

# Chapter 3

## **Integrated and Highly Contestable ASEAN Towards a Single ASEAN Market and Production Base**

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## **Chapter 3**

# **Integrated and Highly Contestable ASEAN Towards a Single ASEAN Market and Production Base**

The previous chapter brought out that it is best to view the next decade and a half post 2015 as the next stage, after AEC 2015, of ASEAN's drive towards an eventual single market and production base, considering that there are tremendous policy and institutional changes among the AMSs and ASEAN that need to be done to become a truly single market indeed. This next stage is for ASEAN to become an integrated production base and a highly contestable market. This is consistent with the gradual and evolving approach of ASEAN to deeper economic integration in the region.

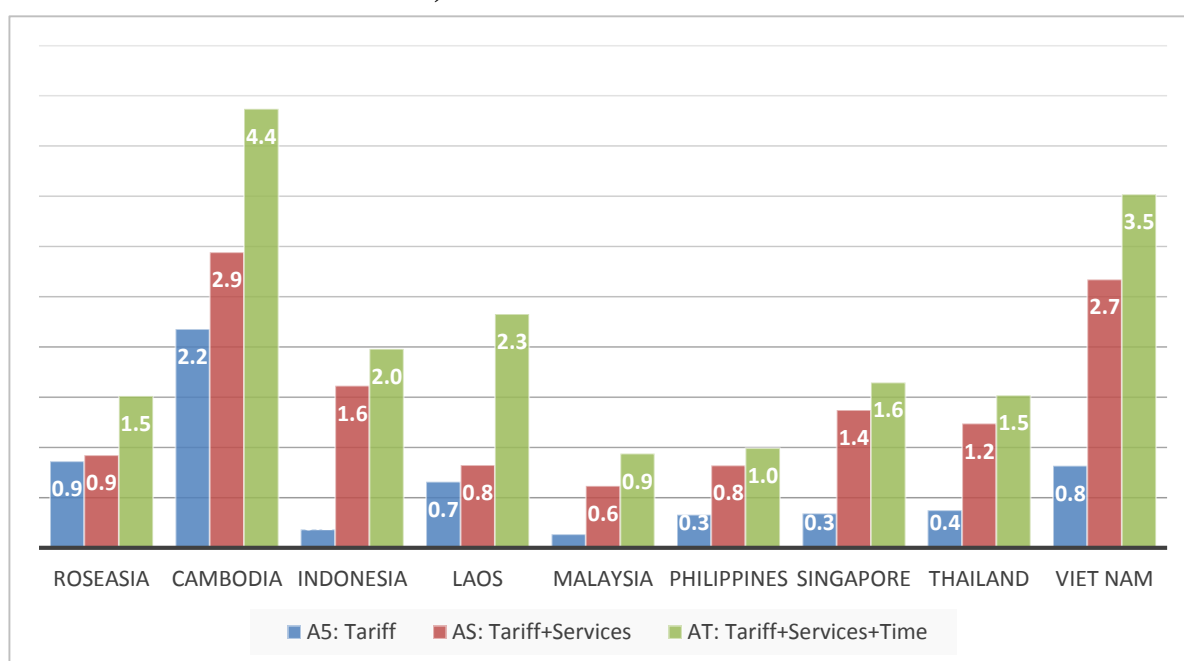
The second stage of ASEAN economic integration, post 2015, is consistent with the new model of economic integration and development that has been actually evolving in, and driving to a large extent, the robust economies of developing East Asia. This new model is anchored on production networks and the accompanying dynamic of investment, technology diffusion, spatial linkages, and international trade. To a great extent, the imperatives for an integrated and highly contestable ASEAN provide the platform for the expected flowering of local clusters and regional production networks in ASEAN and thereby help propel the region to sustained high and relatively equitable growth.

This chapter discusses the key elements, and the corresponding ways forward, towards an integrated and highly contestable ASEAN.

Simulation results of the economy wide impact of ASEAN economic integration under AEC, using a dynamic GTAP model, indicate that there is substantial economic benefit to all the ASEAN member states from the

elimination of intra-ASEAN tariffs on goods and even more from the reduction in barriers to intra-ASEAN services trade and from much improved efficiency in trade facilitation within the region (Itakura, 2012). The potential benefits are largest in the new and less developed ASEAN members because they have the highest average tariff rates, higher implied barriers in services, and more constrained facilities for trade facilitation in the early 2000s which was the base period of the simulation exercises (see **Figure 3.1**). These simulation results are likely conservative estimates as most computable general equilibrium results tend to be because they do not adequately capture substantial changes in investor expectations as well as productivity improvements that an integrated production base brings. And if the statements of the private sector that the “AEC is a game changer” and that investors need to “catch the ASEAN wave” (as highlighted in the previous chapter) are any indication, then it is likely that the potential benefits of deeper economic integration in the region could be larger than what the simulation results suggest.

**Figure 3.1: Impact on GDP (Cumulative Percentage Increase over Baseline 2011-2015 in 2015)**



Source: Itakura (2012)

Thus, the drive towards an integrated and highly contestable ASEAN, as a major stepping stone to an eventual ASEAN single market and production base in the future, is worth undertaking. Indeed, this net beneficial effect is the implicit promise of the ASEAN Economic Community Blueprint. As indicated

in the ASEAN Economic Community Blueprint, there are many things that need to be worked on towards an integrated and highly contestable ASEAN economy. This chapter discusses them and provides recommendations for the way forward.

## Tariffs

The elimination of tariffs is the basic requirement of any regional economic integration initiative. This is almost fulfilled in ASEAN. The average intra-ASEAN tariff for ASEAN-6 countries has barely been 0.05 percent since 2010. The average intra-ASEAN tariff for CLMV countries in 2012 was 1.69 percent and is expected to decline further going into 2015 and, for Cambodia, into 2017 for its imports of unprocessed agricultural products as listed in Schedule D of ATIGA. The list of excluded commodities under Schedule H of ATIGA is tiny and tends to be marginally traded and highly controlled commodities for security or religious reasons. The significant deviation from the total elimination of tariffs is the list of unprocessed agricultural commodities in Schedules D and E of ATIGA, perhaps best exemplified by the politically sensitive rice and sugar. Nonetheless, most of them would be within the 0-5 percent tariff range. Thus, on the whole, ASEAN has essentially succeeded in fulfilling the tariff elimination basic requirement of an integrated regional economy.

## Non-Tariff Measures/Non-Tariff Barriers

With the virtual elimination of tariffs, it is non-tariff measures (NTMs) that are of growing policy concern. This is because they have the potential to be measures for trade protection (and hence non-tariff barriers) but are much less transparent and more complex. NTMs cover a wide range of regulations that can have impact on the volume or pricing of international trade in goods, either intentionally (hence called non-tariff barriers) or, in most cases, unintentionally or indirectly. Indeed, most NTMs have primary objectives that are different from trade protection, e.g., for health or food safety or environment reasons. Given such legitimate objective, the challenge is to ensure that such NTMs do not unnecessarily affect international trade adversely. However, the line between NTM and an NTB is not always clear-cut as in the case of a deliberately discriminatory standard because different stakeholders may have

different views on the appropriate level of safety standard (Cadot, Munadi and Ing, 2013, p.5).

Because of the diversity and complexity of NTMs, there is yet no comprehensive and comparable data set on NTMs, unlike tariffs. NTMs are the mandate of many government agencies without a coordination mechanism for effective data collection (Cadot, Munadi and Ing, 2013, p.8). Moreover, the international classification system of NTMs has been changed recently, with so many countries still not having been transliterated to the new classification. Moreover, the current system of voluntary official reporting of new NTMs is weakened by an incentive problem, resulting further in the substantial uncertainty on the universe of NTMs operative in the world, and by extension, also in the ASEAN.

Using the old UNCTAD classification system, the current publicly available ASEAN database on NTMs (2009 database) shows that Indonesia and Malaysia have the largest number of NTMs while Singapore and Cambodia have the fewest. Moreover, the results of the analysis of the Mid-Term Review of the AEC Blueprint (ERIA, 2012a) show that the two countries have the highest incidence of “core NTMs”, the measures that are likely more prone to their use for trade protection, e.g., non-automatic import licensing, quotas, prohibitions and monopolistic measures. There is a marked use of non-automatic import licensing in a number of AMSs, with the exception of the Philippines (which has largely technical measures), Thailand (automatic licensing and wide range of technical measures) and Viet Nam (which uses mainly prohibitions of sensitive products). A few AMSs also tend to use not just one NTM in a sector but two or three or more NTMs. Among the more “sensitive” sectors because of the multiple use of NTMs are agriculture products (especially in Indonesia, Thailand, Malaysia and Singapore), as expected, chemicals and allied industries (especially Malaysia and Indonesia), machinery and electrical machinery (especially Indonesia, Singapore and Viet Nam) and transport (especially Viet Nam).

Cambodia and Indonesia were covered in a recent multilateral survey of NTMs using the new classification system. The results of the multilateral survey show that (a) there is widespread use of NTMs globally, (b) Indonesia and especially Cambodia have moderate incidence of NTMs as compared to many low income

countries, Japan and especially the EU , (c) sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBT) are heavily used, with the former primarily on agricultural products and the latter, on agricultural-based products, textile and clothing, footwear as well as beverages and tobacco (Cadot, Munadi and Ing, 2013), and (d) NTM incidence tends to be heavier on sectors that are also more protected by tariffs (Gourdon and Nicita, 2012,p.77). The last result becomes salient for policy with tariffs declining, as the protective use of NTMs becomes more apparent.

Cadot, Munadi and Ing explored the severity of the price-raising effect of NTMs imposed by a number of ASEAN countries with data that are classifiable under the new multilateral NTM classification system, i.e., Cambodia, Indonesia, Lao PDR and the Philippines (see **Tables 3.1a** and **3.1b**). The results suggest that the NTMs have substantial price raising effects in a number of sectors such as foodstuffs, textile and clothing, footwear as well as chemicals and machinery. The authors caution that the results are *very preliminary* and need to be interpreted with *utmost caution*. Nonetheless, the results do indicate the following:

- The statistical results for those sectors with large price raising effects would call for case studies to validate the statistical results;
- It is useful to collect data on NTMs consistent with the new multilateral classification system; and
- The statistical results show one way to determine the severity of the NTMs and therefore provide a basis for the prioritisation of NTMs for review and streamlining.

Indeed, in view of the significance of NTMs as potential major constraints to an integrated ASEAN Economic Community, addressing and streamlining NTMs is of primary importance.

**Table 3.1.a: Price-based Estimates of AVEs: Indonesia and the Philippines**

Sector	SPS (A)		TBT (B)		Procedures (C)		Price measures (D)		QRs (E)	
	ID	PH	ID	PH	ID	PH	ID	PH	ID	PH
Animals	27.8	14.7	19.5	13.9	15.4	14.9	10.6	11.9	17	17
Vegetables	29.9	16.5	10.4	7.5	9.9	9.3	15	15.1	10.8	11.3
Fat & oils	11.2	7.3	10.9	2.6	9.7	17.6	16.3	16.7	5.5	5.5
Beverages & tobacco	9	8.7	17.1	8.3	9.5	6.3	13	14.1	11	11.3
Minerals	12.4	13	27.4	18.7	17.5	14.4	21.2	19.1	6.8	6.8
Chemicals	14.7	14.9	16.6	12.3	8.5	7.2	9.4	9.9	9.7	11
Plastics	18.5	17.7	14.6	12.8	7.6	9.3	10.7	10.2	6	7.7
Leather	24.6	20.4	12.2	19.9	32.9	35.1	12.7	14.9	7.9	8.1
Wood products	27.4	24.3	5.7	6	9.1	12	7.6	11.9	14	14.3
Paper	17.1	17	15.8	9.1	7.5	6.2	24.6	25.2	11.2	9.7
Textile and clothing	33.8	33.5	8.5	5.4	26.9	18.3	10	10.5	15.2	14.4
Footwear	47.1	48.5	21	15.7	23.7	24	16.7	9.5	10	14.6
Stone & glass			21.9	19.2	21.1	14.1	17.9	18.6	18.1	18.6
Pearls			24.4	30.7	16.3	28.2	-	2.6	15	14.7
Metals			22.3	8.8	11.4	10.7	8.3	8.6	6.7	6.7
Machinery			15.7	15.3	14.2	13.6	5.2	5.2	23.2	22.8
Vehicles			18.6	15.6	16.8	18.3	8.3	9.5	24	28.1
Optical & med. Instr.			21.6	19.8	18.5	19.4	2	2	19.9	16.4
Arms			38.3	19.9	4.9	14	-	-	6.3	5.9
Miscellaneous			21.3	18.5	8.8	9	14.4	13.5	14	13.5

Note: AVEs are in percent. Negative AVEs have not been taken into account in calculating section averages. Results are not altered drastically if they are included.

Source: Cadot, *et.al.* (2013).

**Table 3.1.b: Price-based Estimates of AVEs: Cambodia and Lao PDR**

Sector	SPS (A)		TBT (B)		Procedures (C)		Price measures (D)		QRs (E)	
	KH	LA	KH	LA	KH	LA	KH	LA	KH	LA
Animals	23.1	26.8	17.7	17.2	15.1	14	9.8	9.6	16.6	16.6
Vegetables	19.4	22.4	8.9	9.5	10.3	9.8	15.3	13.7	10.6	10.2
Fat & oils	11.3	7.8	2.4	3.2	11.3	12.6	16.5	16.5	6	5.5
Beverages & tobacco	13.4	38.7	14.8	15.2	7.7	7.8	13.2	12.7	12.7	10.7
Minerals	13.7	14.8	22.3	23	16.1	18.4	18.9	19	6	6.4
Chemicals	15.7	15.9	13.5	13.6	15.8	9.5	9.8	9.9	10.5	10.3
Plastics	18.5	18.4	14.8	14.9	7.5	7.7	10.7	10.2	7.1	6.7
Leather	21	20.9	18.8	18.2	33.9	34.3	15.1	15	7.9	7.9
Wood products	25.9	25.9	6.7	6.7	12.4	14.7	7.7	9.7	12.3	14.1
Paper	18.3	18.3	13.1	14.1	6.9	35.9	31.2	24.3	9.7	9.4
Textile and clothing	34.1	33	5.5	5.5	19.1	35.8	10.3	10.2	14.1	13.5
Footwear	47.4	47.6	15.6	14.6	22.9	42.7	13.4	15.6	14.7	12.7
Stone & glass			22.3	22.9	16.4	17.4	17	17	17.5	16.3
Pearls			24.8	26.8	19.3	32.2	2.6	2.6	15.2	15.1
Metals			10.2	10.7	12	45.7	8.2	8.2	6.8	6.4
Machinery			19.5	15.9	13.8	43.1	5.2	5.1	23.1	21.9
Vehicles			17.2	17.6	34.9	36.8	6.3	9.3	33.6	21.5
Optical & med. Instr.			20.3	19.9	18.9	21.9	2	2	16	16.6
Arms			19.1	19.1	12.1	20	-	-	6.7	6.7
Miscellaneous			21.4	21.5	10.8	16.9	15.7	14.4	14.2	11.5

Note: Negative AVEs have not been taken into account in calculating section averages. Results are not altered drastically if they are included.

Source: Cadot, *et.al.* (2013).

### ***Addressing and streamlining NTMs: Ways forward.***

ASEAN economic officials have been cognisant of the potential of NTMs as serious impediments to the success of the ASEAN Economic Community. ATIGA article 40 ensures transparency of NTMs such that new measures or modification to existing measures need to be duly notified in accordance with the ATIGA agreement on notification (Article 11). ATIGA Article 41 calls for the general elimination of quantitative restrictions vis-a-vis other AMSs except in accordance with WTO rights and obligations and/or other provisions of ATIGA. ATIGA Article 42 endeavours AMSs to review NTMs in the database to identify NTBs for elimination.

Given the wide range of NTMs, ASEAN assigns various classes of NTMs to different ASEAN committees and working groups, as follows:



- Technical barriers to trade: ASEAN Consultative Committee on Standards and Quality (ACCSQ)
- Sanitary and phytosanitary (SPS) measures; ASEAN Committee on Sanitary and Phytosanitary (AC-SPS)
- Import/export and customs related: ASEAN Directors-General of Customs
- Overall: Coordinating Committee for the Implementation of ATIGA (CCA)

Despite the clear vision in the AEC Blueprint, addressing and streamlining NTMs is easier said than done. Thus, for example, addressing technical measures and regulations like TBTs involves a complex set of regional mutual recognition agreements, corresponding regulatory changes at the national level, and improvements in conformity assessment capabilities and credibility.

Nonetheless, ASEAN has been continuing its efforts to address and minimise the NTB effects of NTMs. The challenge is to strengthen further the efforts to streamline NTMs. The following are the five major areas of intervention:

1. ***Institutionalised consultation mechanism.*** Currently, ASEAN has a G-to-G consultation mechanism under the so-called “Matrix of Cases” where an AMS or a group of AMSs can raise issues or concerns about government measures or regulations by another AMS (or AMSs) because they have adverse (actual or expected) effects on their (mainly) exporters. This mechanism has had a measure of success in terms of better information and understanding of the concerned measures or regulations, refinement or revision in a few of the measures or regulations, and eventual resolution in a significant number of the cases. While the venue of airing of the concerns is a regional body, cases are resolved bilaterally among AMSs.

The publicly available matrix lists 65 cases. The cases center around certification and import permits requirements and processes, length involved in import, SPS or permits processing as well as testing and verification, standards, documentary requirements, and designation of import entry ports. To some extent, they validate the findings of the

recent multinational study on NTMs which show the high incidence of SPSs and TBTs globally. The 65 cases also tend to be operational and nitty gritty issues, rather than policy issues per se.

As economic integration and trade linkages deepen further in ASEAN, there is a great likelihood of even much larger number of trade cases that wait to be resolved. As such, ***ASEAN may need to establish a more continuing body under CCA*** to be able to effectively handle such issues that involve NTMs in the region, or to ***fully operationalise the ASEAN Consultation to Solve Trade and Investment Issues (ACT)***.

## ***2. Effective Monitoring and Transparency Mechanism on NTMs.***

ASEAN can use the drive towards the global implementation of the new multilateral classification of NTMs as a springboard for an ***exhaustive inventory of NTMs in the region*** following the new classification system. Note that NTMs are the purview of many and disparate government agencies in most of the AMSs. It would not be surprising if previously, there was incomplete listing of all the NTMs especially by the newer and poorer AMSs because of the lack of a coordinating body that has a comprehensive data base of regulations and policies of many agencies and which would have trade implications. The exhaustive inventory of NTMs using the new classification system can then form part of the ***ASEAN Trade Repository (ATR) as well as the National Trade Repository in each AMS***. The inventory and the ATR form as important building blocks of an effective NTM monitoring mechanism in the ASEAN. The Common Market for Eastern and Southern Africa (COMESA) has set up an NTB ***monitoring mechanism that relies on the private sector for feedback*** on issues and measures with NTBs instead of the member countries (Cadot, Munadi and Ing, 2012) as is used in ASEAN's "matrix of actual cases". ASEAN may like to explore this mechanism in addition to the inventory of NTMs stated above, either as a complement to ACT or as part of the work of ACT.

## ***3. Analysis of NTMs for Streamlining Prioritisation.*** Given the inventory of NTMs discussed above, it is worthwhile to have a review of NTMs for possible prioritised streamlining. The matrix of cases and the NTB

monitoring based on private sector feedback are possible approaches at prioritisation of NTMs for streamlining. However, a more systematic approach at prioritisation is the statistical analysis-cum-case study on key industries. The statistical analysis similar to the one undertaken by Cadot, Manudi and Ing (2013) will provide indications on what NTMs have serious price increasing impact in which industry. The results of the statistical analysis, together with consultation with the private sector and case studies, will thus provide some basis for determining which industries and which NTMs need to be given priority for possible streamlining. This industry approach provides a more systematic review of NTMs and can be added to the current “matrix of cases” approach for an effective program of streamlining NTMs in the region, focusing on NTMs with revealed large trade barrier and price raising effects.

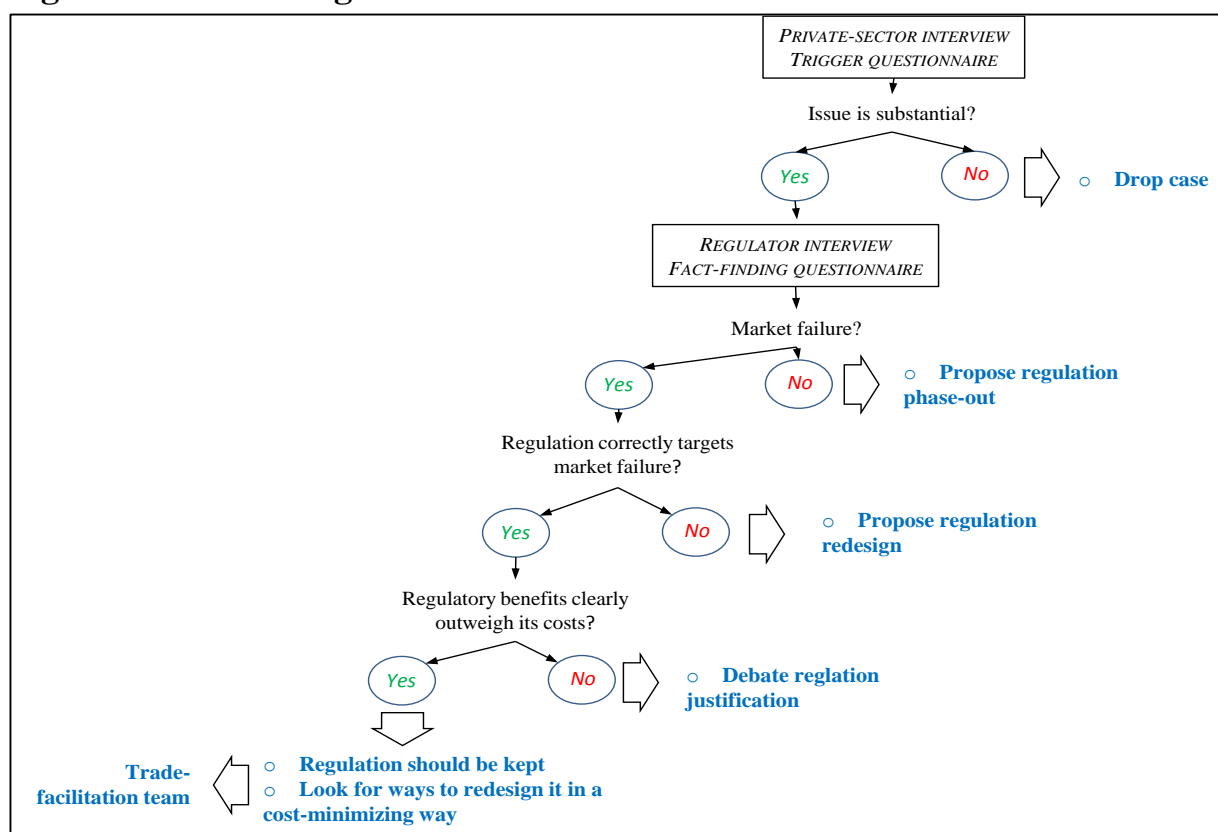
4. ***Address TBTs and SPSs.*** ASEAN’s program to address TBTs is the ASEAN standards and conformance program. Indeed, ASEAN has been cognisant of the importance of addressing issues related to standards, technical regulations and conformance assessment early on, such that it established the ASEAN Consultative Committee on Standards and Quality (ACCSQ). The AEC Blueprint 2009-2015 has a major program on standards and conformance in priority areas. The ASEAN standards and conformance program into 2015 and beyond is discussed later in the chapter.
5. ***NTM streamlining as concerted domestic regulatory reform.*** The initiatives discussed above are all regional initiatives. At the national level, Cadot, Munadi and Ing (2013) argue that it is best to view NTMs not from a trade negotiations point of view but from a better regulation point of view. While NTBs need be eliminated, the challenge for the rest of NTMs is to improve them in order to minimise the cost to the private sector. Poorly designed or poorly administered NTMs, especially on intermediate goods, can hurt exporters and the country’s national competitiveness as much as they are meant to restrict market access.

Streamlining NTMs therefore is really about minimising the cost of compliance by the private sector while the benefits from the NTMs are achieved. Equivalently, streamlining NTMs as better regulation is really

about ensuring the objectives of the NTMs with the minimum possible cost to the private sector and the country. Thus, the review of NTMs involves looking at the balance of benefits from the NTMs and the costs of complying with and administering the NTMs. **Figure 3.2**, taken from Cadot, Munadi and Ing (2013), presents the logical framework of an NTM review as advocated by the World Bank. As noted by the authors, the regulatory review structure set out in **Figure 3.2** is fully consonant with the necessity and proportionality tests principles of WTO disciplines.

The regulatory review presented in the figure has one important underlying assumption: that there is sufficient analytic capability in each AMS and the region to provide the analytic support in undertaking the review. However, this is clearly inadequate in a number of AMSs especially in the CLM countries. Thus, there is a ***need for capacity building and technical training*** to develop the analytic capability to undertake robust review and streamlining of NTMs in each AMS and in the region as a whole. ASEAN's dialogue partners and multilateral institutions like the World Bank are possible partners of ASEAN and AMSs in this capacity building and technical training initiative.

**Figure 3.2: The Logical Flowchart of an NTM Review**



Source: World Bank (2011).

Given the growing importance of NTMs as a potential bottleneck to deeper economic integration in ASEAN, investing in the human and institutional capacity to review the NTM regulations for streamlining is a worthwhile undertaking for the region beyond 2015

## Trade Facilitation and Logistics

Efficient trade facilitation and logistics is absolutely necessary for a seamless production base and integrated ASEAN. It is critical for competitive and well performing regional production networks. The AEC Blueprint 2009-2015 (p.23) presents the importance of trade facilitation clearly as thus:

*Simple, harmonised and standardised trade and customs, processes, procedures and related information flows are expected to reduce transactions costs in ASEAN which will enhance export competitiveness and facilitate the integration of ASEAN into a single market for goods, services and investments and a single production base.*

Trade facilitation and logistics is the revealed premier concern of the private sector in the region. The results of the ERIA survey in 2011 point to the following two trade facilitation measures as the top two most important concerns of the ASEAN private sector for implementation under AEC 2015 (Intal, Narjoko and Simorangkir, 2011, pp. 45-46):

- Improve import and customs administration efficiency and integrity (e.g., greater use of ICT, linked clearance systems, etc.)
- Streamline and expedite import and customs procedures, documents, etc.

The results of the 2012 Survey of Japanese-affiliated firms in Asia and Oceania (see Sukegawa, 2013, p.13) show that the top four problems in the trade system in ASEAN are (1) “complicated customs clearance procedures”, (2) “time consuming customs procedures”, (3) “lack of thorough information of trade rules and regulations”, and (4) “unclear methods for assessing customs duties”. The third and fourth problems listed above bring out the importance of transparency in addition to streamlined procedures and greater use of electronic means in order to improve much further the trade system in the region. Similarly, the results of the ASEAN Business Outlook Survey for 2014 of American firms in ASEAN show that “ease of moving your products through customs” is a major concern of most respondents in a number of AMSs (AmCham Singapore, 2013, p.26).

The private sector's emphasis on trade facilitation and logistics reflects the importance of efficient and timely movement of goods to the efficient operation of their businesses. At the same time, the private sector also experiences the very wide gap in the quality of trade facilitation and logistics between the region's best performers and poor performers, which serves as a deterrent to deeper economic linkages among AMSs. Herein lies one of the biggest challenges of ASEAN as an integrated and seamless production base beyond 2015. At the same time, herein lies one of the potential success stories of ASEAN given the strong policy emphasis by ASEAN and AMSs officials on trade facilitation under AEC.

***Benefits of efficient trade facilitation and logistics.*** Studies show that there are substantial benefits from efficient trade facilitation and logistics. With faster, more predictable and cost competitive trade logistics, ASEAN countries can export and import more competitively and thereby become more competitive players in both regional and global trade. Studies also show that improved trade facilitation raises the productivity of firms, a key determinant of long term competitiveness. Of course, an integrated ASEAN as a production base necessitates efficient trade facilitation and logistics within the region in order to mimic as much as possible the benefits of a large single economy like China or India.

Djankov, Freund and Pham (2006) indicate that a 10 percent reduction in time to export increases exports by about 4 percent globally or about 8-12 percent for developing countries. Moreover, they highlighted that countries with more efficient trade logistics have higher share of time sensitive exports to their total exports. It is worthwhile to note that time sensitive exports tend to be high value exports as well as fast growing exports. In effect, improved trade facilitation and logistics enables countries to participate more in the high value and fast growing (although volatile) commodity trade internationally. A study on the impact of trade facilitation in APEC (APEC, 2004) shows that improved customs procedures, increased use of information and communication technology, business mobility, and especially standards and conformance all contribute positively to increased bilateral trade among APEC member economies.

Okabe and Urata (2013) used gravity modelling to examine the impact of time and cost on importing and exporting agricultural products within ASEAN; their results indicate that indeed, reducing the time and cost of exporting and importing within ASEAN would increase intra-ASEAN trade in agricultural and agri-based products at the aggregate level as well as in a number of individual commodity groups like vegetable oils and fats (HS 15), coffee, tea, etc, (HS 9), and cocoa and cocoa preparations (HS 18). The authors also found that transparency of border administration, efficiency of import and export procedures, availability and quality of transport services and infrastructure as well as of ICT, and the quality of regulatory environment, among others, have significant impact on the time or cost to export and import. A similar econometric work by Narjoko (as cited in Dee, Narjoko and Fukunaga, 2013), focusing on aggregate trade within ASEAN, gives comparable results as Okabe and Urata. He also found that improved trade facilitation and greater domestic competitive environment leads to higher intra-ASEAN trade.

Subramanian (2012) reported an APEC study that shows that a reduction of 5 percent in trade costs over 5 years increases GDP by nearly 1 percent; she also reported another study that shows that a 1 percent reduction in trade costs would increase the GDP of non-OECD Asia Pacific by 0.25 percent. A study by Subramanian, Anderson and Lee (2005) shows that a reduction in export clearance by one day would lead to increased total factor productivity in China's manufacturing industries by 2.1 percent for Apparel, 5.4 percent in electronic equipment and 5.8 percent in consumer goods. The impact of the one day reduction in export clearance on total factor productivity of Brazil's manufacturing sector is, however, much less, at between 1.3 to 1.5 percent for electronics and apparel industries, respectively. Thus, improved trade facilitation and logistics raises national output and therefore national income. Equally important, there are indications that improved trade facilitation also contributes to higher productivity of domestic industries albeit differently by industry and also by country.

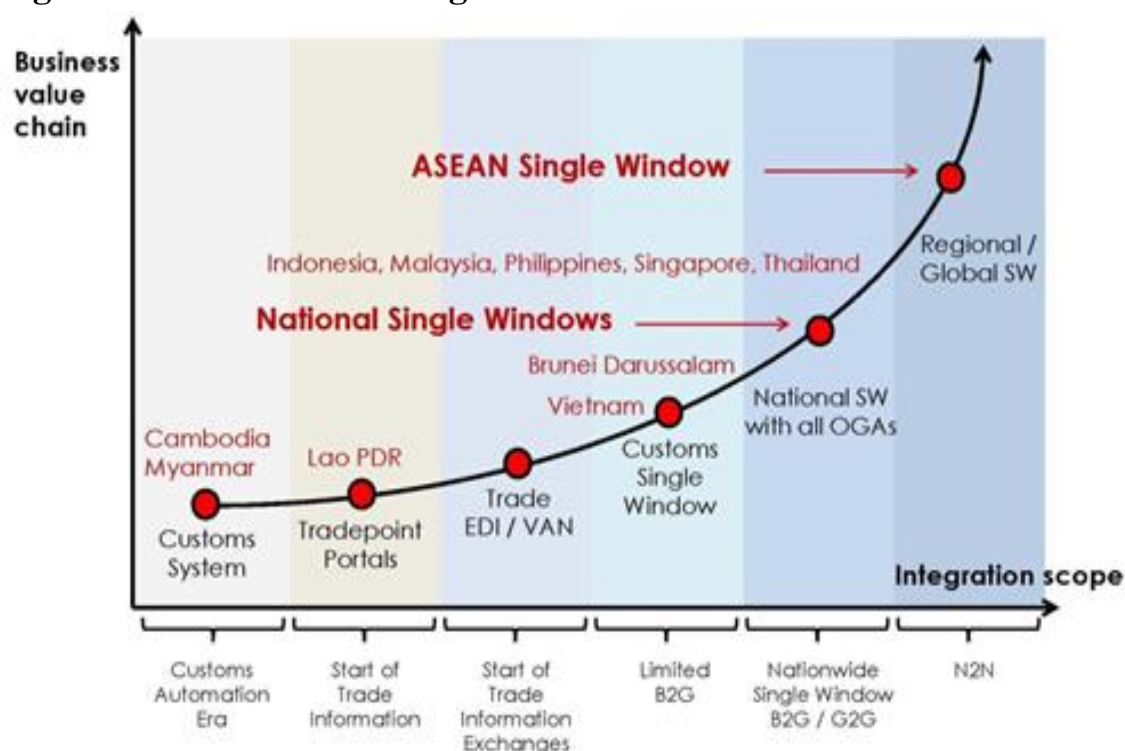
***The trade facilitation agenda in ASEAN: status.*** ASEAN has a comprehensive trade facilitation program but the two key components are the establishment of the ASEAN Trade Facilitation Repository and, more importantly, the ASEAN Single Window (ASW). Both regional initiatives call for corresponding national level initiatives, i.e., the National Trade Repository



and the National Single Window (NSW) in each AMS. The trade repositories, important for transparency, contribute to the effective operationalisation of the national single windows. The regional repository and single window are not yet implemented but member states have been working at the national end albeit at different speed and success.

The progress of the National Single Windows is best seen in **Figure 3.3** which shows AMSs along the path of evolution of single windows. On the one hand are AMSs where there is live implementation of the NSWs (i.e., Indonesia, Malaysia, the Philippines, Thailand and most especially Singapore which is a global pacesetter in single windows). On the other hand are the CLM countries which are still in the early stages of customs modernisation and establishment of national single window. In between are Brunei Darussalam and Viet Nam which have built their Customs Single Window but thus far do not include the integration of other technical control agencies to the platform designed (Koh and Mowerman, 2013). Not all the countries with live implementation of NSWs have fully functioning single windows yet in terms of interface of the systems with customs nor involve most, if not all, of the trade relevant government agencies nor cover at least all the major ports and airports in the countries. Thus, there is quite a distance to be traversed before there is fully functional NSW in most of the AMSs and eventually, a fully functional region-wide ASW since the latter is anchored on the NSWs.

**Figure 3.3: Evolution of Single Windows**



Source: Koh and Hogg (2012)

The ASW simply provides the environment for the NSWs to operate and integrate. With the support primarily of the United States Agency for International Development (USAID), ASEAN is in the process of setting up the building blocks for its implementation, including the establishment of the network architecture and the setting up of the infrastructure for the ASW albeit on a limited pilot basis. The scaled up pilot has not yet been implemented. The legal foundation to allow for ASW implementation in a number of AMSs is not yet in place. Thus, there remain substantial financial and human resources needed to effectively implement the ASW (Koh and Mowerman, 2013).

**Trade facilitation in ASEAN: way forward.**<sup>1</sup> Given the huge difference in the stage of single window development among AMSs, the country-level ways forward could differ. Thus, for example, for the AMSs with live implementation of NSW allowing for B2G and G2G communication, the challenge would be in “...designing and testing quality standards and characteristics to be able to expand the usage of the platform to B2B activities,

<sup>1</sup> This is largely taken from Koh and Mowerman (2013)

as well as invest their efforts in the reduction of documents needed to trade” (Koh and Mowerman, p. 18).

On a region-wide basis, the recommendations for the way forward are best phased into short term (2016-2020) and long term (after 2016). The short term recommendations are high-impact improvements that can generate tangible results in the short run.

## **Short run recommendations:**

- 1. Private sector involvement:** Given the important role of the private sector in providing input for business process analysis, data standardisation and harmonisation, consultation with the industry/private sector is crucial. Thus, a regular forum for public-private sector engagement should be held both at the regional and national levels for ASW and NSWs, respectively. This can be via the creation of Steering and Technical Committees for the Single Windows. In addition to the feedback that can be provided by the private sector, the effort to incorporate the private sector is the means to have the private sector fully informed and engaged with regards to the change in the customs that will take place with the implementation of the ASW.
- 2. Standardisation of procedures:** An effective ASW depends on effective and inclusive NSWs. Thus, it is necessary to strengthen and standardise the existing NSWs that are at different levels of development, and expedite their development. Finally, National Trade Repositories (NTRs), where traders and government agencies can check tariffs and trade related regulations, should be set up as this would generate greater legal security for traders and better understanding with government agencies.
- 3. Online payments:** The implementation of online payment mechanisms via the usage of debit cards, credit cards or giro should ideally be extended not only for Customs and the payment of taxes and tariffs but should also include technical control government agencies that issue licenses and any agency that interacts in trade transactions involving any kind of collection and payment fees for inspection.

- 4. Back-office/support documentation digitalisation:** It is not sufficient to build an online documentary repository or single window. What is really necessary is the digitalisation of technical control agency back-offices. The efforts invested in creating facilitation tools may be diminished if government agencies continue to keep documents in physical form in various places in the country. Time to issue licenses will not decrease if all support information are not available in a handy manner. Real efficiencies from ICT tools come from automating the entire process.
- 5. Digitalisation of support documents:** Documents should be digitalised and shared in a digital form, as Certificates of Origin are shared amongst Colombia, Chile and Mexico, and where the reduction in transaction costs was dramatic. The pilot in the ASEAN region can take the international best practice presented in Latin America, and/or can choose to share other cargo support documents in digital form such as phyto or zoosanitary certificates, technical standards certificates, etc.

## Medium and Long Term – year 2020 and beyond

Should ASEAN governments succeed in the implementation of the short term recommendations detailed above, they should move forward in implementing these deeper reforms that will finalise the possibility of accomplishing trade transactions in a seamless manner. These more complex processes can begin to take place in the year 2020, at the latest, when all NSWs are up to date, functional and under the same standard.

- 1. Physical infrastructure readiness:** All ICT related efforts, be it NSW, ASW or Customs systems, will be diminished if road, air and port infrastructure is not readily available for the expedited movement of cargo. Licenses can be issued in one day, but if cargo takes days to move, the efforts go unnoticed.
- 2. E-commerce legislation:** Having e-commerce legislation readily issued will allow the reaping of the full benefits of the ICT efforts invested by the ASEAN countries. This legislation has to include digital signature,

digital documentary proof, and clear liabilities regarding the proper way to handle electronic documents. Likewise, legislation has to be issued at a local and regional level so information can be shared at a regional level. Disparities can result in trade taking place in a physical manner.

- 3. Adoption of integrated risk management border controls to ensure cross border compliance:** Implementing integrated risk management within the ASW will allow for detailed controls of types of cargo and traders mobilising cargo in the region. All technical control agencies involved in trade transactions should be able to include their missionary risk criteria within the system in such a way that all possible risks inherent to a shipment can be analysed to be able to determine its selectivity. Furthermore, ex-post controls should be implemented so as not to leave any trace of doubt of lack of compliance.
- 4. Encourage the usage of pre-clearance and pre-certification programs:** The aim of this initiative is to decrease congestion in wet and dry ports and allow for a more expedited physical movement of cargo, thus decreasing costs for the private sector. Additionally, granting local authorities the possibility to have information submitted to them prior to the arrival of cargo generates a better risk assessment and compliance with further security measures.

In conclusion, the ideal scenario for the year 2020 would be full integration of technical control agencies' processes for obtaining all cargo support documents. This would be done via the implementation of digital signatures and online payment systems in such a way that no person to person interaction takes place. Ultimately, via the implementation of the ASW, the governments where the cargo is originated will be able to submit original copies of the support documentation (ideally a Single Administrative Document) to the countries of destination of the cargo in a seamless digital manner prior to the arrival of the cargo, in such a way that risks can be assessed ex-ante and no tie-ups take place in the port or warehouses.

Regarding customs transactions, traders should be able to file and submit all import and export declarations (regardless of the modality being used), and this will include the processing of information on the usage of quotas, subsidies or

drawbacks. Likewise, via the usage of this system, traders should be able to pay all fees and duties related to an export or import transaction via an online payment button. Lastly, given that Customs is the government agency that effectively controls the entry and exit of cargo to a country, it should be the agency in charge of hosting the integrated risk management system, which includes the specific risks of the technical control agencies interacting in trade transactions. These agencies will either introduce themselves or send to Customs the information regarding the origin of their cargo related risk, so it can be inputted into the Customs hosted system and be a part of the security risks analysed.

The end result is a seamless single window and trade facilitation regime that will tremendously contribute to an integrated production base and a more unified market.

## **Addressing Technical Barriers to Trade in ASEAN: Standards and Conformance**

In the ERIA survey as part of the Mid-Term Review of the Implementation of the AEC Blueprint, about four-fifths of the private sector respondents in all of the AMSs view diverse technical regulations and product standards in ASEAN to be serious barriers to intra-ASEAN trade. Consistent with this view, more than four-fifths of the private sector consider the harmonisation of national and regional standards to international standards to further enhance competitiveness in global trade to be both beneficial and urgent for the region. Similarly, virtually all of the private sector respondents consider beneficial to them the acceleration of mutual recognition of conformity assessment results, strengthening of institutional capacities and streamlining of conformity assessment processes. Indeed, in their prioritisation of AEC measures that should be implemented for AEC 2015, the private sector respondents consider standards and conformance as the second most important area after trade facilitation.

ASEAN is fully cognisant of the critical importance of standards and conformance for a well performing ASEAN Economic Community, as best reflected in the following passages in the AEC Blueprint 2009-2015 (p. 25), to wit:

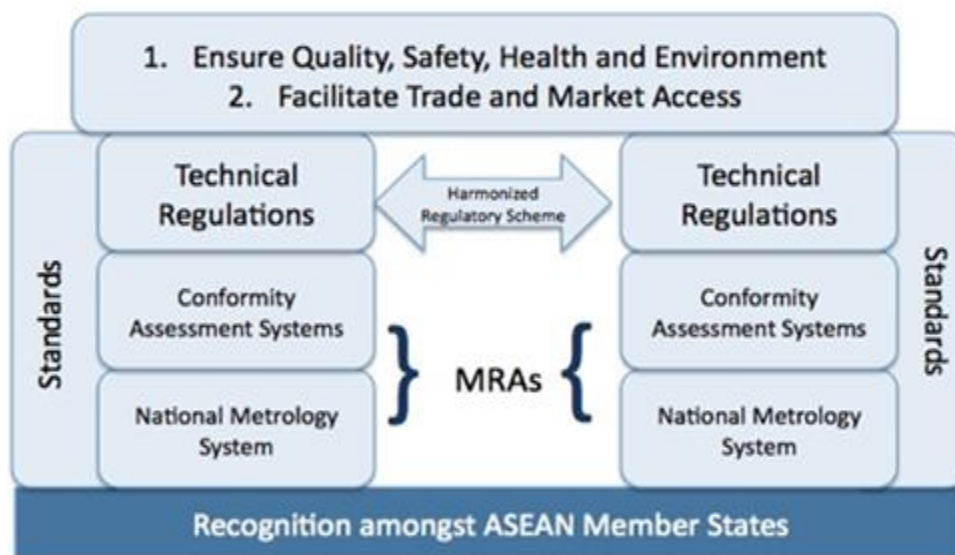
*Systems of standards, quality assurance, accreditation, and measurement are crucial to promote greater efficiency and enhance cost effectiveness of production of intra-regional imports/exports. Standards, technical regulations and conformity assessment procedures will be harmonised through the implementation of the ASEAN Policy Guidelines on Standards and Conformance, with greater transparency, improved quality of conformity assessment and active participation of the private sector.*

The ASEAN standards and conformance framework is summarised in **Figure 3.4** which highlights the twin goals of (1) ensuring quality and safety and protecting health and the environment, and at the same time (2) facilitating trade and market access. The focus is on the harmonisation of standards to international standards, the development of harmonised regulatory schemes for technical regulations, and the development of Mutual Recognition Agreements (MRAs) to connect the conformity assessment systems and national metrology systems of AMSs.

Through the ASEAN Consultative Committee for Standards and Quality (ACCSQ) and its various horizontal and product working groups and a joint sectoral committee, ASEAN has made significant progress in the harmonisation of standards and conformance assessment measures, the development of Mutual Recognition Agreements (MRAs) in regulated areas, and the harmonisation of technical regulations. On harmonisation of standards, 58 standards have been harmonised in electrical appliances, 81 standards harmonised in electrical safety and electromagnetic components, 3 standards harmonised in rubber-based products, and for pharmaceuticals, the ASEAN Technical Dossiers (ACTD) and ASEAN Common Technical Requirement (ACTR) have been completed. The harmonisation of standards is on-going. ASEAN has signed a few MRAs, most notably in electrical and electronics, cosmetics, GMP for manufacturers of medicinal plants, and telecommunications (the latter in conjunction with APEC Telecommunications Working Group). Other MRAs are being developed. The challenge for ACCSQ is to ensure that the MRAs are implemented well to achieve its goal of “One Standard, One Test, Accepted everywhere” (see Pettman, 2013; ERIA, 2012a).

Despite the progress achieved, much remains to be done and the efforts on standards harmonisation, MRAs and harmonised regulatory schemes will be a continuing major challenge for the region, given new products and technologies, changing societal priorities, and the fact that there are a lot more sectors than the ones currently prioritised by ACCSQ. Even in the European Union where the Single European Market with 1992 as target date, work in standards and conformance is continuing today to overcome barriers to trade and achieve regulatory integration (Pettman, 2013, p.10).

**Figure 3.4: ASEAN Standards and Conformance Framework**



Reprinted from Pettman (2013)

**Way forward beyond 2015<sup>2</sup>.** Moving forward, Pettman (2013) recommends the following to strengthen ASEAN's efforts on standards and conformance:

- 1. Define and communicate the benefits from AEC.** As the process of deepening economic integration under AEC calls for more difficult policy and regulatory choices, it is important that the benefits from AEC are defined clearly and communicated to people widely and consistently in order to galvanize efforts towards the future. Such definition of benefits need not only be aggregative but also sector or industry or area-wide. It is useful to have a common methodology for comparability.

<sup>2</sup> This subsection is largely taken from Pettman (2013).



Thus, in addition to defining the benefits from AEC overall, it is useful to define the benefits from standards and conformance initiatives that lead to regulatory convergence and alignment of regulations and standards across ASEAN.

- 2. Identify and address the priority barriers.** At this juncture, it would be useful to have an *external review* of the barriers and the potential economic benefits on addressing those barriers, and thereby be able to determine what the barriers that need to be prioritised are. The external review is worthwhile given that the general tendency is to focus first on the less difficult although not necessarily most economically important for ASEAN. The review may need to look into the questions raised typically in an impact assessment in standards area such as what are the benefits from the intervention, who are the beneficiaries from such intervention, and how would regulatory bodies be affected by the intervention (or the elimination of the intervention). By using a common methodology, the external review could be a mechanism of engaging the private sector in the process and thereby provide inputs and insights on the priorities and future activities in the standards and conformance area.
- 3. Maximise benefits of engagement with the private sector.** The results of private sector engagement in the AEC process are mixed. In the standards and conformance area, the private sector is actively involved in some product working groups but not in others; moreover, SMEs tend to be underrepresented. Given the critical importance of the private sector to the success of the AEC, it is important to give more emphasis to greater engagement with the private sector in terms of information exchange, developing mechanisms for feedback and support for the process, including expertise provision.

In order to create a level playing field among the private sector for engagement in the ASEAN process, the following may need to be considered.

- Set up common minimum standards for all the private sectors that wish to engage with the regional grouping.

- Criteria should be established for ongoing private sector involvement, including the provision of an annual report by each sector based on a common template. This report should include identification of the following: representation of the organisation; the value that the organisation has brought over the previous year and intends to deliver in the coming year; and measures that have been taken to involve small and medium sized companies, which form the backbone of the ASEAN economy.
  - Rules and processes should be established for engagement with Product Working Groups and other bodies, which are common across ASEAN.
  - A clear commitment from ASEAN to the private sector should be made on the minimum that they can expect from engagement if carried out according to the rules.
  - There is a need to focus implementation and feedback in the engagement with the private sector. It is recommended that small delegations of the private sector groups meet at least once a year with the representatives of the High Level Task Force on Economic Integration (or the SEOM), ACCSQ, and ASEC to deliberate on the achievements and challenges, and identify where possible, solutions to issues which run across the product working groups.
  - The private sector organisations should be asked to develop and present during the yearly meeting with the ASEAN officials (e.g., HLTF EI officials) their own **scorecard of progress** achieved based on a survey method to be determined either centrally or by each industry sector.
4. **Add resources to deliver results.** Given the vital importance of standards and conformance (S & C) for the creation of AEC, it is important to put more resources to deliver results. For example, the ASEAN Secretariat (ASEC) is clearly understaffed in the S & C area and there is a huge reliance on member state experts to deliver consistently high time inputs to deliver on goals.

- With the need for even greater engagement of the private sector and as the process of regulatory convergence consistent with the effective implementation on standards and conformance becomes more difficult, it is necessary to *beef up the ASEC staff in S & C*.
- A *High Level Task Force on Standards and Conformance* is proposed to help develop a vision and strategies for standards harmonisation to support the free flow of goods under the eventual single market of the AEC. The High Level Task Force on S & C could be aligned with the High Level Task Force on Economic Integration.
- The Legal Service of ASEAN needs to have focused contact point for the Chairs of the Product Working Groups (PWGs) in order to provide timely legal opinion on the frameworks and technical documents that the PWGs are developing, and which would likely need legal clearance before finalised and agreed upon by AMSs.
- One of the most valuable contributions of the private sector to the PWGs is the provision of technical and scientific expertise, often from outside the region. Such expertise helps speed up the process towards agreement. It is proposed that this role should be identified and clarified in the context of the rules of engagement of the private sector and that an operational guide for this should be established, including case studies on good practices.

**5. Completing S & C in, and broaden out from, the Priority Integration Sectors.** ASEAN's decision to focus first on the Priority Integration Sectors is an inspired one because it permitted more effective utilisation of limited resources and it is delivering results. However, much work remains to be done in order to fully implement the S & C programs in the priority integration sectors. It is indeed important that the priority sectors find the S & C differences and bottlenecks addressed, which can then be the basis for broadening the S & C initiatives beyond the priority integration sectors.

In broadening out from the priority integration sectors, one key consideration is whether to expand to other sectors similar to the

approach being undertaken for the priority integration sectors or whether it is better to bring forward more “horizontal measures” in the standards and conformance area. The implementation of “horizontal measures” has had considerable success in the EU and it had bypassed the need to create many specific measures for individual product sectors. One possible horizontal initiative is the creation of an *ASEAN product safety regulatory framework*.

6. **Strengthen cooperation in capacity building.** The more developed member states need to help, in some capacity or the other, the less developed ASEAN member states such that they can come to grips with standards and conformance and so that they can monitor products they manufacture. The more developed economies have to make attempts to bring the lesser developed economies on board the whole process in order for the divide between them and the late developers not to deepen.

Standards and conformance measures are difficult to harmonise, often because of different objectives of different governments, and sometimes also because the true benefits of standardisation and conformance are not viewed in the same light by all the members. Budgets need to be increased and clearer guidelines need to be laid out to make the whole process smooth and free of delays. More information is needed as well, particularly to convince manufacturers and suppliers of the benefits of adhering to standards and conformance initiatives. This will require investment in research, collection of data and dissemination of information.

Most importantly, in order to achieve its standards and conformance targets such that they do not hinder the region’s progress towards the AEC, ASEAN needs strong leadership and political will at the national and regional levels. Member states themselves have to be convinced that the implementation of these measures, while appearing to be possibly cumbersome and expensive at present, will eventually enhance trade and will benefit their respective economies in due course. That is, the short-term challenges will be mitigated by the medium to longer-term prospects that the harmonisation of standards will bring about.

The ASEAN Secretariat, supported by the various Dialogue Partners, has to play a critical role in driving towards standards and conformance in the region. This will include promoting awareness about the benefits of harmonised standards and conformance measures and encouraging all the 10 ASEAN member states to contribute to the whole process. It also needs to promote greater communication and coordination between agencies that are involved such that the harmonisation of standards and conformance can be attained more easily.

## **Highly Contestable Markets: Services, Investment and Competition Policy**

Markets that are highly contestable are expected to breed efficiency and innovation, the two anchors of competitive and dynamic economies. Highly contestable markets are those where there is relative ease in the entry and exit of goods and services (in the product market) and/or entry and exit of firms (for investments and operations in goods and services industries). Tariff elimination, non-protective NTMs, efficient trade facilitation, and facilitative standards and conformance all contribute to greater contestability in the product market for goods. The discussion and recommendations so far in the chapter are all in support of tariff elimination, non-protective NTMs, efficient trade facilitation, and facilitative standards and conformance regimes, and are therefore in support of greater contestability in the goods markets. They are all under the rubric of “towards free flow of goods” in the ASEAN.

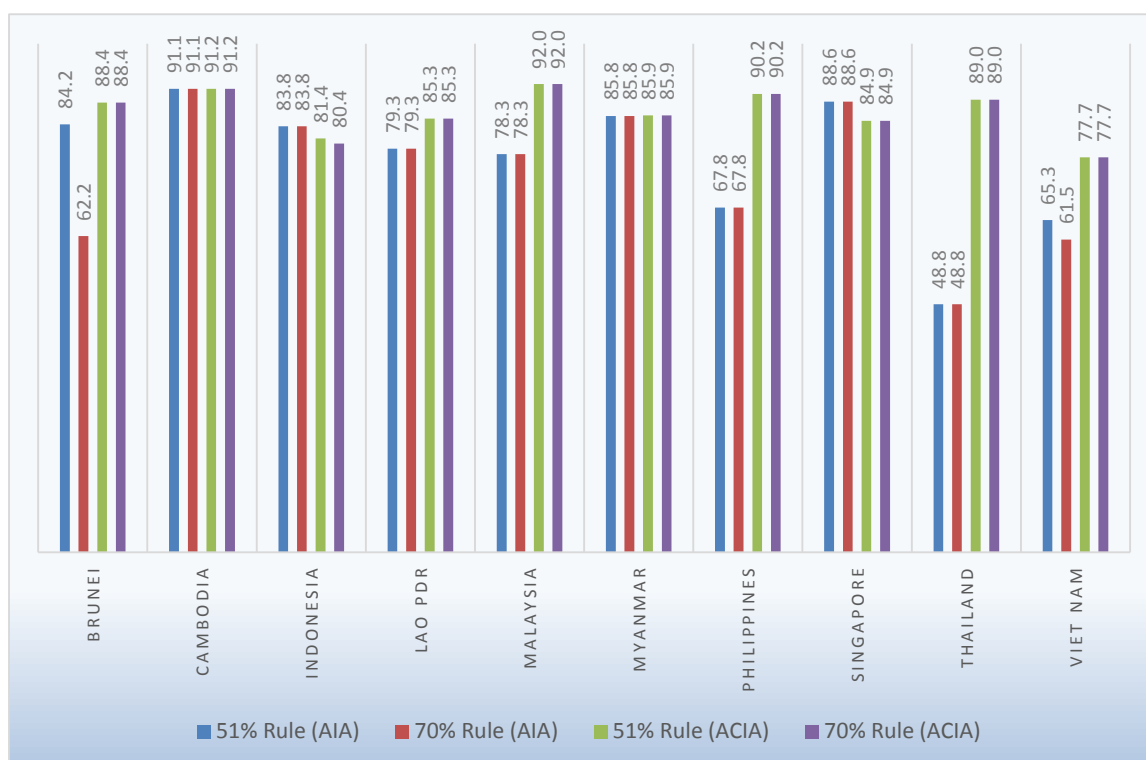
The challenge in the ASEAN is greater with respect to engendering greater contestability in terms of the relative ease of entry and exit of firms in both the goods sectors, and more especially the services sectors because most service provision would call for commercial presence (and therefore investment) in the market of interest. Entry and exit of firms is fundamentally linked to investments and disinvestments; hence, high contestability means essentially a liberal and non-discriminatory regime for investments, whether domestic or foreign. Highly contestable markets in investment and services are the important big steps towards the full realisation of the goals of “free flow of services” and “free flow of investment” under the AEC Blueprint.

Under the AEC Blueprint, the liberalisation program of foreign entry into the goods sectors (and services incidental to the goods sectors) is captured at present under the ASEAN Comprehensive Investment Agreement (ACIA), while that for services sectors (except financial services and air transport services) are captured under the ASEAN Framework Agreement on Services (AFAS). ACIA follows a negative list approach to liberalisation (and hence, AMSs need to submit the Reservations List of sectors where there are foreign investment restrictions among others) while AFAS follows a positive list approach to liberalisation (and as such, AMSs would need to stipulate their list of commitments as per agreed formula under AFAS). Both ACIA and AFAS aim for nearly fully liberalised regimes, either through progressive elimination of sectors in the Reservation List in the ACIA or through the expansion of sectors and deepening of commitments in each of the sectors following an agreed-upon formula of liberalisation process under AFAS.

***Liberalisation rates under ACIA and AFAS.*** The results of the estimation of the liberalisation rates under ACIA, taking note of the Reservation Lists of AMSs, show relatively liberal investment regimes for foreign investors albeit sometimes under some conditional liberalisation schemes as in the Philippines (see **Figure 3.5**).

The figure shows that Cambodia is the most open AMS to foreign investment in terms of allowable foreign equity, followed by Singapore, and interestingly, Myanmar. Brunei Darussalam and Indonesia are also relatively open to foreign equity of at least 70 percent. The Philippines and Thailand are the least open on paper, but when certain conditions are met, e.g., export firms in export zones can have 100 percent foreign ownership, then the liberalisation of the two countries zoom up to among the highest liberalisation rates among the AMSs. Many of the AMSs are much less liberal on foreign equity in agriculture and mining sectors and more liberal in manufacturing.

**Figure 3.5: Overall Foreign Investment Liberalisation Rate**



Source: Intal, *et al.* (2011) as revised by Intal and Panggabean in 2012.

On services, the results of the estimation of the liberalisation rates of AMSs in Modes 1 and 2 under AFAS 8 Package show nearly 100 percent liberalisation rates when “unbound” is viewed as “not a limitation” but dropping substantially lower in most AMSs, most especially the Philippines and Viet Nam, if “unbound” is viewed as “limitation” (see **Table 3.2**). In effect, most of the AMSs have not bound their liberal commitments (and likely practice) with respect to Mode 1 service transactions. Modes 1 and 2 in services are the closest to the goods markets; hence, AFAS 8 shows AMSs have committed to highly contestable services markets in terms of Modes 1 and 2 in ASEAN.

**Table 3.2: Mode 1 Liberalisation Rates, AFAS 7th and AFAS 8th Commitments, ‘Unbound’ Defined ‘as Restrictions’ or ‘Not as Restrictions’ (in Percent)**

COUNTRY	MODE 1			
	AFAS 7		AFAS 8	
	(a)	(b)	(a)	(b)
1 - Brunei	67.9	96.7	71.4	97.2
2 - Cambodia	70.7	97.7	75.1	99.1
3 - Indonesia	74.2	99.4	74.3	99.7
4 - Lao PDR	98.7	100	95.2	100
5 - Malaysia	62.8	98.1	67.5	98.3
6 - Myanmar	85.1	100	87.3	100
7 - Philippines	50	94.6	51.0	94.1
8 - Singapore	91.1	96.3	90.9	96.4
9 - Thailand	61	95.3	65.2	94.9
10 - Viet Nam	49.5	94.6	50.3	94.7
Average	71.1	97.3	72.8	97.4

Note: (a) = computation of the scores assumes an 'Unbound' commitment as a limitation. (b) = computation of the scores assumes an 'Unbound' commitment not as a limitation.

Source: Narjoko and Herdiyanto (2012).

While the investment regime is more liberal for foreign investors in the goods sectors, especially in manufacturing, the liberalisation process in terms of Mode 3 (commercial presence) is getting harder and harder in the services sectors under AFAS. **Table 3.3** presents the *preliminary* estimates of liberalisation rates for Mode 3 for the priority integration sectors, the logistics sectors, other sectors and for all the sectors under AFAS 7 and 8. There is a noticeable decline in the estimated liberalisation rates for a number of AMSs under AFAS 8. This reflects the higher allowable foreign equity thresholds under AFAS 8 as compared to AFAS 7 for priority integration services, logistics services, and other services as well as a larger number of other services that were needed to be scheduled and under higher allowable foreign equity thresholds. Nonetheless, it is worth noting that two of the poorest AMSs (Myanmar and Lao PDR) have actually the highest liberalisation rates, followed by Viet Nam.



**Table 3.3: Mode 3 Liberalisation Rates, AFAS 5th, AFAS 7th and AFAS 8th Commitments, by Group of Sectors (in Percent)**

COUNTRY	Mode 3							
	PIS		LOG		OTHERS		All Sectors	
	AFAS 7	AFAS 8	AFAS 7	AFAS 8	AFAS 7	AFAS 8	AFAS 7	AFAS 8
1 - Brunei	21.6	30.3	63.9	72.5	60.2	58.0	49.6	50.2
2 - Cambodia	46.9	34.1	88.1	37.1	91.9	38.0	78.9	37.0
3 - Indonesia	49.4	52.0	89.2	52.6	79.7	63.7	70.6	59.1
4 - Lao PDR	78.6	86.8	87.2	86.4	80.9	78.1	80.7	80.5
5 - Malaysia	55.9	56.4	82.6	70.5	57.5	66.8	58.3	64.8
6 - Myanmar	81.3	84.3	80.2	86.3	80.2	84.6	80.6	84.5
7 - Philippines	39.2	41.3	66.1	38.2	45.9	39.5	45.8	39.8
8 - Singapore	44.9	35.8	55.5	38.4	77.8	32.9	68.2	34.0
9 - Thailand	25.8	52.2	56.8	51.0	68.5	44.5	58.4	46.3
10 - Viet Nam	91.3	67.3	90.7	29.1	86.2	85.9	87.8	77.4
Average	53.5	54.1	76.0	56.2	72.9	59.2	67.9	57.4

Source: Narjoko and Herdiyanto, (2012).

The later packages of AFAS (i.e., AFAS 9 to AFAS 12) target even higher allowable foreign equity in more sectors until all services sectors, except those included in the AFAS flexibility rule for sensitive industries, are covered and with allowable foreign equity of at least 70 percent. As initially programmed under the AEC Blueprint 2009-2015, all the packages were to be accomplished by 2015. This is extremely unlikely however if AFAS 8 is any guide. It is more likely that the liberalisation program under AFAS would slide into beyond 2015.

**Way forward for services and investment liberalisation.** The way forward for services and investment liberalisation is relatively straightforward; that is, to continue the phased liberalisation process in both the services sectors under AFAS and the investment regime for goods sectors under ACIA.

- Under ACIA, this means the process of progressive reduction in the list of industries under Component 2 (i.e., industries subject to liberalisation or diminution of applicability of restriction) continues.
- Similar to the recommendation of MTR on AEC Blueprint implementation (ERIA, 2012a, p. VIII-31-32), it would be useful to set guidelines on what could be included in the minimum investment

restrictions/impediments under Component 2 so that the flexibility included in Component 2 is not abused.

- Under AFAS, this means continuing further the phased liberalisation in the phases of AFAS that would not be implemented by 2015, together with further refinements of the flexibility rule and a reduction in the flexibility rate.

What is a more difficult issue is to determine the pace of the liberalisation process, post 2015. Will the process need to end by 2020? Or 2025? Almost implicit in the title of the chapter is that it is recommended to have a deliberate and well thought out pacing and phasing of further liberalisation of services and investment post 2015. The simulation results of Itakura (2013) and Dee (2012) suggest that there are indeed significant potential benefits from service liberalisation especially of logistics, transport and finance related services. Efficient services sectors are also important for AMSs moving up the global value chain and production networks (Damuri, 2013). There are political economy issues however especially for the more sensitive services sectors. Thus, there is a need for a more deliberate approach in determining the pace and phasing of further services liberalisation.

What would be more worthwhile for ASEAN is to give more priority to establishing an integrated production base in ASEAN in tandem with a highly contestable ASEAN market, rather than push headlong on liberalisation towards free movement of services and investment and less emphasis on establishing an integrated production base. AMSs and ASEAN need to give more focus on much improved facilitation measures which all involve difficult policy decisions and require larger amount of resources in order to be well performing.

Arguably, it is by giving more emphasis on having an integrated production base upon which regional production networks, and less developed regions engaged in them more deeply, that the road towards a single market in the region becomes more workable, investment climate correspondingly improved, and more robust economic growth attained. This is because a single market that is beneficial to most, if not all, peoples in the region is the one where the current

huge development gaps in the region are narrowed very substantially, and as such, price differentials across AMSs also correspondingly narrow.

***Contestability in financial services, financial integration, and macroeconomic policy coordination.*** Contestability in financial services and financial integration pose significant challenges for ASEAN. On the one hand, contestable financial markets and more integrated financial markets within the region engender efficiency and innovation in the provision of financial services within a country, provide greater venue for better allocation of investment resources within the region, and would likely entice more investment funds into the region. All the above would be supportive of the drive towards sustained high growth in the region. On the other hand, there is a wide range of prudential regulatory capability and regimes among the AMSs; in addition, the region's financial stability infrastructure remains inadequate. Moreover, analysis of transmission of shocks by Majuca (2013) shows that ASEAN's macroeconomic variables like GDP are most influenced by shocks within ASEAN itself, in the same way that the macroeconomic variables of a given country are affected most by domestic shocks, followed by shocks from China and Japan. Thus, given the significant risks, a more measured and cautious approach to financial integration is warranted, especially in the light of the EU experience in recent years.

Financial services liberalisation in ASEAN is carried through the Financial Services Commitment packages, the latest being the 5<sup>th</sup> Package. The results of the analysis of the 5<sup>th</sup> Package under the ERIA Mid-Term Review of the Implementation of the AEC Blueprint (see ERIA, 2012a) show low liberalisation rates, especially with respect to Mode 3 (commercial presence). Similar to the case of AFAS, the challenge is in deepening the liberalisation rate in terms of higher allowable foreign equity especially moving from minority to majority equity position.

The ASEAN Central Bank Governors endorsed the ASEAN Banking Integration Framework (ABIF), which is the key to the region's financial integration plan considering that the region's financial sector is bank-dominated. ABIF sets four preconditions to the success of the banking integration in the region, which is targeted in 2020. The four preconditions, and for which there is a Working Group set up for each, are the following:

harmonisation of principles of prudential regulations; building of financial stability infrastructure; provision of capacity building for BCLMV; and setting up of agreed criteria for ASEAN Qualified Banks (QAB) to operate in any ASEAN country with a single “passport”. Banking integration from the perspective of ABIF is the commercial presence of ASEAN QABs in the AMSs. (See Wihardja, 2013.)

**Way forward.**<sup>3</sup> Much of ABIF is for years beyond 2015. The results of the stock-taking show that there are huge challenges with respect to the harmonisation of prudential regulations and large inadequacies with respect to financial stability architecture in BCLMV countries. There appears to be a lot of political challenges towards banking integration, so much so that the target year 2020 may be not quite realistic.

Nonetheless, the stock-taking brings out the priorities for the way forward:

- **Build the financial stability infrastructure to contain systemic risk and contagion effects after integration.** This includes regional macro-prudential monitoring and surveillance (under AMRO), regional crisis management protocol, regional payment and settlement system, regional financial safety net (under CMIM now), legal system to protect property rights, and possible automatic exchanges of tax information among the AMSs.
- **Harmonise prudential regulations among AMSs.** This may increase regulatory and prudential barriers to banking entry, which would be in contradiction with AFAS. However, strong prudentials are a *sine qua non* to a robust and open financial sector. Hence, the trade-off would be worth it.
- **Capacity building is very important.** This is especially the case for BCLMV countries, where regulatory gaps are substantial.
- **Intensive research and study on various aspects of ABIF and regional financial integration is needed.** This includes, among others, examining the benefits, opportunities, costs and risks of ABIF; mapping

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<sup>3</sup> This subsection is taken from Wihardja (2013).

the networks and degree of integration of the regional banking systems, and determining the differential impacts of ABIF on BLCMV and the ASEAN 5.

- **Move towards greater macroeconomic coordination not only within ASEAN but also with ASEAN + 3 (China, Japan and Korea).**

As the results of Majuca (2013) show, the magnitude of impact of shocks from Northeast Asian countries on individual AMSs is second only to the contribution of domestic shocks.

**Competition policy.** Competition policy is an important complement to the liberalisation and facilitation initiatives discussed earlier in fostering competition in the domestic and regional markets in ASEAN towards an eventual single market and production base in the region. Since competition policy deals with anti-competitive behaviour of firms, competition policy becomes more salient in an increasingly integrated ASEAN not just with respect to practices in the domestic market but also practices that are transnational within the region, e.g., mergers or vertical outsourcing agreements.

The fundamental goal of competition is to ensure a level playing field for all firms, whether local or foreign as well as domestically or regionally. Thus, competition policy need not only focus on the anti-competitive behaviours of firms domestically and regionally but also need to tackle difficult policy issues related to the regulatory environment facing state-owned enterprises and government-linked firms vis-a-vis the rest of the firms (i.e., the notion of competitive neutrality). It should also look into issues like anti-dumping which, although essentially a trade policy issue, does have some implications on the scope of competition policy. In the case of the European Union, there is primacy of competition policy over anti-dumping (Lee and Fukunaga, 2013, p.18).

ASEAN's main initiatives related to competition policy under the AEC Blueprint have focused on competition law implementation, establishment of network of competition, authorities, capacity building, and a regional guideline on competition law. ASEAN has accomplished virtually all of the measures

before 2015, except that not all AMSs have competition laws at present (Lee and Fukunaga, 2013, p.19).

*Way forward in competition policy beyond 2015.*<sup>4</sup> Lee and Fukunaga (2013) propose that, post 2015, ASEAN focuses on the implementation and enforcement of competition laws and the broadening of coverage of competition policy beyond competition law:

- **Implementation of competition law.** AMSs without competition laws by 2015 would need to be encouraged and provided technical support, including further sharing of implementation experiences of the AMSs with competition laws.
- **Capacity building.** More formal and institutionalised approach to capacity building needs to be considered. One possibility is to establish a network of training programs on competition policy, possibly along the lines of the ASEAN Universities Network.
- **Peer review of competition policy.** Given fairly uneven enforcement performance of competition authorities in ASEAN, it is worthwhile to undertake peer review of the competition law and policy in order to improve them further, possibly on a regular 5-year cycle among AMSs for further improvement and reforms.
- **Enforcement cooperation arrangements.** With deeper economic integration, it is important to further strengthen cooperation on enforcement including general information exchange, case handling guidelines, and joint investigations.
- **Competitive neutrality review and implementation.** It is proposed that ASEAN undertakes or commissions a study towards competitive neutrality on issues like government issued financial guarantees and state aid/state subsidy to firms (SOEs/GLCs) as well as government procurement.

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<sup>4</sup> This subsection draws heavily on Lee and Fukunaga (2013).

- **Anti-dumping and regulatory governance.** A review of the anti-dumping cases in ASEAN and the potential conflict between competition policy (which focuses on consumer welfare) and anti-dumping policy (which focuses on firms) may need to be undertaken. There is also a need to study the impact on competition of government regulations like entry restrictions and price controls.

## Connected ASEAN

Connectivity is central to an integrated and competitive ASEAN as a production base and to a more unified ASEAN market. Cognisant of this, ASEAN has developed the Master Plan on ASEAN Connectivity (MPAC) that has a three pronged strategy of “...enhanced physical infrastructure development (physical connectivity), effective institutions, mechanisms and processes (institutional connectivity) and empowered people (people-to-people connectivity)” (ASEC, 2011, p.i). The discussion earlier in the chapter on trade facilitation, streamlining non-tariff measures and engendering more facilitative standards and conformance regime enhance institutional connectivity within the region. This section discusses other important means towards greater connectivity in ASEAN; namely, physical infrastructure for physical connectivity, air and maritime transport services for transport facilitation, and movement of skilled labour within the region.

***Physical connectivity.*** ERIA worked together with the ASEAN STOM in developing the ASEAN Strategic Transport Plan (ASTP) 2011-2015. The Plan provides a comprehensive framework and detailed plan towards seamless physical and transport connectivity into 2015 as well as the key strategies beyond 2015. (See ERIA, 2010b.) The Plan underpins the priorities on physical connectivity that are in MPAC. As ASTP emphasized, ASEAN’s supply chain network is only as strong as its weakest link, and hence, it needs to eliminate missing links and improve the quality of weak links.

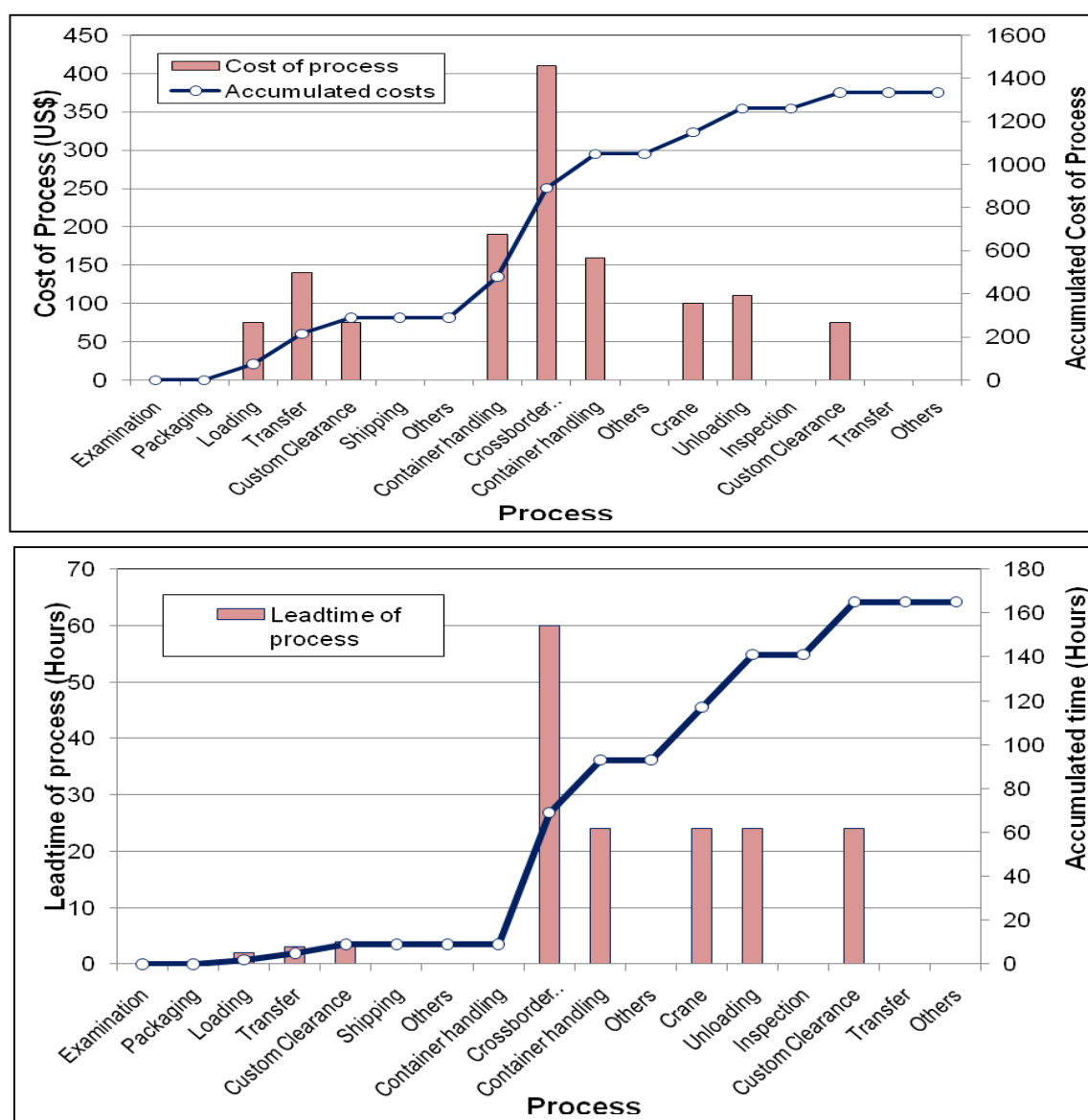
On land transport, this means the focus into 2015 and some years beyond is to complete and upgrade ASEAN Highways, complete the Singapore-Kunming Railway Link (SKRL), and implement the transport facilitation agreements, i.e., ASEAN Framework Agreement on the Facilitation of Goods in Transit (AFAFGIT), ASEAN Framework Agreement on the Facilitation of Inter-State

Transport (AFAFIST), and ASEAN Framework on Multimodal Transport (AFAMT). The abovementioned transport facilitation agreements are very important for seamless transport connectivity because the results of logistics flow studies in ASEAN indicate that the costs and time for border-crossing for trucks in ASEAN are very substantial (see **Figure 3.6**). While there is substantial progress on the transport facilitation agreements above, the two most important protocols of AFAFGIT (Protocol 2 and Protocol 7) need to be finalised and/or still be operationalised (ERIA, 2012a, p. X-27).

Moving forward beyond 2015, the completion of the missing links and upgrading of “below class 3” roads of the ASEAN Highway will likely go beyond 2015, primarily in Myanmar and the upgrading of class 2 and 3 roads with high traffic volume in the ASEAN Highway system would have to be done in AMSs. Similarly, there remain segments in the SKRL which would likely be completed well beyond 2015 yet. The completed ASEAN Highways and SKRL network will be the main skeleton of land transport for ASEAN. For greater accessibility of the hinterlands and to engender further inclusiveness, it is important to develop at the national level feeder and distribution networks linked to the ASEAN Highway (ERIA, 2010b). Additionally, AFAFGIT, AFAFIST, and AFAMT would need to be fully functioning in order for all the investments in physical infrastructure to lead to significant benefits to firms and people. Finally, ASEAN aims to establish itself as the transport hub of the world’s growth corridor from India through ASEAN thence to Northeast Asia or to Australia-New Zealand (MPAC strategy 5). This is through the development of “land bridges” or corridors like the Mekong-India Economic Corridor or East West Economic Corridor.



**Figure 3.6: Cost and time for cross border transportation by trucks**



Source: JETRO, ASEAN Logistic Network Map (2008) as reprinted in ERIA (2012a), p.X-16.

In depth studies may need to be done to determine how ASEAN can maximise the potentials of being at the geographic heart of East Asia growth corridor.

### ***Air transport<sup>5</sup>***

In a region as geographically spread out as ASEAN and with members that are in continental Asia and others in large archipelagos, a connected ASEAN would require very good air connectivity. ASEAN does aim for that and more, with the ultimate goal of setting up an ASEAN Single Aviation Market (ASAM). ASEAN has the Roadmap for Integration of Air Travel Sector (RIATS) which has spawned three major formal Agreements and

<sup>5</sup> This subsection draws heavily on Tan (2013).

their implementing protocols. They are the Multilateral Agreement on Air Services (MAAS), Multilateral Agreement for Full Liberalisation of Passenger Air Services (MAFLPAS), and the Multilateral Agreement for Full Liberalisation of Air Freight Services (MAFLAFS). Because of the ASEAN – X principle, all of the three multilateral agreements are in force but only among the state parties to the agreements. ASAM will remain elusive into 2015 and beyond without significant change of heart in the most important non-state party, i.e., Indonesia.

The most notable non-state party is Indonesia for Protocols 5 and 6 of MAAS and all the protocols of MAFLPAS and MAFLAFS. Given that it has the largest population and economy in ASEAN with a large air travel market, Indonesia's absence throws a big dent in the single aviation market aspiration of ASEAN. Underlying the hesitation in Indonesia is the threat of loss of market in international travel directly and in domestic travel indirectly (if foreign carriers have unlimited access to secondary airports) due to the perceived huge disparity in airline size and competitiveness between the large foreign carriers like Singapore Airlines, Malaysian Airlines and Thai Airways (for both passengers and freight), on the one hand, and the Indonesian carriers like Garuda and Lion, on the other hand.

***Moving forward beyond 2015***, the following provide some hopeful signs that there could be some ways forward towards a more integrated ASEAN air travel sector:

- Growing confidence of Indonesian carriers which are expanding aggressively (e.g. Lion, Garuda). As the limits of bilateral treaties get reached with their expansions and they become confident that they could compete well in a freer market, it is hoped that the current objections of Indonesian air carriers to the relevant protocols of the multilateral agreements in ASEAN would subside substantially and shift towards support for them.
- Pressure from provincial and local governments, tourism authorities, and business community to open up air travel since the opportunity cost to the country from restricted air travel is growing with the fast growing

tourism and business travels in the region. The partial open skies policy in the Philippines is a product of such pressure to a large extent.

- Pressure from increased competition from carriers outside the region that benefit more from ASEAN's agreements with larger countries like China.
- Innovations of market players such as in cross-border joint ventures/subsidiary model of AirAsia as a means of getting around "seventh freedom" or cabotage restrictions in some AMSs like Indonesia and the Philippines.

In short, the movement forward beyond 2015 rests primarily on market forces forcing recalcitrant stakeholders to open up and governments to rethink policies towards greater competitive environment and thereby paving the way towards a more integrated air travel sector in ASEAN.

***Maritime Transport.*** ASEAN contains two of the world's largest archipelagos in the world. It also includes one of the most important sea ways in the world, i. e., the Malacca Straits. Thus, maritime transport is a core element of ASEAN connectivity. Indeed, ASEAN aims to establish an integrated, efficient, competitive, and safe maritime transport system (MPAC Strategy 4). It also aims to promote the progressive liberalisation of maritime transport services in the region, as embodied in the "Roadmap towards an Integrated and Competitive Maritime Transport in ASEAN" adopted in 2008.

Virtually all the planned actions on maritime transport in MPAC and ASTP can be expected to be implemented mainly beyond 2015. These include the enhancement of the performance and capacity of the 47 designated ports in ASEAN maritime integration program, establishment of efficient and reliable shipping routes, including RORO connections between mainland and archipelagic ASEAN, enhancing search and rescue (SAR) capacity and capability, the development of human resources to strengthen port and shipping operations, and realise an ASEAN Single Shipping Market (ERIA, 2010b). Note however that ASEAN's single shipping market does not address cabotage; yet, good economic access of the periphery islands in a country would call for efficient and competitive shipping services. Thus, some AMSs

may need to address the issue of cabotage as inefficient domestic shipping could make farmers and firms from the domestic hinterlands less competitive vis-a-vis ASEAN exporters in the country's capital city and likely major domestic market.

ASTP and MPAC have clear strategic actions to develop ASEAN connectivity. The challenge into 2015 and beyond is essentially one of implementation.

***Intra-ASEAN Mobility of Skilled Labour.*** The AEC Blueprint 2009-2015 includes “Free Flow of Skilled Labour” as among the five core elements of Pillar One “Single Market and Production Base”, together with the “free flow of goods”, “free flow of services”, “free flow of investment” and “freer flow of capital”. However, in contrast to the free flows of goods, services and investments where there are stated targets to minimize barriers to their flows, the action points for “free flow of skilled labour” pertain mainly to “managed mobility or facilitated entry for the movement of natural persons...” (ASEC, 2009, p.29). The ASEAN Agreement on the Movement of Natural Persons, signed in Cambodia last year, applies primarily to entry of business visitors, intra-corporate transferees, and contractual service suppliers for limited stay. It does not apply to people seeking employment, citizenship, residence, or permanent residence in another member state. ASEAN has been developing and negotiating Mutual Recognition Arrangements (MRAs) in selected professional services, albeit under “free flow of services”. ASEAN also aims to develop core competencies and qualifications as well as enhance cooperation among the members of the ASEAN University Network (AUN) to increase mobility for both students and staff within the region.

The fair reading of the actions stated above is that ASEAN is really aiming for **“freer flow of labour”** and **not “free flow of labour”**. The logical effect of a “free flow of labour” is a single labour market as in EU where a citizen can move, reside freely and seek employment in any EU state subject to some limitations and conditions of public security, public health and public policy (Chia, 2013, p.14). CARICOM's measures are also relatively close to EU but only for selected professions so far. ASEAN's measures related to mobility of skilled labour are far away from the demands of “free flow of labour”.

There is some internal logic for “free flow of labour” in the case of EU and “freer flow of labour” as seems to be the case for ASEAN. In the case of EU, adherence to a single currency requires that adjustment to imbalances or shocks should not only be through fiscal and monetary means and capital flows but also through labour flows to minimize the adverse social effects of adjustment. In the case of ASEAN where countries have individual currencies and separate exchange rate policies, a “free flow of labour” is not absolutely necessary for smoother economic adjustment to external imbalances since exchange rate adjustment is the direct and potent policy measure to address such external imbalances. Note that in EU, despite the pro-single labour market policies, the actual labour mobility within EU is rather low because of many costs, e.g., financial, social, cultural, information, etc., involved (Chia, 2013, p.14).

Thus, it is best to view the “free flow of skilled labour” measures in the AEC Blueprint in terms more of in support of greater connectivity within ASEAN and less as an important feature of a drive towards a single market. This is consistent with the Master Plan on ASEAN Connectivity. In addition, “freer” or “managed” flow of skilled worker is also important for increased competitiveness of ASEAN, as suggested by the importance of face-to-face contacts among engineers for effective transmission of new technologies and of a liberal R & D environment for a more innovative ASEAN as discussed in the next chapter on Competitive and Dynamic ASEAN.

On the measures towards freer flow of skilled labour in ASEAN, there has been mixed progress on the implementation of MRAs in professional services, especially in engineering and architecture. However, the corresponding changes in national laws and regulations to allow ASEAN certified professionals to practice their professions in another AMS have not yet been fully accomplished in virtually all the AMSs. The ASEAN University Network (AUN) has been progressing well with a significant number of initiatives, including the ASEAN Credit Transfer System (ACTS), AUN-Quality Assurance, etc. The “...increased mobility for both students and staff within the region” (ASEC, 2009, p. 29), however, appears to be still wanting. This reflects to some extent the sharp differences in curricula and standards among the institutions, limited financial resources for student and staff exchange, and language differences (Chia, 2013, p.23).

Moving forward beyond 2015, Chia (2013) recommends the following<sup>6</sup>:

- **More effective cooperation among tertiary institutions and facilitation of exchange of students and staff.** The greater use of English as a medium of instruction in ASEAN could facilitate student and staff exchanges. ASEAN may also consider two successful European programs, namely, the *Erasmus Programme* and the **Bologna Process**, for adaptation and implementation in ASEAN. The Erasmus Programme promotes tertiary students to spend 3-12 months in another European country with transferability of course credits, waiver of tuition fees in the host institution, and an Erasmus grant to cover living costs. The Bologna Process adopts a system of comparable degree and system of credits to promote easier process of qualifications recognition and European cooperation in quality assurance.
- **Liberalisation and facilitation of entry and employment of ASEAN professionals and skilled workers.** Measures include:
  - facilitation in the issuance of visas and employment permits for professionals and skilled works engaged in cross border trade and investment, including the availability of forms in English on government websites;
  - need for transparency and information on the legal and policy restrictions governing employment of foreign professionals and skilled workers (e.g., work visas, labour market tests, opportunities for contract extension and permanent residence; taxation; etc.);
  - acceleration of development of core competencies for job/occupational skills especially in services.
  - creation of an ASEAN skills recognition framework. ASEAN countries still use very different systems and standards for labour skills regulations and certification. Harmonisation and mutual recognition is a time-consuming process.
  - improvement of the information network on employment opportunities and employment conditions in ASEAN countries.
  - ensurance of the portability of social security benefits.

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<sup>6</sup> The lists and discussion below is taken from Chia (2013).

- **Build ASEAN centres of excellence.** With mutual recognition of qualifications and freer movement of professionals and skilled labour, ASEAN should look into developing centres of excellence and hubs for various services and sub-sectors in different countries in the region. Collaborations and partnerships among ASEAN professionals could lead to the emergence of the ASEAN equivalents of Price Waterhouse Coopers, Ernst & Young, McKinsey, etc.
- **More effective implementation of MRAs.** ASEAN could explore the ASEAN equivalence of the EU Professional Card for some ASEAN professions. The EU Professional Card facilitates the recognition of professional qualifications in all EU member states.
- **Need to change mindset about skilled labour mobility.** That it is not a zero sum game. That skilled labour mobility can have synergistic effect on domestic talents and improve domestic consumer choice of service providers. That cultural diversity and international work experience is a competitive edge in the era of globalisation. That mobility of people for employment is an important element of community building in ASEAN.

To sum up, fostering an integrated and highly contestable ASEAN towards an eventual single ASEAN market and production base entails not only the elimination of tariff barriers but also streamlined and non-protectionist non-tariff measures (NTMs), seamless single windows and trade facilitation, facilitative standards and conformance, highly contestable services and investment regimes, prudently managed and deeper financial markets, much greater infrastructure connectivity, seamless air, maritime and multimodal connectivity, and freer flow of skilled labour in the region.