaping that quality. The lack of effective institutions—and good governance—makes it impossible for developing economies to attract high and sustained levels of private investment, including FDI. Furthermore, within society, bad governance hurts mostly the poor. Good governance not only promotes development, but also leads to more equitable and inclusive growth (Kaufmann and Kraay 2002; Nambiar 2012).[120]

Not surprisingly, ASEAN shows great diversity in governance indicators across its member countries. Accordingly, the strategies and policies followed by ASEAN

120 Kaufmann and Kraay (2002) define governance as encompassing three broad categories: (i) the process of selecting, monitoring, and replacing governments; (ii) the capacity to formulate and implement sound policies and deliver public services; and (iii) the respect of citizens and the state for the institutions that govern economic and social interactions. They also identify six components of governance that can be quantified and monitored through specific indicators: (i) voice and external accountability; (ii) political stability and lack of violence, crime, and terrorism; (iii) government effectiveness; (iv) lack of regulatory burden; (v) the rule of law; and (vi) control of corruption.

as a group are subject to a process of adaptation and contextualization, reflecting specific conditions and needs. Each ASEAN member may find merit in embracing a set of common principles and objectives, while adjusting work plans based on their specific situation. However, the common factor is the importance of ensuring good governance and institutions — a key issue, especially for emerging economies, directly affecting the level and perception of economic and social progress.

The role of government in promoting economic growth has long been debated. On one hand, public policies are needed to foster development and provide the framework for vibrant private enterprise. On the other, excessive market intervention can entrap an economy through too many powerful state-owned enterprises, crony capitalism, or an overly restrictive regulatory environment. While ASEAN countries struggle to identify the right balance between the role of the state and the market in their economies, a set of policies are typically needed to facilitate private sector growth and development, eliminate corruption, and ensure rule of law.

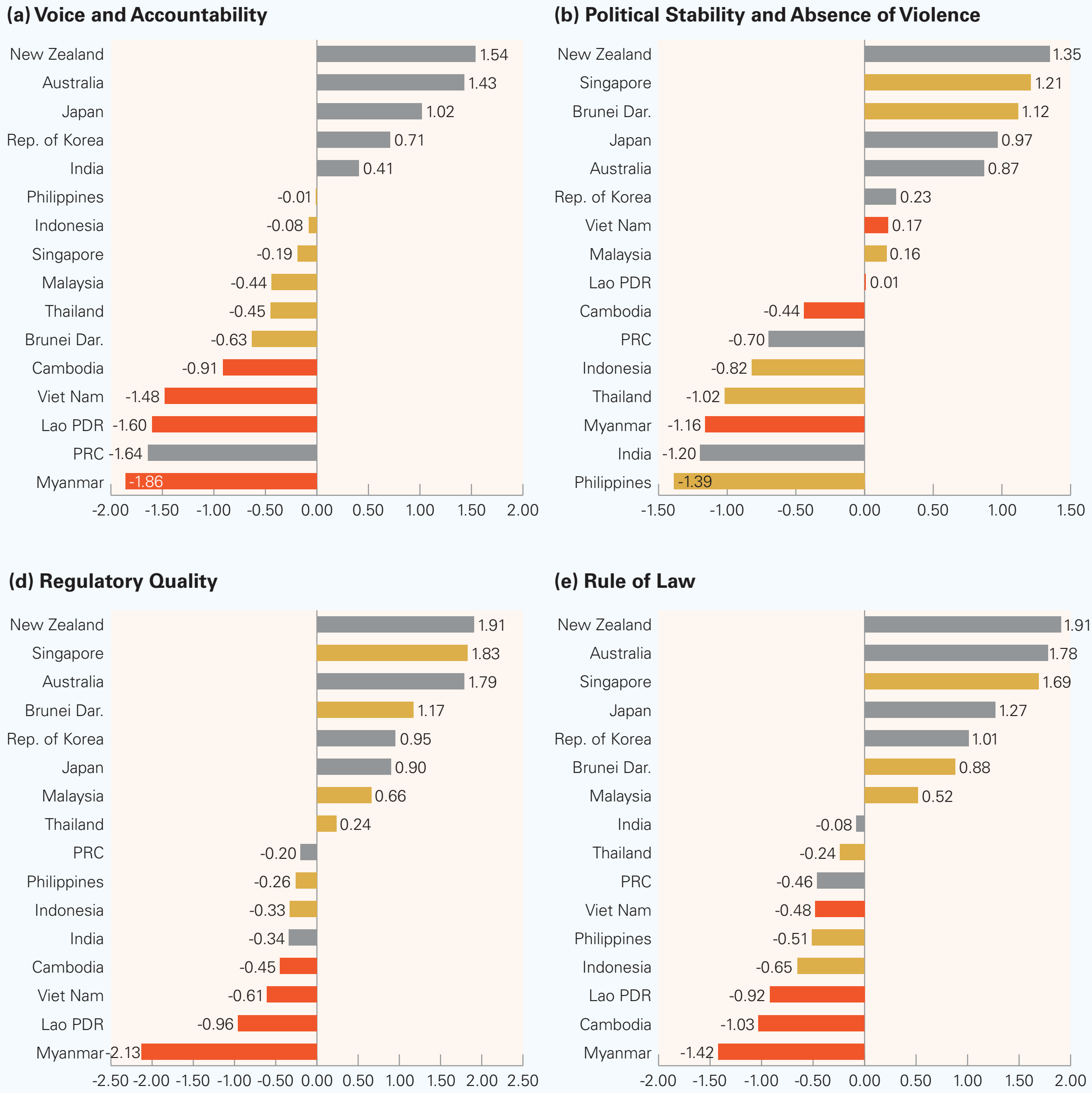
The economic liberalization and harmonization needed to comply with AEC requirements tends to minimize the scope of rent-seeking strategies and the potential for corruption. Yet, the introduction of proactive measures and actions is a necessary step in promoting good governance through building solid, transparent, and credible institutions, both nationally and regionally. Ultimately, administrative and civil service reforms — with strong political backing — are needed to strengthen ASEAN governance standards.

4.4.1 Dimensions of Governance

The ASEAN Charter clearly states that member states should pursue democracy, good governance, and the rule of law (ASEAN 2007). In particular, Article 1.7 is a direct call for reform and strengthening institutional effectiveness. Enhancing existing institutions and building new ones with sound governance principles and structures is a key objective among all ASEAN members. Yet, progress has been uneven across the region (Figure 4.7). Countries with poor governance remain unable to deliver equitable development nationally and worsening gaps will hamper further regional development — and integration.

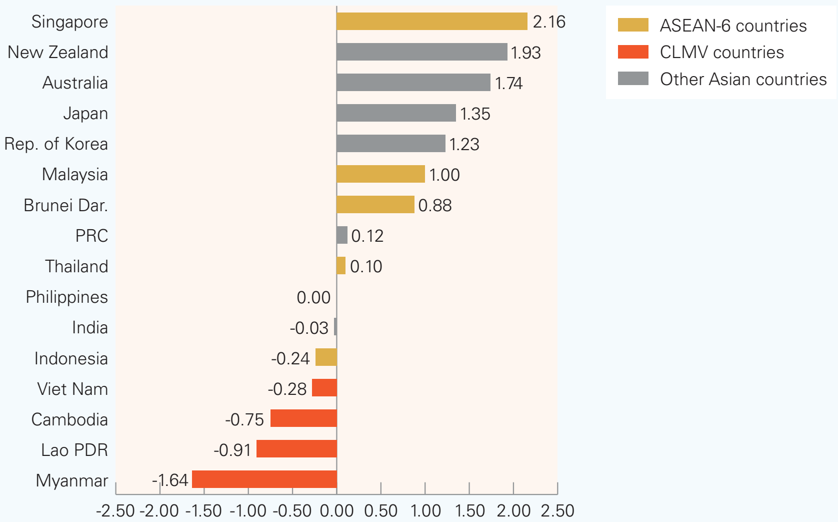
In five of the six dimensions of governance measured by the World Bank, CLMV countries in general perform poorly, ranking at the bottom among East Asian and Pacific countries. Results for political stability and absence of violence are relatively better than in other categories for the CLMV, while the Philippines, Thailand, and Indonesia also rank relatively low. Singapore, and increasingly Brunei Darussalam and Malaysia, tend to perform well in almost all indicators, but for “voice and accountability” these countries also rank below average, similar to the rest of ASEAN. On government effectiveness and regulatory quality, several ASEAN countries score above average, while CLMV countries appear burdened by weak administrative infrastructure due to problems with

Figure 4.7 Dimensions of Governance: ASEAN and Other Asian Countries, 2011
(point estimated values of six governance dimensions used by the World Bank)

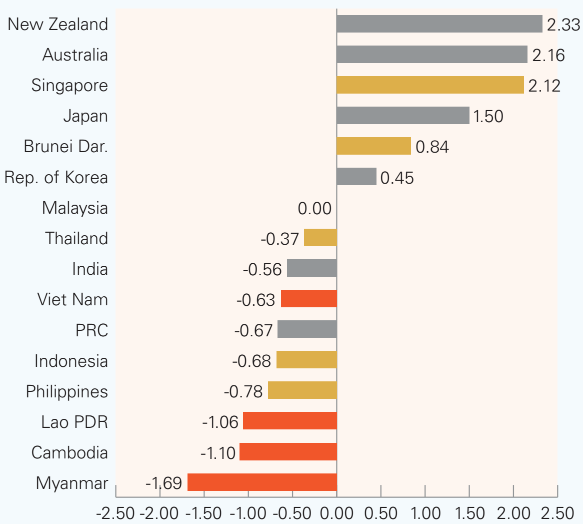


ASEAN = Association of Southeast Asian Nations; ASEAN-6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic; PNG = Papua New Guinea; PRC = People's Republic of China.
Note: Point estimated values are measured in units ranging from approximately -2.5 (weak) to 2.5 (strong) governance performance. Higher point estimate values correspond to better governance outcomes (the World Bank database includes a total of 215 economies).

(c) Government Effectiveness



(f) Control of Corruption



Source: World Bank. 2012. The Worldwide Governance Indicators. http://info.worldbank.org/governance/wgi/index.asp (accessed September 2013).

customs and procedures to start new businesses, for example. Indexes related to the rule of law and corruption rank low not only for CLMV countries, but also for Indonesia, the Philippines, and Thailand, damaging perceptions of potential investors, whether domestic or foreign.

Data from the Economic Freedom of the World Index (Kaufmann and Kraay 2008) also suggest that the legal structure and property rights are weak in several ASEAN countries. Judicial independence, for instance, is questionable for most members. Related problems include integrity and enforcement of contracts. Problems lie in the independence of judicial systems, their impartiality, efficiency, and freedom from vested interests.

4.4.2 Mechanisms and Regulatory Frameworks

As incomes and socio-economic development rise, higher governance standards become central to social cohesion and political stability. Enhanced institutional effectiveness will help ASEAN avoid falling into the middle-income trap (see Box 3.3). The priority is to first improve governance nationally, then regionally. Long-term development cannot be sustained under existing conditions unless there is the political will to reform institutions and achieve good governance. The "ASEAN Competitiveness Report" suggests that, to move successfully from vision to action, institutional mechanisms and capacity have to be strengthened (Wong et al. 2011).

Regulatory burden is often identified as a major obstacle for ASEAN to become a regional investment hub. Several ASEAN countries suffer from excessive red tape — unattractive to investors and foreign companies alike (Dee 2010b).

But these problems do not necessarily mean countries are better off without regulations. While they do not need unnecessary rules and procedures, sound regulatory agencies can play very important roles, both nationally and regionally. And although cross-country differences remain quite pronounced, businesses require better regulatory frameworks covering trade, investment, finance and professional services, labor mobility, transport, energy, education, human resource development, and tourism. Such a wide-ranging list suggests the need for a comprehensive framework to address competition-related issues as an integrated ASEAN community (Nambiar 2010; see section 6.8).

4.4.3 Competition Law and Policy

Competition law and policy is ultimately meant to prevent and reduce the abuse of monopoly power that can lead to market failures against the public interest. The objective of competition policy is to ease market entry and exit conditions by eliminating government-erected barriers and private cartels. Its aim is to create conditions and develop institutions for efficiently allocating resources.[121] It is

121 See Sivalingam (2005), WTO (1997, 2004).

widely recognized that strong competition, coupled with effective enforcement, promotes economic efficiency, lowers production costs and consumer prices, and creates fair and efficient markets.

A well-designed and operational competition policy complements and supports other economic policies — including trade liberalization, industrial development, and investment promotion. Moreover, strong domestic competition prepares exporters to compete in international markets. By reducing barriers to entry, competition policy also promotes the establishment of strong supporting industries and increases SME efficiency.[122]

Provisions for a region-wide approach to competition policy are part of the AEC Blueprint with the key objective of increasing ASEAN international competitiveness. Several anticompetitive practices are considered harmful to trade and investment: (i) price fixing and related practices; (ii) exclusion of enterprises from markets; (iii) segmenting markets and customers; (iv) fixing sales and purchase quotas; (v) discrimination against specific enterprises; (vi) output restrictions and quotas; (vii) agreements preventing the development of patented or unpatented technologies and inventions; and (vii) certain extensions of the use of rights under patents, trademarks, or copyrights.

Competition law comprises the sets of rules governments create and maintain to restrict practices — such as collusive agreements, arrangements between enterprises that substantially lessen competition, or abusing market dominance. Once competition policies and strategies are formulated, competition laws are usually crafted to facilitate the operation of competitive forces in a market economy, introduce standards, and include appropriate sanctions and penalties for noncompliance (Silalahi 2012).

Competition policies and laws have been introduced in Indonesia, Malaysia, Singapore, Thailand, and Viet Nam, while the Philippines is in the midst of drafting acts for fair trade and competition. It remains uncertain, however, whether competition policies and laws will be introduced in Brunei Darussalam, Cambodia, the Lao PDR, and Myanmar. Several developing countries are reluctant to introduce competition policies and enact competition laws because of possible conflicts with their own national economic development strategies. In many cases SMEs are perceived to end up on the losing end, which can lead to worries of potential social unrest and political turmoil related to distributional issues.

Having competition laws in place does not immediately make a country economically free. The Heritage Foundation (2012) has developed an index of "economic freedom" which can be used as a proxy for measuring the presence and effectiveness of competition. Results for 2013 show that Singapore is the freest country in ASEAN: it ranks second out of 183 countries worldwide. While Singapore is the only ASEAN member country listed as "free," Malaysia and

122 For more details and a comprehensive explanation, see UNCTAD (1997).

Thailand follow as "moderately free," while other countries fall in the "mostly un-free" group. Particularly difficult areas include investment freedom, property rights, and corruption (Table 4.10).

While it cannot be simply assumed that the index of "economic freedom" directly reflects the extent to which competition policies and strategies exist in ASEAN countries and have been translated into competition laws, state economic intervention remains quite pervasive in most ASEAN economies. In many cases, competition laws were introduced as a result of external pressure, either from international financial institutions or as an effect of bilateral negotiations on

Table 4.10 Indicators of Economic Freedom, 2013

	SIN	MAL	THA	CAM	INO	PHI	VIE	LAO
World Rank	**2**	**56**	**61**	**95**	**97**	**108**	**140**	**144**
Overall Score	**88.0**	**66.1**	**64.1**	**58.5**	**58.2**	**56.9**	**51.0**	**50.1**
Business freedom	97.1	79.9	73.2	39.4	53.1	50.2	63.8	62.1
Trade freedom	90.0	77.0	75.2	70.2	75.5	75.0	78.6	58.7
Fiscal freedom	91.1	85.1	78.9	90.9	79.3	83.4	75.6	79.7
Government spending	91.3	73.5	83.7	88.4	90.2	89.2	72.4	85.8
Monetary freedom	82.0	79.8	68.3	81.3	76.6	75.5	65.3	73.0
Investment freedom	75.0	45.0	40.0	60.0	50.0	35.0	15.0	30.0
Financial freedom	80.0	50.0	70.0	50.0	50.0	50.0	30.0	20.0
Property rights	90.0	55.0	45.0	30.0	30.0	30.0	15.0	15.0
Freedom from corruption	92.0	43.0	34.0	21.0	26.0	30.0	29.0	22.0
Labor freedom	91.4	72.3	72.9	54.2	51.0	50.8	65.5	54.7

CAM = Cambodia; INO = Indonesia; LAO = Lao People's Democratic Republic; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Notes: Each of the 10 economic freedoms is graded on a scale from 0 to 100 with the latter representing the freest economic environment and are equally weighted and averaged to get an overall economic freedom score for each economy. "Business freedom" refers to the amount of time, number of procedures, and cost of starting, operating, and closing a business. "Trade freedom" is a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. "Fiscal freedom" is a measure of the tax burden imposed by government, which includes the direct tax burden in terms of the top tax rates on individual and corporate incomes and the overall amount of tax revenue as a percentage of gross domestic product (GDP). Government spending considers the level of government expenditures as a percentage of GDP. "Monetary freedom" combines a measure of price stability with an assessment of price controls, where price stability without microeconomic intervention is the ideal state for the free market. "Investment freedom" refers to the constraints on the flow of investment capital such as access to foreign exchange and capital transactions, and openness of industries to foreign investment. "Financial freedom" is a measure of banking efficiency as well as a measure of independence from government control and interference in the financial sector. "Property rights" refer to the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state. "Freedom from corruption" is derived primarily from Transparency International's Corruption Perceptions Index for 2010 that measures the level of corruption in 178 countries. "Labor freedom" refers to various aspects of the legal and regulatory framework of a country's labor market such as the ratio of the minimum wage to value added per worker, hindrance to hiring additional workers, and difficulty of firing redundant employees.

Source: The Heritage Foundation. 2013. Index of Economic Freedom. http://www.heritage.org/index/ (accessed November 2013).

free trade and investment agreements. Designing an ASEAN-wide approach to competition policy and law must begin by assessing existing cross-country similarities and differences, as well as establishing a common mechanism to exchange detailed information and learning from the experience of other countries and regions (Silalahi 2012).

The ASEAN Experts Group on Competition — the official body for cooperation on competition law and policy coordinated by the ASEAN Secretariat — currently comprises a network of national agencies that share experiences on structures and institutional norms among members.[123] While individual countries' active participation is vital to properly reflect priorities and concerns, the secretariat will eventually need to develop a unified ASEAN approach to competition policy and law, and introduce mechanisms to monitor country progress and compliance to the agreed regional norms (see section 6.8).

123 The ASEAN Experts Group on Competition was established at the 39th ASEAN Economic Ministers' Meeting in Manila in August 2007.

Chapter 5

Institutional Architecture

5 Institutional Architecture

A sound and effective institutional architecture is important for ASEAN to remain relevant to its member countries and its external partners. It helps better balance national interests with the need to create a distinctive, outward-oriented, cohesive brand of regionalism — forming a partnership for shared prosperity that benefits not only individual members but also the broader Asia and the rest of the world.

The governing principles of the so-called *ASEAN Way* have served the region well so far. But these principles need reform to improve the group's institutional efficiency, maintain centrality, and lead ASEAN into its next phase of integration — moving beyond the ASEAN Economic Community (AEC) in 2015, toward a truly borderless economic community by 2030. And while strong leadership is needed to introduce institutional reforms, areas for improvement include the group's basic approach to decision making, financial contributions, and the delegation of powers from national to regional agencies. The current system also does not provide for a proper treatment of sanctions, feedback, and compensating mechanisms for those affected by the costs of integration. Structural reforms are important as well to provide the ASEAN Secretariat with the human and financial resources it needs to fulfill its ever expanding mandate, including the capacity to properly manage the AEC. A generalized lack of resources is also limiting the effectiveness of national agencies in charge of ASEAN affairs, as well as other subregional and regional agencies involved with the ASEAN process.

The creation of the ASEAN Community implies not only adopting institutional reform and the innovation needed to build a mature and thriving community, but also close coordination in advancing its three pillars — political-security, economic, and socio-cultural. By following an approach to cooperation that is inclusive and capable of resolving national and regional conflicts, ASEAN can better fit with existing global and regional frameworks. Eventually, the group can promote the creation of new functional bodies through regional decentralization, where individual members decide to host institutions based on their specific interests and availability of human and financial resources, spreading responsibilities among members.

Although ASEAN needs a stronger institutional framework — and new agencies to govern the newly formed markets under the AEC — it should be clear that these bodies are quite different from those of the European Union (EU). First, needed functional institutions cover specific areas — it is not envisaged for ASEAN to establish major organs such as a parliament, a court of justice, or a central bank, as in the case of the EU. Second, new bodies are expected to obtain powers confined to technical matters and to play coordinating roles with national and other regional agencies. If devolution from national to regional agencies is to occur, it will be focused in distinct areas with the delegation of powers to regional bodies based on a feedback system ensuring agreement from each stakeholder. Power and functions are expected to start from a small scale and to expand only once member countries realize the institution's benefits and contributions. Third, as regional agencies are to be established with the active participation of the private sector, civil society, and other stakeholders, their fiscal burden on a country's public debt will be fairly limited.

This chapter discusses ASEAN's institutional architecture. The first section reviews the role ASEAN plays in global forums and the *ASEAN Way*, and discusses the economic dimension of centrality. The second section focuses on ASEAN's governing mechanisms. The final section analyzes the regional institutional framework and issues related to the creation of new functional bodies.

5.1 ASEAN in Asia and the World

ASEAN's growing economic interdependence with the rest of the world creates a set of new opportunities to bolster its global role. However, the ASEAN Chair and Secretary-General's delegated powers are too limited to allow for a group-wide agenda. The *ASEAN Way* has served well so far in maintaining regional security and promoting internal cohesion, given member countries' pronounced differences. Still, ASEAN leaders need to seriously consider the possibility of revising some governing principles as the rise of the People's Republic of China (PRC) and India creates new challenges. If ASEAN wants to maintain its centrality in Asia's architecture for cooperation, then it should be ready to introduce more formal rules — and sanctions — to ensure members fulfill their international commitments.

5.1.1 ASEAN's Role in Global Forums

The international community's response to the 2008/09 global financial crisis reinforced the urgency for ASEAN to strengthen its global role. ASEAN's Chair and Secretary-General are now invited to participate in the Group of Twenty (G20) Summits, which offers an opportunity to raise ASEAN's international agenda and profile. However, the two representatives have yet to be given sufficient authority by member countries to represent the group effectively. The ASEAN Charter states that defining the group's strategies and policies in international relations remains the strict prerogative of member countries—which leaves the group unable to fully benefit from the opportunities created by its growing global profile.

While the ASEAN Chair's statements at G20 Summits are prepared with inputs from all member countries, there is no group-centered agenda being pushed in global forums. ASEAN's Secretary-General merely plays a symbolic role, taking notes of discussions and reporting back to Southeast Asian capitals. Although many countries outside the region acknowledge ASEAN's strategic role as a catalyst in Asia's institutional architecture, its representatives do not yet have the power to promote an ASEAN agenda in the G20 and similar forums.

Under the current allocation of powers, it is difficult for the ASEAN Chair and Secretary-General to play an assertive role in multilateral institutions. De facto, ASEAN can only rely on individual members' initiatives to promote a region-wide agenda (ADB 2010a). For example, Indonesia (ASEAN's sole G20 member) was the group's chair in 2011. Given this dual role, Indonesia actively consulted other ASEAN members before attending G20 meetings to ensure the region's wider voice was properly represented. But as smaller countries assumed the ASEAN Chair position in 2012 and 2013, it was difficult for them to represent ASEAN globally.[124] Indeed, by entrusting the ASEAN Chair and Secretary-General with sufficient authority to articulate an ASEAN agenda in international meetings, smaller members would be better able to raise their voice and concerns in world forums.

5.1.2 The *ASEAN Way*

ASEAN has proven over time quite effective in affirming itself as a family of nations sharing common values, based on consensus, openness, and pragmatism through the adoption of informal, nonbinding rules among its members and external partners. And despite the very limited power delegated to common institutions (section 5.3), this *ASEAN Way* has created a unique model, allowing internal flexibility through a multi-track, multi-speed approach used to implement its members' regional commitments—a variable geometry that underscores the group's large diversity in economic, political, and social development (ADB 2008b).

Several scholars see the *ASEAN Way* as absolutely critical to ensure long-term resilience and sustainability. Principles of non-interference in domestic affairs, respect of national sovereignty, discreteness, and informality have often been cited—together with the use of extensive consultations—as distinctive features

124 To be sure, an ASEAN Position Paper was prepared by ASEAN officials and presented for the first time at the G20 meeting in St. Petersburg, Russian Federation, in September 2013. The paper was delivered by the ASEAN Chair (Brunei Darussalam) to reflect the group's views on the G20 agenda, as well as on global and regional issues.

in conducting a uniquely successful regional approach to multilateralism. The *ASEAN Way* is also seen as bolstering the tenets of peaceful, diplomatic resolution of conflict based on the renunciation of the threat or use of force (Acharya 2012; Caballero-Anthony 2012).[125]

Other scholars, however, without denying the importance of following the *ASEAN Way*, have also stressed the urgency to update some of its principles in order to improve the group's efficiency and effectiveness (Soesastro 2006; Capannelli 2011b). Needed reforms are identified in consensus decision-making, equality in financial contributions, and the absence of sanctions against member countries that do not adhere to commitments (section 5.3).[126]

While the *ASEAN Way* could evolve through efficiency updates to boost its relevance and influence in an increasingly multipolar world, over the years ASEAN has taken center stage in Asian regionalism, especially in its role as "honest broker" in security and economic arenas. It has been able to create an ASEAN-Plus framework of relationships based on pragmatism and flexibility. It has developed an articulated system of dialogue partnerships and alliances with major powers such as the United States (US), the PRC, the EU, and Japan.[127] And it has also played a cohesive role among major Asian economies in providing dynamism—and never being perceived as a threat.

Bilaterally, ASEAN maintains strategic relations with Australia, Canada, the PRC, the EU, India, Japan, the Republic of Korea, New Zealand, the Russian Federation, and the US (ASEAN 2013b). As discussed in chapter 1, bilateral free trade and investment agreements have been signed with Australia and New Zealand, the PRC, India, Japan, and the Republic of Korea; while India, Japan, the Republic of Korea, and the US have also created bilateral programs in support of economic cooperation for ASEAN's Mekong River countries—Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, and Viet Nam.[128]

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125 Many *ASEAN Way* principles are enshrined in the Treaty of Amity and Cooperation in Southeast Asia, signed in 1976.

126 Yahuda (2003) even suggested that the *ASEAN Way*, while designed to encourage regional and national stability, discourages member states from embracing the idea of forming an economic and political union, as it promotes members' independence and sovereignty.

127 In 1972, the European Economic Community (today's EU) become ASEAN's first dialogue partner. During the period when ASEAN's interest in the dialogue process was mainly focused on receiving official development assistance, attracting foreign direct investment, and expanding export markets, its only dialogue partners were Australia, Canada, Japan, New Zealand, and the US, apart from the EU. Today ASEAN holds dialogue partnerships with several developing countries (Kesavapany 2010).

128 These bilateral programs include the Mekong–Ganga Cooperation (with India), the Japan–Mekong Cooperation, the Mekong–Republic of Korea Comprehensive Partnership for Mutual Prosperity, and the Lower Mekong Initiative (with the US). In 1992, the Asian Development Bank launched the Greater Mekong Subregion (GMS) program, including as areas of operations Yunnan Province and the Guangxi Zhuang Autonomous Region of the PRC along with Cambodia, the Lao PDR, Myanmar, Thailand, and Viet Nam.

The ASEAN Regional Forum was established in 1994 at a time when the end of the Cold War, combined with the rapid rise of the PRC and settlement of the Cambodian conflict, provided a completely new environment for establishing a regional architecture for peace and security.[129] In economic cooperation, the ASEAN+3 process—ASEAN plus the PRC, Japan, and the Republic of Korea—came in response to the 1997/98 Asian financial crisis. In 2005, the East Asia Summit (EAS) was established expanding dialogue and cooperation into new areas under an ASEAN+6 framework—with Australia, India, and New Zealand adding to ASEAN+3.[130]

5.1.3 ASEAN Centrality

Despite being criticized for a lack of internal cohesion and binding rules, ASEAN has been able to assume a central position in Asia's institutional architecture for cooperation. It plays a prominent role in Asia and global integration. By bringing large and small powers together, it serves as a catalyst for different interests within the region. Through regular ministerial meetings and its secretariat, it provides a unique platform for channeling efforts at expanding regionalism across Asia and the rest of the world. ASEAN's pivotal role in the region can be easily mapped (Figure 5.1).

A large number of trans-regional, regional, and subregional groups are de facto centered on ASEAN. For example, the Asia–Europe Meeting (ASEM) connects East Asia with Europe, while linkages with the Americas are organized under the Asia-Pacific Economic Cooperation (APEC)[131] and the Forum for East Asia–Latin America Cooperation (FEALAC). APEC focuses on economic initiatives while FEALAC promotes dialogue on international political issues. At the subregional level, several ASEAN countries are linked to some South Asian neighbors through the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), and with Pacific island countries—such as Papua New Guinea and Timor-Leste—through the Coral Triangle Initiative (CTI) (Figure 5.2).

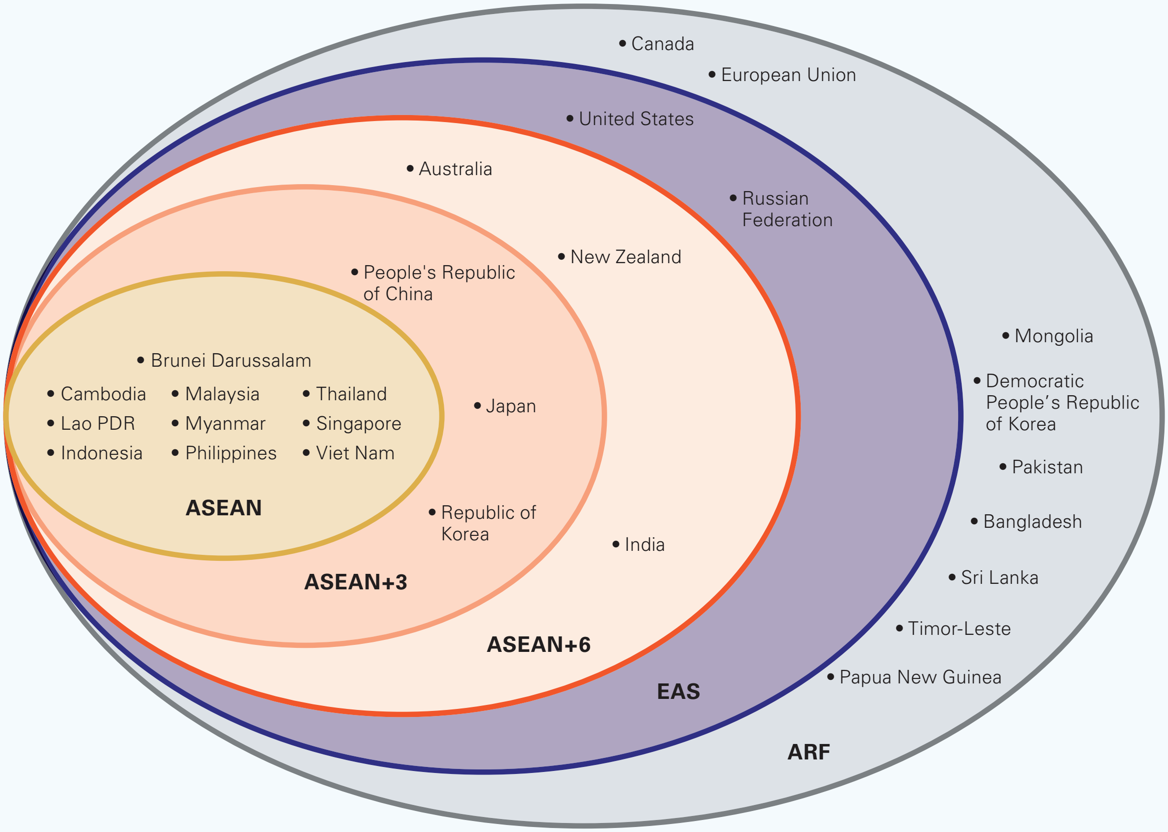
Several programs, such as the Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area (BIMP-EAGA), the Greater Mekong Subregion (GMS), and the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT), further connect ASEAN members and with other Asian countries at the

129 The ASEAN Regional Forum, which gathers foreign ministers and senior officials from defense, military, and foreign affairs, is today an inclusive platform for dialogue and cooperation based on consensus decision-making, minimal institutionalization, and an evolutionary approach moving from confidence building to preventive diplomacy and eventually to conflict resolution mechanisms.

130 More recently, the EAS expanded to include the Russian Federation and the US as well.

131 APEC—launched in 1989—initially focused on ASEAN, with APEC Summits rotating between non-ASEAN and ASEAN chairs. However, Cambodia, the Lao PDR, and Myanmar, which joined ASEAN in the late 1990s, have yet to join APEC.

Figure 5.1 ASEAN Centrality: Major Groups Focused on ASEAN

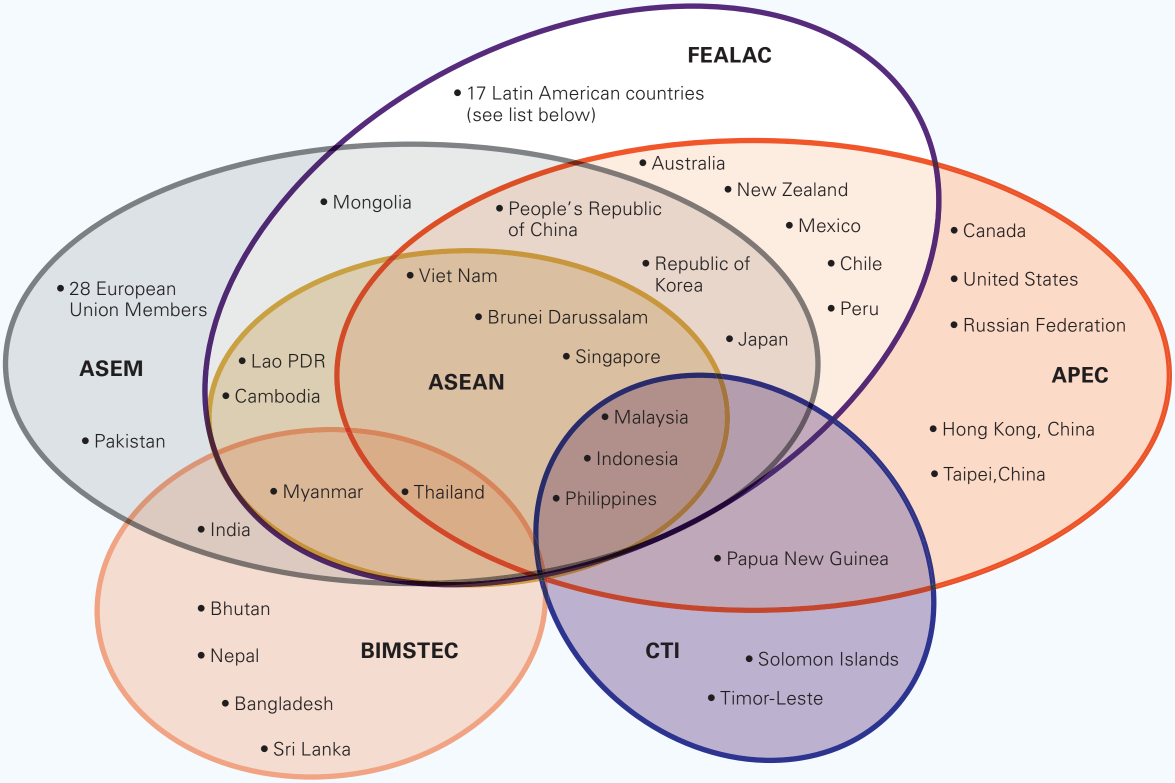


ARF = ASEAN Regional Forum; ASEAN = Association of Southeast Asian Nations; ASEAN+3 = ASEAN plus the People's Republic of China, Japan, and the Republic of Korea; ASEAN+6 = ASEAN+3 plus Australia, India, and New Zealand; EAS = East Asia Summit; Lao PDR = Lao People's Democratic Republic.
Source: Authors.

subregional level. ASEAN has also started formal relationships with various regional groupings and international organizations such as the Economic Cooperation Organization (ECO), the Gulf Cooperation Council (GCC), the Mercado Commún del Sur (MERCOSUR), the South Asian Association for Regional Cooperation (SAARC), and the United Nations (UN).[132]

132 ASEAN has developed joint work plans with ECO, GCC, MERCOSUR, and SAARC, based on agreements signed by respective secretariats and covering areas of common interest. It also signed a Joint Declaration on Comprehensive Partnership with the UN in 2011 (ASEAN 2013b).

Figure 5.2 ASEAN Centrality: Major Transregional Groups Involving ASEAN Countries



APEC = Asia-Pacific Economic Cooperation (21 members); ASEAN = Association of Southeast Asian Nations (10 members); ASEM = Asia–Europe Meeting (44 members); BIMSTEC = Bay of Bengal Initiative for Multi–Sectoral Technical and Economic Cooperation (7 members); CTI = Coral Triangle Initiative (6 members); FEALAC = Forum for East Asia–Latin America Cooperation (36 members); Lao PDR = Lao People's Democratic Republic.
Note: The list of additional 17 Latin American members of FEALAC includes Argentina, Bolivia, Brazil, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Paraguay, Suriname, Uruguay, and Venezuela.
Source: Authors.

It must be noted, however, that the notion of centrality is not any result of a preconceived plan by ASEAN to locate itself at the fulcrum of Asia's institutional architecture. Rather, the increasingly central role played by ASEAN in Asia-wide cooperation has emerged more as an outcome of its pragmatic approach to problem solving and its own evolution, which moved along with the changing international political and economic environment.

ASEAN's centrality can also be seen as the default mechanism for maintaining peace and stability in the region—when other major regional powers such as Japan, the PRC, and India have lacked either the political acceptability or the human and financial resources needed to lead the formation of an Asia-wide agenda, promoting regional cooperation and driving the provision of regional public goods.

Also, several scholars believe that large, rapidly growing powers such as the PRC and India may be unable to emerge as Asia-wide leaders due to the social and political challenges they face internally, which may inherently keep them more focused on promoting a domestic agenda than a regional one. As a consequence, although ASEAN still lacks the material capacity and institutional strength to compel the major powers that shape the regional and global order, it currently remains the only viable alternative to lead Asian regionalism — able to persuade dialogue partners to follow its way (Kesavapany 2010; Caballero-Anthony 2012; Acharya 2013).

But ASEAN cannot merely be considered the residual choice. ASEAN leaders realize that the group needs to strategically locate itself at Asia's core — contributing to the enhancement of regional and global prosperity. To support efforts to fulfill a more strategic and assertive role, regionally and globally, ASEAN recently began a review of its institutional processes to maintain its centrality in Asia's security and economic architecture. And following the 23rd ASEAN Summit of October 2013, it also established a High-Level Task Force to strengthen the ASEAN Secretariat and review its structure and functions (ASEAN 2013a).

The notion of ASEAN centrality has been reinforced by the decision to establish the ASEAN Community — structured on its political-security, economic, and socio-cultural pillars. The ASEAN Trade in Goods Agreement and the ASEAN Comprehensive Investment Agreement for example, were respectively introduced in 2010 and 2012 as part of the AEC with the aim to maintain the group's centrality.

Another fundamental step that strengthened ASEAN centrality was the adoption of the ASEAN Charter in 2007, which provided, among others, for the creation of the Committee of Permanent Representatives (CPR).[133] The ASEAN Charter and CPR have indeed helped elevate ASEAN's ambitions and reinforce its internal cohesion and identity, pushing at the same time for a structural revision of some of the group's basic governance principles.[134]

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133 Article 1 of the ASEAN Charter affirms ASEAN's commitment to maintain its central and proactive role as a driving force in its relationships and cooperation initiatives with external partners (ASEAN 2007).

134 The CPR took over the work of the ASEAN Standing Committee — established in 1967 to coordinate the group. Since the CPR was established — and the appointment of delegation heads (with the rank of ambassador) from each member state — many non-members have also appointed ambassadors to ASEAN. In July 2013, the ASEAN Secretariat reported 74 Jakarta-based ambassadors to ASEAN — including those from the PRC, Japan, and the Republic of Korea — heading dedicated missions to ASEAN.

Economic Dimension

ASEAN centrality can also be seen as a strategy that seeks to coordinate decisions among member countries in order to promote their common interest, both within the group and in their relationships with external powers (Petri and Plummer 2013). Based on this concept, assuming and maintaining ASEAN centrality implies member countries follow a two-track strategy focused on strengthening their internal cohesion and fulfilling external commitments with non-members.[135]

With ASEAN seeking to maintain a lead position in negotiating trade, investment, and economic partnership agreements with external parties, the concept of centrality has practical implications as it implies close coordination between members. There is, however, much ambiguity on how to define coordination among ASEAN members as far as external partnership agreements are concerned—which call for institutional reform and innovation.[136]

As discussed in chapter 1, the adoption of the Master Plan on ASEAN Connectivity (MPAC) has reinforced the idea of centrality in the regional institutional architecture. For example, Indonesia, APEC Chair in 2013, proposed to adopt MPAC as the basic reference concept for creating a connectivity plan for APEC as well as other regional groupings. The decision to establish the Regional Comprehensive Economic Partnership (RCEP) has also contributed to strengthening the idea of ASEAN centrality (Capannelli and Kawai 2014).

Whether ASEAN can continue to maintain its centrality as Asia's integration broadens is an open question. Its flexible approach articulated through the *ASEAN Way* has the virtue of enabling member countries with diverse interests to remain nominally united. At the same time, however, ASEAN's informality and consensus decision-making are also its greatest limitations as it is difficult to strengthen regional cooperation when members can use their veto power to maintain the status quo. Finding a proper balance between these two opposite forces is a major challenge for ASEAN policymakers. It is the threat of losing centrality that provides a strong rationale for pushing institutional reform and innovation to the next stage.

135 The AEC Blueprint explicitly mentions the importance of maintaining centrality in external economic relations, such as during negotiations of free trade and economic partnership agreements.

136 In fact, the ASEAN Charter and other basic institutional arrangements do not specify how to coordinate member countries, or the modality to be followed in negotiating and implementing agreements with external partners (such as free trade or economic partnership agreements). Coordination may simply refer to negotiations conducted in consultation with other member countries or jointly concluded by all members. It may also imply delegating powers to a central authority (such as the ASEAN Secretariat).

5.2 ASEAN Governing Mechanisms

Today ASEAN operates in a substantially different environment than the one it faced when it was established in 1967. The world has shrunk and its economy has globalized. ASEAN has also evolved. From a focus on regional security, the group's agenda has gradually expanded to cover many new issues, especially economic. The importance of the economic community is expected to continue growing in relative terms compared with the political-security and socio-cultural communities.

ASEAN's institutional set-up has served the region well so far. Its limitations have, however, become evident as it was designed for a group focused on regional security and handling a limited scope of activities. As ASEAN's mandate and operations have largely expanded over the years, its institutional framework and governing mechanisms need efficiency updates. They have become inadequate in keeping pace with internal and external developments.

ASEAN's current structure and basic principles have created several inefficiencies that must be addressed. This section lays out the key policy issues related to the need for reforming the group's principles related to decision-making, financial contributions, power delegation, the use of feedback systems, sanctions, compensatory mechanisms for those harmed by integration, and the ASEAN Secretariat's need for resources. Policy options on ways to reform these basic governing mechanisms are outlined in section 6.9.

5.2.1 Decision-Making System

Consensus has been ASEAN's basic principle for decision making. Although a multi-track, multi-speed approach was often used in implementing agreements, decisions are typically made only when agreement is unanimously reached by all member countries. The principle of consensus decision-making is enshrined in the ASEAN Charter (Article 20), which also cites the importance of consultations to inform decisions, deferring to the Leaders' Summit to resolve cases when consensus cannot be reached.[137]

Consensus has worked well to date, especially in dealing with political and security matters. For economic and social issues, however, it often creates unnecessary rigidities. A qualified majority system can in fact be seen as a better substitute to consensus for non-fundamental, operational decisions as it eliminates inefficiencies when resolutions need to be timely made. This is especially true when matters are of

137 It must be noted however that, while decisions are based on consensus, flexibility is often applied via a multi-track, multi-speed approach—or the application of the so-called "ASEAN minus X" formula—which allows countries not yet ready to fully embrace economic liberalization, or similar initiatives, to temporarily exclude critical sectors, or proceed at a slower pace in implementing their commitments.

a non-fundamental nature.[138] A qualified majority also avoids the possibility of small minorities holding the entire group hostage when dealing with relatively minor issues. As ASEAN activities become more articulated and economic in nature, consensus alone can be too restrictive in making decisions. Agreeing on day-to-day matters by consensus is cumbersome and a source of avoidable delays.

A system using a qualified majority for day-to-day operational decisions, while maintaining consensus for decisions on fundamental issues, was introduced by the Chiang Mai Initiative Multilateralization (CMIM), with percentage shares of financial contributions used as the basic criterion to decide voting powers for members. For example, while ASEAN countries account for only 20% of total CMIM contributions, they are granted 28.4% of voting power (see section 3.1, table B3.1). The CMIM also uses a two-track decision-making system, where consensus is required on fundamental issues — size of the pooled fund, membership, individual member contributions, and lending terms — while a qualified two-thirds majority is enough to decide on operational issues — such as lending details, renewals, and defaults, among others.[139]

5.2.2 Financial Contributions

Closely connected to decision making are financial contributions made by member countries to the ASEAN Secretariat's budget. Alongside the principle of consensus, the secretariat's budget is currently equally funded by ASEAN member countries, regardless of their capacity or willingness to contribute. However, given the limited financial resources available from the group's smallest economies (Cambodia, the Lao PDR, and Myanmar), applying this principle imposes a structurally low budgetary ceiling on the entire group. But the greatly enhanced integration plans and increased scope of secretariat operations introduced by the ASEAN Charter and the blueprints forming the ASEAN Community require a corresponding expansion in the secretariat's budget.

It is clear that the way contributions are currently collected does not allow meeting ASEAN's increased financing needs. Anchoring funding on equal shares not only hampers budget growth: it also makes the group intrinsically dependent on external funding from international donors. In practice, while funds are typically available, donor and ASEAN priorities do not always match. Thus, ASEAN is unable to independently accomplish its plans and realize its strategies

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138 For example, decisions on "fundamental" issues are those related to membership and funding, while less strategic issues such as those related to implementing approved programs, or renewing existing schemes, can be classified as "operational."

139 Table B3.1 (chapter 3) provides detailed information on financial contributions and voting powers of the CMIM. It is interesting that the Credit Guarantee and Investment Facility and the ASEAN Infrastructure Fund (AIF) adopt similar systems. In particular, the AIF uses a two-tier voting system for its Board of Directors, where at least two thirds of shares and number of shareholders are required to decide on fundamental issues, while a simple majority is sufficient for operational, or "regular" issues.

as decisions are distorted by accommodating requests from the many external stakeholders contributing to the association's budget. If ASEAN is to become a mature and thriving institution, member countries should realize that the principle used in funding the budget is obsolete.

In several cases, regional institutions trying to boost their effectiveness in delivering their mandates adopt the principles of "capacity" or "willingness" to contribute—or a combination of the two. Regional institutions tend to perform efficiently under schemes using diversified budget contributions. In the CMIM, for example, the largest ASEAN-5 economies committed contributions corresponding to a total of $45.5 billion, equal to about 95% of the group's total financial commitment ($48 billion). The remaining 5% has been pledged by the other five economies using diverse financial contributions—a major, yet workable departure from the equal contribution principle.[140]

Even if financing shares vary greatly across countries (based on their capacity or willingness to pay), differences can be smoothed out by imposing a more equal distribution of voting powers. Besides, it is important to note that in a decision-making system where fundamental issues require consensus, national sovereignty remains strategically protected—even while using qualified majority used for decisions on operational issues.

5.2.3 Delegation of Powers

The creation of ASEAN has never been part of any "grand plan" for regionalism in Southeast Asia. And in the absence of a political objective to "unite" the region, ASEAN members never contemplated to substitute a large part of their national sovereignty with shared regional sovereignty—two major differences with the EU approach (ADB 2010a). Indeed, until a few years before ASEAN was founded, many member countries remained under colonial rule, struggling to unite various ethnic groups populating their territories. War in Indochina had just ended when the CLMV countries became part of ASEAN. Under these circumstances, it is not surprising that in Southeast Asia, the political priority still remains to cement national identities over creating common regional structures and institutions.

ASEAN's early years were a formative period marked by only a few meetings and the identification of areas for future cooperation.[141] Its initial focus was on maintaining regional peace and security, translating mainly into intergovernmental dialogues through ministerial meetings. No common institutional bodies were created. In the early 1970s, some form of organized collective action began to

140 Viet Nam $2 billion, Cambodia $240 million, Myanmar $120 million, and Brunei Darussalam and the Lao PDR $60 million each.

141 One significant achievement was the signing of the "Zone of Peace, Freedom, and Neutrality (ZOPFAN)" in 1971, where the then five ASEAN member countries stated their neutrality from interference by outside powers.

take shape in economic areas — for example, the first meetings of economic and labor ministers were held in 1975. But no regional agency was yet established.

ASEAN cooperation began to make its first substantial steps in 1976, when the ASEAN Secretariat was created and the first ASEAN Summit among heads of government was held (see Chapter 1).[142] However, the powers delegated to the secretariat were — and remain — limited to providing support in organizing summits, formulating and implementing integration plans, and harmonizing ASEAN activities.

Moreover, members never felt the need to create a sizable, strong regional technocracy — an ASEAN civil service. During its first 15 years, the ASEAN Secretariat operated with a very small number of dedicated staff, the majority of which were seconded from members' foreign affairs ministries. While several ministerial meetings were started between the end of the 1970s and the 1980s, initiatives for regional cooperation remained limited, requiring marginal secretariat coordination — with funding almost entirely provided by dialogue partners.[143]

The need for a better organized regional civil service and for stronger institutions arose as soon as the ASEAN economic agenda gained importance. It is not by chance that the ASEAN Secretariat underwent a major restructuring and expansion in 1992, at the time the ASEAN Free Trade Area (AFTA) was introduced. A second fundamental change came in 2007 with the adoption of the ASEAN Charter, the establishment of the CPR, and the introduction of the blueprints for the creation of the three communities that together comprise the ASEAN Community (section 5.1).

By the end of 2013 ASEAN maintained several key institutional bodies, including various ministerial meetings under the overall ASEAN Community framework (Table 5.1).

The ASEAN Secretariat is the only common institution with a bureaucracy of approximately 70 openly recruited professionals, 110 technical staff recruited from member countries, and 120 local support staff (or about 300 in all as of 2010). Other ASEAN institutions are run by domestic personnel from line agencies with specific functions and responsibilities limited to their home countries. However, the strategic decision taken by ASEAN leaders to create the ASEAN Community — and the profound changes implied by the introduction of the ASEAN Charter — have yet to be followed by an expansion in the association's civil service and corresponding enlargement of powers delegated to common institutions.

142 The proposal for the creation of a stable secretariat was first presented by the Philippines at the Second Ministerial Meeting in 1968, but its approval, including the decision to locate it in Jakarta, was only obtained at the Sixth Ministerial Meeting in 1973. When the ASEAN Secretariat was created in 1976, it was initially situated inside the Indonesian Ministry of Foreign Affairs. It was only in 1981 that the ASEAN Secretariat was moved to its current building — donated by the Government of Indonesia.

143 From 1977–1991, only two ASEAN Summits were held, one in 1977 and one in 1987.

Table 5.1 Institutional Bodies and Ministerial Meetings Forming the ASEAN Community

<table>
<tr><th colspan="3">ASEAN Summit–established in 1976</th></tr>
<tr><td colspan="3">Comprises the heads of state or government; supreme policy-making body</td></tr>
<tr><th colspan="3">ASEAN Secretariat–established in 1976</th></tr>
<tr><td colspan="3">Comprises one Secretary-General, four Deputy Secretaries-General
Basic Functions: Ensure the effective implementation of projects and activities; coordinate ASEAN bodies efficiently; support the organization of ASEAN Summits</td></tr>
<tr><th>ASEAN Secretary-General
established in 1981</th><th>ASEAN Chair</th><th>Committee of Permanent Representatives (CPR)
established in 2009</th></tr>
<tr><td>Main Functions: Facilitate and monitor progress to implement ASEAN agreements and decisions; participate in internal and external meetings; serve as ASEAN CEO</td><td>Main Functions: Host Summits and promotes ASEAN overall agenda; represent ASEAN with external partners; coordinate activities in case of crises</td><td>Main Functions: Support the work of the ASEAN Community Councils and Sectoral Ministerial Bodies; liaise with the ASEAN Secretariat and the Secretary-General for activities' implementation; facilitate cooperation with external partners</td></tr>
<tr><th colspan="3">ASEAN National Secretariats</th></tr>
<tr><td colspan="3">Located in each member country's Ministry of Foreign Affairs (national focal point)
Main Functions: Coordinate the implementation of ASEAN decisions at the national level; support the national preparation of ASEAN meetings; promote ASEAN identity</td></tr>
</table>

While ASEAN members are not keen to substantially transfer sovereignty from national to regional agencies, the creation of the ASEAN Community—especially the AEC—requires a certain degree of centralized decisions, operations, and human and financial resources to govern the newly created markets. Eventually, ASEAN members must agree on the adoption of common rules and regulations, the provision of a proper feedback system, the introduction of sanctions, and the use of compensating mechanisms for those who are negatively affected by regional integration (see section 6.9).

5.2.4 Feedback, Sanctions, and Compensating Mechanisms

Monitoring and feedback of member countries' adherence to cooperation initiatives (such as trade and investment agreements) or commitments to temper potential damage caused by economic interdependence (such as transboundary pollution and human trafficking) is essential for ensuring the effectiveness and credibility of ASEAN as an institution. The group, however, still lacks a proper feedback mechanism, a way to track compliance of members' agreements, and applying sanctions when commitments are not honored.

To be sure, the Eminent Persons Group (EPG) that helped draft the ASEAN Charter recommended the creation of a system to settle disputes and introduce

ASEAN Community–to be launched in 2015					
ASEAN Coordinating Council (ACC)–established in 2008 (comprises ASEAN Foreign Ministers) **ASEAN Connectivity Coordinating Committee (ACCC)**–established in 2011					
ASEAN Political-Security Community (APSC)		**ASEAN Economic Community (AEC)**		**ASEAN Socio-Cultural Community (ASCC)**	
Name	**Year**	**Name**	**Year**	**Name**	**Year**
ASEAN Political-Security Community Council	1999	ASEAN Economic Community Council	2009	ASEAN Socio-Cultural Community Council	2003
ASEAN Law Ministers Meeting (ALawMM)	1986	ASEAN Economic Ministers (AEM)	1975	ASEAN Labour Ministers Meeting (ALMM)	1975
ASEAN Regional Forum (ARF)	1994	ASEAN Ministerial Meeting on Agriculture and Forestry (AMAF)	1979	ASEAN Ministerial Meeting for Social Welfare and Development (AMMSWD)	1979
ASEAN Ministerial Meeting on Transnational Crime (AMMTC)	1997	ASEAN Ministers on Energy Meeting (AMEM)	1980	ASEAN Health Ministers Meeting (AHMM)	1980
ASEAN Foreign Ministerial Meeting (AMM)	1999	ASEAN Ministerial Meeting on Science and Technology (AMMST)	1980	ASEAN Conference on Civil Service Matters (ACCSM)	1980
Commission on the Southeast Asia Nuclear Weapon-Free Zone	1999	ASEAN Free Trade Area (AFTA) Council	1992	ASEAN Ministerial Meeting on the Environment (AMME)	1981
ASEAN Defence Ministers' Meeting (ADMM)	2006	ASEAN Transport Ministers Meeting (ATM)	1996	ASEAN Ministers Responsible for Information (AMRI)	1989
		Meeting of the ASEAN Tourism Ministers (M-ATM)	1996	ASEAN Ministerial Meeting on Youth (AMMY)	1992
		ASEAN Mekong Basin Development Cooperation (AMBDC)	1996	ASEAN Ministers Meeting on Rural and Poverty Eradication (AMRDPE)	1997
		ASEAN Finance Ministers Meeting (AFMM)	1997	ASEAN Ministers Responsible for Culture and Arts (AMCA)	2003
		ASEAN Investment Area (AIA) Council	1998	Conference of the Parties to the ASEAN Agreement on Transboundary Pollution	2003
		ASEAN Telecommunications and IT Ministers Meeting (TELMIN)	2001	ASEAN Ministerial Meeting on Disaster Management (AMMDM)	2004
		ASEAN Ministerial Meeting on Minerals (AMMin)	2005	ASEAN Education Ministers Meeting (ASED)	2006
				ASEAN Commission on the Protection and Promotion of the Rights of Women and Children (ACWC)	2010
				ASEAN Ministerial Meeting on Sports (AMMS)	2011

ASEAN = Association of Southeast Asian Nations.
Source: Authors' elaboration based on the ASEAN Charter and ASEAN (2013b).

sanctions against those who violate agreements and commitments made by member countries. The EPG Report suggested the possibility to "take measures to redress cases of serious breach of ASEAN's objectives, major principles, and commitments to important agreements." The report also advised that sanctions against member countries that do not comply with their commitments should also "include suspension of any of the rights and privileges of membership" (ASEAN 2006).

The ASEAN Charter, however, does not incorporate all EPG recommendations, failing to empower institutions—including the ASEAN Secretariat and the ASEAN Summit—with the possibility to apply sanctions against members that do not comply with their commitments. Therefore, much room remains for introducing reforms and institutional innovation that create a culture of compliance to commitments—to ensure the effective implementation of decisions, honor timelines, and apply the rule of law. Without sanctions, there are no real incentives apart from peer pressure for member countries to respect commitments. In addition, it will be extremely difficult for ASEAN to govern the new markets the AEC creates.

The ASEAN Secretariat monitors the AEC through a scorecard system (see chapter 1). While the disclosure of scorecards among member countries is meant to exert peer pressure when performance falls short of commitments, the fact that the system relies on members' voluntary declarations instead of independent external assessments reduces its reliability, as a natural implicit conflict of interest arises. Besides, the absence of sanctions for noncompliance also contributes to delays in implementing the AEC Blueprint.

5.2.5 The Secretariat and Its Resources

The lack of capacity by the ASEAN Secretariat to properly monitor the realization of the AEC reflects a more generalized deficiency in the extent of human and financial resources made available by member countries to the secretariat. Limited resources also affect national agencies in charge of ASEAN affairs—along with other regional and subregional institutions involved with the ASEAN process.

While the secretariat's mandate and activities have expanded over the years, the fact that its human and financial resources have remained almost static for the last 20 years is delaying the implementation of its activities and plans. According to a recent ADB survey, Asian opinion leaders believe the structural lack of resources available to the ASEAN Secretariat is one of the major factors behind a generalized skepticism regarding the delays in realizing the AEC by the end of 2015 (Capannelli 2011b).[144]

144 Other key concerns relate to the need of updating some governing principles—particularly decision-making systems and budget contributions—and the ability to close intraregional development gaps, especially those separating ASEAN-6 countries from Cambodia, the Lao PDR, Myanmar, and Viet Nam.

The total ASEAN Secretariat budget in 2012 was just $16 million — tiny for such a prominent institution. In the same year, the European Commission (EC) budget was approximately $4.5 billion — 280 times larger than that of the ASEAN Secretariat.[145] Also in 2012, the total personnel working for the EC was approximately 34,000, including 23,800 directly hired and 9,200 external consultants and service providers. As mentioned earlier, the ASEAN Secretariat employed about 300 people, of which only about 70 were professional staff.[146]

Comparing the ASEAN Secretariat with the EC may not be appropriate, given the different scope and mandates of the two institutions. Besides, several experts have recently criticized the EC exactly for it size and bloated bureaucracy. Nonetheless, if one considers that ASEAN's 620 million population is more than 20% larger than the EU's 500 million, it is easy to conclude that even a 50-fold increase in financial and human resources devoted to the ASEAN Secretariat from existing levels (rising, for example, from an annual budget of $16 million to $800 million) will remain a small fraction compared with resources available to the EC.

The ASEAN Secretariat has always been lightly funded with relatively few human resources. To be sure, over the years, more powers and resources were added — also an effect of successive reports prepared by "eminent persons" groups arguing that regional cooperation should be strengthened. Indeed, the secretariat can mobilize considerably more resources today than 20 years ago, especially when contributions from donors are added. Still, the available pool of highly-qualified professional staff and the agency's operational budget remain chronically short of ASEAN's actual needs (see section 6.9).

5.2.6 ASEAN Civil Service

The quality of human resources available at the ASEAN Secretariat varies according to the attractiveness of various jobs. While professional staff and all other positions are openly recruited from the market, individuals have a variety of expertise and formation backgrounds. Several individuals converge to the secretariat from serving as civil servants in one of the member countries. Others come from the private sector or academia.

While no regional institution has been established so far to build specific capacity of ASEAN technocrats, giving the history and extent of maturity reached by the association, member countries may be ready to consider the possibility of establishing a dedicated academy aimed at graduating civil servants with specific knowledge and skills on ASEAN-related issues (see section 6.9).

145 The 2012 $4.5 billion budget for the administration of the European Commission was only about 3% of the EU's total budget of more than $150 billion.
146 However, these numbers would increase significantly if all consultants made available by bilateral donors were added.

5.3 The Institutional Framework

Creating an ASEAN Community in 2015 implies close coordination in advancing its three pillars—political-security, economic, socio-cultural—and in adopting institutional reforms and the innovation needed for ASEAN to build a mature and thriving community. By following an approach to cooperation that is inclusive and capable of resolving national and regional conflicts (and disputes), ASEAN can easily fit within global frameworks where there is much room to strengthen and rationalize ASEAN-centered bodies, whether business entities, civil society organizations, regional centers, or other agencies. The creation of new functional institutions can follow a regionally decentralized approach, where individual members decide to host institutions based on specific interests and availability of human and financial resources.

5.3.1 Building a Mature and Thriving ASEAN Community

In 2017, ASEAN will celebrate its 50th anniversary. When it was established, few analysts thought it could survive infancy. But from the start, to the surprise of skeptics, the group was able to adapt to changing geopolitical and economic conditions. Since its inception, ASEAN has indeed served as a stabilizing force for peace and security, as well as for economic development and cooperation, not only in Southeast Asia but also in the wider Asian region. Earlier attempts at cooperation—such as the Association of Southeast Asia in 1961 or the "Greater Malayan Confederation" of Malaya-Philippines-Indonesia (MAPHILINDO) in 1963—had little influence or actually exacerbated conflict.

Throughout its history, ASEAN confronted major political and economic shocks—whether the Malaysia–Philippines dispute over Sabah in 1969, the aftermath of the US withdrawal from Viet Nam in 1975, the Vietnamese invasion of Cambodia in 1979, geopolitical rebalancing following the end of the Cold War, the fallout from the 1997/98 Asian financial crisis, or the 2008/09 global financial crisis. Nevertheless, ASEAN survived and grew in relevance as a key, central institution in Asia's architecture for cooperation.

Resilience to political and economic crises is a prerequisite for ASEAN to survive and maintain its centrality. However, building a mature regional community and realizing a "RICH" ASEAN by 2030 requires a paradigm shift in the region's institutional architecture for cooperation. As ASEAN consolidates its achievements and strives toward more ambitious targets, it needs to reform and innovate its institutional framework in a way that will allow it to thrive—not just "survive" (see section 6.9).

5.3.2 Supporting the Socio-Cultural and Political-Security Communities

The ASEAN Community is based on political-security, economic, and socio-cultural pillars (see chapter 1). Although this study focuses on perspectives for long-term economic growth, efforts to complete the AEC must be seen as an integral part of creating the broader ASEAN Community. Therefore, it is important to briefly review the political-security and socio-cultural pillars as well.

The fundamental aim of the ASEAN Political-Security Community (APSC) is to ensure that the rule of law applies and that peace and security is maintained within the region and with the rest of the world. APSC's objective is to promote justice and ensure that members embrace an overall approach to peace, rejecting force or violence in settling conflict and disputes. The APSC Blueprint focuses on realizing a rules-based community by sharing norms and regulations, fostering political development, and strengthening cooperation.

Cohesion, peace, and resilience, together with the shared responsibility for comprehensive security, will come through measures that prevent conflict and promote confidence-building mechanisms, such as respect for territorial integrity and state sovereignty. Other components of the APSC Blueprint include post-conflict assistance, cooperation initiatives covering non-traditional security issues such as transnational crime, counter-terrorism, and disaster management and emergency response.

The APSC Blueprint (Table 5.2) also aims to strengthen ASEAN centrality in regional cooperation and community-building, and enhancing diplomatic relations with non-members. The key ministries involved in the APSC cover defense and foreign affairs.

The creation of the ASEAN Socio-Cultural Community (ASCC) is designed to enhance social responsibility and build solidarity among member states by creating a "people-oriented" community. It also intends to promote a sustainable and inclusive development model with a focus on forging a common ASEAN identity. The ASCC covers a wide range of issues: human development, social welfare and protection, social justice and rights, environmental sustainability, regional identity, and ways to narrow development gaps.

Given the pillar's broad scope, many bodies have been created under the ministries of labor, education, justice, natural resources, information, environment, science, and culture to address the main ASCC issues and the key policy actions required in its blueprint (Table 5.3).

5.3.3 Functional Institutions

Using three pillars to structure the ASEAN Community consolidates and rationalizes the large variety of programs, initiatives, and bodies under a single overarching institutional umbrella (ADB 2010a). ASEAN gradually evolved from a focus on security and politics to an association covering a broad range

Table 5.2 ASEAN Political-Security Community (APSC) Blueprint

Features	Issues	Policy Actions
A Rules-Based Community of Shared Values and Norms	Cooperation in Political Development	Promoting understanding of member states' political systems, culture, and history
		Laying the groundwork to facilitate the free flow of information among member states
		Establishing mutual support and assistance in strengthening the rule of law, judiciary systems, and legal infrastructure
		Promoting good governance
		Promoting and protecting human rights
		Increasing the participation of relevant entities associated with moving forward ASEAN political development initiatives
		Preventing and combating corruption
		Promoting principles of democracy
		Promoting peace and stability in the region
	Shaping and Sharing of Norms	Adjusting the institutional framework to comply with the ASEAN Charter
		Strengthening cooperation under the Treaty of Amity and Cooperation in Southeast Asia
		Ensuring full implementation of the Declaration of the Conduct of Parties in the South China Sea
		Ensuring full implementation of the Southeast Asian Nuclear Weapon-Free Zone Treaty and its Plan of Action
		Promoting ASEAN maritime cooperation
A Cohesive, Peaceful and Resilient Region with Shared Responsibility for Comprehensive Security	Conflict Prevention and Confidence-Building Measures	Strengthening confidence-building measures
		Promoting greater transparency and understanding of defense policies and security perceptions
		Building up the necessary institutional framework to strengthen the ASEAN Regional Forum process
		Strengthening efforts to maintaining respect for territorial integrity, sovereignty, and unity of member states
		Promoting the development of norms that enhance ASEAN security and defense cooperation
	Conflict Resolution and Pacific Settlement of Disputes	Building upon existing modes of pacific settlement of disputes and strengthening them with additional mechanisms
		Strengthening research activities on peace, conflict management, and conflict resolution
		Promoting regional cooperation to maintain peace and stability
	Post-Conflict Peace Building	Strengthening humanitarian assistance
		Implementing human resource development and capacity building programs in post-conflict areas
		Increasing cooperation in reconciliation and further strengthen peace-oriented values
	Non-Traditional Security Issues	Combating transnational crimes and other transboundary challenges
		Ensuring the full implementation of the ASEAN Convention on Counter-Terrorism
		Strengthening disaster management and emergency response
A Dynamic and Outward-Looking Region in an Increasingly Integrated and Interdependent World		Strengthening ASEAN centrality in regional cooperation and community building
		Promoting enhanced ties with external parties
		Strengthening cooperation on multilateral issues of common concern

ASEAN = Association of Southeast Asian Nations.

Source: Adapted from ASEAN Secretariat. 2009. ASEAN Political-Security Community Blueprint. http://www.asean.org/archive/5187-18.pdf.

Table 5.3 ASEAN Socio-Cultural Community (ASCC) Blueprint

Issues	Policy Actions
Human Development	Advancing and prioritizing education
	Investing in human resource development
	Promoting decent work
	Promoting information and communication technology
	Facilitating access to applied science and technology
	Strengthening entrepreneurship skills for women, youth, the elderly, and persons with disabilities
	Building civil service capability
Social Welfare and Protection	Alleviating poverty
	Introducing social safety net and protecting from the negative impacts of integration and globalization
	Enhancing food security and safety
	Ensuring access to healthcare and promoting healthy lifestyles
	Improving capability to control communicable diseases
	Ensuring a drug-free ASEAN
	Building disaster-resilient nations and safer communities
Social Justice and Rights	Promoting and protecting the rights and welfare of women, youth, the elderly, and persons with disabilities
	Protecting and promoting the rights of migrant workers
	Promoting corporate social responsibility
Environmental Sustainability	Addressing global environmental issues
	Managing and preventing transboundary environmental pollution (haze pollution and movement of hazardous wastes)
	Promoting sustainable development through environmental education and public participation
	Promoting environmentally sound technology
	Promoting high quality living standards in urban areas
	Harmonizing environmental policies and databases
	Promoting the sustainable use of coastal and marine environment
	Promoting sustainable management of natural resources and biodiversity
	Promoting the sustainability of freshwater resources
	Responding to climate change and addressing its impacts
	Promoting sustainable forest management
ASEAN Identity	Promoting ASEAN awareness and a sense of community
	Preserving and promoting ASEAN cultural heritage
	Promoting cultural creativity and industry
	Engaging with the local communities
	Narrowing the ASEAN development gap

ASEAN = Association of Southeast Asian Nations.
Source: Adapted from ASEAN Secretariat. 2009. ASEAN Socio-Cultural Community Blueprint. http://www.asean.org/archive/5187-19.pdf.

of areas — including economic growth, social and human development, environmental sustainability, natural resource management, and cultural affairs (see Chapter 1). The institutional framework used by ASEAN to deliver its mandate is based on intergovernmental dialogue among members and external partners. It also includes several functional institutions — independently established or coordinated by the ASEAN Secretariat — to implement various programs and initiatives.

AFTA is one of the most successful functional initiatives so far introduced in Southeast Asia and the developing world. Launched in 1992 to increase members' competitiveness, AFTA has done well in promoting trade liberalization, institutionalizing dialogue among members (despite the marked diversity in readiness to open up their systems), and ensuring adherence to reciprocal commitments. When introduced, AFTA was also seen, especially by its most advanced members, as an effective way to lock in domestic reforms through a regional agreement and accompanying detailed plan of action.[147]

The ASEAN Infrastructure Fund (AIF) — created in 2012 — is another functional institution that plays an important role in the region's development. Given the massive need for infrastructure financing throughout Southeast Asia, the AIF can support ASEAN's growth by improving connectivity across member countries and with the rest of the world.[148] And while the AIF remains small relative to demand (see chapters 1 and 4), it holds enormous potential to leverage itself through public–private partnerships funding highways, railways, bridges, and other transport projects. ASEAN central banks have recently taken a proactive approach to financing regional infrastructure projects under the AIF. Whether these efforts work has yet to be seen. But authorities from a variety of public institutions are showing increased interest in infrastructure financing through innovative schemes involving the private sector.

RCEP — currently under negotiation among ASEAN+6 members (see chapter 1) — is another potentially crucial functional institution, which could consolidate efforts for liberalizing trade and investment Asia-wide. RCEP could eventually expand its current membership to include other Asian as well as non-Asian economies (such as the US or the EU). If successfully

147 AFTA's implementation timetable was first accelerated by the 1997/98 financial crisis, and later as a means of boosting ASEAN competitiveness in response to the economic rise of the PRC and India.

148 In this context, Myanmar can play a fundamental role in linking ASEAN with the PRC, and India, Bangladesh, and other South Asian countries. The rationale for strengthening physical, institutional, and people-to-people connectivity is provided in the Master Plan for ASEAN Connectivity (see section 4.3). ASEAN's regional infrastructure needs for 2010–2020 are estimated to be around $60 billion a year (ADB and ADBI 2009). This does not include national infrastructure projects, which are particularly needed in Indonesia, Myanmar, and the Philippines, among others.

concluded, RCEP will provide tremendous support to ASEAN centrality in promoting Asia-wide regionalism.[149]

In addition to AFTA, AIF, and RCEP, a large number of centers, organizations, and other institutional bodies have been created over the years to support ASEAN operations. The first cluster of institutions focused on political-security issues and emerged immediately after ASEAN's creation in 1967. For example, the ASEAN Inter-Parliamentary Organization[150] first met in 1975, while the ASEAN Secretariat was established in 1976 to help coordinate the group's activities and institutions. In 1981, ASEAN police chiefs met, leading to the formation of ASEANAPOL.

Moreover, several ASEAN-related professional bodies and business organizations were created in the late 1970s and 1980s. Examples include the ASEAN Bankers' Association (1976), the ASEAN Confederation of Employers (1979), the ASEAN Chamber of Commerce and Industry (1980), and the ASEAN Ports Association (1981)—just to mention a few. Moreover, during the 1980s and early 1990s, several centers were established for capacity building and to support priority development activities—the ASEAN Centre for the Development of Agricultural Cooperatives (1985) is one example.

With ASEAN well-established, the number of institutional bodies expanded in the 1990s and 2000s. For example, the Centre for Energy and the Centre for Biodiversity, both governed by boards made up of ASEAN Senior Officials and the Secretary-General, were created in 1999 and 2005, respectively. Similar bodies were also established covering the environment (the Earthquake Information Centre, the Coordinating Centre for Transboundary Haze Pollution Control, and the Meteorological Centre) as well as natural resources and financial services (the Council on Petroleum and the Insurance Training and Research Institute).

In education, the ASEAN University Network was created in 1990 (although the Southeast Asian Ministers of Education Organization predates ASEAN—established in 1965). In 1988, several ASEAN think tanks close to ministries of foreign affairs formed the ASEAN-ISIS group. According to the ASEAN Secretariat, as of January 2014, ASEAN-related institutional bodies included 8 centers, 20 business entities, 58 civil society organizations, and 13 other organizations (Table 5.4).

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149 As explained in chapter 1, RCEP emerged in response to the start of negotiations for the Trans-Pacific Partnership (TPP). In particular, the fact that only four ASEAN members (Brunei Darussalam, Malaysia, Singapore, and Viet Nam) were involved in TPP negotiations was seen by ASEAN as undermining its unity—and its centrality in the regional architecture for economic cooperation.

150 The ASEAN Inter-Parliamentary Organization was later renamed the ASEAN Inter-Parliamentary Assembly.

Table 5.4 List of ASEAN-Related Centers, Business Organizations, and Other Bodies

Technical Centers
ASEAN Centre for the Development of Agricultural Cooperatives
ASEAN Specialised Meteorological Centre
ASEAN Centre for Energy
ASEAN Earthquake Information Centre
ASEAN Insurance Training and Research Institute
ASEAN Council on Petroleum
ASEAN Centre for Biodiversity
ASEAN Coordinating Centre for Transboundary Haze Pollution Control

Other Bodies
ASEAN Foundation
ASEAN Inter-Parliamentary Assembly
ASEAN Supreme Audit Institutions
ASEAN University Network Secretariat
ASEANAPOL (Chiefs of Police)
ASEAN–China Center
ASEAN–Japan Centre
ASEAN–Korea Centre
Federation of Institutes of Food Science and Technology in ASEAN
South East Asian Central Banks (SEACEN)
Southeast Asian Fisheries Development Centre
Southeast Asian Ministries of Education Organization
Working Group for an ASEAN Human Rights Mechanism

Business Organizations
ASEAN Airlines Meeting
ASEAN Alliance of Health Supplement Association
ASEAN Automotive Federation
ASEAN Bankers Association
ASEAN Business Advisory Council
ASEAN Business Forum
ASEAN Chamber of Commerce and Industry
ASEAN Chemical Industries Council
ASEAN Federation of Textiles Industries
ASEAN Furniture Industries Council
ASEAN Insurance Council
ASEAN Intellectual Property Association
ASEAN International Airports Association
ASEAN Iron and Steel Industry Federation
ASEAN Pharmaceutical Club
ASEAN Tourism Association
ASEAN–EC Management Centre
Federation of ASEAN Economic Associations
Federation of ASEAN Shippers' Council
US–ASEAN Business Council

Note: As of September 2013, a total of 58 civil society organizations (CSOs) focused on ASEAN were established. These CSOs cover a wide range of areas, from finance, medical professions, sports, etc. The list is available from the ASEAN Secretariat website at http://www.asean.org/images/archive/6070.pdf.
Source: Adapted from information available from the ASEAN Secretariat website at http://www.asean.org/asean/entities-associated-with-asean/entities-associated-with-asean.

5.3.4 Regional Decentralization

While the existing number of ASEAN-related agencies is impressive, the potential to further develop an articulated network of functional institutions covering a broad set of issues remains large. First, many entities mentioned above are quite small, with activities limited to organizing a few meetings or conferences each year—particularly civil society organizations and professional business bodies.

With sufficient human and financial resources, these institutions could substantially expand and play an important role in promoting the ASEAN Community. Second, several areas where functional institutions could help are not yet properly covered—such as disaster risk management, environmental mitigation and adaptation, natural resource management, health and the spread of infectious disease, tourism, tertiary and vocational education, as well as human and drug trafficking.

As discussed earlier, ASEAN+3 cooperation continues to expand through economic and financial institutions such as the Economic Review and Policy Dialogue between finance ministers and central bank governors, the CMIM, the ASEAN+3 Macroeconomic Research Office, and the Asian Bond Markets Initiative, among others. Cooperation is growing in economic areas, issues related to the environment and sustainable development, labor markets and social protection, health, cultural heritage, as well as information and media. ASEAN can strengthen its presence and influence future ASEAN-Plus initiatives in these areas.

In addition, to fulfill its long-term aspirations, ASEAN should be capable of gradually absorbing under its wings the large number of donor assistance programs developed by the international community related to regional integration. Bilateral donors such as Australia, the PRC, the EU, Germany, Japan, the Republic of Korea, and New Zealand have created large funds to support new and existing ASEAN programs and projects. The ASEAN Secretariat has been benefiting from these funds and will continue to do so as long as it will remain capable of effectively linking them to its defined strategy and programs.

ASEAN members can create new functional institutions based on their willingness to serve as host countries according to their own financial capabilities, contributing larger shares of their budgets than other countries—if they so wish. Member countries should be invited to host agencies that best fit their own interests and regional development plans. New regional agencies can be created in several member countries, following an approach to regional decentralization, instead of being all concentrated around the ASEAN Secretariat in Jakarta (see section 6.9).

A decentralized approach to creating new ASEAN functional institutions can allow a better spread across the region, as different members become hosts. Various members have already stated on different occasions their interest in hosting new institutions to promote the ASEAN agenda, based on available internal resources, capabilities, and interests. Following a regionally decentralized approach can in turn create national champions on regional themes, contributing to the association's development and promoting the idea of ASEAN as a family of nations in an increasingly borderless economic region.

It should be noted that there are also risks associated with regional decentralization. First, member countries may be unable to properly assess the usefulness and sustainability of functional bodies, which could create a tendency to establish more institutions than actually needed—or support inefficient institutions in the long run. Second, institutions may become ineffective after their establishment in case ASEAN members lose interest in coordinating their agendas with the ASEAN Secretariat, unless clear rules are set when the agency is established.

5.3.5 Coordinating Regional Initiatives

As the ASEAN economy globalizes, improving cooperation and coordination in the provision of regional commons becomes an increasingly strategic function—also to avoid duplication and to leverage emerging synergies. Indeed, a smooth functioning of the group's institutional framework requires close coordination among various ASEAN bodies and organs, member countries' national agencies, functional institutions, and international organizations involved in implementing regional activities.

Coordination with subregional groups and programs (such as BIMP-EAGA, GMS, IMT-GT, BIMSTEC, or CTI), along with overarching regional bodies such as SAARC or the Pacific Islands Forum, and international organizations is a prerogative of the ASEAN Secretariat. However, it is the CPR mandated by the ASEAN Charter to coordinate between the ASEAN Secretariat and member countries' national secretariats—including ministerial bodies and sectoral agencies involved with ASEAN issues.

Another important coordinating function played by the ASEAN Secretariat lies with business groups and private sector organizations in general—the single most important engine of ASEAN economic integration in building industries and fostering growth and competitiveness. Business leaders already play a major role in advising member countries and ASEAN institutions to thoroughly review their strategic positions in helping achieve a "RICH" ASEAN—and in creating a borderless economic community by 2030.

Chapter 6
Policy Options

6 Policy Options

To realize ASEAN's 2030 growth aspirations as discussed in chapter 2 — tripling per capita income and raising quality of life to levels enjoyed by Organisation for Economic Co-operation and Development countries today — policymakers need an appropriate set of national and regional policies. As they face the key development challenges analyzed in chapter 3 and aim to leverage the growth-enabling factors discussed in chapter 4, each ASEAN country needs to introduce deep domestic structural reforms. They also must agree on moving beyond an ASEAN Economic Community (AEC) and create, by 2030, a truly borderless economic community by eliminating remaining barriers to the free flow of goods, services, and factors of production. ASEAN needs to develop its own "brand" through standardization and harmonization. Eventually, it can maintain its centrality as the core institution for Asian regionalism, in part by reforming its institutional architecture and governing principles (chapter 5).

Bold efforts to promote regional economic integration must accompany ASEAN's progress in the years ahead. The price paid for choosing a low-integration approach lies in the risk for many individual ASEAN economies to succumb to the middle-income trap. Collectively, it would forfeit ASEAN's competitiveness and comparative advantage against the People's Republic of China (PRC), India, and other large or integrating emerging economies. The low-integration, low-growth scenario also implies greater difficulties in managing climate change, natural disasters, as well as political tensions or territorial disputes.

This chapter examines the array of policy options available to ASEAN authorities in dealing with the region's key development challenges: (6.1) enhancing macroeconomic and financial stability; (6.2) supporting equitable growth; (6.3) promoting competitiveness and innovation; and (6.4) protecting the environment. It also discusses policy options to promote growth-enabling factors: (6.5) developing financial markets; (6.6) harnessing human capital; (6.7) building seamless connectivity; (6.8) strengthening governance; and (6.9) enhancing ASEAN's institutional architecture. The recommendations for national and regional policies — including the creation of several ASEAN functional institutions — are based on the country consultations and background papers prepared for this study. Each section begins with a short overview of the key challenges and enabling factors. Policy options are then discussed — first from a national and then regional perspective.

6.1 Macroeconomic and Financial Stability

6.1.1 Overview

If ASEAN countries are to fulfill their 2030 development aspirations — while creating a resilient, inclusive, competitive, and harmonious (RICH) region — they must prevent another major economic or financial crisis. Monetary authorities should follow prudent and coherent macroeconomic policies to balance the demand for sustained, rapid economic growth with the need to ensure overall economic and financial stability.

Current macroeconomic policies have been shaped by the structural reforms ASEAN countries introduced in the aftermath of the 1997/98 Asian financial crisis. The crisis not only exposed several major inconsistent or unsustainable policies, but also laid bare the growing interdependence between East Asian economies. One key lesson from the crisis was that economic policies should be balanced in favor of sustained growth, given the country's level of domestic financial development and macroeconomic tools available.

As Southeast Asian countries become more integrated through market forces and initiatives such as the AEC, decisions made in one country will have an ever-larger impact on its neighbors. Economic shocks are transmitted between economies with greater speed and impact as information technology advances. Prices will adjust closer to real time, and they will reflect country conditions more accurately. Therefore, cooperation initiatives become even more important to build and maintain macroeconomic and financial stability. They help ensure long-term economic growth can be both rapid and sustainable.

6.1.2 National Policies

The analysis in section 3.1 identified the internal and external risks ASEAN economies will likely face as they move toward 2030. It suggests three basic options to increase resilience to macroeconomic shocks. First, national economic authorities should include financial stability as a clear policy objective, and conduct economic and financial supervision using proper macroprudential tools. Second, they need to regularly review basic assumptions underlying how their economies and financial markets function — to avoid mistakes due to outdated policies and reduce related risks. And third, they must strive to ensure banking soundness through periodical monitoring and stress tests.

ASEAN countries need to adopt macroeconomic policies to bolster resilience against domestic and external shocks and volatilities. Policies should (i) ensure flexibility in adjusting to shocks; (ii) develop strong external positions as self-insurance against financial crises; (iii) carefully monitor short-term capital flows to appropriately manage associated risks and volatilities; (iv) upgrade technical, regulatory, and supervisory capacity to ensure financial sector resilience and efficiency; (v) pursue fiscal and monetary discipline; and (vi) reduce dollarization in the CLMV countries—Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam (Box 6.1).

Recommendations summarized from national background papers prepared for this study show five countries (Cambodia, Indonesia, the Lao PDR, Myanmar, and Thailand) citing enhanced macroeconomic management as a key challenge to achieve their 2030 growth targets. Improving fiscal management is also important for the Philippines. Common policy options suggested at the national level reflect the need to maintain price stability, keep capital flows under control, and establish proper crisis management control mechanisms through early warning systems. On the fiscal front, recommended policies include widening the tax base, cutting subsidies, and strengthening fiscal discipline (Table 6.1).

6.1.3 Regional Policies

Maintaining ASEAN macroeconomic and financial stability requires a set of regional policies that strengthen (i) macroeconomic cooperation, (ii) the management of short-term capital flows, (iii) exchange rate coordination, and (iv) the institutional architecture for financial cooperation.

Macroeconomic Cooperation

Section 3.1 reviewed ASEAN and ASEAN+3[151] regional macroeconomic cooperation initiatives, including the creation of the Chiang Mai Initiative Multilateralization (CMIM) and the ASEAN+3 Macroeconomic Research Office (AMRO). ASEAN countries should continue to fully support and leverage ASEAN+3 financial cooperation initiatives designed to make the region more resilient against potential crises. The CMIM should be developed further to increase the amount of emergency liquidity a country can access (as a share of the total available to that country) without having to be supervised by the International Monetary Fund (IMF). This can ensure the amount will be sufficient to deal with temporary foreign exchange liquidity problems—such as those that occurred during the global financial crisis. Eventually, the direct link between the CMIM and IMF should be eliminated. ASEAN's voice in CMIM operational decisions should also be increased, so that at least two ASEAN countries are needed (together with the "Plus-Three" countries) to reach a two-thirds majority.

Leveraging AMRO's surveillance for ASEAN's own use makes sense as it maximizes use of available resources. In particular, specific support should be provided to CLMV countries, which are relatively more exposed to macroeconomic and financial vulnerabilities (see section 3.1). The ASEAN+3 Finance Ministers

151 ASEAN countries plus the People's Republic of China, Japan, and the Republic of Korea.

Box 6.1 National Policies for Macroeconomic and Financial Stability in ASEAN

Maintain flexibility. Ensuring industrial and price flexibility provides an economy the means to adjust to shocks. Exchange rate flexibility, domestic price flexibility, and labor market flexibility are all important features of macroeconomic policies, best promoted through the extensive use of market mechanisms—rather than regulations or controls—in allocating resources.

Keep strong external position. Maintaining a strong external position acts as self-insurance against the risk of financial crises. The importance of reserve sufficiency became clear for ASEAN economies during the 2008/09 global financial crisis, when the presence of sizable international reserves allowed them to successfully absorb associated shocks. Policies that promote strong external positions include those that favor sustainable current account balances, low levels of external debt, and adequate levels of international reserves.

Manage short-term capital flows. Rapid short-term capital inflows can strain macroeconomic management and contribute to the creation of asset bubbles. Inflows cause currency appreciation, affecting net exports and economic growth, and driving more speculative capital inflows to profit from rising asset prices. Central banks can purchase foreign currency inflows to minimize appreciation, but the costs of sterilization can be high and seriously affect central bank balance sheets, with possible fiscal implications. Short-term capital inflows also increase a country's potential short-term foreign currency liabilities—capital can flow out just as rapidly, clearly evident after the closure of Lehman Brothers in 2008. Therefore, authorities need to carefully monitor short-term capital flows to manage associated risks and volatilities—a task which also requires close regional cooperation.

Ensure resilience and efficiency of the domestic financial sector. The 1997/98 Asian financial crisis and the global economic and financial crisis of 2008/09 clearly showed the need for a robust and strong financial sector to adjust to shocks and preempt threats to financial stability. Ensuring the presence of sound financial fundamentals is important, especially for banks, through policies that help maintain adequate profitability, a strong capital base, and effective risk management, as well as through robust financial regulatory and supervisory frameworks. The rising trend of global financial integration and product sophistication, as well as lessons from the United States financial crash in 2008 and the eurozone crisis, means that financial regulators need to continually upgrade their technical, regulatory, and supervisory capacity to ensure financial system soundness.

Maintain fiscal and monetary discipline. Disciplined fiscal and monetary policies—essential conditions for ensuring sustained and stable economic growth—help immunize the economy against the risk of locally induced crises. ASEAN domestic institutions must be strengthened to allow the policy focus to correctly balance economic growth with price and financial stability, taking into account the longer-term implications of short-term policy objectives—particularly involving central bank political independence.

Promote de-dollarization in CLMV. To various degrees, CLMV countries (Cambodia, the Lao People's Democratic Republic, Myanmar, and Viet Nam) face the challenge of managing a high degree dollarization in their economies (see section 3.1). Dollarization can indeed benefit price stability, but comes at the cost of losing monetary autonomy and seigniorage. As ASEAN passes its ASEAN Economic Community milestone and becomes a single market and production base, its currencies require greater stability relative to one another. CLMV countries should thus begin moving away from linking currencies externally and increasing links with other ASEAN currencies.

Source: Authors based on country consultations and background papers.

and Central Bank Governors' Meeting in May 2012 suggested AMRO should be upgraded and evolve into a fully fledged international organization. ASEAN policymakers should support and operationalize this suggestion, with an eye to the CMIM and AMRO evolving into an "Asian Monetary Fund," established well before 2030. The new fund would require pledged CMIM international reserves to be disbursed and invested. And it would require an appropriate governance structure, including technical bodies, properly staffed.

Management of Short-Term Capital Flows

Aside from the benefits short-term capital flows bring, there are considerable risks. Large and rapid flows affect exchange rate trends, implying huge sterilization costs. Capital flows can also be volatile and subject to sudden reversals, leaving monetary authorities with major liquidity challenges (see Box 6.1). Despite Thailand's failure in introducing short-term capital flows in 2010 (see Box 3.1 in section 3.1), capital control measures should not be ruled out *per se*. If well-designed — temporary and well-targeted — they can provide a valuable additional instrument or buffer as authorities manage capital flow volatility. However, as the financial system continues to change rapidly and financial globalization deepens, measures that worked in the past may turn out to be counterproductive in the future. Thus, capital controls must be properly tuned to generate the desired market effect (Kawai and Lamberte 2010).

Equally important is the risk of one country adopting capital controls outside regional or global agreements or without appropriate rules. In fact, unilateral measures can lead to credit rating downgrades or even regulatory retaliation from countries whose investments are affected. Therefore, ASEAN countries should promote regional consultation as part of the ASEAN+3 (or expanded) framework to develop *regional guidelines on effective capital control measures*. These can assist local authorities during times of excessive short-term capital movements when deciding whether capital controls are needed as an additional macroeconomic tool to maintain economic and financial stability. The predictability that guidelines provide should also help reduce volatility and would be welcomed by the private sector.

Exchange Rate Coordination

Excessive intraregional exchange rate volatility creates considerable adjustment costs for ASEAN economies. It affects the value of contracts, disrupting trade and investment relations, and compromises the AEC. Given rising intra-ASEAN economic interdependence, the region would vastly benefit from fairly stable intraregional exchange rates during normal times, while allowing for greater flexibility in times of balance of payments stress. It appears that informal exchange rate cooperation already exists to some extent, as ASEAN central banks and monetary authorities do take into account other currency trends in the region

Table 6.1 National Policy Options to Enhance Macroeconomic and Financial Stability

Countries	Policy Options		
	I	II	III
Challenge I.1 — Enhance Macroeconomic Management			
CAMBODIA	Widen the tax base and register informal business to improve tax administration and increase revenues	Establish a sovereign wealth fund and carefully monitor its management to finance priority development projects and attract private investment	Ensure monetary policy tools are effective to contain inflation within its target
INDONESIA	Introduce an early warning system and establish a crisis management protocol to monitor macroeconomic and financial stability	Ensure monetary policy tools are effective to control inflation and stabilize the exchange rate	Enhance management of capital flows and coordination among financial regulators to strengthen financial resilience
LAO PDR	Ensure monetary policy tools are effective to control inflation and stabilize the exchange rate	Maintain balanced budget and use natural resource revenues to improve human capital, infrastructure, and health care assistance	Continue financial reforms by strengthening fiscal discipline, financial transparency, and accountability
MYANMAR	Start fiscal reforms: raise spending on education and health; decentralize tax collection and administration; expand social safety nets; eliminate or reduce subsidies, including on oil and gas	Improve monetary policy tools to control inflation; continue exchange rate stabilization; increase capacity to manage capital flows; phase out monetizing the budget deficit	Create a sound banking regulatory and supervisory framework and introduce measures to develop capital markets
THAILAND	Improve fiscal policy: Use fiscal discipline, transparency, and sustainability guidelines; consolidate on- and off-budget items in the medium term	Widen the tax base introducing new property and green taxes, and extending tax coverage to the informal sector	Reform investment promotion schemes eliminating firm size discrimination to level the tax burden for all firms
Challenge I.2 — Improve Fiscal Management			
PHILIPPINES	Restructure the excise tax on tobacco and alcohol with an index to inflation	Replace income tax holidays with a 25% corporate income tax and/or a 5% tax on gross income; rationalize other fiscal incentives	Increase government fees and user charges, including those for roads and highways
Challenge I.6 — Promote Financial Deepening			
BRUNEI DAR.	Establish international partnerships and training enhancing labor skills to develop competitive financial services	Prepare a strategy to develop financial niches (such as *Shariah*-compliant products) focusing on subsectors poorly served by competitors	Establish a modern payment system to facilitate local companies in high-tech sectors conduct business in global internet markets

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic; SMEs = small and medium-sized enterprises.
Source: Authors based on background papers prepared for this study.

	IV	V	VI
	Introduce administrative measures and use monetary tools to restore market confidence in the riel and gradually eliminate dollarization		
	Increase capital expenditure as a proportion of total public expenditure	Better align civil servant remuneration to central and local government budgets	
	Stabilize the exchange rate and contain inflation to restore market confidence in the kip and gradually eliminate dollarization	Intensify research on effective macroeconomic management to better formulate policies and implement long-term strategies	Strengthen and deepen the banking and financial sector including support to micro-finance for SMEs and rural development
	Prudently open the capital account and gradually liberalize financial markets	Accelerate the privatization of state-owned enterprises	Promote financial inclusion and development of infrastructure for microfinance
	Introduce a strategy to deepen financial markets, particularly corporate bond markets, and ensure prudential supervision and risk management	Adopt short- and long-term policy goals on economic growth and price stability through public deliberations; improve monetary and fiscal policy coordination	
	Reform the tax code to widen the tax base; consolidate tax rates and decrease myriad exemptions	Cut subsidies to government corporations, particularly those competing with the private sector	
	Introduce new schemes for local banks to finance SMEs and business start-ups		

when managing exchange rates. Exceptions occur when countries face foreign exchange liquidity shortages or balance of payments difficulties and must allow their exchange rates to shift significantly in relation to other currencies. External shocks could create a diverging dynamic where one currency deviates far from its exchange rate trend, before re-aligning with the region's other currencies once the shock has passed.

Based on the risks related to excessive exchange rate volatility, this study argues that an *informal exchange rate coordination mechanism* would be useful among ASEAN (and ASEAN+3) countries — such as explicit or implicit inflation target ranges. Instead of directly managing exchange rates, intra-ASEAN currency stability can also be achieved through monetary policy convergence. Assuming relative purchasing power parity, two countries adopting common inflation targets will have relatively more stable bilateral exchange rates.[152] Historically, it has been difficult for countries to maintain a pegged-rate regime under a deregulated financial system and open capital account. The adjustment cost under a pegged rate could be large when the regime is forced to change — as happened during the 1997/98 Asian financial crisis. With most ASEAN exchange rate regimes now under a managed float with explicit or implicit inflation targeting, a gradual convergence of inflation targets should lead to greater exchange rate stability.

It should be stressed, however, that monetary cooperation to limit excessive exchange rate volatility does not imply the creation of a single currency. While initiatives for closer regional monetary and financial cooperation are needed to limit excessive intraregional exchange rate volatility, this study does not suggest in any way the formation of an ASEAN monetary union by 2030 or the creation of a regional currency similar to the euro.[153]

Also, this study does not envisage an exchange rate mechanism where each ASEAN currency is rigidly pegged with one another within a narrow band. As noted earlier, under appropriate circumstances, exchange rate flexibility increases

152 Empirical studies show lower exchange rate volatility among countries using inflation targets (Kuttner and Posen 2001; Rose 2006). A study comparing exchange rate pegging, a parallel regional currency, and harmonized inflation targeting in Asia against three criteria—robustness of capital mobility, compatibility with political circumstances, and congruence with modern monetary policy conduct—came to a similar conclusion (Eichengreen 2009). The study suggested that, given the current financial, political and technical constraints, harmonized inflation targeting is the best approach for exchange rate stability in Asia.

153 An ASEAN Central Bank Forum's Task Force on ASEAN Currency and Exchange Rate Mechanism conducted a 2001/02 study to assess ASEAN's suitability for a common currency (Kuang and Singh 2003; Guinigundo 2005). The study concluded the time was not ripe for ASEAN to create a single currency, because the region lacked the necessary preconditions and institutions—such as greater macroeconomic convergence, a strong regional institutional framework, and greater intraregional trade. At their August 2003 meeting, ASEAN finance ministers concurred with the study's findings and agreed to "focus first on areas of currency cooperation that could further facilitate and promote intraregional trade and deepen regional economic integration" (ASEAN 2003).

resilience. A good example occurred during the global financial crisis, when Indonesia was hit harder than other ASEAN countries by the shortage in US dollar liquidity. The rupiah weakened substantially relative to other ASEAN currencies, which helped Indonesia adjust. If monetary authorities had tried to keep the rupiah more stable, it would have had to use a large amount of international reserves — which could have destabilized the situation even further. As the liquidity crunch eventually normalized, the rupiah strengthened back in line with other ASEAN currencies.

Fiscal Sustainability

While introducing any kind of "ASEAN fiscal compact" by 2030 is unrealistic, fiscal sustainability remains a very important policy objective for the region. Monitoring the fiscal stance and public debt positions are already part of regional surveillance mechanisms, including that of AMRO. Some countries, such as Indonesia, already place legal limits on the ratios of fiscal deficits and public debt to gross domestic product (GDP), but the fiscal situation varies greatly from country to country (see section 3.1). Thus, it would be useful for ASEAN to prepare the technical support for developing informal *regional guidelines on fiscal sustainability*. These would define tolerable levels of fiscal deficit and public debt ratios of member countries. The fiscal and public debt parameters used under these regional guidelines — which could become benchmarks for fiscal surveillance — will necessarily reflect ASEAN's socio-economic diversity.

Institutional Architecture for Financial Cooperation

Consultation and cooperation on macroeconomic issues are extremely important to ensure financial stability. Until recently, Finance Ministers' Meetings have been the main forum for ASEAN+3 countries. But they had important limitations. For example, it was difficult for finance ministers to discuss exchange rate issues when these policies are under the purview of central banks. Statements by finance ministers on exchange rate cooperation could generate accusations of political interference, compromising central bank independence. However, starting in 2012, central bank governors were invited to participate in ASEAN+3 Finance Minister Meetings, making the forum far more able to address wide-ranging issues related to macroeconomic and financial stability, including exchange rates.

In the future, key independent financial regulators and supervisory agencies — apart from finance ministers or central bank governors — should be drawn into the process to form an *ASEAN Financial Stability Dialogue (AFSD)* well before 2030. Patterned after the 2008 ADB proposal to create an "Asian Financial Stability Dialogue" for ASEAN+3 countries (ADB 2008a), this new institution would broaden the scope of the surveillance process to include exchange rate movements within financial consultations and cooperation, together with macroprudential issues. This would contribute to greater regional economic resilience.[154]

6.2 Equitable and Inclusive Growth

6.2.1 Overview

ASEAN was born out of regional security concerns, but grew into an institution directed toward promoting region-wide economic and social prosperity. Indeed, there has been signal success in terms of economic growth. Today, Brunei Darussalam and Singapore are high-income countries, while low- and middle-income ASEAN countries have seen poverty incidence vastly reduced. While these are solid accomplishments, to achieve true prosperity, equitable and inclusive development must go hand in hand with economic growth. Still, poverty remains widespread in CLMV countries and in many remote, poorly connected islands of archipelagic Southeast Asia. Moreover during the last decade, inequality has been rising between urban and rural areas and across income groups within countries (section 3.2). The drive to spread development opportunities equally for all has become a critical priority — both nationally and regionally.

Efforts to reduce poverty must be accompanied by coherent policies that reverse the trend of rising inequality. The bulk of the gains from development and economic growth cannot accrue to a few at the top of the pyramid. Rising inequality in ASEAN partly reflects global trends — access to expanding international markets has not been equally distributed across the population. Yet there are many policies that can reverse these trends. For example, as shown by Viet Nam, progressing to middle-income living standards can occur without exacerbating social inequality.

Building an inclusive society requires a multi-faceted policy approach. It includes macro-level programs aimed at narrowing income gaps and improving social cohesion and welfare across the region. It also involves initiatives promoting education and health care, enhancing governance, and introducing specific regulations that improve the business climate and support small and medium-sized enterprises (SMEs), the backbone of ASEAN economies.

6.2.2 National Policies

In general, ASEAN countries need a broad set of national policies to expand economic opportunity and promote financial inclusion by drawing in marginalized

154 While all ASEAN members are an integral part of the ASEAN+3 process, individual countries are too small to have a significant voice in the forum. ASEAN members must therefore strengthen their own financial cooperation and consultation processes to develop unified positions on major issues, speak with one voice, and have their views reflected in regional decision-making forums—including global arenas such as the G20.

populations. Overall, they also need to avoid falling into the middle-income trap (section 3.2).

Expanding Economic Opportunities

It is evident that low-income Cambodia, Lao PDR, and Myanmar face the urgent task of shrinking widespread pockets of poverty — partly through efforts to achieve the Millennium Development Goals. But the issue of inequality and poor social cohesion matters for all ASEAN countries, including the richest.[155] In general, policies that expand economic opportunity through widely distributed, effective public services tend to narrow inequality best.

A proper policy set can help ASEAN countries build more equitable and inclusive societies (Table 6.2). Reducing poverty and improving economic and social equality are twin government goals throughout much of ASEAN. Strengthening social protection and the welfare system is a widespread need across the region, increasingly realized by introducing conditional cash transfer schemes related to health, education, and public housing. Improving labor market conditions is another crucial policy area where programs for developing technical skills, improving access to education for people with disabilities and for racial minorities, as well as strengthening labor laws and the rights of workers can yield valuable results.

All ASEAN countries (except Singapore) require policies to improve physical and institutional infrastructure. The least developed countries must focus on rural infrastructure, while more developed ones — such as Malaysia or Thailand — need to provide better public transportation. Improving databases to monitor the poor is important for Brunei Darussalam, the Philippines, and Thailand, while Indonesia needs an improved legal framework to ensure decentralization is effective in closing the huge development gap existing across provinces. Cambodia needs safety nets to cushion low-income groups facing temporary emergencies. In contrast, richer, relatively homogeneous Brunei Darussalam should adopt measures aimed at building an affluent society that improves the quality of life for all citizens, including policies that promote women's participation in the economy.

Promoting Financial Inclusion

Taking bold policy action to promote financial inclusion is important everywhere in ASEAN — particularly in the CLMV countries. Initiatives are needed to facilitate access to banking and other financial services by the poor, elderly, and other vulnerable groups, and to SMEs. Improved access to finance not only equalizes opportunities, but also helps strengthen local demand, ultimately helping rebalance the sources of economic growth more toward domestic consumption.

155 As suggested by the background papers prepared for this study.

Table 6.2 National Policy Options to Support Equitable Growth

Countries	Policy Options		
	I	II	III
Challenge II.1 — Reduce Inequality and Improve Social Cohesion			
INDONESIA	Revise the legal framework for central and local governments to promote decentralization and close the development gap among provinces	Create schemes to improve skills development and labor participation of low-income households	Strengthen social safety nets for the poor through income support programs and the provision of better housing, health care, and education
MALAYSIA	Introduce transparent and market-friendly affirmative intervention programs to reduce inequality between and within ethnic groups and regions, urban and rural areas	Continue promoting business opportunities and assistance to the disadvantaged such as single mothers and the elderly to raise rural incomes	Provide affordable public housing to the poor and lower income group, especially in urban areas
PHILIPPINES	Introduce social safety nets for the poor to better access health and education services; create and maintain database of the poor to monitor progress	Establish conditional cash transfer program to help poor children's education, preventive health care, and nutrition	Promote community-driven development of farm-to-market and urban access roads, health clinics, clean water supply, and irrigation
SINGAPORE	Improve education attainment, skill development, and labor participation of low-income households	Improve housing, health care, and income support programs for low-income groups	Ease workplace meritocracy with flexibility for those with disabilities and for minorities
THAILAND	Create database of the poor and vulnerable to support a functional social welfare system	Provide extra subsidies to poor students and health care for the vulnerable elderly	Establish a social outreach system to monitor welfare distribution
Challenge II.2 — Develop Sustainable Social Safety Nets			
LAO PDR	Extend social protection to all, especially in rural areas	Create a social assistance fund for health care for the poor	Create community social protection funds, including village or district funds in rural areas
VIET NAM	Develop a comprehensive social protection system, including national target programs, social insurance, and contingent support	Strengthen legal provisions to improve job security and ensure fundamental rights of workers	Expand programs that expand economic opportunities for the poor, develop infrastructure, and provide social protection
Challenge II.3 — Reduce Poverty			
CAMBODIA	Expand public investment in rural infrastructure	Increase investment in power generation	Improve access to health care and education for the poor
Challenge IV.1 — Improve Quality of Life			
BRUNEI DAR.	Track internationally comparable gross national happiness statistics and quality of life indicators	Use sensible indicators to measure employment, career development, and job satisfaction, comparing private and public sectors	Introduce a strategy to level the playing field between the public and private sector so that compensation and benefits paid for similar works are equal

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; ICT = information and communication technology; Lao PDR = Lao People's Democratic Republic.
Source: Authors based on background papers prepared for this study.

	IV	V	VI
	Introduce schemes to enhance financial literacy and facilitate access to banking and other formal financial institutions to promote financial inclusion		
	Improve coordination of public agencies involved in social assistance programs to increase efficiency and avoid duplication	Increase provision of safe and cost-effective public transport to mitigate rising costs	Introduce programs supporting business activities such as industrial projects and large-scale agriculture to promote regional economic convergence
	Introduce programs to facilitate inclusive finance, access to microenterprise credit and financial services for the poor	Support "kindergarten through 12th grade" system, improve quality and quantity of teachers and schools; provide adequate financing for health and education of the poor	
	Increase dialogue with the civil society using social media to make policies more inclusive		
	Strengthen labor laws and regulations while promoting long-term economic growth		
	Introduce conditional cash transfers for the rural poor, especially for health and education	Establish education-related programs (e.g. school lunches) targeting the rural poor	
	Strengthen community-based monitoring to ensure timely data on poverty incidence	Develop and implement support plans directly targeting the poor and near-poor	
	Introduce emergency safety nets (cash, food) to counter temporary income shocks		
	Adopt information strategy and other measures to ensure ICT innovations are evenly available, particularly to households		

The range of initiatives ASEAN monetary and financial authorities can take to promote financial inclusion is quite broad, from providing wider and fairer access to credit, supporting microfinance, and providing credit to SMEs. These initiatives lower information asymmetries between lenders and borrowers, and improve the accuracy of risk assessments. Central banks can help reduce financial service costs and promote financial innovation by strengthening financial market infrastructure by introducing credit bureaus, payment systems, collateral registries, as well as legal and regulatory frameworks.

Extending technological innovation in financial services to rural areas and other remote places can greatly reduce costs and raise efficiency. The rapid expansion in mobile banking is a striking feature of financial services for the poor and isolated populations. It leverages existing infrastructure to serve a wider range of potential customers. But it must also come with adequate consumer protection to ensure inclusiveness. ASEAN monetary and financial authorities should thus promote a sound financial and business environment through an appropriate regulatory and flexible supervisory framework — balancing financial provision with consumer protection. In addition, with aging populations, the demand for financial services tailored for the elderly will expand dramatically. Thus, as ASEAN countries improve their individual pension and health insurance systems, the private sector — including microfinance institutions — will increasingly enter these expanding markets.

Avoiding the Middle-Income Trap

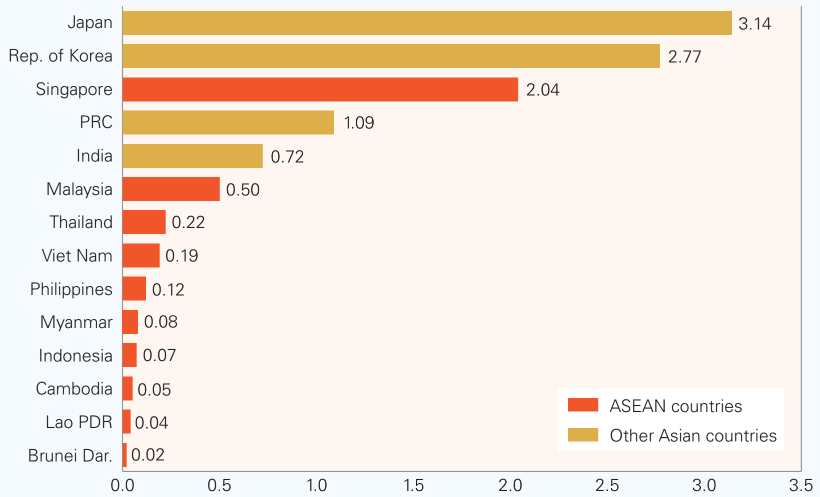
A key priority for lower- and upper-middle-income countries — which cover more than 86% of Southeast Asia's total population — is to avoid falling into the middle-income trap (see section 3.1, Box 3.4). A effective strategy includes a combination of policies: (i) strengthening innovation by investing in research and development (R&D); (ii) promoting knowledge-led growth as information and communication technology (ICT) becomes widely available; (iii) encouraging private sector dynamism by reducing business costs and improving the investment climate; and (iv) enhancing the quality of governance and institutions (Habito 2012; Tran 2013).[156]

Boosting R&D Investment

A modern, consumer-oriented economy requires innovation to improve product and process quality while lowering costs. However, middle-income ASEAN countries spend only a fraction of their income on R&D — in some cases less than 10% of what the Republic of Korea spends on R&D (Figure 6.1). In fact, over the past decade only Malaysia shows a (moderate) trend toward increasing

156 These policies should be considered together with those discussed in the following sections, particularly those related to improving competitiveness, innovation, and governance.

Figure 6.1 Average Expenditure on Research and Development
(selected Asian countries' % share of GDP, 1996–2010 average)



ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.
Source: World Bank, World Development Indicators Database. http://databank.worldbank.org/ddp/home.do?Step = 2&id = 4&DisplayAggregation = N&SdmxSupported = Y&CNO = 2&SET_BRANDING = YES (accessed October 2013).

R&D expenditure as a portion of GDP. This is not encouraging, as several countries' experience suggests that increasing R&D investment is a major prerequisite for climbing the per capita income ladder. ASEAN countries need to drastically increase R&D spending as they strive to become more competitive and innovative (see section 6.3).

Promoting Knowledge-Led Growth

To boost productivity in industry and services, innovation is needed to drive the creation of knowledge-intensive products and processes, such as those related to ICT. For example, ASEAN countries hold comparative advantage in electricity production from green energy sources, such as solar, tidal, wind, or wave generating systems; biotechnology and biofuels; maritime farming or aquaculture; and services related to tourism, health care for the elderly, distance education, and back-office operations. Supporting R&D in these sectors will help deepen the value chain and climb the technological ladder. Close collaboration between knowledge-creating institutions such as research laboratories, universities, and the private sector is crucial. Commercial use of innovative ideas is as important as innovation itself. Specific policies are needed to generate innovation in SMEs, especially those involved in production networks and supply chains. Tax systems also require reforms to encourage R&D investment.

Reducing Business Costs

ASEAN shows huge diversity across countries in terms of the cost and "ease" of doing business (see section 3.3). It is important not only to reduce existing barriers to business, but also to identify what effective and efficient support new industries need to grow and flourish. Critically important are infrastructure systems (energy supply, ICT, transport) that allow firms — especially SMEs — to migrate into new, promising sectors.

Improving Governance and Quality of Institutions

Escaping the middle-income trap also requires a leap forward in the quality of governance and institutions. Throughout ASEAN countries, there is an urgent need for high-quality institutions with enhanced governance structures that offer efficient public sector decision-making while encouraging strong private sector development (Rodrik 2004). Specific policy options to improve the quality of governance and institutions are discussed in section 6.8.

6.2.3 Regional Policies

ASEAN's regional approach to promote equity and inclusion should be ultimately designed to reduce poverty, narrow development gaps — within and across countries — and create development opportunities for everyone, regardless of gender, ethnicity, age, or disability. The formation of the AEC in 2015 and a truly borderless economic community by 2030 should be structured on principles of good governance, especially in relation to defining trade and investment regulations — which should not disadvantage minorities. Furthermore, the AEC will not be realized if (skilled and unskilled) labor markets remain segmented by national boundaries. By 2015, ASEAN countries are supposed to achieve the free movement of skilled labor through harmonization and mutual recognition agreements (see section 6.6).

Some of the factors that ensure growth will narrow intra-ASEAN development gaps are well known. CLMV countries need to strengthen their macroeconomic policy frameworks to create stability and encourage investment. Transparent and predictable decisions by accountable officials — allowing the public a voice in decision making — improve governance and create a policy environment that encourages both domestic and foreign investment. Regionally consistent policies and standards multiply the impact of national efforts by encouraging cross-border investment and trade.

In general, expanded regional dialogue on national development plans could fall under the purview of national economic planning agencies — eventually transferred to the executive or prime minister's (or president's) offices. A region-wide dialogue on inclusive and equitable growth could focus on issues such as how the AEC will affect individual countries and/or sectors, emerging needs for regional cooperation, and practical application of lessons-learned from integration schemes in other countries and/or regions.

To help this process, the technical and financial capacity of the ASEAN Secretariat should be strengthened to promote regional programs that effectively bridge development divides and income gaps. In particular, more technical and financial assistance is needed to assist programs, such as the Initiative for ASEAN Integration (IAI) and the ASEAN Framework for Equitable Economic Development (AFEED), to meet their goals.

In addition to existing programs, the challenge facing ASEAN as a whole is to garner the substantial additional resources needed as it assumes a more central role in the region's development process. ASEAN authorities should consider establishing an *ASEAN Convergence Fund (ACF)* to mitigate the possible negative impact of economic integration initiatives on specific groups and sectors. The ACF could also be useful in fostering economic growth in lagging regions and supporting subregional programs. For example, the ACF could target specific subregions and complement assistance already being offered through the Greater Mekong Subregion (GMS), the Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area (BIMP-EAGA), or similar programs and institutions (see section 3.2).

In establishing the ACF, regional policymakers could study the structure and experience of similar funds developed by the European Union (EU) (Box 6.2), those that ensure funds are not used for single-country projects or address disparities within countries. Rather, the ACF should focus on regional initiatives generating cross-country benefits. It could be structured on the existing, albeit very small, ASEAN Development Fund, with administration left more to professionals than bureaucrats from foreign affairs or finance ministries.

An important use of the ACF is to mitigate economic dislocation resulting from integration — to compensate those who lose out from regional economic integration. In the long term, greater regional integration is clearly beneficial to the economy overall. Nonetheless, in the short term, specific geographical areas and economic groups may require support to make the necessary adjustments as they shift from national to regional systems. The ACF could target groups, sectors, or regions at a disadvantage by changes in terms of trade caused by integration, particularly through infrastructure and human capital investment that lead to more inclusive regional growth. Examples would be the ICT infrastructure needed to bring people in lagging regions closer to evolving markets.

Box 6.2 Funds to Bridge Development Gaps in the European Union

Having long recognized the importance of favoring economic convergence to strengthen regionalism, the European Union (EU) introduced various funds aimed at bridging the development gap between richer and poorer areas. During 2007–2013, EU spending in support of regional convergence (targeting those areas whose per capita GDP is below 75% of the EU average) totaled €347 billion ($470 billion), about 30% of the EU budget.

Different types of funds were created for financing regional convergence: (i) structural funds—including the European Regional Development Fund (ERDF) and the European Social Fund (ESF); (ii) the Cohesion Fund; and (iii) other funds contributing indirectly to developing backward regions, such as the European Agricultural Guarantee Fund, the European Agricultural Fund for Rural Development, and the European Fisheries Fund.

The ERDF focuses on economic and social issues. It aims to address uneven regional development by promoting (i) direct investment in private sector enterprises—especially small and medium-sized enterprises to encourage employment generation; (ii) investment in infrastructure to support innovative business activities that protect the environment and to promote sector development in energy, telecommunications, and transport; and (iii) financial market development to enhance regional cooperation initiatives. The fund also supports technical assistance programs to targeted areas.

The objective of the ESF is to improve labor market conditions by facilitating flexibility, reducing differences across regions, and promoting social inclusion—by improving access to the disadvantaged and combating discrimination. Promoting labor flexibility is done by helping workers and enterprises adapt to changing economic conditions, improving labor force participation, and improving access to employment.

The Cohesion Fund, which applies to regions with an average GDP below 90% of the EU average, targets environmental issues and improvement in the regional transport network. Projects related to energy (such as those promoting energy efficiency and the use of renewable energy) can also be financed by the fund, provided they contribute to improving environmental conditions.

Source: EU website and various EU reports.

6.3 Competitiveness and Innovation

6.3.1 Overview

Strengthening competitiveness and innovation is the most frequently mentioned challenge for ASEAN countries in meeting their 2030 aspirations, according to the bottom–up approach used in this study. A broad range of policies that promote competitiveness and innovation can improve macro- and microeconomic conditions, the business climate, social infrastructure, and political institutions. Improvements in factor endowments require, in particular, policies aimed at enhancing human and physical capital, including education, health, labor market conditions, and financial market development.

Investment in R&D is critical for technological advancement and innovation — prerequisite for higher productivity and increased competitiveness. Developing countries can acquire new technology through indigenous R&D, imitation, and transfers (see section 3.3.2). Technology spreads through trade in capital goods, labor mobility, and formal channels of technology licensing or foreign direct investment (FDI) that internalize returns from investors' intellectual property rights. With ASEAN highly open to international trade and well-exposed to high-tech manufacturing, substantial opportunities exist for absorbing new technology through transfer and diffusion. But exposure to trade and FDI alone is insufficient to ensure technology transfer and stimulate innovation. To transform available knowledge into new products and processes, countries need to consciously invest in expanding their ability to absorb new technologies. Competitiveness in primary and secondary sectors, especially manufacturing, largely depends on productivity and innovation based on codified technology. However, services are based more on immaterial knowledge, with innovation often coming more quickly. Besides, services offer crucial links across economic sectors (see section 3.3.5).[157]

Government policies need to consider the regional context, the breadth of their national economy, their institutional framework, and the local availability of various technologies. For example, CLMV countries should focus on learning and imitating technologies created in advanced economies and on removing barriers to the spread of technology through expanded trade, increased FDI, and flow of human capital. Middle- and high-income ASEAN countries should stress, however, their capacity to move up the technological scale in industries where they already possess — or want to strategically develop — new comparative advantage. These efforts should aim at improving tertiary education to emphasize science and engineering, orienting public research to applied R&D, and providing private sector incentives to increase investment in upgrading technology.

6.3.2 National Policies

The background papers prepared for this study offer a broad set of policy recommendations for individual ASEAN countries to promote competitiveness and innovation. They focus on ways to cultivate technological and innovative capabilities, increase labor productivity, and improve the business and investment climate. Singapore and Thailand are keen to identify new drivers of economic growth; Brunei Darussalam, Cambodia, Indonesia, and the Lao PDR want to diversify their economies; while the Philippines and Myanmar want to strengthen industry — with Myanmar also needing to upgrade agriculture (Table 6.3).

157 National and regional policies to promote competitiveness and innovation need to assess how economic sectors interact and contribute to overall economic development.

Table 6.3 National Policy Options to Promote Competitiveness and Innovation

Countries	Policy Options		
	I	II	III
Challenge III.1 — Make The Economy More Competitive			
MALAYSIA	Reduce government role in business so as to support, not to compete with the private sector	Promote government-linked companies' operations in strategic industries, working with the private sector on a commercially viable basis	Adopt international best practices to simplify business regulations and reduce entry restrictions, especially for small business
Challenge III.2 — Cultivate Technology and Innovation Capabilities			
MALAYSIA	Ease market entry and exit of firms, minimize the penalty of failure in bankruptcy law, and provide venture capital to nurture innovation	Establish more research institutes and create an environment conducive to attract researchers	Provide financial and technical support to promote innovation and entrepreneurship in SMEs
SINGAPORE	Increase spending on R&D, promote design-driven innovation and institutions, and recruit more researchers in public agencies	Increase collaboration between local and foreign and public and private research institutes	Introduce incentives to attract venture capital, use equity markets, and provide technical and organizational support to encourage innovation in SMEs
Challenge III.3 — Increase Labor Productivity			
MALAYSIA	Review immigration policies to reduce unskilled foreign workers, increase highly skilled ones, and adopt global best practices in employing foreigner workers	Strengthen education system and on-the-job training to improve average skills of workers	Provide support to cushion structural adjustment costs for workers
Challenge I.3 — Improve the Business and Investment Climate			
BRUNEI DAR.	Remove regulatory bottlenecks to encourage business start-ups and more efficient small-scale trading	Increase R&D spending to raise competitiveness	Replace energy and public utility subsidies with spending on social safety nets to improve resource allocation
PHILIPPINES	Streamline regulations, reduce time needed for opening and closing businesses, introduce one-stop investment clearing shops, and computerize processing	Strengthen rule of law, improve peace and order, and modernize the police	Adopt cluster-based industrial development to improve SME competitiveness—similar to the approach used by the Republic of Korea and Singapore
Challenge III.4 — Identify New Drivers of Growth			
SINGAPORE	Continue with the strategy to make the economy a hub for global investors to expand their markets	Strengthen incentives to promote outward investment, raise returns on capital, and overcome the domestic labor shortage	Foster comparative advantage in knowledge-based industries such as biomedical, green technology, ICT, tertiary education, and urban management
THAILAND	Introduce a strategy promoting cost-effective infrastructure investment to broaden domestic drivers of growth	Further open services to foreign competition to improve domestic efficiency and promote technological sophistication	Increase investment in R&D and boost public–private research links

	IV	V	VI
	Adopt a "whole-of-government" approach for integrated administrative services and expand e-government to reduce the cost of doing business	Maintain sound monetary and financial policies to continue ensuring strong macroeconomic fundamentals and providing competitive business conditions	Provide incentives for domestic companies to become regional and global leaders in their areas
	Roll out nationwide broadband connectivity to ensure "last-mile" broadband connections and provide internationally competitive services	Strictly adhere to global standards for the protection of intellectual property rights	
	Invest in modern science, technology, and business education to promote innovation and entrepreneurship	Use productivity-enhancement programs to raise consciousness among employers and workers	
	Introduce child-care support system, more flexible working arrangements, and incentives for productivity improvement to increase female participation in the workforce	Review the labor law allowing more flexibility to hire and terminate workers and introduce a wage system commensurate to skills that promotes productivity improvements	
	Establish a business promotion agency to support private sector development	Create consultative forums to draw the business community into development plans and promote public sector transparency	
	Develop SME skills and provide R&D support through programs designed to bring domestic firms into global production networks	Complete trade, investment, and services liberalization in line with the AEC Blueprint	
	Expand multilateral and bilateral free trade and investment agreements to further penetrate foreign markets		
	Prioritize connectivity projects using regional cooperation schemes	Increase public investment to help "crowd-in" private investment and promote economic growth	

(Continued)

(Table 6.3 continued)

Countries	Policy Options		
	I	II	III
Challenge III.5 — Diversify the Economy			
BRUNEI DAR.	Increase ICT opportunities to facilitate small, high-tech firms prospering from global internet markets	Continue capital-intensive energy and infrastructure investments that boost trade, transit, and travel	Attract FDI in comparative advantage industries, such as fossil fuels, high-tech services, Halal agro-processes, and tourism
CAMBODIA	Create an incentive scheme to boost investment in agricultural technology and infrastructure	Introduce fiscal incentives and training programs to expand light manufacturing production	Use trade facilitation schemes under GMS and ASEAN networks to enhance manufactured exports
INDONESIA	Promote seed industry development and upgrade irrigation technology to boost agricultural productivity and food security	Train farmers to improve the value added of food products and strengthen agricultural supply chains	Promote ICT development to improve connectivity and satisfy growing domestic market demand
LAO PDR	Modernize irrigation and develop agricultural supply chains to raise agricultural productivity in an eco-friendly manner	Introduce an incentive scheme to promote FDI outside natural resources	Adopt a strategy to develop stronger links between FDI and local companies for drawing SMEs into foreign supply chains
Challenge III.6 — Strengthen Agriculture			
MYANMAR	Introduce incentives, support, and extension services to improve agricultural productivity	Improve rural infrastructure, including transport facilities, to reduce costs and output losses	Provide incentives for private investment to boost value-added and develop agro-business
Challenge III.7 — Strengthen the Industrial Base			
MYANMAR	Adopt a strategy to strengthen industrial development including FDI promotion, reform of state-owned enterprises, and local SME development through inclusion in production networks	Formulate and implement a strategy to create and manage “special economic zones”	Create an independent investment board offering incentives and one-stop processing facilities
PHILIPPINES	Introduce a sector-specific industrial policy based on the business process outsourcing model, to identify bottlenecks and promote public–private partnership	Analyze value chains in key industries and encourage local firms to shift to higher value-added products	Create an agency under the President’s office—similar to the Competitiveness Council—to promote FDI

AEC = ASEAN Economic Community; ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; FDI = foreign direct investment; GMS = Greater Mekong Subregion; ICT = information and communication technology; Lao PDR = Lao People’s Democratic Republic; R&D = research and development; SMEs = small and medium-sized enterprises.
Source: Authors based on background papers prepared for this study.

IV	V	VI
Create business incubators and enhance labor skills to support development of small enterprises	Create facilities to accommodate smaller vessels in ports to boost subregional retail trade	
Introduce incentives in industries with comparative advantage identified by diagnostic studies		
Promote the creation of business incubators for SMEs, strengthen trade and logistics networks, and provide financial support for R&D development of SMEs	Introduce incentives to further develop commercial agriculture such as rubber and palm oil	
Introduce incentives to promote SMEs in trade and logistics	Participate in foreign exhibitions and fairs and begin media campaign to promote tourism	Introduce a strategy developing niche markets of high-quality, globally competitive goods
Introduce a strategy to develop the seed industry and enhance SME participation in regional supply chains—including rice, vegetables, and livestock	Improve land titling and introduce production incentives to develop remote regions	
Establish programs to provide financial support for SMEs, including market R&D	Liberalize health and education services to attract FDI	Introduce measures to develop the country as a logistic hub; promote participation of local firms in regional and global supply chains
Lift the cabotage law to ease freight forwarding and increase logistics efficiency		

The most advanced ASEAN countries (such as Singapore, Brunei Darussalam, and Malaysia) need to increase R&D spending to promote high-tech and institutional innovation, create a more favorable business environment — by reducing regulations and easing market entry — as well as deepen financial development to attract venture capital. They also need to create more science institutes to effectively link corporate research with government-related research. And to improve labor productivity, they need to attract highly skilled foreign workers by offering a high quality of life and living environment. Better adhering to global standards for the protection of intellectual property rights is also key for Malaysia to promote its indigenous innovative capabilities.

Policies related to infrastructure development and public–private partnerships hold relative importance to enhance competitiveness in Thailand, while the Philippines needs to strengthen the rule of law and streamline regulations to improve the business climate and attract more R&D-enhancing private investment. Most ASEAN countries also need to help SMEs become more competitive and innovative through financial support and programs focused on their inclusion in regional production, trade, and logistics networks.

National policies are also needed to promote economic diversification in many countries. While industrial diversification to expand manufacturing production is required in all CLMV countries, technological development is urgently needed to improve agricultural productivity across the region — from Indonesia, to the Philippines, Cambodia, the Lao PDR, and Myanmar. Advanced agriculture requires increased investment in irrigation and mechanization, a competitive seed industry, and closer integration of local firms in regional supply chains. New methods include cold storage facilities and other farm-to-market infrastructure to reduce waste.

Improving education systems is the lynchpin for a more competitive and innovative ASEAN. Data for students aged 15 and above (see section 4.2) show that during the last two decades, Malaysia has been most successful in raising education quality, followed by the Philippines and Singapore. However, high school enrollment is not necessarily an adequate indicator of readiness for innovation, technological development, and increased productivity. It is the quality of education that is critically important in promoting innovation. While tertiary education must concentrate on science and technology, there are deficiencies in mathematics and science in the Philippines and in the quality of management schools in Thailand and Viet Nam. ASEAN countries in general should allow more foreign technicians, scientists, and engineers to augment the limited domestic pool. Singapore, which uses a proactive policy to encourage foreign professionals to join its public and private sectors, can be a good example for other countries to follow.

Another way to foster competitiveness and innovation is by promoting industrial clusters for advanced sectors. But making clustering successful is not easy. It requires the right concentration of high-tech industries, a vibrant entrepreneurial and innovative culture, close links between industry and research facilities, the availability of venture capital, and a dynamic labor market for scientists and engineers. It also implies highly advanced logistics and administrative systems, infrastructure, and ICT facilities. Without these, the quest for higher value-added, innovative production could be stunted. There are several success stories in Asia that ASEAN could examine, such as Taipei,China's Hsinchu Science-based Industrial Park; the People's Republic of China–Singapore Suzhou Industrial Park; and Singapore's own success in developing biomedical sciences (Wong et al. 2009; see Box 3.5).

6.3.3 Regional Policies for Promoting Competitiveness and Innovation

A key policy priority for individual countries (and the region as a whole) requires strengthening ASEAN competitiveness in those sectors that currently hold comparative advantage and where the potential for acquiring future advantage is particularly high. Regional programs should be designed to complement and leverage specific national policies. Policymakers should prioritize implementation of the ASEAN ICT 2015 Master Plan (ASEAN 2011a) and the Master Plan on ASEAN Connectivity (ASEAN 2011d), which involve specific initiatives to strengthen the foundations for promoting regional competitiveness and innovation. National innovation policies should also be supported by ASEAN-wide policies and projects. A regional innovation policy should focus on accelerating the use of technology where positive spill-over effects on the rest of the region are large.

With their diversity and structurally different areas of comparative advantage, a region-wide innovation policy should identify appropriate interventions by geographical area and sector. While the exploitation of synergies with science is a cross-cutting theme, R&D and innovation in areas such as biotechnology, nanotechnology, and green technology could make ASEAN a leader in emerging market niches. At the same time, however, a regional approach can help ensure local SMEs are drawn into regional production, logistic, and distribution networks — which often require existing technologies to be absorbed through targeted public and private R&D investment. However, ASEAN policymakers must be careful not to be enticed into using public resources to promote technological development by picking "winners," or favoring specific types of entrepreneurship. History has shown that only a level playing field for large firms and SMEs can create the entrepreneurial breeding ground for technological dynamism. Upgrading standards across the region would also be an important contribution for building a friendly environment for innovation.

ASEAN countries should adopt a well-crafted, regional strategy to promote competitiveness and innovation — to capture the opportunities for R&D investment and productivity increases present in different countries and industries.

They should consider establishing an *ASEAN Competitiveness Institute (ACI)* to articulate the regional strategy and construct a framework for introducing innovation policies that contribute to rising productivity and competitiveness. The ACI could be established as a new functional institution (see section 5.2), hosted by any ASEAN member interested in championing the cause of innovation and competitiveness.

Enhancing Agricultural Productivity and Food Security

Strengthening ASEAN agricultural productivity and food security requires innovative and bold policy reforms, better institutional and legal frameworks, as well as training and funding facilities. Rather than a plethora of isolated solutions aimed at solving individual problems, cross-disciplinary and networked solutions that factor in agricultural supply chains and trade networks — thereby leveraging the AEC — make better sense. However, mitigating the risk of marginalizing small farmers and local supply chain stakeholders is also important.

Strengthening agricultural productivity can raise incomes and help ensure food security and environmental sustainability — central in forging a competitive and innovative region. Existing agricultural research in palm oil, rubber, and rice genomes (see section 3.3.3) should be marketed to attract more international funding. Research on the impact of climate change on ASEAN agriculture should be part of a broad regional research agenda. ASEAN countries are facing the impelling challenge not to degrade their ecosystems from overusing yield-boosting chemical fertilizers and pesticides. They must also reduce pollution generated by agricultural waste in production and processing — for example, discharge from rubber factories and palm oil mills. Ecosystems must be treated as "public goods" and engineered accordingly. A region-wide approach to introducing regulation and incentives in agriculture must avoid any "race to the bottom."

An important role ASEAN plays is to ensure food security Asia-wide — a role likely to expand in the future. Regional food security centers on rice and is based on the ASEAN Plus Three Emergency Rice Reserve mechanism. A bolder initiative to link food security with regional welfare would be creating an *ASEAN Rice Authority (ARA)* aimed to assisting member countries organize rice production, supply chains, and trading networks. ARA's mandate could eventually be broadened to cover other food commodities and product development for energy or other green applications. It should be noted, however, that similar ideas in the past, while good in theory, were unable to form new functional institutions in practice due to the reluctance of individual countries to agree on the amount of power to be delegated to regional agencies. In any case, ASEAN countries should first exchange more information on production plans, facilitate cross-border trade, and more importantly commit to avoid beggar-thy-neighbor policies.

Strengthening Production Networks and Industrial Clusters

Strengthening regional production networks and industrial clusters is of strategic importance to enhance productivity, innovation, and competitiveness of individual ASEAN countries and the region as a whole (see section 3.3.4). As globalization deepens, existing ASEAN production networks will reshape to retain competitive advantage — and new industrial clusters will emerge. ASEAN needs to carefully evaluate how these trends will affect the region's industrial development. Policymakers must think beyond the 2015 AEC milestone and set goals to create a borderless economic community by 2030.

In particular, ASEAN must build on existing production networks and industrial clusters to strengthen the region's competitiveness. As local business moves up the global value chain and strives to innovate, each ASEAN member and the region as a whole will undergo profound socio-economic change. More advanced countries such as Singapore, Malaysia, and Thailand will need to deepen their leadership and competitive advantage in existing production networks and clusters — such as automobiles in Thailand, electronics in Malaysia, and biotechnology in Singapore. While the process of industrial restructuring moves forward, other sectors will find it profitable to relocate across ASEAN borders to countries like Indonesia, the Philippines, Viet Nam, Cambodia, and Myanmar — much as Japanese firms have relocated specific production facilities to ASEAN, for example.

In many ways, ASEAN is better recognized in Asia-wide and global forums than within its own borders. Its centrality in Asian regionalism is well acknowledged. Yet, often citizens are unaware of developments pertaining to ASEAN itself, their extent and implications, including detailed plans for creating and implementing the AEC. As ASEAN strives to strengthen competitiveness and innovation, it needs to build pride and recognition among its own people — both to build a sense of community and to brand itself globally.

Policymakers should therefore make conscious efforts at "*ASEAN branding*." Initiatives are needed not only through advertising campaigns. The ASEAN brand must offer products that inspire consumer confidence as much as recognition. A functioning AEC would be a major contribution in this direction. Ultimately, ASEAN should establish *a regional agency for the certification and standardization of made-in-ASEAN products (AMAP)*.

An essential step toward building an ASEAN brand — developed as a product label marketed internationally — is to build products that compete successfully within ASEAN first. The establishment of a dedicated regional agency for certification and applied quality standards would be important for testing ASEAN products and receive an ASEAN seal of approval. Products with a "made-in-ASEAN" label can be leveraged to the international audience and markets. Eventually, branding ASEAN could have a multiplier effect not only on industrial development, but also on strengthening a corporate and individual ASEAN identity.

The need for harmonization and standardization is a widely held priority for ASEAN, forming a basic requirement for the creation of the single market and production base envisaged by the AEC. Harmonization and standardization should also be extended to strict environmental and governance standards, which eventually must be reflected in product regulations adopted across the region. For example, without convergence in environmental production standards, polluting industries will tend to congregate in countries with low environmental standards, in both production and governance, which will eventually block the region from becoming an effective AEC single production base.

Developing Competitive Services

Services' contribution to ASEAN economic growth is increasing, including through enhanced competitiveness and innovation (see section 3.3.5). A major task for ASEAN policymakers is to provide a regulatory environment conducive to greater service productivity. Introducing regulatory services reform is a complex and multi-dimensional task, requiring the delicate management of domestic and trade-related policies. Because there is no equivalent of cross-border measures — such as tariffs — in services, market regulatory reform and trade liberalization measures are intimately linked. Therefore, there is considerable scope for policymakers to leverage regional integration initiatives to promote regulatory reform at home, and to use regional agreements as a way of locking in reforms already under way (Shepherd 2012).

The political economy has a large impact on the actual implementation of the services policy agenda for ASEAN, both in establishing an AEC by 2015 and in moving toward the creation of a truly borderless economic community by 2030. In particular, entrenched producers in import-competing services could unite against reforms that bring lower prices, greater variety in supply, and other gains. But as consumers tend to be diverse and poorly organized, policymakers should work with beneficiaries and reformers as well as consumers. Evidence shows that more efficient services bring gains to other economic sectors, giving a boost to reformers. Policymakers must prove services policy reforms benefit both national aggregates and those sectors that use services intensively. Joining forces with service exporters and potential exporters makes it more likely that liberal policy reforms can be implemented, while safeguarding domestic policy objectives like consumer protection.

Among various services, tourism offers great potential for contributing to the overall ASEAN economy. Given their rich natural landscape and historical-cultural attractions, Southeast Asian countries should build on their comparative advantage in tourism. Promoting tourism should be seen as an essential strategy for realizing a borderless economic community from within, and creating an ASEAN brand acknowledged globally (Box 6.3).

In addition to developing basic facilities such as hotels, training qualified tourist guides, and properly managing tourist attractions (historical-cultural sights, theme parks, entertainment, restaurants, and shopping centers, among others), tourism requires improving and expanding land, air, and sea links between ASEAN countries. The existing Master Plan on ASEAN Connectivity helps provide seamless connectivity for travel. For example, the ASEAN Highway Network and the Singapore–Kunming Rail Link are expected to connect several ASEAN countries with the PRC and India, two countries where the number of tourists visiting ASEAN is rapidly rising. The ASEAN Open Sky agreement—which aims at removing restrictions on air traffic rights—helps expand flight capacity and offers air travel to a wide array of ASEAN destinations, boosting business and tourist travel.

While the ASEAN Tourism Strategic Plan (2011–2015) is being implemented, policymakers should consider establishing an *ASEAN Tourism Council (ATC)* to

Box 6.3 ASEAN's Tourism Potential

The economic impact of tourism is usually estimated in terms of employment and foreign exchange generation. But it also can generate deep backward linkages—from agriculture to services—and play an important role in promoting inclusive growth. Studies show that a 1% increase in tourist arrivals per capita in Southeast Asia adds from 0.03% to 0.28% to economic growth. By value, tourism receipts have a large impact on Cambodia, the Lao People's Democratic Republic, Malaysia, and Thailand (Francois et al. 2009). With the opening of integrated resorts, tourism has become increasingly important to Singapore as well. And with political and economic reforms in Myanmar, tourism has entered a boom phase, with demand constrained by a severe shortage of hotels and related facilities.

Changing global and regional market dynamics could greatly benefit ASEAN tourism. Evolving demographics worldwide, new economic and social travel preferences, regional and national tourism development programs, and realizing the ASEAN Economic Community Blueprint contribute to these dynamics. Important factors supporting this trend include geographical proximity to large and growing markets such as the People's Republic of China and India, as well as the traditional presence of high spending visitors from high-income Asian economies (Japan, the Republic of Korea, and Taipei,China) and the Middle East—and expanding niche markets such as sports.

The rapid expansion of low-cost carriers serving the region have also brought increased seat capacity and lower airfares—benefiting mostly short-haul regional flights. In addition, several ASEAN members (Thailand, Singapore, and Malaysia) have targeted medical tourism and the so-called MICE (meetings, incentives, conventions, exhibitions) tourism, which also promote cruises, among other forms of travel.

Tourism naturally grows along with the liberalization of trade, investment, and labor mobility. It is hurt by political or economic disputes. In all likelihood, tourism will continue to be a significant export earner for ASEAN members. It also holds tremendous scope for "win–win" regional cooperation initiatives. However, as ASEAN tourism expands, a balance must be struck between economic gains and the impact on sustainable development.

Source: Authors based on Rodolfo (2011).

help coordinate national strategies under a single framework and promote region-wide initiatives to further develop tourism and its related industries. In addition to other proposed initiatives such as the introduction of a single ASEAN visa, a business travel card, and a tourism professional permit (see section 3.3.5), the ATC could be a new functional institution involving both government officials and private sector operators — primarily private sector-driven and funded by ASEAN governments.

Contributions to the ATC forwarded by national tourism organizations can be designed to generate increased volume and yields expected from syndicated marketing. The ATC could help package multi-country tourism catering to specific interests — from history to culture, sports, geography, or even food — and promoting ASEAN as a single tourism destination with world-class standards, facilities, and attractions. It could be designed to promote ASEAN as a brand across international markets and adopt a single ASEAN visa for qualified tourists.

6.4 Environmental Protection

6.4.1 Overview

Improving environmental protection and natural resource management is a prerequisite for achieving harmonious and sustainable development, contributing to a better quality of life. Given the ongoing deterioration in ASEAN's environmental resource base (forests, marine resources, water, and air — see section 3.4), immediate and bold action is needed to reverse this trend. National and regional efforts are required to manage economic development so it conserves resources, ensures energy security, and minimizes the deleterious environmental impact of urbanization.

The ASEAN Socio-Cultural Community (ASCC) Blueprint calls for long-term development strategies that mainstream "green" (environment-friendly) economic growth, protecting the environment without sacrificing continued progress toward higher living standards (see section 5.2). A key requirement to ensure that these strategies can be implemented within an evolving AEC is that national environmental laws and standards be harmonized regionally. Adopting common regional standards is particularly important for ASEAN to encourage and promote the development of green products.

A strategy that enhances effective implementation of appropriate environmental policies includes the provision of financial incentives to guide the private sector in a socially responsible manner. Specifically, environmental "public bads" — such as pollution — need to be properly taxed, while financially unsustainable subsidies should be eliminated.

Good governance and institutions are essential to properly manage water, forestry, and clean air. Although national laws in Southeast Asia typically set environmental standards that embrace international best practices, implementation tends to be weak. Good governance can ensure that standards are actually enforced. Unfortunately, studies suggest that corruption among local government officials maintains, even promotes, illegal trade in logs — a main cause of deforestation and the haze associated with land clearing. Weak enforcement of air and water pollution laws and regulations on proper disposal of solid waste also exacerbates environmental degradation. To achieve a "RICH" ASEAN by 2030, countries must improve governance standards on the environment and natural resource management. Change must come both nationally and regionally. In particular, ASEAN as a group should promote environmentally sound development policies through regional dialogue.

6.4.2 National Policies

In working to balance growth with environmental protection, ASEAN countries need to adopt green development strategies — covering all aspects of economic and social life. A wide range of specific policies can be adopted at the national level (see Table 6.4), from the introduction of stricter regulations on environmental standards than those currently in place (Indonesia, Malaysia, the Lao PDR, and Viet Nam) to increasing environmental awareness and introducing training programs to enhance public sector capacity (Brunei Darussalam, the Lao PDR, Thailand, and Viet Nam). Several countries also need to increase R&D investment and institute a proper regulatory environment to develop green technologies that limit pollution and solid waste (Cambodia, Indonesia, Malaysia, and Thailand).

Controlling Pollution and Solid Waste

The need to improve the control and monitoring of industrial waste and water discharge is widespread across ASEAN. National authorities must introduce measures to improve safe water access at reasonable cost, which in addition to boosting health indicators will also help with poverty reduction — as healthier rivers increase livelihood prospects for less developed areas. ASEAN countries should realize that better access to safe water helps reduce the cost in manufacturing industrial goods and increase agricultural productivity — which could lead to the development of commercially attractive biofuels. In Indonesia, Malaysia, and Singapore there is also a need for designing and implementing national plans to assure protection of water systems from overuse, redressing ongoing regional deterioration in water quality.

Improving Energy Efficiency

ASEAN governments are often tempted to hasten the adoption of renewable fuels by lowering prices, or through subsidies (see section 3.4). Such policies can, however, create huge fiscal burdens and implementing them efficiently is often difficult. A better policy option for ASEAN countries would be to tax the environmental public bads that cause pollution. Concurrently, authorities need

Table 6.4 National Policy Options to Protect the Environment

Countries	Policy Options		
	I	II	III
Challenge IV.1 — Improve Environmental Protection and Natural Resource Management			
BRUNEI DAR.	Increase environmental awareness through Coral Triangle and Heart of Borneo initiatives	Reduce energy and public utility subsidies to encourage conservation	Strengthen BIMP-EAGA and other regional programs to preserve biodiversity and tackle other common environmental issues
CAMBODIA	Allow local communities to manage natural resources with other stakeholders	Cautiously invest natural resource revenues (oil, gas, etc.) to develop infrastructure	Increase investment in technology and R&D to mitigate the environmental impact of using natural resources
INDONESIA	Avoid energy subsidies and largely increase research funding in alternative energy sources such as biofuels	Increase funds to strengthen the institutional capacity to manage natural resources	Encourage households to use alternative energy sources and introduce strict regulations to stop deforestation and reduce greenhouse gas emissions
LAO PDR	Formulate a long-term strategy to balance economic and social development with environmental protection	Build capacity to monitor and enforce existing and new laws and regulations protecting natural resources	Conduct strict environmental assessments of development projects, especially those exploiting natural resources
MALAYSIA	Introduce energy pricing and regulatory policies to sustain non-renewable resources	Formulate a comprehensive energy policy embracing green technologies	Introduce a new water strategy to ensure cost-effective pricing mechanism and proper supply and quality standards
VIET NAM	Introduce strict environmental regulations on construction, transportation, and industrial activities to ensure compliance with international standards while minimizing adjustment costs for enterprises	Implement environmental protection and biodiversity conservation measures in river deltas and coastal areas	Increase funding to develop environmental technology and environment-friendly industries, particularly in cooperation with advanced economies
Challenge I.4 — Manage Limited Resources			
SINGAPORE	Expand land reclamation and develop vertical space above and under ground	Adopt a strategy to use space more efficiently for housing, transportation, and industry	Ensure ability to import natural resources and agricultural products
Challenge IV.2 — Ensure Energy Security			
THAILAND	Invest in alternative energy sources, such as bio-energy, nuclear, solar, and wind	Lessen dependence on fossil-fuel imports	Introduce regulations promoting the use of green production processes and energy-efficient products

	IV	V	VI
	Work with neighbors to reduce deforestation and depletion of marine resources		
	Bolster capacity building in public institutions managing natural resources	Employ best international practices in managing use of resources from the Mekong River and Tonle Sap Lake	
	Create a national agency for disaster prevention, early warning, and management	Introduce strict regulations to use fresh water, protect marine resources, and preserve biodiversity	Implement long-term strategy for climate change mitigation and adaptation and promote regional cooperation on the environment
	Provide training for public officials to strengthen the institutional capacity of natural resource management		
	Build local capacity to assess and monitor projects adopting green technologies, especially in ICT and other technology-intensive sectors	Adopt a strategy to become a regional and global leader in selected primary commodities such as oil and gas and palm oil	Introduce a strategy to expand production of downstream goods and services for primary commodities
	Introduce capacity building programs for local communities to participate in environmental protection schemes	Introduce programs that address natural disaster preparedness and potential climate change impact, particularly rising sea levels	Use sustained media coverage to enhance public awareness on environmental protection
	Ensure access to natural resources and agricultural products to improve energy and food security	Strengthen strategy to diversify water resources and develop new water technology	
	Build capacity of public institutions entrusted with managing natural resources		

(Continued)

(Table 6.4 continued)

Countries	Policy Options		
	I	II	III
Challenge I.5 — Improve Urbanization Management			
VIET NAM	Divert FDI concentration from large urban and industrial centers to rural areas to reduce pressures created by migrant workers on urban infrastructure	Properly sequence urban development to ensure resources are efficiently used to develop critical institutions and public infrastructure	Ensure migrant workers have access to basic facilities and services as urban residents
Challenge IV.2 — Ensure Energy Security			
SINGAPORE	Continue visionary urban planning and management	Improve design and pricing schemes to promote energy-efficient industries, services, processes, and lifestyles	Continue addressing key environmental issues such as air, water, land, and trans-boundary pollution

ASEAN = Association of Southeast Asian Nations; BIMP-EAGA = Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area; Brunei Dar. = Brunei Darussalam; FDI = foreign direct investment; Lao PDR = Lao People's Democratic Republic; R&D = research and development.
Source: Authors based on background papers prepared for this study.

to better enforce existing environmental plans and regulations, also as a way to encourage biodiversity and reduce ongoing devastation of marine, coastal, and forest areas (in Brunei Darussalam, Indonesia, Singapore, and Viet Nam).

ASEAN national authorities should eliminate utility subsidies so prices of energy sources reflect their full social and environmental cost. At the same time, interventions are needed to target the poorest households and mitigate the impact of price hikes—an important issue in Indonesia, but also in richer Brunei Darussalam. Several countries need to introduce policies that discourage fossil fuel energy production, limiting the increase in use of petroleum-related products and coal through expanded supply of renewable energy, such as biofuels (Indonesia, Malaysia, and Thailand).

Managing Urbanization

Adopting green urbanization strategies offers enormous opportunities to redesign cities on environmentally sound principles, providing for waste management, clean water, and better sanitation. With the exception of Singapore and Bandar Sri Begawan, most ASEAN cities need better electricity supply, safer water, and improved sanitation systems. Eco-friendly infrastructure is also needed to improve the efficiency of energy and power supply, drainage and sewerage, roads and railways, telecommunications, and water supply—ultimately upgrading the quality of life in existing urban communities, especially for those living in slums or other poor areas.

	IV	V	VI
	Use spatial development plans in urban infrastructure projects to increase their effectiveness	Identify indicators and obtain data to monitor urban poverty	Develop "smart cities" to improve the quality of urban life, starting with Ha Noi and Ho Chi Minh City
	Adopt measures to preserve biodiversity, and adapt and mitigate climate change and rising sea levels		

Adopting several relatively new technologies—such as rooftop solar panels, “smart” lighting, and closed-loop waste recycling—can help implement green strategies that use limited energy sources more efficiently and in an environment-friendly way. Singapore’s garden city concept is an excellent example of enmeshing greenery, plants, and trees as critical elements of urban design, which other ASEAN cities could follow.

6.4.3 Regional Policies for Protecting the Environment

Implementing environmental protection and natural resource management requires regional and global effort. ASEAN members should collectively contribute to slowing global warming by promoting low-carbon emissions and adopting environmental standards defining green products and production techniques. Governments should also introduce strict governance standards to protect the environment.

Several regional centers dealing with environmental issues have already been created in ASEAN to deal with energy, biodiversity, transboundary haze, and earthquake and meteorological information. Activities conducted by these centers should be expanded and strengthened following directions suggested by global and regional dialogues.

In addition, ASEAN members should strengthen efforts under the ASCC to define a long-term strategy that mainstreams green growth and encourages the use of eco-friendly, green products, services, jobs, buildings, and transportation systems. Governments should work to fully implement the strategy by actively promoting sustainable forest management through initiatives such as the Asia Forest Partnership and the Heart of Borneo Initiative (see section 3.4). Region-wide forest law enforcement and the adoption of strict governance standards should also be strengthened.

As pollution can easily cause damage as it spills over from one country to its neighbors, establishing an effective ASEAN dispute settlement mechanism is needed.

6.5 Financial Market Development

6.5.1 Overview

In many ASEAN countries financial markets remain underdeveloped. Equity, bond, and other capital markets need to broaden and deepen (see section 4.1). The financial reforms introduced in response to the 1997/98 Asian financial crisis made ASEAN financial markets more efficient, resilient, and better integrated with each other. However, these markets need to become more effective in mobilizing regional savings to finance regional investment—including long-term infrastructure projects. Reducing financial transaction costs and closing information gaps are prerequisite for a favorable environment for financial market development. But given ASEAN's pronounced diversity, policy requirements vary widely across countries. In particular, CLMV countries still lag and need to prioritize banking system development and broaden access to bank finance and lending—especially microfinance for farmers and SMEs.

As financial globalization deepens and markets become more sophisticated, ASEAN countries need to constantly upgrade their monetary and financial institutions' regulatory and supervisory capacity. They also need to promote financial innovation, while ensuring macroeconomic and financial stability. Still, financial services liberalization has been slow and ASEAN remains unable to fully exploit the potential benefits of financial integration.

Policymakers should encourage greater banking and insurance integration to gain from economies of scale, reduce costs through enhanced competition, improve financial stability and resilience, and increase bank capacity for financial intermediation. However, easing entry restrictions to foreign banks and insurance companies exposes domestic markets to the possibility that new entrants lack the capacity to adequately assess local risk. Also, new market entrants could narrowly concentrate on speculative cross-border transactions, inducing excessive capital flow volatility. Another risk is that foreign institutions could eventually grow to dominate domestic markets. ASEAN monetary and financial authorities should consider all these factors as they strive for further financial liberalization and integration, both within the region and the rest of the world.

6.5.2 National Policies

To mitigate the risks posed by liberalizing financial services, ASEAN countries should set preconditions for easing market entry, properly sequencing relaxation of entry rules — for example, distinguishing between banks and insurance companies from inside and outside ASEAN — and ensure information sharing between home and host country supervisors. To deepen and widen domestic bond markets and increase liquidity, expanding the number of qualified issuers and potential buyers is critical. For increasing the efficiency of equity markets, attaining critical mass, including widening the issuer and investor base, is also an essential requirement.

Capital Account Liberalization

ASEAN countries — with the exception of Singapore — still apply extensive capital controls, especially related to residents' ability to invest abroad (while nonresidents can usually buy domestic securities with few conditions). At the same time, all ASEAN countries welcome FDI, frequently offering very attractive incentive packages to investing firms. Capital account liberalization should be prudent and sequentially based on the extent and quality of a country's financial development.

Two opposing considerations dictate the pace and scope of capital account liberalization. On the one hand, the conventional wisdom on sequencing suggests that outflows should be the last to be liberalized — lifting restrictions on capital outflows should proceed judiciously. On the other hand, as several ASEAN countries are already net capital exporters — with central banks largely serving as intermediaries — a case can be made for promoting private capital outflows to mitigate currency appreciation pressures.

Moreover, the asymmetry in inflow and outflow controls implies that no meaningful de facto regional financial integration can take place, unless ASEAN countries become significant creditors to each other. On balance, easing controls on capital outflows should be on the liberalization agenda, starting with higher-income ASEAN countries, moving on to CLMV countries later. As part of AEC efforts to achieve free capital flows, ASEAN countries agreed to prepare national work programs for capital account liberalization, to be monitored by the ASEAN Secretariat, including a self-assessment of rules liberalizing FDI and portfolio investment, as well as capacity building initiatives.

Many ASEAN countries include broadening and widening financial markets part of overall policies to enhance macroeconomic conditions (Table 6.1) — only Brunei Darussalam explicitly included "financial deepening" as an independent policy option. But as the table explains, Thailand also requires a specific strategy to develop its financial markets — especially for corporate bonds — and to improve domestic financial supervision and risk management.

Other Policies

In addition to deepening and widening capital markets, policy options for individual ASEAN countries include promoting financial inclusion (see section 6.2) and the establishment of a modern payment and settlement system. Based on the experience of other developing economies, Cambodia also needs to consider creating a sovereign wealth fund to attract private investment for financing priority development projects, while the Lao PDR would largely benefit from strengthening microfinance support for SMEs and rural development. Myanmar—the ASEAN member where financial market development is expected to grow much faster than the rest of the region—must focus on creating a sound banking regulatory and supervisory framework, introduce specific initiatives to develop capital markets, and promote access to financial services and the development of proper market infrastructure for strengthening microfinance.

6.5.3 Regional Policies for ASEAN Financial Integration

ASEAN Finance Ministers adopted a Roadmap for Monetary and Financial Integration (RIA-Fin) in 2003, which guides regional initiatives for financial integration. The roadmap now forms an integral part of the AEC Blueprint (see section 4.1). During the 10 years since the RIA-Fin was adopted, considerable progress has been made in capital market development, financial services liberalization, and capital account liberalization—three of RIA-Fin's main components. However, discussions still lag on its fourth component—monetary cooperation.

Financial Market Development and Liberalization

As for initiatives aimed at developing financial markets, harmonizing payment standards will improve market efficiency and help ensure stability across the region. ASEAN authorities should harmonize the minimum prudential requirements required of their domestic banks. Standardizing accounting practices for financial services—and payments and settlement systems—will further ease development of the region's capital markets.

Overall financial liberalization—particularly in capital markets—is a strategic policy direction for all ASEAN countries. However, there may be cases where openness leaves a domestic market dominated by foreign institutions, as happened in Mexico, the Czech Republic, or Slovakia, for example.[158] National supervisors may think this poses a threat to financial stability and domestic credit creation.

To avoid this risk, preconditions may be needed for liberalizing market entry, and a two-track approach may be suitable—with financial market integration

158 In 2009, the share of total bank assets held by foreign banks was 75% in Mexico, 86% in the Czech Republic, and 88% in Slovakia. Recent studies suggest a negative correlation between the foreign bank presence and domestic credit creation in developing countries (Claessens and van Horen 2012).

moving more quickly among higher income ASEAN, spreading later to the CLMV countries when their financial systems become more developed. CLMV countries should be allowed to liberalize market access for foreign institutions only when internal conditions are propitious, avoiding the threat of swallowing up domestic firms. Alternatively, caps on domestic market shares of individual financial institutions may be introduced over the medium term by establishing appropriate competition policies.

Regional cooperation to further develop ASEAN equity markets is geared toward creating market infrastructure, building capacity to address gaps, and linking national equity markets. Several proposals have been put forward, including building an ASEAN asset class (ADB 2010b). A number of initiatives have also been introduced by the ASEAN Finance Ministers' Meeting, including the creation of an ASEAN Capital Market Forum and facilities such as the ASEAN Common Exchange Gateway and the ASEAN Stock Exchange Linkage Initiative.[159] Indeed, to gain from economies of scale in equity markets, financial authorities should harmonize listing standards and information disclosure requirements. By 2030, this could lead to the creation of an ASEAN-wide market for all locally issued securities.

Financial Market Supervision

While promoting banking and insurance integration, ASEAN policymakers must closely guard against risks. Easing entry restrictions increases the possibility that foreign companies jump in without adequate local risk management capabilities, exposing domestic markets to systemic risks should new-entry companies fail. Harmonizing minimum prudential requirements and ensuring information sharing between home and host country supervisors are prerequisite to mitigating these risks. Another risk occurs if foreign entrants excessively concentrate on speculative cross-border transactions, potentially boosting capital flow volatility.

Cooperation among ASEAN national supervisors aimed at building an integrated financial supervisory system would greatly bolster stability. In particular, ASEAN members should work toward building a mechanism that harmonizes financial supervision, starting from better integrating national systems. Robust institutions would need to be established to ensure sound financial governance — national and regional. Monitoring financial market development, harmonization, and integration could be done through the creation of an ASEAN Financial Stability Dialogue, as discussed in section 6.1.

An ASEAN College of Financial Supervisors (ACFS) could also be established well before 2030 as a permanent, yet flexible institution for cooperation and coordination among financial supervisors. Membership could consist of member

159 See the "Joint Ministerial Statement of the 17th ASEAN Finance Ministers' Meeting (AFMM)" issued 4 April 2013 in Bandar Seri Begawan, Brunei Darussalam.

countries' banking, insurance, and financial supervisors. The ACFS would assist national supervisors in monitoring ASEAN-wide financial groups, enabling them to develop a common understanding of risk profiles as a starting point for supervision. An additional ACFS role would be to coordinate decisions made by local authorities and contribute to the consistent implementation nationally of regionally coordinated policies.

Single Payment and Settlement System

As the volume of ASEAN cross-border financial transactions increases, the vision of a truly borderless economic community would not be complete without the inclusion of a risk-free, cost-efficient regional payment and settlement system. The system would combine a single platform — or harmonized system at least — of real time gross settlement, a retail payment system, and a foreign exchange transactions system (Khiaonarong 2013).

However, given the early stage of financial development in CLMV and a few other ASEAN countries, strong national payment and settlement systems must be developed prior to linking them with the rest of the region. They should be developed with an eye to joining the regional system later.

Credit Rating

Domestic rating agencies are available in Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam. In the future, national agencies may also be created in Brunei Darussalam, Cambodia, the Lao PDR, and Myanmar. Given the intraregional diversity in stages of financial market development, national credit rating agencies do not always use similar methodologies and criteria when rating companies or bonds. But to form a borderless ASEAN economic community, rating standards and methodologies must meld, eventually merging into a uniform ASEAN-wide credit rating system.

Comparable regional credit rating schemes will strengthen financial integration. Also, region-wide credit ratings would allow any investor access to ratings and other credit-relevant information based on uniform and transparent criteria across ASEAN. The presence of a uniform system would not prevent global rating agencies — such as Moody's, Standard & Poor's, and Fitch — from rating large issuers. Nor would it preclude the possibility of local agencies collaborating or associating with regional and global firms in developing skills and techniques. Existing institutions, such as the Association of Credit Rating Agencies in Asia, are already working to help harmonize different national systems.[160]

160 The Association of Credit Rating Agencies in Asia—established in 2001—includes 25 credit rating agencies from 14 Asian economies. The association regularly meets to improve and standardize rating methods used in the region.

Deposit Insurance

ASEAN countries have different deposit insurance systems — several have none. For those with deposit insurance, rates and coverage vary widely, especially in terms of maximum payout. These disparities must narrow for banking integration to proceed smoothly, or deposits could be withdrawn from institutions located in one country with a less favorable insurance system and transferred to countries with more favorable systems.

A single depository insurance system would help level the playing field for the region's financial institutions and create an integrated banking system based on a uniform definition of insured deposits. One possible approach for creating such a system would be to harmonize existing systems with respect to payout limit, coverage, and insurance rate, while ensuring a proper governance system that would avoid moral hazard. Eventually, an ASEAN-wide deposit insurance system would cover bank deposits of all members to prevent arbitrage between countries and to enhance regional financial system stability.

Other Areas for Financial Cooperation

Developing broader and deeper financial markets and creating a truly borderless ASEAN economic community requires tackling other areas of cooperation, including infrastructure financing, consumer protection, and capacity building initiatives.

Infrastructure Financing — Given the importance of regional infrastructure in promoting sustainable growth and economic development, in 2012 ASEAN established an ASEAN Infrastructure Fund to help finance priority connectivity projects through public–private partnerships (see section 4.3). This initiative could develop into an ASEAN+3 (or even wider-based) infrastructure fund, although ASEAN countries — individually and as a group — must ensure they retain appropriate management leverage, or project prioritization may occur based on interests external to the region.

Consumer Protection — Consumer protection laws are typically designed to ensure fair competition and the free flow of accurate market information. In finance, consumer protection not only helps boost welfare, it also improves efficiency by reducing information asymmetries and imbalances between providers and users of financial services. In ASEAN, however, while financial services users should be equally protected as in advanced economies, consumer protection for financial services remains underdeveloped. As ASEAN economies adopt best practices for financial integration, consumer protection regulations must also be harmonized over time.

Capacity Building Initiatives — ASEAN monetary and financial authorities and regulatory agencies must be adequately trained and equipped to promote regional financial integration. Currently, low-income countries lack the resources to build capacity, despite an acute need for training. ASEAN should use existing financial regional training and research institutes — such as the South East Asian Central Banks (SEACEN) — to help develop the needed human capital. Strengthening financial infrastructure will require assistance programs from more developed ASEAN members to the less developed ones. In addition, ASEAN should seek an arrangement for systematic assistance from its "Plus-Three" partners — the PRC, Japan, and the Republic of Korea — and from regional and international institutions such as the Asian Development Bank and World Bank.

6.6 Human Capital Development

6.6.1 Overview

Developing human capital — including the primary need to strengthen educational systems — is widely recognized as a key factor for achieving sustainable and inclusive development and building a competitive and innovative ASEAN. In shaping strategies, policymakers need to consider the major demographic changes countries will face in the medium and long run, as they affect education demand, labor supply, and health-related markets.

ASEAN's population is expected to reach 700 million by 2030, approximately 100 million above its 2010 level. Labor supply will increase accordingly, posing a major challenge to create new jobs while ensuring social security and providing workers the skills needed to sustain economic development. The region's population is not only expanding, but also getting older. Although dependency ratios have generally been declining, they will start increasing before 2030 — in most countries the demographic dividend will end over the next two decades (see section 4.2). To address the challenges related to a fast-aging population, ASEAN countries should enhance the delivery of health-related and other public services used by the elderly.

ASEAN social security systems tend to be weak — Brunei Darussalam and Singapore are exceptions — with the supporting system for the aged relying on informal and community- (or family-) based systems. Thus, there is an urgent need to establish effective, properly funded social security systems and health services across the region. Beyond investment in basic health care, safe water and sanitation must be available to prevent disease in urban and rural areas — especially in CLMV countries and the least developed provinces of Indonesia and the Philippines.

ASEAN countries need to invest more in education, a strategy involving not simply allocating more resources, but also improving education quality. Curricula must continually be reviewed to match skills that will be in demand over the coming decades. Introducing a wide mix of subjects amid ever-shifting labor market demand must be guided by public–private partnerships and institutional support for continuing education. Developing ICT requires both software engineers and semi-skilled technical personnel. Improving primary education is one key policy direction that must be supported by more affordable, accessible, and high-quality technical secondary education.

While every ASEAN child should have the opportunity to attain higher education, vocational schools should be available for those who stop sooner, shaped by new, innovative sectors. Closer coordination with the private sector can help define and train for the skills needed.

As ASEAN countries increase income levels, productivity will rely less on physical labor and more on intellectual skills. ASEAN will need fewer laborers in the field and more at the desk. The age at which a person provides useful, productive labor is rising just as population is aging. ASEAN labor markets must therefore be flexible enough to support the elderly, ensuring their actual and potential skills are not wasted. The challenge lies in preparing people for the shift in workforce role ahead of time.

Education systems must evolve and provide lifetime learning that allows workers to upgrade their careers as labor demand as well as their own life cycle evolves. While a wide set of ASEAN human capital development indicators have improved, there remain significant gender gaps in education, health, and formal employment opportunities, preventing women from fully realizing their potential — and thus that of the region.

6.6.2 National Policies

ASEAN countries need to conduct a detailed analysis of their domestic labor markets and introduce educational strategies that properly match demand with supply (see section 4.2). All countries must strengthen technical and vocational training and the private sector should be allowed to have a more prominent role in offering training programs.

Myanmar, in particular, needs to liberalize its education sector to allow private institutions to operate in the market and to expand the Ministry of Education's capacity to modernize curricula at all levels. Other least developed ASEAN countries like Cambodia, the Lao PDR, and Viet Nam should increase public R&D spending to increase the science base of tertiary education and offer training programs specifically designed for teachers. They should also improve facilities and school-related infrastructure to expand educational opportunities for all — a policy that Malaysia and Thailand should adopt as well.

Judging from Millennium Development Goal indicators, ASEAN health systems need to be strengthened, especially in the CLMV countries and in some parts of Indonesia and the Philippines, to continue the process of improving health, especially for women and children. More advanced Brunei Darussalam and Singapore, which depend on the supply of foreign skilled workers, need to continue policies offering incentives to expatriates, including attractive benefit packages and pension systems. Singapore should also introduce policies to raise fertility, emphasize work-life balance, and improve female labor participation. A specific policy recommendation for Malaysia and Viet Nam is to provide incentives to attract their own professional expatriates working abroad (Table 6.5).

6.6.3 Regional Policies to Harness Human Capital Development

Education

An ASEAN-wide human capital development strategy must support increasing the region's competitiveness and innovation. At all educational levels — primary, secondary, tertiary — there should be a focus on science, technology, engineering, and mathematics to underpin a region that is technologically ready to promote progress and innovation. A policy for matching education with the needs of the labor market should be structured to meet the rising labor demand in service industries, particularly those related to ICT.

Another important goal for strengthening the ASEAN labor market is to introduce structural reforms aimed at guaranteeing equal opportunity for women, adopting region-wide standards for eliminating discriminatory employment barriers. Gender disparity remains a major issue in many ASEAN countries that needs to be tackled with policies to improve job opportunities and working conditions for women. These include the introduction of maternity leave systems for males, the provision of effective childcare systems, as well as proactive measures to promote career and managerial development of women.

To help create an ASEAN community, better prepare Southeast Asian students to meet the challenges of globalization, and build regional identity, ASEAN should expand its existing scholarship and exchange programs to encourage more students to study abroad. Exposing students from different ASEAN countries to each other through carefully crafted and structured regional programs will help build an ASEAN-wide labor pool, at the same time helping build an ASEAN community that better understands its own identity.

An *ASEAN credit transfer system* has already been created within the ASEAN University Network to facilitate student mobility under the AEC — part of the free flow of skilled labor. The EU can provide useful lessons to improve ASEAN's existing system. In Europe, the possibility to study abroad in partner universities with credits properly transferred was introduced more than 25 years ago through the Erasmus Programme, a system allowing undergraduates to spend 6 months of college in foreign universities (one or two), while receiving full credit for the subjects and course-grades received abroad. Later, through the so-called Bologna Process (started in 1999), European countries have been refining a region-wide system to allow comparability in the standard and quality of higher education qualifications, including overall harmonization as well as transfer of credits. Other properly designed programs should be introduced in ASEAN countries for teacher exchange and vocational training.

Labor Market

The mutual recognition of ASEAN educational standards and job qualifications is a target included in ASEAN Labour Ministers' work program for 2010–2015 (see section 4.2). In particular, the program includes the creation of "national skills frameworks" in each country as a first step — classified to facilitate mutual recognition of professions and skills across the region — before they are (mutually) recognized by other ASEAN members.

Policymakers must ensure that once national skills frameworks and mutual recognition agreements (MRAs) are in place, they can be effectively used to facilitate regional migration of skilled labor. In addition to the MRAs already signed in advance of the AEC (for accountants, architects, dentists, engineers, medical practitioners, nurses, some providers of business-related services, surveyors, and tourism professionals), by 2015 all MRAs related to professional services must be in place to meet the requirement for the free movement of skilled labor.[161] A related issue for ASEAN labor efficiency is to strengthen an institutions' ability in labor surplus countries to match skills with those needed in labor deficit countries (see Table 4.6).

A truly borderless ASEAN economic community should move beyond the AEC provisions for free skilled labor movement across the region. Besides achieving the full recognition of skills and providing conditions for ASEAN workers to actually transfer and live in other member countries — fully synchronizing immigration laws and visas in the region — policymakers should tackle the more difficult issue of managing migration flows of unskilled workers. A system of *"freer but managed migration for unskilled labor"* needs to evolve from the ASEAN Declaration of Protection and Promotion of the Rights of Migrant Workers endorsed by ASEAN leaders in 2007. A proper ASEAN registry of foreign workers is needed to map the presence of migrant labor and provide workers with proper protection against potential discrimination and abuse on the work site.

Indeed, labor migration is a sensitive political issue in most countries. But to build a regional community that accommodates cross-border investment and encourages rationalization of resource use flexibly, ASEAN must develop an integrated system of managed labor movement based on a common framework across the region — whereby workers can more easily in response to changes in labor demand. There will be challenges in meeting such an ambitious goal. The wide diversity in the quality of labor protection, social security, and governance systems across the region will make it difficult to agree on common standards needed to encourage labor mobility. Increasing the quantity and quality of information available on ASEAN-wide migration is the logical starting point for

161 Professional services relate to the following sectors: air transport, business services, construction, distribution, education, environment, financial services, health care, logistics, telecommunication, transport, and tourism.

Table 6.5 National Policy Options to Harness Human Capital

Countries	Policy Options		
	I	II	III
Challenge II.4 — Develop Human Capital			
BRUNEI DAR.	Link tertiary education with private sector operations to better provide skills that match emerging labor demand	Design programs and provide incentives for local skilled workers to gain experience abroad in relevant industries	Rationalize the public pension system to boost incentives for joining the private sector
CAMBODIA	Use an integrated approach to improve the overall quality of education	Improve school infrastructure of rural areas to achieve universal secondary education	Increase supply of technical and vocational schools to match demand for skilled labor
LAO PDR	Upgrade the quality of teachers and enhance the national education system to align it with labor market needs	Strengthen higher education, especially in engineering and other science-based subjects, to match labor demand	Boost vocational and technical training in engineering, tourism, and health care
MALAYSIA	Increase pre-school enrollment and implement the Education Blueprint 2025 to provide quality education for all and create a globally competitive workforce	Strengthen training programs for teachers and other trainers to raise their overall quality	Increase public facilities to reduce disparities in the quality of education among states, and between rural and urban areas
MYANMAR	Lower tuition fees of tertiary education institutions to increase enrollment ratio	Train civil servants of key government agencies to enhance their capacity to promote economic and social development	Liberalize education sector to private institutions and expand the capacity of the Ministry of Education to modernize curricula at all levels
THAILAND	Review the education system and its overall management to provide equal access for all	Introduce accountability and evaluation procedures to improve quality of education	Design flexible skills development programs to respond to changes in labor demand
VIET NAM	Expand national education and training system and focus on getting a better matching between the supply and demand of skilled labor	Increase public R&D spending; promote exchanges between universities, research centers, and firms to boost use of new technologies	Promote mutual recognition of ASEAN educational standards and qualifications to increase labor competitiveness
Challenge II.5 — Address Demographic and Labor Constraints			
SINGAPORE	Use pro-family policies to raise fertility rates; emphasize work–life balance and child-rearing incentives	Ease post-natal re-entry and expand part-time employment to improve female labor participation	Raise retirement age and revised retirement schemes to expand labor participation

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; R&D = research and development.
Source: Authors based on background papers prepared for this study.

	IV	V	VI
	Increase number and quality of technical and vocational schools to match demand for skilled labor		
	Improve teacher quality and governance system of tertiary education	Institutionalize research and development activities in higher education institutions	
	Increase R&D investment and introduce tax incentives to promote skills training from the private sector	Encourage the private sector to contribute to human resource development at all levels of education	
	Introduce incentives attracting professional Malaysians working overseas to repatriate	Meet the 60% target of secondary school enrollment in science and technology	Strengthen technical and vocational training and increase access to higher education in engineering and electronics
	Create schemes and offer incentives for the private sector to provide vocational training	Improve capacity of the Ministry of Health and other public agencies responsible for delivering health services	
	Increase private sector role in providing vocational education	Strictly enforce existing laws requiring large companies to introduce worker-designed training programs	
	Introduce incentives for professional overseas Vietnamese to repatriate	Provide vocational training programs for rural workers to satisfy labor demand	
	Adopt labor-saving technologies and processes, and redesign job manuals to save labor inputs	Continue with recruitment of foreign professionals using incentives such as scholarships and easing procedures to receive Singaporean citizenship	

future policy coordination, including the introduction of International Labour Organization standards.

6.7 Seamless Connectivity

6.7.1 Overview

Building seamless connectivity is a key enabling factor in reaching many ASEAN objectives and aspirations, from increasing the region's competitiveness to ensuring inclusive and equitable long-term growth and development. The ASEAN Master Plan on Connectivity (MPAC) offers a comprehensive and updated framework for specific policies aimed at connecting the region with itself and the rest of the world. It covers all areas related to infrastructure development, institutions — regulatory frameworks — and people-to-people exchange.

6.7.2 National Policies

The need for physical infrastructure varies remarkably across different ASEAN countries. It ranges from the road and railway links across continental Southeast Asia — stretching from the western borders of Myanmar to Singapore — to the maritime links connecting the many remote islands in Indonesia and the Philippines with centers of economic and social activity. Since the mid-1990s, the Greater Mekong Subregion (GMS) program has assisted the development of transport infrastructure across continental ASEAN. However, countries such as the Lao PDR and Viet Nam are keen to further improve coordination of the GMS within the MPAC and other region-wide programs, especially to avoid duplication and to extend the benefits of transforming existing transport corridors into full economic corridors (see section 4.3).

For maritime connectivity, most ASEAN countries need to enhance port efficiency. Many of the region's ports — with the exception of those in Singapore and Malaysia — remain subpar, especially those in the poorer, more isolated islands of Indonesia and the Philippines. Studies suggest that vessels involved in domestic trade in Indonesia spend over half their travel time simply waiting inside or outside ports (USAID 2008). Indonesia and the Philippines must upgrade their port facilities, allowing more active participation from the private sector. They need to introduce market-based services and expand the use of roll-on/roll-off ferries. In general, ASEAN countries should encourage the development of multi-modal transport systems to increase transport efficiency (Table 6.6).

Enhancing road links is a policy priority for the Lao PDR to better connect rural and urban areas. This is also true for Myanmar, where domestic connectivity urgently needs to be strengthened through more extensive provision of electricity and telecommunication systems. Improving existing airport facilities and building new ones is an important policy direction for continental as well as archipelagic

ASEAN. Strengthening coordination between national and local governments in planning and implementing infrastructure investment is particularly urgent in Indonesia, Myanmar, the Philippines, and Viet Nam. Overall, ASEAN countries should simplify government procedures to receive more private capital for public–private partnership (PPP) programs.

6.7.3 Regional Policies to Build Seamless Connectivity

The MPAC provides the overall direction and priorities to build a seamless ASEAN. Ensuring the plan's timely implementation is of utmost importance to support the AEC and create a borderless economic community. Infrastructure must be expanded to provide smooth transport of goods, supply energy, and communicate. The policy environment needs to be refined and reformed to increase the efficacy of investments in hard infrastructure. People-to-people exchange should also be promoted to build a better sense of regional identity and shared ASEAN community.

Infrastructure Financing

The MPAC needs to be matched with sufficient financing. The recently created ASEAN Infrastructure Fund (AIF) should be expanded to increase both its size (considerably) and membership by inviting "Plus-Three" (the PRC, Japan, and the Republic of Korea) and other countries to join as contributors, while ensuring proper management control of the fund by ASEAN countries. The number of projects AIF is currently able to fund is only a fraction of those identified by ASEAN countries and included in the priority AIF list. Much more can be done to prioritize those eligible for funding.

Also, PPPs should be more actively promoted to expand the sources of finance for regional infrastructure projects. PPPs often require difficult political and legal work for land acquisition or the review and revision of public utility rates (electricity or water fees, for example). Weak government capacity to carry out this work in a timely fashion — to international standards and with contractual consistency — can put projects at risk. ASEAN as an organization can help by setting common standards consistent with international best practices and providing capacity building in CLMV countries.

Creating a Single Aviation Market

ASEAN policymakers should prioritize removing policy barriers to cross-border air travel — which is behind schedule — or members may quickly lose the competitive advantage of creating a unified market to large neighbors such as the PRC. While the ASEAN Single Aviation Market is a major 2015 target (see section 4.3), it remains substantially easier to travel from provincial locations to capital cities in most ASEAN members than to neighboring countries. This creates obstacles to regional tourism as international flights

Table 6.6 National Policy Options to Develop Economic Infrastructure

Countries	Policy Options		
	I	II	III
INDONESIA	Open port systems to private sector operators and introduce privately-run roll-on/roll-off ferries	Simplify government procedures for infrastructure project approvals to promote PPP	Increase approvals of public and private investment improving road and railway efficiency and ensuring their maintenance
LAO PDR	Construct transport infrastructure such as roads and bridges using a “land link” strategy to improve connections between urban and rural areas	Modernize and expand domestic and international airports	Improve local infrastructure to transform GMS transit corridors into economic corridors linking with neighboring countries
MYANMAR	Increase investment in transport, power, telecommunications, water, sanitation, urbanization, and rural development	Introduce policies to attract external financial and technical assistance for developing the transport sector	Develop modern and efficient airports, ports, railways, and roads ensuring their proper maintenance
PHILIPPINES	Introduce a comprehensive and integrated infrastructure program that emphasizes cooperation between national and local governments	Expand use of build–operate–transfer schemes and PPP for infrastructure development	Implement the Electric Power Industry Restructuring Act as soon as possible
VIET NAM	Popularize use of PPP to mobilize resources for infrastructure investment	Strengthen public coordination of infrastructure investment at the provincial level	Improve investment coordination with other GMS and ASEAN countries to enhance regional connectivity avoiding duplication

ASEAN = Association of Southeast Asian Nations; GMS = Greater Mekong Subregion; ICT = information and communication technology; Lao PDR = Lao People’s Democratic Republic; PPP = public–private partnership; SMEs = small and medium-sized enterprises.
Source: Authors based on background papers prepared for this study.

originating from provincial airports remain rare. Without a truly borderless ASEAN aviation market, members will be unable to leverage the growth of regional tourism.[162]

Overall, ASEAN is committed to liberalizing air traffic for passengers and cargo. The ASEAN Multilateral Agreement on Air Services and the ASEAN

162 For a more detailed discussion on the ASEAN Single Aviation Market, see the ASEAN Secretariat website for the Joint Ministerial Statement Seventeenth ASEAN Transport Ministers Meeting, 2011. Initiatives such as BIMP-EAGA and IMT-GT have also frequently cited the importance of these air links in their 2012 blueprints. ASEAN ministers also stressed coordinating policy efforts over a wide range of areas, including customs and health for phyto-sanitary and quarantine issues, for example.

	IV	V	VI
	Strengthen public coordination of infrastructure investment between national and local governments		
	Develop and modernize logistics infrastructure using PPP to lower transport costs		
	Improve telecommunication infrastructure such as internet and telephone lines to facilitate technology leapfrogging in ICT		
	Modernize port operations and expand use of Subic Bay Freeport	Harmonize transport regulations and streamline public transport agencies, including the Philippine Ports Authority	Liberalize international air cargo and expand use of Clark International Airport
	Revise and implement a master plan to improve infrastructure investment in transportation, energy, urbanization, and ICT	Introduce financial sector master plan to develop a more balanced system, strengthen institutions, deepen bond markets, and improve access to microfinance for SMEs and rural communities	Strengthen regional financial cooperation, including initiatives to develop the banking sector, manage capital flows, and improve liquidity support

Multilateral Agreement on the Full Liberalization of Passenger Air Services have already been signed. These allow, in principle, air carriers freedom to initiate cross-border flights from any international airport to any other international airport in member countries. In practice, however, many impediments remain.

For example, both Indonesia and the Philippines have yet to ratify the overall air services agreement, so they remain excluded from current regional liberalization. In addition, Brunei Darussalam, Cambodia, the Lao PDR, and Indonesia, have yet to ratify the passenger air services agreement, while the Philippines continues to request Manila's exclusion from the agreement. In addition, the 2010 agreement still falls short of fully liberalizing cargo service, as the ability of an ASEAN-based foreign airline to connect two domestic points in a member country — the right of cabotage—is not included. Similarly, a same airline cannot connect two cities in ASEAN member countries if its own country is not included as the starting or ending point (a Malaysian carrier, for example, cannot connect Singapore with any other ASEAN city without the flight originating or terminating in Malaysia).[163]

It is clear that the intra-ASEAN liberalization process must accelerate to keep pace with global market trends and help bridge regional development gaps. More importantly, ASEAN may rapidly lose intraregional market share to carriers from the PRC and other countries. While the two ASEAN multilateral agreements on liberalizing regional aviation remain incomplete, five ASEAN governments (Malaysia, Myanmar, Singapore, Thailand, and Viet Nam) nonetheless signed the ASEAN–[People's Republic of] China Air Transport Agreement in 2010. This agreement gives a de facto competitive advantage to PRC carriers in connecting two cities from any ASEAN signatory with the PRC. ASEAN countries remain constrained by their own impediments.

Domestic lobbies supporting existing airline companies should realize that in the long run they will be unable to compete with PRC carriers. ASEAN authorities urgently need to create a truly unified regional aviation market to raise its regional profile in air transportation and tourism.[164]

6.8 Governance Issues

6.8.1 Overview

The positive effects of economic growth and development tend to be closely associated with governance and quality of institutions available in emerging countries. World Bank governance indicators show a broad spectrum of quality levels across the region. While all ASEAN countries will benefit from adopting international best practices—following principles of transparency, accountability, and equity—idiosyncratic adjustments are needed to account for the region's huge diversity, reflecting local practices, levels of development, and the presence of various stakeholders.

In governance indicators, CLMV countries tend to rank low compared with the ASEAN-6. Indonesia and the Philippines, however, rank below Viet Nam on several indicators (political stability and the absence of violence, rule of law, and control of corruption). And while the most recent available survey on "economic freedom" shows an encouragingly high ranking for Cambodia, ASEAN's best

163 ASEAN countries have yet to agree on fully liberalizing foreign airline ownership. Still, ASEAN-based airlines can typically only expand in other member countries by incorporating or creating joint ventures with local airlines.
164 The five ASEAN members not covered by the agreement with the PRC (Brunei Darussalam, Cambodia, Indonesia, the Lao PDR, and the Philippines) can join whenever ready.

performers remain Singapore, Malaysia, and Brunei Darussalam, with Thailand fourth (see section 4.4).

Policy reforms related to law enforcement are probably the most urgent initiatives needed in ASEAN countries to strengthen domestic governance. Improving the overall legal quality and administrative integrity will help solidify ASEAN as a regional hub in production networks and supply chains. ASEAN as an institution has indeed an important role to play in coordinating and encouraging individual members to improve internal governance and institutions. Strategies, policies, and laws related to "competition" issues also play a strategic role in implementing the AEC. Still, Brunei Darussalam, Cambodia, Lao PDR, and Myanmar do not have a competition law, while the Philippines is currently finalizing one and creating a Fair Trade Commission.

6.8.2 National Policies

Although the quality of governance and institutions varies greatly across ASEAN countries (see section 4.4), policies aimed at strengthening governance and institutions tend to have quite uniform requirements for promoting ASEAN economic development. With the notable exception of Singapore, all ASEAN members need to strengthen contract enforcement and the rule of law. Governance and regulatory reforms are widely needed to limit corruption.[165]

Domestic public sector reforms that increase transparency and introduce best practices are general priorities for the entire region — including the need to improve local communication strategies (Indonesia) and to streamline court procedures (Philippines).

The success of institutional reform pivots on the strength and independence of the national civil service. Civil servants should possess enough skills to align short-term government targets with their country's long-term needs. Therefore, with civil service reforms needed in most ASEAN countries, concerted efforts to train and develop efficient and independent national civil services should be prioritized. Reforms should focus on enhancing the quality of public servants and adjusting salary structures to attract and retain competent people. Various studies link rising civil servant salaries with declining corruption levels (Table 6.7).

6.8.3 Regional Policies for Strengthening Governance

As a starting point to the creation of an ASEAN-wide approach to strengthen governance and institutional quality, standards and practices should be harmonized across the region. Close coordination among member governments, national and regional institutions, nongovernment agencies and other stakeholders is needed to

165 It should be noted that policies to prevent and reduce corruption are not only needed in ASEAN but across the world, in developing as well as advanced countries (Kaufmann and Kraay 2002).

exchange relevant information and views on the intrinsic differences in national policies and procedures across the region. Based on reciprocal understanding, national authorities can more easily agree on the comparability and possibility of better unifying standards and practices applied in each country. Consultations are also necessary with national chambers of commerce and other private sector organizations, those mostly affected by decisions taken on issues related to the quality of governance and institutions.

Table 6.7 National Policy Options to Strengthen Governance and Institutions

Countries	Policy Options		
	I	II	III
CAMBODIA	Implement existing reforms to decentralize and improve public administration, as well as legal and judicial systems	Introduce regulation to minimize rent-seeking activities and maximize effectiveness of public institutions	Implement agreed measures to ensure transparency of public institutions
INDONESIA	Introduce a communication strategy to instill principles of good governance as a civil service mindset to build integrity, accountability, rule of law, and transparency	Reform public administration to raise its quality and efficiency at the central and local levels	Strengthen regulatory oversight and law enforcement to reduce corruption and boost trust in the public administration
MYANMAR	Reform and restructure government institutions: particularly agriculture, finance, central bank, education, and health	Create new institutions to support economic development such as an investment board and an agency for special economic zones	Update existing laws and introduce new ones on land use and rights, enterprises, and environmental safeguards to strengthen the legal system
PHILIPPINES	Adopt an effective competition law and create an agency to discipline markets, curb monopolies, and level the playing field	Strengthen linkages across government agencies, adhere to the rule of law, and streamline procedures to improve delivery of public goods	Streamline court processes, increase transparency, and strengthen the Ombudsman and public prosecutors to curb corruption
THAILAND	Reform the public sector adopting international best practices and improving transparency	Encourage the private sector to participate in anti-corruption campaigns	Reform the legal and regulatory framework to prevent corruption
VIET NAM	Further reform public administration to improve transparency, accountability, professionalism, and public participation	Continue judiciary reforms to increase protection of people's rights and ensure enforcement of the rule of law	Accelerate SOE market-based reforms and improve competition policy to ensure a more leveled playing field with the private sector

ASEAN = Association of Southeast Asian Nations; FTA = free trade agreement; SOE = state-owned enterprise.
Source: Authors based on background papers prepared for this study.

Any common approach to building an ASEAN regulatory framework will have to grapple with issues such as the issuance of permits and licenses, dispute-settlement mechanisms, resolution of conflicts relating to competition policies and laws, harmonization of standards, customs procedures, trade facilitation measures, legal conformity, and so on. Institutional structures and their design will greatly affect the way these issues will be handled and resolved. Thus, to facilitate convergence toward a single regional standard, ASEAN authorities should take special care in

IV	V	VI
Increase remuneration of civil servants to curb corruption	Implement strategy to increase capacity of local government agencies in public administration and other areas	
Introduce capacity-building programs to strengthen quality and efficiency of central and local governments	Simplify procedures for starting businesses, strengthening investor protection, and registering property	
Reform the legal framework governing state enterprises to level the playing field with the private sector	Adopt a strategy to increase transparency and promote decentralization of public administration	
Increase government salaries, especially higher echelons, and improve working conditions of civil servants	Continue public procurement reforms, and increase transparency by posting in government website contract details and actions of the Bids and Awards Committee	Streamline government agencies to eliminate redundancy and unnecessary expenditures, especially by local governments
Reform civil service recruitment to attract and keep qualified public administration personnel		
Improve macroeconomic policy coordination among government agencies and create more effective economic surveillance and financial supervision	Harmonize regulatory reforms within the regional integration process, from negotiating to implementing commitments, especially FTAs	

designing and molding high-quality national institutions, based on sound principles of transparency, accountability, and equity, among others (ADB 2010a).

The regulatory burden and multiplicity of issues, standards, and practices present in different ASEAN countries are often seen as major impediments in establishing a regional investment hub. Over time, ASEAN should create an *ASEAN Governance Institute (AGI)*—a strong and independent agency to serve as the venue to work out regional regulatory issues.

This new agency would collaborate closely with the ASEAN Secretariat and focus on three broad tasks: (i) designing and implementing regulatory frameworks applicable to ASEAN-wide issues, (ii) assisting and supporting members as they introduce and strengthen their domestic regulatory institutions; and (iii) promoting close cooperation among ASEAN institutions to create a region-wide investor-friendly regulatory environment. As the underlying foundation for regulatory frameworks, this new institution should stress principles of good governance—both nationally and regionally.

Strengthening Competition Policies and Laws

Creating a competitive region requires the adoption of best practices related to competition policies and laws. While work continues through the ASEAN Experts Group on Competition (see section 4.4), an *ASEAN Competition Authority (ACA)* should be established before 2030 to monitor implementation and compliance with national competition laws. Its overall objectives should be to (i) limit the formation of cartels and monopolies, (ii) avoid anti-trust practices such as the abuse of market dominance and excessive concentration of economic power, (iii) advance consumer protection, and (iv) introduce campaigns that advocate the benefits of competition.

As ASEAN integration progresses, the urgency for a harmonized competition policy and law becomes ever more critical. ASEAN members without competition laws should begin preparing national strategies that can easily meld with an eventual regional competition law and policy—one designed, crafted, and approved by all ASEAN members. A region-wide, unified competition policy and law is needed by 2030 for a truly borderless ASEAN economic community.

6.9 Institutional Architecture

6.9.1 Bolstering ASEAN's Global and Regional Role

Strengthening ASEAN's institutional architecture and governance is a natural stepping stone if the group is to remain relevant to its member countries and external partners. Reforms are needed to establish an effective AEC and to create a truly borderless economic community by 2030. To fully exploit the benefits of increasing economic integration with the rest of the world, ASEAN must considerably increase the powers member countries delegate to common institutions—such as the ASEAN Chair, Secretary-General, Committee of Permanent Representatives (CPR), Secretariat, and certain functional institutions.

In particular, the role of the ASEAN Chair and Secretary-General in global forums such as the Group of Twenty (G20) and other similar institutions should be elevated from merely taking notes on behalf of member countries to the ability to articulate a unified agenda of regional interests. Strengthening ASEAN's global role also requires consolidating the central role the group plays in regional cooperation, ensuring its initiatives are compatible with global dialogues and processes.

ASEAN policymakers must ensure that measures adopted by members both cement regional integration and strengthen links with the rest of the world, contributing to—rather than jeopardizing—the trend toward global economic integration (section 5.1).

6.9.2 Reforming Key ASEAN Governing Mechanisms

In order to increase institutional efficiency, ASEAN must update some of its key governance principles: its unique approach to (i) decision making, (ii) financial contributions, (iii) delegation of powers from national to regional agencies, and (iv) the introduction of sanctions, feedback, and compensating mechanisms to those who must adapt if they are to reap the benefits of integration. Critically, the ASEAN Secretariat's human and financial resources must increase significantly to help coordinate and implement ASEAN agreements and cooperation initiatives. A credible ASEAN civil service needs to be established to support the attainment of the group's 2030 aspirations.

Increasing Flexibility in Decision Making

ASEAN's approach to decision making needs to become more flexible, introducing the possibility of applying qualified majority systems for non-fundamental day-to-day operations, while maintaining consensus for deciding on fundamental issues (see section 5.2). It is time ASEAN moves beyond consensus to better suit its emerging needs, especially for decisions on economic and social matters.

While the ASEAN Charter provides for the ASEAN Summit to decide on alternative decision-making methods in the case consensus cannot be reached, a qualified majority system should be adopted as a new "default" principle for operational and non-sensitive areas—excluding security and foreign policy issues. Several schemes are available for defining voting powers under a qualified majority system. Sometimes, a simple majority will do, while in other situations shares as high as 75% may be required, with additional qualifications also needed.

An important aspect in the decision-making process is defining voting powers. In the CMIM, for example, voting powers are decided on the basis of an economy's financial contribution (85% of total) and equally distributed initial voting rights (15% of total). The five largest ASEAN economies have equal voting powers (forming 21.9% of total) while the other economies hold smaller shares (see Table B3.1 in chapter 3).

Population and GDP are the two standard indicators used in allocating voting powers among members of regional groups. Other often used variables include total land area and trade volume. An important factor usually considered in allocating voting powers is the need for positive biases to protect minorities, those who may suffer if calculated ratios are otherwise applied straightforwardly.[166]

The chapter appendix outlines a sample of different combinations available based on which variable—or set of variables—is adopted (Table A6.1, Figure A6.1). Political decisions are needed to decide which indicators to use in calculating weights to assign voting powers.[167]

Diversifying Financial Contributions

To ensure sufficient financing, ASEAN leaders need to seriously rethink how contributions are collected. Any real improvement on funding the ASEAN Secretariat must come from a clear shift from equal budget contributions to more diversified schemes. Although flexibility implies allowing different weights for countries in governing bodies, a positive bias can be introduced as a balancing factor in favor of small countries—or minorities (see section 5.2).

Updating the budget contribution principle can be done by introducing a simple, periodically revised formula based on two factors. First is an individual member's ability to pay, in line with the idea that contributions are part of the regional social responsibility supporting ASEAN's collective action. As integration gains can vary by economic size, the second factor relates to the extent a member country benefits from regional projects and activities. While defining formulae will require compromise among members, once clear principles are enunciated, these calculations can be used to form new standards, balancing efficiency with equity.

Proposals so far to supplement finance beyond the ASEAN Secretariat budget include the creation of a multi-donor fund—with voluntary contributions made by member countries. While it may take time to establish the fund, it is also

166 When the proportion between the largest and smallest voting shares is too large, scholars have suggested calculating new distributions based on natural logarithms instead of actual numbers (Setboornsarng and Singh 2012b).

167 For example, ASEAN's largest country—Indonesia—holds close to 40% of the group's total population, GDP, or land area. However, when adjustments are made to account for other factors, its total voting power may fluctuate from 12.5% to 19.5% of the total. Similarly, while Brunei Darussalam's share of total population, GDP, or land area is less than 1%, its voting power can increase to the 3%–6% range, after adjustments are made. The largest change is usually required for Singapore, with ratios varying between 4% and 15.5% of ASEAN's total shares, depending on the choice of variables used to determine voting powers.

possible to pool available funds under the existing ASEAN Development Fund (ADF) — linked to operations in a wide range of functional areas.[168]

In particular, the ADF could play a more central role in driving the ASEAN community-building agenda and become more effective in project financing — allowing for operational decisions to be made through a qualified majority system. While ADF activities have been limited, and the fund has often performed below expectations, its governance and administration can be improved by asking finance ministers to assist in its overall structure and project prioritization, entrusting professionals to daily management.

Delegating More Powers to Common Institutions

Although ASEAN was not established with the idea of transferring sovereignty from national to regional agencies, the extent of powers currently delegated to common institutions — including the ASEAN Secretariat, Summit, CPR, and functional agencies — need to gradually increase as integration plans become more ambitious. While the ASEAN idea of devolution from national to regional agencies is fundamentally different from that of the EU, ASEAN's current system of delegating power should evolve toward strengthening the role of common institutions (see section 5.2).

The new regional market created by the AEC underscores the need for greater power to be delegated from members to ASEAN institutions. Under the AEC, centralized agencies must be granted the needed authority to effectively standardize and harmonize rules and regulations across the region, as well as monitor the implementation of member countries' agreements and commitments.

The greater mandate conferred by the ASEAN Charter to the ASEAN Secretariat for settling disputes (Articles 22–27) — and the related need for establishing a new legal department within the Secretariat for monitoring compliance — suggest the critical importance of an increase in authority delegated to common regional institutions. Also, upgrading the approach to building a strengthened ASEAN technocracy is urgently required.

Eventually, member countries need to realize that as ASEAN ambitions grow and its agenda widens, the gains from substituting national sovereignty with shared regional sovereignty — in several distinct areas — will increase dramatically. This is particularly true as cooperation on economic and social issues expands with respect to political and security issues. Despite these benefits, it must be made clear that it does not require the creation of a bloated regional bureaucracy — or an EU-like ASEAN.

168 During the ASEAN Summit in Vientiane, Lao PDR, in July 2005, the ADF was created with \$10 million in initial capital. Under the purview of the foreign ministers, the ADF aims to provide seed money to leverage funding for regional cooperation programs and projects from external donors. Contributions come from ASEAN member states and dialogue partners.

Introducing Sanctions, Feedback, and Compensating Mechanisms

Introducing sanctions as part of ASEAN's working principles and mechanisms is important to ensure members' regional and global commitments are properly enforced and disputes resolved. Once introduced, sanctions will be able to complement the *ASEAN Way* with a philosophy of adherence to the rule of law and support the introduction of a functioning dispute settlement mechanism, as contemplated by the ASEAN Charter.

As sanctions can be applied in many ways, ASEAN members need to discuss in detail which sanctioning model is most appropriate for improving the group's efficiency and effectiveness. This assumes the argument is accepted that introducing sanctions is a strategically important step as ASEAN matures as the overarching institution for Asian regionalism. This process should not be delayed further (see section 5.2).

Adherence to cooperative initiatives (such as trade and investment agreements) or commitments to mitigate damage arising from economic interdependence (such as transboundary pollution and human trafficking) is core to both the perception and reality of ASEAN's effectiveness and credibility as an institution. Introducing a proper monitoring and feedback system that objectively tracks members' commitments is urgently needed. Also, an effective feedback system within the ASEAN Secretariat and other common institutions would be able to better monitor implementation of blueprints for the AEC as well as the other two communities.

A feedback system can also be used to assess the impact of cooperation initiatives on ASEAN member countries to design appropriate compensatory schemes for those where initial costs outweigh the benefits of integration (see section 5.2). An example would be the creation of an ASEAN Convergence Fund (see section 6.2), used to properly redistribute benefits and mitigate short-term economic dislocations from enhanced regional economic integration.

Building a Stronger Secretariat

Realizing an ASEAN Community is a massive effort. To fulfill the community's ambitious aspirations, ASEAN as an institution must possess the necessary human and financial resources to empower its secretariat—along with other regional and subregional agencies involved with the integration process (see section 5.2). Member countries must also considerably strengthen domestic agencies in charge of ASEAN affairs.

The small secretariat budget ($16 million in 2012) only covers ASEAN's key central institutional functions. Many staff and consultants continue to be funded by external donors, which have dedicated offices at the ASEAN Secretariat's Jakarta premises. However, under current budget principles and constraints, sustaining those positions in the long run becomes problematic as donor support becomes increasingly scarce.

In 2012, for example, the estimated direct contribution to the ASEAN Secretariat from donor agencies was about $3 million—approximately 5% of the $60 million total made available to fund ASEAN's overall operations.[169] Consequently, given the Secretariat's $16 million budget, member states had direct control over just 27% of the total spent on ASEAN-related initiatives by the international community.

A paper prepared for this study estimated that by the year 2030, total Secretariat staff must increase to 1,620 — or 5.5 times the 2012 level. And the Secretariat's budget should grow to about $220 million, nearly 14 times the 2012 level (Setboornsarng and Singh 2012a).

Although these totals may seem large, the calculations were simple and used conservative logic.[170] Comparing the ASEAN Secretariat salary structure for 2012 with that of a similar United Nations (UN) agency (Table 6.8), one finds on average that ASEAN salaries were only two-thirds of those paid for similar jobs by a comparable Jakarta-based UN agency (the calculation does not include additional benefits). Thus, it is clear the ASEAN Secretariat cannot compete with the UN (or similar international organizations), as high-quality staff gravitate to better-paid jobs. The reason for this huge discrepancy is easy to grasp — no adjustment, even to account for inflation, has been made since the ASEAN Secretariat's salary structure was aligned to that of the UN back in 1993.[171] Salaries have been frozen since.

The first step in calculating needed human and financial resources at the ASEAN Secretariat in 2030 was to apply corresponding UN salaries. The figures allow some time for adjustment starting in 2015 (Table 6.9). The calculations assume an annual upward adjustment of 5% from 2015 to account for inflation. The second step was to estimate the increase in the number of secretariat personnel. The number was based on the new tasks required since the decision was made to create the ASEAN Community and introduce the ASEAN Charter in 2007 — although these tasks do not reflect those to be included in the post-2015 agenda, currently under preparation.[172] The results show that the ASEAN Secretariat's budget needs to increase by a factor of seven through 2020, and double that from 2020 to 2030.

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169 These figures were calculated from confidential information made available to the study by bilateral donors.

170 Estimated figures do not include investments in additional buildings and physical space, which should be added to calculate more precise financial requirements.

171 The salary structure of personnel working for the ASEAN Secretariat was aligned with that of the UN in 1993 to oversee AFTA implementation.

172 It is estimated that by 2020 the ASEAN Secretariat's current nine Director positions will be upgraded to Director-General level, heading respective departments. Each department is estimated to average 33 professional staff, 36 technical staff, and 52 support staff. The simple assumption made in this calculation is that each Directorate General will include 3 Directors, 6 Assistant Directors, 12 Managers, and 24 Assistant Managers. It is also estimated that by 2030, the number of departments will increase to 11. Another indicator is the number of meetings each professional staff has to attend. A total of 426 official ASEAN meetings were organized from June 2012 to May 2013 (ASEAN 2013b). ASEAN staff informally estimate that the number actually increases to more than 700 when unofficial meetings are added.

Table 6.8 Comparison of Salary Structures: ASEAN Secretariat vis-à-vis the United Nations

Year 2012	ASEAN Secretariat			United Nations		
Positions	**2012**	**Average Salary ($)**	**Total ($)**	**Level**	**Average Salary ($)**	**Total**
Professional Staff	67	—	4,434,000		—	6,244,000
- Secretary-General	1	150,000	150,000	SG	240,000	240,000
- Deputy Secretaries-General	4	96,000	384,000	USG	190,000	760,000
- Directors	9	84,000	756,000	P-5	108,000	972,000
- Assistant Directors	25	72,000	1,800,000	P-4	88,000	2,200,000
- Managers (Senior Officers)	28	48,000	1,344,000	P-3	74,000	2,072,000
Technical Staff	110	24,000	2,640,000	L-7	37,000	4,070,000
Local Supporting Staff	120	8,400	1,008,000	L-2–7	13,000	1,560,000
TOTAL	**297**	**—**	**8,082,000**		**—**	**11,874,000**

ASEAN = Association of Southeast Asian Nations.
Source: Author's elaborations based on Setboornsarng and Singh (2012b).

Although the calculations can be criticized as to the detailed figures used in the estimates, it remains clear that ASEAN's expanded mandate must be matched by increased financial and human resources devoted to its Secretariat. Cognizant of this, ASEAN leaders agreed at the 23rd Summit held in Brunei Darussalam in October 2013 to strengthen the ASEAN Secretariat and review its structure — they agreed to form a High-Level Task Force for this purpose (ASEAN 2013a). Hopefully, sufficient human and financial resources will be added to the ASEAN Secretariat as a result of this initiative.

Building a stronger ASEAN Secretariat not only requires a considerable amount of additional human and financial resources. It also implies the creation of a new, solid legal department to fulfill the ASEAN Charter's mandate in monitoring, evaluation, and conflict resolution — to ensure ASEAN members comply with their regional commitments, to enhance the internal capability in contract procurement, and to promote the rule of law in implementing strategies and activities.[173]

173 The ASEAN Charter calls for the resolution of disputes between members in a peaceful and timely manner through dialogue, consultation, and negotiation. It also mandates dispute-settlement mechanisms for all fields of ASEAN cooperation. Whereas the economic community is covered by the ASEAN Protocol on Enhanced Dispute Settlement Mechanism (introduced in 2004), the other two communities will require new dispute settlement mechanisms, underscoring the need for a strong legal department. While a new legal unit was recently established in the ASEAN Secretariat, it remains too small to accomplish the new tasks mandated by the ASEAN Charter.

Table 6.9 Estimated ASEAN Secretariat Budget in 2020 and 2030

Positions	2012	2020	2030	2012	2020	2030
	No. of people			Total Salary ($)		
Professional Staff	67	419	511	4,434,000	38,792,699	76,770,487
- Secretary-General	1	1	1	150,000	306,308	498,943
- Deputy Secretaries-General	4	4	4	384,000	966,651	1,574,572
- Directors-General	0	9	11	0	1,482,303	2,951,074
- Directors	9	27	33	756,000	3,677,460	7,321,349
- Assistant Directors (Managers)	25	54	66	1,800,000	6,060,272	12,065,222
- Senior Officers (subject matter experts)	28	108	132	1,344,000	9,961,168	19,831,403
- Assistant Managers	0	216	264	0	16,338,538	32,527,925
Technical Staff	110	432	528	2,640,000	20,283,198	40,381,234
Local Supporting Staff	120	475	581	1,008,000	7,427,421	14,787,039
Total Personnel	297	1,326	1,620	8,082,000	66,503,318	131,938,760
Other Expenses				7,681,000	44,336,892	87,960,527
TOTAL BUDGET				**15,763,000**	**110,842,230**	**219,901,317**

ASEAN = Association of Southeast Asian Nations.
Source: Author's elaborations based on Setboornsarng and Singh (2012b).

Fostering an ASEAN Civil Service

Parallel to strengthening secretariat resources, ASEAN will also need extensive capacity-building programs to create a dedicated regional civil service—a regional technocracy capable of planning, introducing, and managing the reforms, rules, and regulations included in the Blueprints for the three communities. This is true not only for personnel working for ASEAN institutions—such as the ASEAN Secretariat or the CPR—but also for national agency staff involved with ASEAN affairs. Proper training should be offered in specific areas, with an emphasis not only on technical matters but also on regional topics. Increased awareness on how regional cooperation and the implementation of the ASEAN agenda can strengthen national interests is a critical training component.

Thus, ASEAN should consider creating an ASEAN Academy (ASAC) to graduate highly qualified personnel in regional affairs, covering a broad range of areas and topics as needed under the three pillars of the ASEAN Community. The new institution should attract the best students from member countries and be instrumental in creating a regional body of experts on technical issues as well as ASEAN-specific matters. It should strengthen the group's principles and mechanisms—ultimately helping reinforce the ASEAN identity.

ASAC would focus on promulgating ASEAN's purposes and principles as defined in the ASEAN Charter. Maintaining peace and stability, enhancing regional resilience, forming a region-wide democratic and harmonious political environment, promoting the rule of law, alleviating poverty and narrowing development gaps, as well as creating a prosperous single market and production base would be the ultimate goals of ASAC. Its courses and activities should be inspired by the principles of non-interference in domestic affairs and respect for national independence, shared commitment and collective responsibility, reliance on the peaceful settlement of disputes, and rejection of the use of force. Aside from graduating qualified technocrats, ASAC could also serve as a think tank for strategic policy advice supporting community-building and other cooperation priorities. The CPR and the ASEAN Secretariat should be invited to provide general guidance and help coordinate ASAC's operations, avoiding duplication and matching activities within ASEAN's development strategy.

ASAC could be located in any member country ready to champion its cause, while several national branches could be established in other member countries, based on individual interests and strategies. Resources could be pooled directly from member countries and from development partners under the ASEAN Secretariat's and CPR's overview. Eventually, ASAC should help promulgate ASEAN priorities and strategies—improving their adherence to and inclusion in projects and programs with bilateral and multilateral donor support.

6.9.3 Enhancing the Regional Institutional Framework

ASEAN needs to embrace institutional reform to strengthen the pivotal role it plays in Asia's cooperation and to become a more mature and thriving institution (see section 5.3). Reforms are needed to address challenges members face related to their domestic social, political, and economic situations, the evolution of intra-group relations, and the shaping of strategic links with major regional and global powers. This involves (i) promoting an inclusive approach; (ii) strengthening the group's role in conflict resolution; and (iii) ensuring that ASEAN initiatives are properly nested within global frameworks, complying with members' commitments with multilateral initiatives.

First, inclusiveness in cross-border cooperation requires an approach that stresses openness and fairness. It implies introducing mechanisms to compensate those hurt by regionalism as well as capacity-building initiatives to allow latecomers to catch up with those more advanced. An inclusive approach to regionalism also requires using non-discriminatory practices in dealing with internal and external partners, regardless of size or power—to promote internal cohesion and support the group's image as 'honest broker'.

Second, using institutional and diplomatic mechanisms for resolving conflicts requires the political will to investigate root causes of domestic and regional disputes, or other tensions. In the past, the *ASEAN Way* often meant simply scratching the surface of problems—as happened, for instance, in addressing trans boundary haze. Instead, the introduction of a proper conflict resolution mechanism should be a part of ASEAN's core agenda, which will require designing and implementing a proper feedback system to inform institutional rulings. Existing dispute-settlement and arbitration mechanisms, often forgotten or bypassed by members as well as the ASEAN Secretariat, can be used widely and made more effective by introducing a degree of "automaticity" to their implementation (Acharya 2012).[174]

Third, nesting regional initiatives and commitments into global frameworks is another critical issue in building a mature and thriving ASEAN Community. Regional arrangements must be fully compatible with global dialogues and institutions governing related functional areas. For example, new trade and investment initiatives such as the Regional Comprehensive Economic Partnership (RCEP) must fully adhere to World Trade Organization rules. Similarly, developments related to the CMIM and AMRO must complement the global approach followed by the IMF. New mechanisms to resolve regional political or territorial disputes and ethnic conflicts must comply with UN principles and regulations.

Creating New Functional Bodies

ASEAN should be open to creating new functional bodies—properly funded and governed—in response to emerging needs (see section 5.3). To this effect, ASEAN policymakers should continue to support policy research that identifies new topics and areas of interest, while adopting a flexible approach to funding. They should promote a decentralized strategy in designing and establishing new functional institutions—taking into consideration members' priorities and financing capabilities.

Identifying needs and planning institutional responses should distinguish between short- and long-term requirements for any new functional institutions, assessing relevance to regional objectives. Overlap with similar institutions already a part of ASEAN or ASEAN-plus frameworks should be avoided. Together with the new functional agencies proposed in this study (Table 6.10) there remains large scope for strengthening existing agencies, adding human and financial resources as required. Indeed, a way to promote institutional development is by reforming existing agencies, strengthening their governance, and redirecting their objectives and operations to reflect emerging needs.

174 Some scholars suggested creating an ASEAN Council for conflict resolution, using third-party judges as a way to strengthen regional arbitration mechanisms (Acharya 2012).

A key factor in shaping new institutional bodies is the availability of the human and financial resources needed to ensure long-term sustainability. Unfortunately, existing functional centers under the ASEAN purview remain dependent on external financing, which creates uncertainty over their sustainability, as donor programs may suddenly end or their scope may alter.

Therefore, ASEAN needs to gradually internalize external contributions. This can be done by absorbing them into an expanding body of functional institutions

Table 6.10 List of Proposed Functional Institutions

Name	Area	Initial member countries
Asian Monetary Fund (AMF)	Macroeconomic and financial cooperation	ASEAN+3 plus other Asian countries
ASEAN Financial Stability Dialogue (AFSD)	Macroeconomic and financial cooperation	ASEAN member countries
ASEAN Convergence Fund (ACF)	Equitable and inclusive growth	ASEAN member countries
ASEAN Competitiveness Institute (ACI)	Competitiveness and innovation	ASEAN member countries
ASEAN Rice Authority (ARA)	Competitiveness and innovation	ASEAN member countries
Agency for the certification and standardization of Made-in-ASEAN Products (AMAP)	Competitiveness and innovation	ASEAN member countries
ASEAN Tourism Council (ATC)	Competitiveness and innovation	ASEAN member countries
ASEAN College of Financial Supervisors (ACFS)	Financial market development	ASEAN member countries
ASEAN Academy (ASAC)	Human capital development	ASEAN member countries
ASEAN Governance Institute (AGI)	Governance and institutions	ASEAN member countries
ASEAN Competition Authority (ACA)	Governance and institutions	ASEAN member countries

AFEED = ASEAN Framework for Equitable Economic Development; ASEAN = Association of Southeast Asian Nations; ASEAN+3 = ASEAN plus the People's Republic of China, Japan, and the Republic of Korea; IAI = Initiative for ASEAN Integration; RCEP = Regional Comprehensive Economic Partnership; TPP = Trans-Pacific Partnership.
Source: Authors.

that support the spectrum of work needed to implement its regional cooperation and integration strategy. External funds should be administered directly by the ASEAN Secretariat or by members, so priorities remain truly regional, instead of being set by non-ASEAN, external donors.

Functional bodies must be effective in fulfilling their mandate. However, assessing institutional effectiveness is quite difficult, as economic performance is often a biased indicator—the net effect of regionalism can indeed be damaged

	Member agencies	Function
	Ministries of finance and central banks	Conduct regional macroeconomic and financial monitoring and provide liquidity support and other forms of financial assistance
	Ministries of finance, central banks, financial regulators, supervisory agencies	Promote regional resilience to macroeconomic shock through broad macro-prudential surveillance
	Prime ministers'/presidents' offices, ministries of foreign affairs, ministries of finance, civil society	Mitigate the negative impact of integration on specific regions, groups of people, and sectors
	Ministries of commerce, economic affairs, and trade, private sector representatives, civil society	Articulate a region-wide innovation, research, and development strategy to improve countries' productivity and competitiveness
	Ministries of agriculture, private sector organizations, civil society	Organize rice production, supply chains, and trading networks
	Ministries of commerce, economic affairs, and trade, private sector representatives, civil society	Promote ASEAN branding and labeling of products that inspire consumer confidence and recognition
	Ministries of tourism, private sector representatives, civil society	Coordinate national strategies under a single framework and promote region-wide initiatives to further develop tourism and its related industries
	Ministries of finance, central banks, financial regulators, supervisory agencies	Monitor financial groups operating region-wide and help implement regional policies
	Prime ministers'/presidents' offices, ministries of foreign affairs, ministries of education	Create a highly qualified and effective regional technocracy capable to plan, introduce, and manage ASEAN reforms, rules, and regulations
	Prime ministers'/presidents' offices, private sector representatives, civil society	Design and implement a region-wide regulatory environment; assist members to strengthen national regulatory institutions
	Prime ministers'/presidents' offices, private sector representatives, civil society	Assist ASEAN members that do not have a competition law and policy to introduce one; monitor firms' compliance with national competition laws and policies

by poor domestic policies or adverse external shocks. One problem is that the charters of functional institutions often include broad objectives with few clear, measurable benchmarks or deadlines.

Another way could be to estimate an institution's influence on shaping regional issues and its effect on national policies. But subjective judgments may have to be made where data or other evidence are unavailable. Also, identifying a clear counterfactual explanation of what national policies would have been in the absence of a particular regional functional body complicates measuring institutional effectiveness.

Promoting Regional Decentralization

As new functional bodies are created, ASEAN countries may find merit in promoting "regional decentralization," where new institutions are hosted in a variety of members and not simply concentrated around the ASEAN Secretariat in Jakarta. Following this approach implies agreeing on a relatively higher financial support from the host country compared with that offered by other members, as the host country has a keen interest to promote the activities undertaken by the new institution. In principle, as external agencies could also contribute to funding these new agencies, it is important that a proper governance framework emphasizing transparency and accountability are adopted.

A mature and thriving ASEAN Community should include many functional institutions, created through regional decentralization that allow funding initiatives and programs based on the volunteer host's priorities. However, in designing these institutions, it is important to adopt proper mechanisms to ensure they remain closely coordinated with the ASEAN Secretariat and among themselves. Otherwise, ASEAN may lose the centrality it has achieved in the region's architecture for cooperation.

Strengthening Regional Coordination

Finally, ASEAN must strengthen coordination with member countries' national agencies, with regional functional institutions, and with other international organizations. While the CPR is expected to play a more effective role in coordinating the ASEAN Secretariat's activities with member countries' national secretariats and domestic ministerial agencies involved with ASEAN activities, there remains large scope for the ASEAN Secretariat to increase its role in helping create and manage the AEC — and more broadly the ASEAN Community.

The size of member country delegations attached to each permanent representative will need also to be substantially increased. Moreover, to strengthen coordination with regional functional agencies, the ASEAN Secretariat should develop a system for delegating some responsibilities (implied under the blueprints for the creation of the AEC and the ASCC) to some of these agencies, either existing or new institutions.[175]

175 Given the nature of the ASEAN Political-Security Community, functions related to its implementation should be implemented either by the ASEAN Secretariat or directly by member countries.

An articulated process of regional decentralization can greatly help implement the ASEAN Community road map and manage the newly created regional markets and systems — including regional public goods under each of its three pillars (see section 5.3). Active private sector involvement in ASEAN integration could be organized by different industry associations, starting perhaps from the AEC's 12 priority integration sectors (see chapter 1).[176]

6.10 Conclusion

Thus far, ASEAN integration has been institution-light (ADB 2008b, 2010a). The need for a stronger institutional base — with an adequately empowered ASEAN Secretariat and more effective regional technocracy — is increasingly important as ASEAN moves beyond creating an AEC and enters the next phase of economic integration. The ultimate objective of institutional reform should be to increase responsibility and accountability for the ASEAN Secretariat and other common institutions to help member countries better balance their national interests with their growing regional responsibilities.

Eventually, ASEAN members need to appreciate that growing together for shared prosperity requires more decision-making powers to be shared in a flexible way. Political leadership is crucial in successfully addressing this important policy option.

176 One practical way to coordinate private sector involvement could be to ask representatives of private sector organizations to submit applications for consultations during ministerial forums and the ASEAN Summit, with the AEC Council deciding on the agenda based on the ASEAN Secretariat's recommendations.

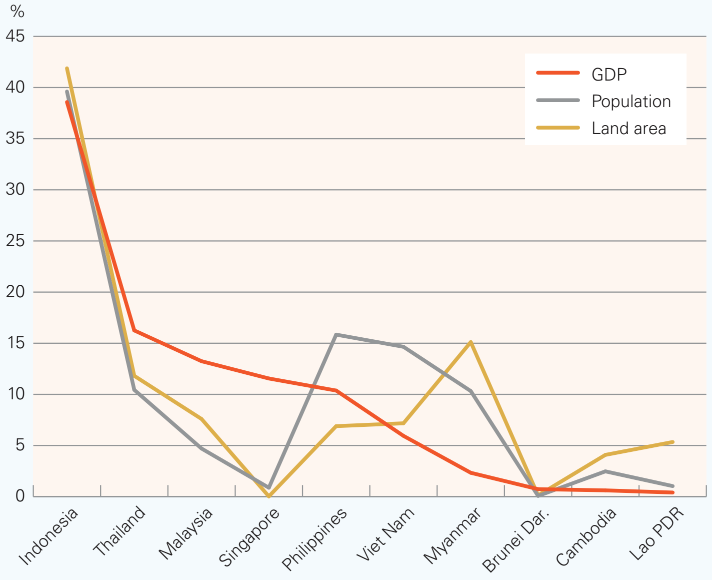
Chapter 6: Appendix

Table A6.1 ASEAN Countries' Shares of Selected Economic Variables

	GDP[a]	Population[a]	Land Area[a]	Reference Voting Share[b]		
	% share	% share	% share	Minimum	Maximum	Difference
Indonesia	38.58	39.61	41.88	12.5	19.5	7.0
Thailand	16.25	10.44	11.81	11.5	15.5	4.0
Malaysia	13.24	4.70	7.59	10.5	15.5	5.0
Singapore	11.55	0.87	0.02	4.0	15.5	12.5
Philippines	10.37	15.84	6.89	10.5	15.5	5.0
Viet Nam	5.94	14.65	7.17	10.5	13.0	2.5
Myanmar	2.33	10.32	15.11	9.5	13.0	3.5
Brunei Dar.	0.73	0.07	0.12	3.0	6.0	3.0
Cambodia	0.61	2.47	4.08	7.5	9.0	1.5
Lao PDR	0.40	1.03	5.34	6.5	8.5	2.0
ASEAN	100.0	100.0	100.0	—	—	—

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic.
Notes: [a] Data for 2012. [b] Refers to the minimum and maximum values of shares calculated using natural logarithms of different indicators (such as GDP, population, land area, etc.) and averages of different combinations of variables (the difference between the maximum and minimum shares is also shown).
Source: Authors' elaboration based on International Monetary Fund, ASEAN Secretariat data, and calculations included in Setboonsarng and Singh (2012a).

Figure A6.1 Distribution of Selected Indicators across ASEAN Countries



ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic.
Source: Authors' elaboration based on International Monetary Fund, ASEAN Secretariat data, and calculations included in Setboornsarng and Singh (2012a).

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Borderless ASEAN Map

ASEAN 2030

Toward a Borderless Economic Community

This book investigates long-term development issues for members of the Association of Southeast Asian Nations (ASEAN). It finds that with a proper policy mix including domestic structural reforms and bold initiatives for regional integration, by 2030 ASEAN has the potential to reach the average quality of life enjoyed today in advanced economies and fulfill its aspirations to become a resilient, inclusive, competitive, and harmonious (RICH) region.

Key challenges moving forward are to enhance macroeconomic and financial stability, support equitable growth, promote competitiveness and innovation, and protect the environment. Overcoming these challenges to build a truly borderless economic region implies eliminating remaining barriers to the flow of goods, services, and production factors, and strengthening competitiveness and the institutional framework, while updating some governing principles. But ASEAN should not merely copy the European Union. It must maintain its flexibility and pragmatism, without creating a bloated regional bureaucracy.

The study's main message is that through closer integration, ASEAN can form a partnership for shared prosperity, regionally and globally.

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About the Asian Development Bank Institute (ADBI)

ADBI, located in Tokyo, is the think tank of the Asian Development Bank. Its mission is to identify effective development strategies and improve development management in ADB's developing member countries. ADBI has an extensive network of partners in the Asia and Pacific region and beyond. ADBI's activities are guided by its three strategic priority themes of inclusive and sustainable growth, regional cooperation and integration, and governance for policies and institutions.