

Policy Brief

ASEAN in the Global Economy- An Enhanced Economic and Political Role

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Established in 1967, ASEAN has travelled a long way from a group of five nations to a thriving and leading group of ten countries. Based on the progress in the implementation of the blueprints for building the ASEAN community by 2015, there is an enhanced role for the ASEAN in dealing with regional and global challenges. It is emerging as a services hub in the region and is the chosen destination for investments.

At the end of Indonesia's chairmanship of ASEAN, which had set the theme 'ASEAN in a global community of nations', it is imperative to take a stock of the readiness of the region if it is well on its way to step into a truly global role in the near future, especially by its goal of becoming one community by 2015.

With its strategic location, abundant natural resources, quality human resources and growing economies, ASEAN has engaged economically, by way of trade and investments, with all the large economies of the world. It has also gained strategic weight and drawn the attention of global players, both economically and politically. Its global engagement is best exemplified by the fact that 55 countries across the globe have appointed their envoys to the regional grouping and this number is growing.

Sitting in the midst of giant economies like Japan, China and India, and with active economic relations with USA and the EU, ASEAN is now seeking its due share in the global economy and politics. This Policy Brief looks into the current global profile of ASEAN and brings out policy recommendations that would help ASEAN in finding its appropriate role in the global politics and economy.

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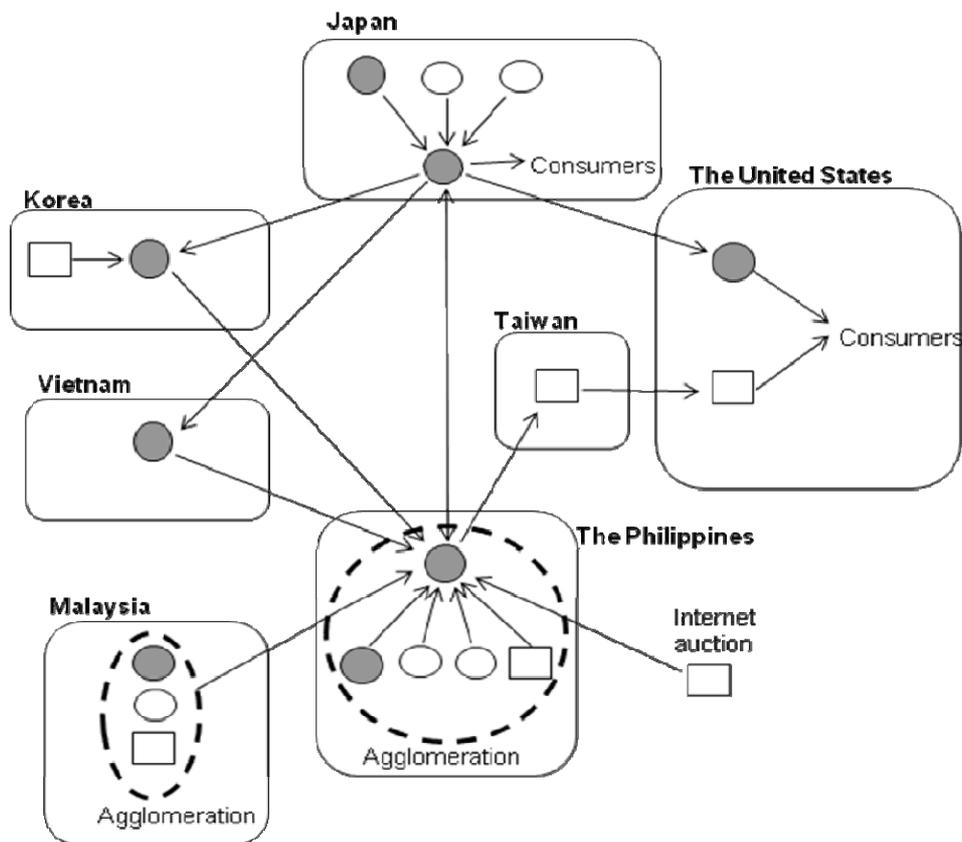
Founded in 1967 as a community of five South East Asian countries, namely Indonesia, Malaysia, Thailand, Singapore and the Philippines – the Association of South East Asia Nations (ASEAN) is now a group of 10 member countries which includes, Brunei, Cambodia, Lao PDR, Myanmar and Vietnam. Since 1967, ASEAN has travelled a long way from a young group of countries to a major economic and political group, which is anchoring the geopolitical landscape of East Asia. The recently concluded 19th ASEAN Summit and the accompanying 6th East Asia Summit (comprising of ASEAN countries and Australia, China, India, Japan, New Zealand, Republic of Korea, USA, and Russia) in Bali, Indonesia have brought the focus of the world to the economic and political weight of this region. ASEAN, so far, has played a key role in this shift. However the growth of neighbouring economies of

China and India, and an increasing interest in the region by the global players have brought the ASEAN to the centre of the East Asian landscape, where it has to learn to play a more pronounced global role. With competing and sometime shifting economic and political forces in Asia Pacific's geopolitical landscape, the multilateral forums of ASEAN are required to play a key role in maintaining a stable balance in the region.

1. The Growth of ASEAN as a Major Economic Group

In the period immediately after the Asian Financial Crisis, ASEAN was home to two crucial aspects of economic growth. One, a proliferation of bilateral and multilateral Free Trade Agreements (FTAs) and second, possessing a unique and

Figure 1. Production Network in ASEAN and East Asia



Source: Comprehensive Asia Development Plan, ERIA (2010)

sophisticated production network comprising of both big firms and SMEs (Figure 1). Soon after the financial crisis, as the need for interdependence grew in the region, ASEAN began to explore and conclude FTAs with other neighbouring economies, first with China and Korea and then with Japan, India, Australia and New Zealand.

In ASEAN and East Asia, proliferation of FTA is strongly linked to proliferation of production networks, because main users and beneficiaries of FTA are multinational enterprises in manufacturing sector. Now FTA is incorporating local firms, SMEs, as well as firms in services sectors.

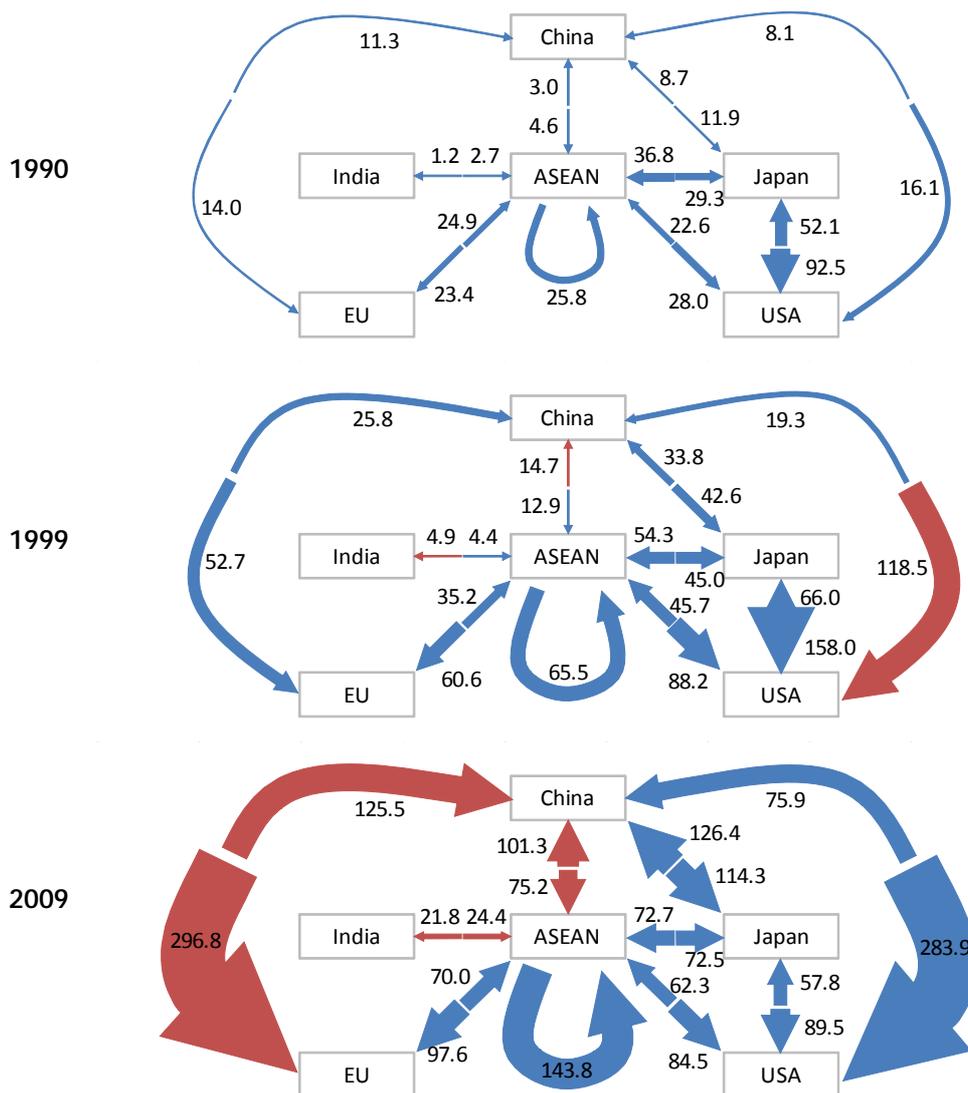
ASEAN is a part of the world production base or the world growth center with surrounding partners. In fact, East Asia comprising of ASEAN+6 countries has 36.2% of world's manufacturing value added while it has only 23.5% of world's GDP and 26.3% of world's export in 2008. ASEAN also has relatively high share in exports. ASEAN's share to world manufacturing value added, world GDP and world export are 3.8%, 6.0% and 2.5%, respectively.

We are now witnessing an expanding intra-ASEAN trade, expanding trade between ASEAN-China and ASEAN-India, a lowering relative importance of Japan and Korea as suppliers of parts and components, and a lowering importance of USA as a final destination of exports. Figure 2 clearly illustrates the changing trade structure among ASEAN, China, Japan, India, EU and USA in 1990, 1999 and 2009. Arrows in red in 1999 and 2009 indicate that these directions of export increased four times and more compared with 1990 and 1999, respectively. In 1990,

trade was mainly carried out between Japan and USA. Trade between Japan and ASEAN was relatively high, reflecting the proceeding of Japanese manufacturing firms to ASEAN countries. However, intra-ASEAN trade was not so active during that time. In 1999, the situation has dramatically changed and it especially recognizes the role of China's economic growth. ASEAN's intra-trade also increased substantially during the same time and surpassed the trade between Japan and ASEAN. In 1999, even though the largest trade direction was from Japan to USA, China's export to USA increased more than seven times as compared to 1990. We can see two more red arrows from ASEAN to China and from ASEAN to India. They reflect the rapid economic growth of ASEAN, China and India. In 2009, all export directions see substantial increase, except for the trade between Japan and USA. Trade between ASEAN and China and between ASEAN and India clearly increased, due to their economic development as well as proliferation of production networks. By 2009, many multinational enterprises in manufacturing sector had started making the best use of industrial clusters in ASEAN and China, as well as incorporating CLM (Cambodia, Laos and Myanmar) countries and India into the existing production networks.

To maintain and strengthen current production networks, ASEAN can take a leadership to utilize ASEAN+1 FTAs, ASEAN connectivity framework, and various cooperation schemes as building blocks and establish a new region-wide FTA in East Asia. At the same time, ASEAN can also improve the quality of existing FTAs through trade liberalization, which will change the economic structures in the

Figure 2. Trade among ASEAN and Big Economic Partners (In Billion USD)



Note: Red arrows indicate that these directions increased more than four times than the previous period.

Source: Compiled from RIETI-TID 2010

region and also bring about assistance programmes for workers who may be adversely affected by the outcomes of such FTAs.

2. ASEAN Economic Community (AEC) as a Hub of Services and Investment

In 2007, the ASEAN Leaders issued the Declaration on the ASEAN Economic Community (AEC) Blueprint which aims to

transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy. Several measures have been incorporated into the Blueprint to realize the envisaged transformation of ASEAN by 2015.

The success of long-term stable economic development in ASEAN countries depends on both the stimulation

of intra-regional demand, and opening up the region to outside demand. The ASEAN Economic Community has the potential to meet these conditions for achieving long-term stable development in this region. ASEAN's strength in trade in goods has been established over the years and explained in the preceding part. An equally strong role in services and investment would promote both regional domestic demand on the one hand and the competitiveness and attractiveness of this region in the global market on the other. ASEAN also has the potential to play an important role in re-balancing the global economy, by promoting demand growth in the regional market. As the region moves towards the AEC, the growth and liberalization of services and investments will decide the strength of this community as well as define the role that ASEAN will play in the larger global economy.

The AEC Blueprint presents the visions of the AEC, as well as work plans and strategic schedules for its implementation. Table 1 shows the four key elements of the Blueprint, namely, A) establishment of a single market and production base, B) realization of a highly competitive economic region, C) achievement of equitable economic development and D) full integration into the global economy. Each head/element consists of several core elements and each core element has its objectives, action plans and strategic schedules. However, the objectives of the Blueprint are only expected to indicate the goals and timeframes for developing the AEC. These are not to be taken as clearly defined targets. This is mostly due to the gaps that exist among the member countries.

Table 1. Four Key Characteristics and Core Elements of the AEC Blueprint

<p>A. Single Market and Production Base</p> <p>A1. Free flow of goods (9 strategic approaches)</p> <p>A2. Free flow of services (3 strategic approaches)</p> <p>A3. Free flow of investment (5 strategic approaches)</p> <p>A4. Free flow of capital (7 strategic approaches)</p> <p>A5. Free flow of skilled labor</p> <p>A6. Priority of integration sectors</p> <p>A7. Food, agriculture and forestry</p> <p>B. Competitive Economic Region</p> <p>B1. Competition policy</p> <p>B2. Consumer protection</p> <p>B3. Intellectual property rights</p> <p>B4. Infrastructure development (10 strategic approaches)</p> <p>B5. Taxation</p> <p>B6. E-commerce</p> <p>C. Equitable Economic Development</p> <p>C1. SME development</p> <p>C2. Initiative for ASEAN Integration</p> <p>D. Full Integration into the Global Economy</p>
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3. Services Liberalization

Services have a very important role to play in all the economies of the region. An efficient and competitive service sectors will have an immediate effect on growth rates and employment creation. Business (including IT and communications) services, transport and financial services are key inputs into almost all other sectors of the economy and, crucially, to the export-oriented manufacturing industries of the region. The previously cited pattern of production networks in ASEAN can only operate with efficient transport, freight, logistics, ICT and

financial services. Liberalization and efficiency in these sectors could contribute to reducing the cost burden to manufacturing. It will also provide an efficient business avenue for the production networks in the region.

Promotion of the free flow of services is an essential factor in the realization of free flow of goods and investment, capital and skilled labor, which are core elements for one of the principal pillars of the single market and production base defined by the AEC Blueprint.

Services contribute substantially to national output and employment growth in ASEAN Member States. Total ASEAN trade in commercial services has increased rapidly in less than a decade since 2000, from US\$154.6 billion in 2000 to US\$343.2 billion in 2009. Notwithstanding the favorable performance in this sector, there is large variation in the extent of trade in services across the Member States. The bulk of the ASEAN trade in services is concentrated only in some countries, i.e., Singapore, Malaysia, Thailand, and the Philippines and there appears to be a great scope for effective liberalization of and investments in the services sector. For example, in the air transportation sector most ASEAN countries appear relatively liberal. But there are still remaining barriers, which prevent effective competition. In addition, government subsidies of domestic airlines are still one of remaining problems. There are similar, if not greater, restrictions in other sectors too, which may prevent the ASEAN to grow into a services hub for the global economy. The services sector provides the basis for innovative industries for which there would be a great demand in the coming decades. ASEAN may have a global opportunity in developing its services

sector through effective services liberalization.

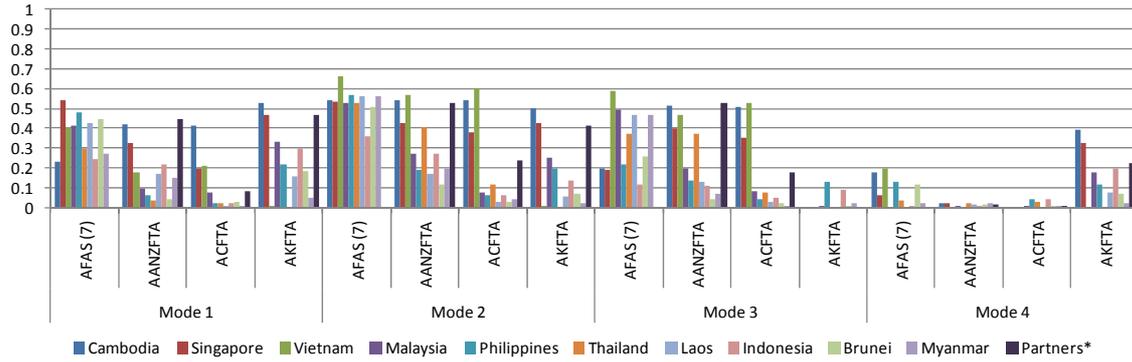
There are many challenges and impediments in the way to developing a credible services sector liberalization in ASEAN. It is generally agreed that increased services liberalization will facilitate greater integration and development of services within the overall economy of the ASEAN. For example, domestic legal and regulation often pose a constraint to further liberalization of services, particularly for the liberalization of Mode 3 (i.e., commercial presence). Mode 4 (i.e., movement of natural persons) has accounted for least progress in ASEAN as compared to the liberalization plan of the other modes.

Much room is left in this sector for improvement in the degrees of liberalization. Hoekman (1995) proposes an indexation methodology for measuring the GATS-style degree of commitments in services sector. This method assigns values to each of 8 cells {4 Modes¹ multiplied by 2 aspects, namely, Market Access (MA) or National Treatment (NT)} in the following manner:

Unbound= 0; Limited (or restricted) but bound= 0.5; and No limitation (and bound) = 1

The index then calculates the average value by services sector and by country. In the context of ASEAN, Figure 3 illustrates compiled "Hoekman Index" by country, by FTA and by mode. On average, Cambodia is the most liberalized in ASEAN Member States and Singapore and Vietnam follow. ASEAN Member States set lower liberalization level in FTAs with the Dialogue Partners than ASEAN Framework Agreement on Services (AFAS) 7th

Figure 3. Hoekman Index for the ASEAN+1 FTAs with Four Dialogue Partner Countries and by Mode

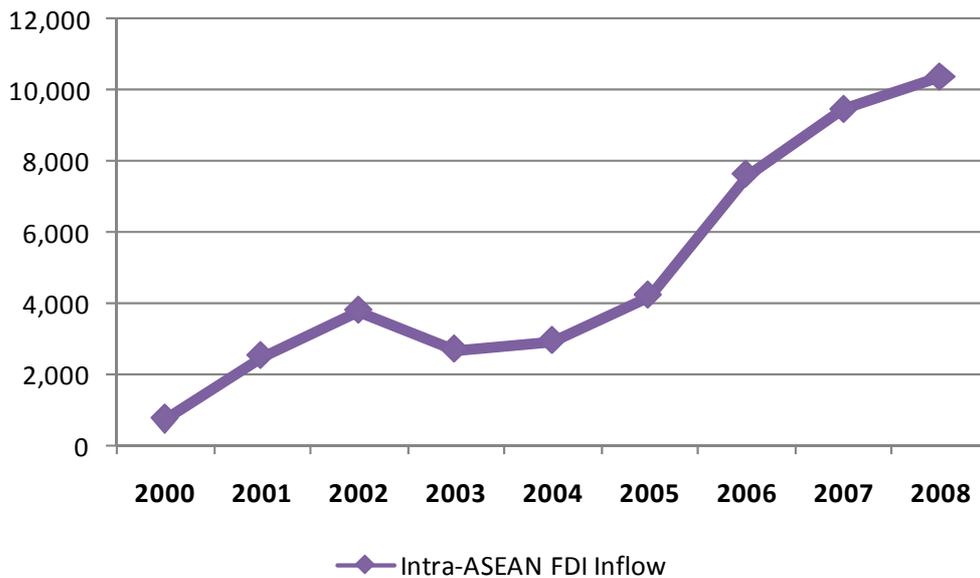


Note: *Partners denote the average levels of Australia and New Zealand for AANZFTA, China for ACFTA and Korea for AKFTA.
 1 = Fully Liberalized. Data for Thailand is missing in ASEAN-Korea FTA. China's level of liberalization may not be fully captured due to possible lack of information in its commitments

Source: ERIA Comprehensive Mapping of FTAs in ASEAN and East Asia

Original Source: Ishido (2011)

Figure 4. Intra-ASEAN Foreign Direct Investment Inflow (US\$ million)



Source: ASEANstat

package. In this index, Mode 2 and Mode 1 in AFAS 7th package show higher liberalization levels in all ASEAN Member States while for the others the levels vary across countries and many Member States set lower levels than the respective Dialogue Partners. Mode 4 shows least commitments among the four Modes with

exception of the case of the ASEAN-Korea FTA where Mode 3 is least committed.

ASEAN has an opportunity for greater and gradual liberalization by adopting AFAS as a starting point. The ASEAN community is in search of the perfect mix of liberalization and protection of services in each member country, which

will both put it on the pathway to increased global integration and at the same time allow the growth of local services enterprise.

4. Free Flow of Investment

For an economically integrated and competitive ASEAN, investment liberalization and facilitation are also crucial. In the AEC Blueprint, free flow of investment and freer flow of capital are two major integral parts. A free and open investment regime is considered to be a key to enhancing ASEAN's competitiveness in attracting Foreign Direct Investment (FDI) and intra-ASEAN investment to ensure dynamic development of ASEAN economies. The inflow of FDI gives the region a greater choice for its growth models. In particular, enhanced FDI brings an innovative approach to the production networks in the region so that they may develop new business models which help the region in its economic growth. The FDI also integrates the ASEAN with the investing region on a long term basis.

ASEAN Member States are generally performing well in attracting FDI (Figure 4). FDI inflows to the Member States as a group currently accounted for about ten percent of the total FDI inflows to developing countries. Intra-ASEAN FDI flows have also been increasing, and indeed, intra-ASEAN FDI increased in 2008 when the general trend of FDI into ASEAN region was declining during this year.

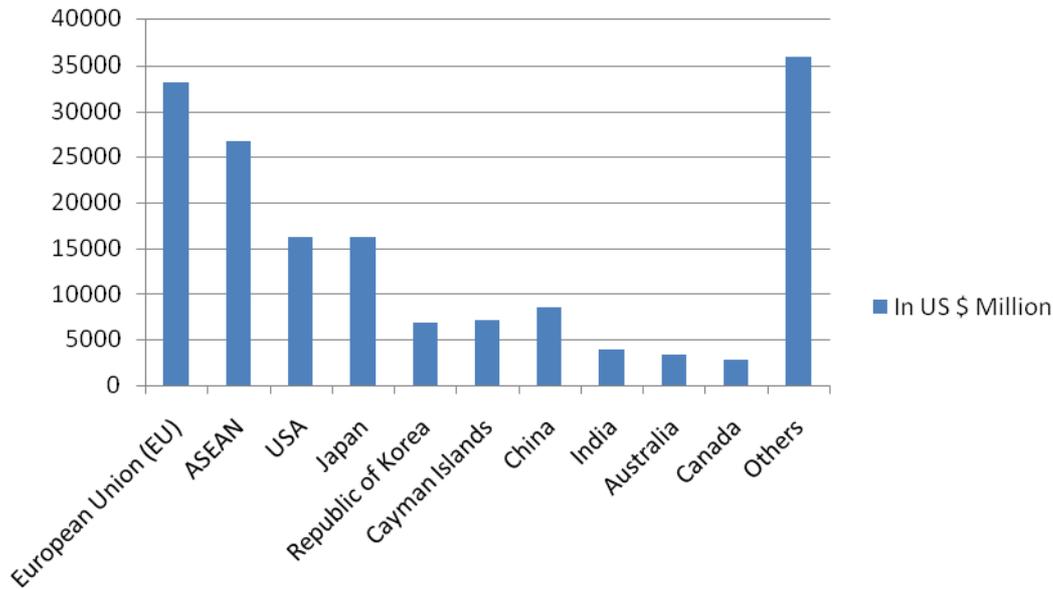
ASEAN has concluded a new investment agreement, namely ASEAN Comprehensive Investment Agreement (ACIA), which contains more comprehensive provisions, covering

investment liberalization, protection, facilitation and promotion. ACIA brings together two separate initiatives, namely the ASEAN Investment Guarantee Agreement (AIGA) and the ASEAN Investment Area (AIA). ACIA was concluded in 2008 and signed in 2009. ACIA grants immediate benefits to ASEAN investors and ASEAN-based foreign investors, with the deadline to achieve free and open investment shortened to 2015.

However, ASEAN countries are known to have restrictive FDI regimes in the areas of the movement of investors, and screening and appraisal procedures. There are wide variations among countries in these areas, as also in the area of national treatment. Restriction on market access is considered to be the most important policy relating to inward FDI. In this regard, regulations are rather relaxed in the manufacturing sector compared to the high levels of restriction found in the public and service sectors for foreign entities. Although variations among countries are found, tight restrictions are often imposed on service sectors such as information and communication.

In addition, firm-level surveys have revealed various indirect barriers to FDI that exist in this region, and that the main problems are concerned with FDI facilitation. There is plenty of room to improve FDI facilitation, in particular institutional problems, such as lack of transparency, and implementation problems such as complicated procedures. The challenge is to ensure that this is undertaken in a phased, progressive manner ultimately leading the free flow of investments. One of the surest ways to achieve the goal of FDI facilitation is that the ASEAN countries should actively use

Figure 5. Top Sources of FDI in ASEAN Between 2008-2010



Source: ASEAN Foreign Direct Investment Statistics Database, ASEANStat.

various cooperation programs with its FTA Partner countries. This cooperation should also include improvement of the human resources engaged in the implementation and enforcement of FDI policies.

5. Economic Engagement is Both a Precursor to and Result of ASEAN's Increased Geo-Political Engagement

Historically, ASEAN had practiced a cautious outlook on external relationships. Moreover, the Asian financial crisis had dented ASEAN's economic credibility and standing. However, ASEAN quickly recovered from this crisis and individually, most of the ASEAN countries are now enjoying positive growth rates of 4%-7%. ASEAN is also an integral part of the wider East Asian region, which will continue to grow strongly. The fundamental strengths of the East Asian economies, including ASEAN, remain intact. They have young populations, and an educated and hardworking work force. They are big emerging markets both for trade and

investments. This economic standing has brought about a political and strategic weight on the region which has encouraged the ASEAN to explore an enhanced geo-political role for itself in the Asia Pacific and even among the global community. A clear sign of ASEAN's increased engagement with its trade and dialogue partners is reflected in the confidence that the latter have shown in the economy of ASEAN. This can be gauged through the fact the top FDI in the region have come from sources with which ASEAN has a close dialogue and strategic partnership (Figure 5).

With the economic weight of the world shifting to the East Asia, ASEAN finds itself in an enviable position of being right in the middle of this region and with a unique opportunity, and even ability, to influence the global political and strategic scenario. However, internally, ASEAN must first complete the formation of the AEC in 2015. Beyond the region, ASEAN can then collectively respond to the opportunities offered by its geographical and

comparative advantages and to the competitive challenges brought about by global trade and investment environment. ASEAN enjoys a strategic position in East Asia as it is located at the heart of an economically vibrant and growing region bounded by India in the West; China, Japan and the Republic of Korea in the Northeast; and Australia and New Zealand in the South. Given this advantage, ASEAN could easily work on providing and also inspiring a model of growth and development in the region.

6. ASEAN at the Center of Regional Integration

One of the features that is unique to ASEAN is the peaceful pathway that the member countries have pursued in achieving their economic growth. ASEAN is seen as a non-threatening bloc by most major trading partners who wish to pursue closer economic cooperation. ASEAN can utilise this position and use it to strengthen its central role in the integration in the wider region. For example, there are areas where ASEAN has made more progress than its external partners, resulting from its effort to establish ASEAN Community by 2015. It should use this as a basis in fostering cooperation with external partners and promoting deeper economic integration beyond ASEAN along the ASEAN approach, which accentuates the areas of common interest from which multilateral cooperation can be developed. ASEAN has, over the years, developed useful linkages with countries beyond the region through its dialogues and forums, such as the Dialogue Partnerships, the ASEAN Regional Forum (ARF), ASEAN Plus Three, and the East

Asian Summit (EAS). ASEAN can build on such links to ensure that it remains outward-looking and successfully pursues friendly relations and mutually beneficial cooperation with partners and friends. This will help forge a regional architecture that is both open and inclusive, as well as strengthen regional cooperation. Besides economic integration, ASEAN can offer to meet cross-regional challenges ranging from pollution to terrorism, transnational crime, food and energy security, and maritime security to natural disasters and communicable diseases.

All major powers are ASEAN's dialogue partners, and they engage with ASEAN on regional and international affairs of common concern as well as contributing to development activities within ASEAN. Most of the Dialogue Partners have appointed their Ambassadors to be accredited to ASEAN and based in Jakarta to facilitate and develop their relationships with ASEAN. ASEAN should seek to retain its centrality and strengthen its role as the driving force in regional cooperation. Traditionally, the Secretary-General of ASEAN has been pro active in representing ASEAN's interests and nurturing cooperation with Dialogue Partners, and other regional and international organizations. The Secretary-General can continue to promote the ASEAN vision of peace and prosperity through close cooperation with partner countries.

7. An International Role for ASEAN

The south east region sits at the crossroads between China and India in Asia and USA (and Australia and New

Zealand) in the Pacific. It is also home to major sea lines of communication. In addition, the ASEAN member states contribute significantly towards the global economy, in terms of natural and human resources.

Given this setting, along with the rapid economic growth of ASEAN in the eighties and nineties, the nature of dialogue relations with its partners has shifted from development assistance to that of a partnership between equals. Development cooperation with dialogue partners has taken a diminished role relative to the more strategic elements of the relationships. The focus of these relationships, especially after conclusion of FTAs with many of its dialogue partners, have now shifted towards market access, trade, investment, tourism, services, science and technology, human resource development and technology transfer. Political and security issues have found a growing place in the dialogue forums. Given the economic importance and uniqueness of the region, it is not surprising that ASEAN is predisposed to helping maintain balance in the region.

Similarly, given the ASEAN's reputation of integrity and diversity, it is expected to play an important role in international gatherings such as WTO and G-20. This is especially because of ASEAN's experience in addressing the issue of inequality in economic development and integration within the region. ASEAN brings a miniature version of global economy to these international forums and can showcase the ways of dealing with issues of economic inequality and development gaps. At a regional level, ASEAN can help to create a greater mutual understanding among its partners with the view to

achieve a common position on critical issues that will influence the region's stability, security, and prosperity. Having a 'common platform' by ASEAN in international forums will surely strengthen its voice. In an increasingly interdependent world, ASEAN can bring an accelerated cooperative relationships with interested non-dialogue countries and international organizations too.

8. Policy Recommendations

To remain relevant in an international setting, ASEAN has to strike a balance between preserving ASEAN's fundamentals and putting in place a stronger basis for ASEAN's cooperation and future integration. At the economic level, ASEAN is a leading trade partner of all the major economies of the world. A clear and timely achievement of ASEAN Community and further initiative to establish a region-wide FTA will help in bringing in the investments from its partner countries and regions. An improved facilitation of trade through lowering of behind the border trade barriers and continued liberalization of services and investments will help the region to connect tangibly with the rest of the world, especially with its immediate neighbourhood in the Asia and Pacific.

From the political perspective, the ASEAN Charter should provide a basis for a stronger ASEAN which is at the center of regional and international cooperation. Regional cooperation has the potential to be an important bridge between ASEAN countries and the rest of the world. To ensure its competitiveness and act as a central building block for wider international schemes, ASEAN should

encourage the cohesiveness among ASEAN Member States and the people in ASEAN. This can be achieved through accelerated and committed efforts for achieving the goals of ASEAN Community by 2015. In realizing the objective of the AEC, ASEAN will become significantly more important over time and it should expect to achieve a greater regional cooperation within Asia and rest of the world as a whole. By taking on this lead role, ASEAN will play a central role in shaping how the regional security architecture evolves to maintain peace, stability and growth.

¹ Mode 1 is cross-border trade in services, Mode 2 is consuming services abroad, Mode 3 is commercial presence, and Mode 4 is presence of natural persons.

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