



**CIMB ASEAN RESEARCH INSTITUTE**  
DEDICATED TO ASEAN INTEGRATION



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# The ASEAN Economic Community:

The Status of Implementation, Challenges and Bottlenecks



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DEDICATED TO ASEAN INTEGRATION

## ABOUT US

CIMB ASEAN Research Institute (CARI) was established in 2011 by CIMB Group as a regional public service in support of ASEAN's programme of economic integration, the ASEAN Economic Community (AEC).

## MISSION

CARI conducts practical oriented research and helps focus the private sector's interest into meaningful progress towards an integrated and competitive ASEAN economy. The institute helps business leaders to develop perspectives, networks and tools to operate in a rapidly changing region.

## BACKGROUND

As the centre of gravity of global economic activity shifts to Asia, ASEAN finds itself at the crossroads of global trade in goods, services and ideas. ASEAN has succeeded by embracing open markets and regional co-operation. As we continue to remove barriers to the movement of goods, services, people and capital, and with an integral effort to improve inclusion, good governance and sustainability, we are within reach of an ASEAN Community.

Asia's increasing economic role must be attended by the growth of institutions dedicated to thinking through the consequences and possibilities brought by this great transformation.

## VALUE

### **Business Application**

CARI's research is focused on advancing regional integration and growing cross-border trade and investment within and beyond ASEAN.

### **Networks**

CARI connects leaders in government, academia and business to identify key opportunities for growth and development in the region.

### **Global Channels**

Tapping a global network of thought-leaders, CARI views the region from a global perspective and helps project ASEAN to the world.

### **Current Monitor**

Our expertise offers short-term analysis of current events which impact on business decision-making.

### **Horizon Scanning**

CARI works to spot emerging trends, and helps our stakeholders identify constructive responses to these trends.

## ACKNOWLEDGEMENT

As ASEAN counts down to the formation of the ASEAN Community on 31st December 2015, the private sector across ASEAN finds itself trying to decipher the vision of one of its three pillars, the ASEAN Economic Community (AEC), and ascertain the impact it would have on businesses.

ASEAN is a regional architecture, which most ASEAN stakeholders would agree to be crucial and vital to the business vibrancy of ASEAN. However, one undeniable reality is that there remains uncertainty, and seemingly underwhelming interest of a majority of the ASEAN business stakeholders, and most of which are native to ASEAN, as to how the AEC would eventually benefit the business sector.

Although the AEC has never been constructed to model after the European Union (EU), the most common response from the non-public sector to the idea of AEC, is undoubtedly how it compares to the EU experience, and what disparities between the two regional co-operations are.

It is in this context, and in line with CARI's commitment to facilitate the private sector in embracing the imminent formation of AEC, that we decided to publish a position paper, with the expertise of Prof. Jörn Dosch, to take stock on the status of implementation of the AEC, with a small degree of comparison to the EU experience as a starting point.

It is also based on the premise and conviction that the AEC must work for the private sector across ASEAN, that the paper does not shy away from asking the tough questions, and attempts to provide some brave answers. This study aims to produce an independent assessment of the progress made towards achieving the AEC by 2015, and to identify the pain points, which should not be ignored. This paper draws empirical observations from existing evidences, public and hidden, which we believe should provide substantial basis to spark discussion and launch other in-depth research.

CARI would like to thank the School of Arts and Social Science at the Monash University for this partnership.

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Jukhee Hong  
Director of Operations, CARI  
Project Supervisor

## THE PRINCIPAL AUTHOR

**Prof Dr Jörn Dosch** is Professor of International Relations and Acting Head of the School of Arts and Social Sciences at Monash University, Sunway Campus, Malaysia. He previously held the chair of Asia Pacific Studies at the University of Leeds where he was also Head of the Department of East Asian Studies, one of the largest university departments of its kind in Europe.

He began his academic career in the early 1990s as a lecturer in Political Science and International Relations at the University of Mainz, Germany, before moving to Stanford University as a Fulbright Scholar later in the same decade. He has also held visiting fellowships at several universities and research institutes, including the East West Center in Honolulu, UNPAR in Bandung, Prince of Songkla University in Thailand, the Institute of Southeast Asian Studies (ISEAS) in Singapore, De La Salle University in Manila and the Centre for Strategic and International Studies (CSIS) in Jakarta.

Prof Dosch has been working in the field of international relations in Southeast Asia and the wider Asia Pacific region for more than 20 years. He has published several dozen books and articles on ASEAN-related issues. He has also worked as an evaluator and consultant on ASEAN matters for the European Union, the German Federal Ministries of Economic Cooperation and Development and Foreign Affairs respectively, UNDP, and several other organisations. He has been team leader or deputy team leader of ten missions to the ASEAN Secretariat and ASEAN member states since 2008.

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## ABBREVIATIONS

<b>ACD</b>	ASEAN Cosmetics Directive
<b>ACDD</b>	ASEAN Customs Declaration Document
<b>ACFTA</b>	ASEAN-China Free Trade Area
<b>ACIA</b>	ASEAN Comprehensive Investment Agreement
<b>ACTLN</b>	ASEAN Cosmetic Testing Laboratory Network
<b>ACTS</b>	ASEAN Customs Transit System
<b>AEC</b>	ASEAN Economic Community
<b>AEGC</b>	ASEAN Experts Group on Competition
<b>AEM</b>	ASEAN Economic Ministers
<b>AFAS</b>	ASEAN Framework Agreement on Services
<b>AFTA</b>	ASEAN Free Trade Agreement
<b>AHSOM</b>	ASEAN Heads of Statistical Offices Meeting
<b>AIA</b>	ASEAN Investment Area
<b>AIMO</b>	ASEAN Integration Monitoring Office
<b>AMS</b>	ASEAN Member States
<b>APBSD</b>	ASEAN Policy Blueprint for SME Development
<b>APRIS</b>	ASEAN Programme for Regional Integration Support
<b>ASEAN</b>	Association of South East Asian Nations
<b>ASEAN-6</b>	Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand
<b>ASEAN-BAC</b>	ASEAN Business Advisory Council
<b>ASEC</b>	ASEAN Secretariat
<b>ASW</b>	ASEAN Single Window

<b>ATIGA</b>	ASEAN Trade in Goods Agreement
<b>AusAID</b>	Australian Agency for International Development
<b>BOC</b>	Bureau of Customs
<b>CCPID</b>	Competition Consumer Protection and IPR Division
<b>CEP</b>	Comprehensive Economic Partnerships
<b>CEPA</b>	Comprehensive Economic Partnership Agreements
<b>CEPT</b>	Common Effective Preferential Tariff
<b>CLMV</b>	Cambodia, Laos, Myanmar, Vietnam
<b>CPL</b>	Competition Policy and Law
<b>EMU</b>	European Monetary Union
<b>EU</b>	European Union
<b>EUR</b>	Euro
<b>FDI</b>	Foreign Direct Investment
<b>FTA</b>	Free Trade Agreement/Area
<b>GATS</b>	General Agreement on Trade in Services
<b>GDP</b>	Gross Domestic Product
<b>GHS</b>	Classification and Labelling of Chemicals
<b>GIZ</b>	Deutsche Gesellschaft für Internationale Zusammenarbeit
<b>IAI</b>	Initiative for ASEAN Integration
<b>ICT</b>	Information and Communications Technology
<b>IGA</b>	ASEAN Investment Guarantee Agreement
<b>IMF</b>	International Monetary Fund
<b>IP</b>	Intellectual Property
<b>JICA</b>	Japan International Cooperation Agency
<b>LPI</b>	World Bank Logistics Performance Index
<b>MFN</b>	Most Favoured Nation
<b>MRA</b>	Mutual Recognition Agreements
<b>NTBs</b>	Non-Tariff Barriers
<b>PMS</b>	Post-Market Surveillance
<b>PSI</b>	Pre-Shipment Inspection
<b>RoO</b>	Rules of Origin
<b>SGL</b>	Super Green Lane
<b>SME</b>	Small and Medium Sized Enterprise
<b>SPS</b>	Sanitary and Phyto-Sanitary measures
<b>TBT</b>	Technical Barriers to Trade
<b>TRTA</b>	Trade-Related Technical Assistance project (Philippines)
<b>UN</b>	United Nations
<b>UNITAR</b>	United Nations Institute for Training and Research
<b>USAID</b>	United States Agency for International Development
<b>USD</b>	US Dollar
<b>USITC</b>	US International Trade Commission
<b>VA</b>	Value added
<b>WTO</b>	World Trade Organisation





# EXECUTIVE SUMMARY



## ASEAN ECONOMIC COMMUNITY (AEC) 2015

Signed by the leaders of the Association of South East Asian Nations (ASEAN) at the 13th ASEAN Summit on 20 November 2007, the ASEAN Economic Community (AEC) Blueprint lays the foundation for realising the goal of ASEAN as an integrated economic region by 2015.

The AEC is based on four characteristics: Single market and production base; Competitive economic region; Equitable economic development; and Integration into the Global Economy, committing ASEAN to work towards maintaining “ASEAN Centrality” in its external economic relations, including, but not limited to, its negotiations for free trade (FTAs) and comprehensive economic partnership (CEPs) agreements.

Each characteristic is defined by various detailed implementation objectives, timelines and specific action points. The 19th ASEAN Economic Ministers Meeting, held in Hanoi on 8 March 2013, reaffirmed ASEAN’s determination to establish the AEC by 31 December 2015.

## THE ASEAN MONITORING SYSTEM

Progress towards achievements of the agreed goals outlined in the AEC Blueprint is monitored through the ASEAN Scorecard mechanism, which was established in 2008. However, the ASEAN Secretariat (ASEC) is currently neither mandated nor in the position to assess the progress of AEC implementation independently. Instead, it prepares and publishes the Scorecard based on data provided by the ASEAN Member States (AMS). Consequently, the current approach to monitoring and dissemination of data on regional economic integration is largely driven by political motives and incentives, for example, the need for national governments, and ASEAN collectively, to demonstrate substantial progress towards the implementation of the AEC.

Therefore, it is the objective of this report to provide an independent and unbiased assessment of the achievements, hurdles and challenges in the process of AEC implementation that goes beyond political window dressing.

## METHODOLOGY

The report was conducted as a desk study between January and March 2013, but also draws on research carried out in the second half of 2012. The report is mainly based on documents and data which are already in the public domain and, to a smaller extent, on unpublished material. Many of these materials are hidden away on specialised websites and have been largely neglected by researchers.

## SCOPE OF STUDY

The report attempts to address the following key integration agendas:

- Implementation and utilisation of the ASEAN Free Trade Agreement (AFTA) under the Common Effective Preferential Tariffs (CEPT), and now ASEAN Trade in Goods Agreement (ATIGA) schedule;
- Customs procedures, especially improvements (and remaining challenges) with regards to customs harmonisation, transit times, and the efficiency of national customs regimes;
- Elimination of impediments to investment and liberalisation of investment rules and policies;
- The state of the implementation and utilisation of the ASEAN Framework Agreement on Services (AFAS) with particular emphasis on financial services;
- The status and enforcement of Competition Policy and Law (CPL) across ASEAN;
- Progress towards regional standards and the prevalence of non-tariff barriers; and,
- Regional and national measures taken in support of SMEs.

## FINDINGS

### 1. Free Trade: Implementation and Utilisation

The hurdles in the process of deepening economic integration in general, and liberalising regional trade in particular, are primarily of a political and macroeconomic nature. It is also the result of the way the private sector is structured and operates in Southeast Asia.

- **Oversized ambition**

While AMS governments regularly praise the benefits of deeper regional economic integration and have enthusiastically signed dozens of ASEAN agreements to this end, the establishment of national policy and legislative frameworks to implement the agreed provisions lags behind. One of the striking characteristics of the regional integration process in Southeast Asia is the gap between ambitious political goals (the visions for economic integration as prominently spelled out in the AEC Blueprint and the ASEAN Charter) and reality.

- **Structurally unready**

Regional integration and harmonisation in the field of tariffs, standards, Intellectual Property (IP), foreign investment regimes etc. have been advancing slowly. The basic conditions for creating common regimes or even for harmonising national legislative frameworks and enforcement practises among ASEAN countries are not yet in place, mainly due to considerable disparities in technical and institutional capacities, economic development, and political priorities.

- **Development gap**

AMS are at different stages of economic and political development within the region, ranging from Singapore, which is one of the wealthiest nations in the world, to Laos, Cambodia and Myanmar, which are among the poorest in ASEAN. The ratio between the largest and smallest national GDP per capita within ASEAN is 1:61; within the EU, the ratio is only 1:8.

- **Stagnation of intra-ASEAN trade volume**

To-date, regional free trade is not fully achieved, not even among the ASEAN-6. AMS have made use of an extensive exclusion system and placed products on the Temporary Exclusion List, the Sensitive and Highly Sensitive List or the General Exclusion List.

However, the main reason for the stagnation of the relative volume of intra-ASEAN trade

is not the implementation delay, but both the relatively small size of the ASEAN market; and the outward-orientation of the AMS.

Overall, since the year 2000, the general trend has been:

- (a) only marginal growth of intra-ASEAN trade as a percentage of ASEAN's total trade;
- (b) a decrease of ASEAN's relative trade volume with the US and the EU, and;
- (c) a substantial increase of ASEAN's trade with other Asian economies, except Japan. This is particularly the case for China, which is now ASEAN's largest trading partner.

Furthermore, ASEAN's industries are dominated by SMEs, which account for between 95-98 per cent (according to different estimates) of all enterprises, of which most have little interest and opportunity to expand across national borders.

### 2. Customs Regimes

- **Reluctance to enforce customs regimes**

The gradual implementation of the ASEAN Single Window (ASW), ASEAN Customs Declaration Document (ACDD) and Certificates of Origin are all steps on the way of a fully computerised ASEAN Customs Transit System (ACTS) under the ASEAN Framework Agreement on the Facilitation of Goods in Transit. The overall objective is to reduce average clearance times per container to less than 30 minutes, and to lessen the burden on goods crossing national borders. This goal remains aspirational. Customs sector reforms face the same challenges as all the other initiatives of the AEC, and some AMS have been reluctant to enforce new customs regimes.

- **Reliance on foreign donors**

Since 2005, up to 2,000 technical assistance and capacity building projects in 50 different sectors have been implemented to achieve the customs-related goals as set out in the AEC Blueprint and related agreements. Virtually all of these interventions have been funded through multi-million-dollar donor programmes. However, donor support has been most successful where it has directly targeted national customs facilities and procedures to increase efficiency and transparency, not having the same effect as when targeting regional customs sector reforms.

- **Slight decline in custom efficiency**  
While developments towards customs integration have generally been slower than anticipated, some progress has been achieved. A useful tool for measuring the effectiveness of customs procedures is the World Bank Logistics Performance Index (LPI). This indicator rates the efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies, including customs. For ASEAN, the results are inconclusive. The following AMS were able to improve their LPI scores for customs between 2007 and 2012: Cambodia, Lao PDR, Malaysia, Myanmar and Singapore (the global top performer in 2012). However, the following countries showed a slight decline of their customs scores over the same period: Indonesia, Vietnam, the Philippines and Thailand.
- **Improved Border administration efficiency**  
Data provided by the Global Enabling Trade Report (“The Enabling Trade Index”), which has been published by the World Economic Forum since 2008, allows for a more detailed assessment. Of particular interest is the Border Administration Subindex, which assesses the extent to which border administrations facilitate the entry and exit of goods. A comparison of the scores in the 2009 and 2012 reports for overall border administration efficiency and transparency shows improvements for Cambodia, Indonesia, the Philippines and Vietnam; Malaysia and Singapore maintained their – already high – scores. Only Thailand’s 2012 score was slightly lower than in 2009.

### 3. Competition Policy and Law (CPL)

The action points under competition policy are soft targets and modest in their ambition. The relevant sectoral body to work on competition policy in ASEAN, the ASEAN Experts Group on Competition (AEGC), has focused on developing the ASEAN Regional Guidelines on Competition Policy and compiling a Handbook on CPL in ASEAN for Business, among other activities. The Guidelines set out different policy and institutional options that serve as a reference guide and non-binding general framework for AMS in their efforts to create a fair competition environment. The Handbook illustrates CPL and CPL-related legislation in each AMS.

Overall, ASEAN is far from being able to create a level playing field for companies with regards to a harmonised regional competition regime.

“Encouraging capacity building programmes” or “endeavouring to introduce competition policy in all AMS” as outlined in the AEC Blueprint are unlikely to result in a regional regulatory framework.

### 4. Investment Regimes

- **Mismatch of goals and implementation**  
As in other areas of AEC implementation, AMS’s main focus of investment liberalisation has been on the sharing and dissemination of information. This is an important starting point but not enough to achieve the ambitious goals of the AEC Blueprint. While some progress has been made, the overall liberalisation of investment has not kept pace with the liberalisation of goods.
- **Lack of commitment and compliance**  
ASEAN economies are cautious to make binding commitments and there is a lack of a monitoring and compliance mechanism that can enforce the implementation of targets. Another impeding factor is that investment liberalisation is based on the ASEAN-X principle, which allows AMS to join in only when they feel ready to do so.
- **Absence of dispute settlement mechanism**  
The establishment of an investor-state dispute settlement mechanism is key to stimulating more intra-ASEAN investments. The simple fact is that in the absence of reliable and transparent dispute settlement mechanisms, companies often feel that their investments are not safe.
- **Competition among AMS in attracting FDI**  
There is, however, less concern about investment flows than the other fields of the economic integration process as ASEAN has done generally well in attracting FDI and is considered one of top FDI destinations in the world. Despite some ups and downs, mainly due to the 2008-09 global financial crisis, the development of FDI since 2010 shows a strong upward trajectory for both extra-ASEAN investment and – although at a lower level – for intra-ASEAN investment flows.

Yet, the generally positive FDI figures overshadow the fact that AMS still see each other as competitors, competing to attract FDI. In addition, each AMS is in a different stage of legal system development, which is very important as the legal system creates the framework upon which business is conducted.



## 5. Trade in Services

- **ASEAN minus X factor**

As in other sectors, the main challenge to integration in the service sector is the voluntary nature and the lack of clear time frames regarding member state's participation. Liberalisation is governed by the ASEAN minus X formula.

- **Private-sector driven**

Private-sector driven financial sector integration is visibly taking place. In a bid to increase their size and profitability, many leading banks in the region are expanding their operations beyond national borders to become regional banks. Governments are less committed to provide the needed favourable framework conditions. ASEAN governments recognise that the future financial market architecture should be based on greater private sector participation, proper standards for transparency and disclosure, dissemination of necessary information and early warning systems. However, this is a wish-list and does not guarantee implementation.

- **Absence of conditions critical to integration in financial sector**

Government-led integration requires strong political will and commitment, and certain favourable framework conditions. The example of the European Monetary Union (EMU) shows that effective regional financial sector integration requires (i) high trade interdependencies, (ii) the common acceptance of basic political and social values, (iii) fairly even economic development and comparable living standards, despite divergences among its richest and poorest members, and (iv) a strong commitment to solidarity. None of these factors are present within ASEAN.

It should not be suggested here that ASEAN should follow the European model, but it is legitimate to ask how AMS envision to achieve regional integration in a highly complex field on the basis of non-binding agreements and the ASEAN-X formula that does not require AMS to firmly commit themselves to implementation targets.

## 6. SME Support

The most pressing challenge is a coordinated and effective ASEAN approach to “enhance SMEs’ competitiveness and resilience” as prescribed by the Action Plan. Several SME promotional activities have been successful and innovative. However, they resemble a patchwork as they are not usually part of a coordinated regional strategy and not well aligned with the AEC Blueprint or the Action Plan.

Overall, the ASEAN Action Plan for SME Development has not been given the necessary attention by the ASEC and related regional bodies. Yet, accelerating the process in this area should not be too challenging as SME support is a matter of technical and financial assistance and capacity-building that, unlike free trade and customs integration, can be facilitated in a purely inter-governmental manner and thus does not touch upon the sensitive political issue of national sovereignty.

## 7. Standards and Non-Tariff Barriers (NTBs)

Standards harmonisation allows for goods produced or marketed in one country to enter other participating countries by removing the barriers linked to standards, technical regulations and conformity assessment, thereby streamlining technical controls and ensuring consistency in products safety and quality. Development has been made in the cosmetics and electrical & electronics sectors, and even with harmonisation of technical regulations also underway for rubber-based, automotive, medical devices, pharmaceuticals, traditional medicine and health supplement sectors, objectives are still far from being completed. There is a clear lack of information on how regional standards affect businesses across the region and to what extent agreed standards have actually been implemented nationally.

## SUMMARY FINDINGS

### **Sound political, legal, institutional, and technical frameworks**

A clear finding is that ASEAN scores high on the political, legal, institutional, and technical frameworks that govern regional economic integration. The AEC, and a multitude of related agreements in facilitation of the free flow of goods and services, intra-regional investments, customs harmonisation, SME support, standards and non-tariff barriers to trade and other fields, if implemented, would indeed lead to an economic community.

However, there is ample evidence to suggest that actual implementation lags significantly behind the timelines of stated objectives.

### **Mismatch between political ambitions and reality**

The main hurdle is the mismatch between political ambitions and the capacities, capabilities and, often, political will of several member states to walk the talk. The basic conditions for creating common regimes or even for harmonising national legislative frameworks and enforcement practises among ASEAN countries are not yet in place, owing to considerable disparities in technical and institutional capacities, economic development and political priorities. The reasons for the slow and insufficient process towards AEC implementation can be broadly divided into economic and political arguments.

### **Lack of binding commitment**

Economic integration cannot work on the basis of non-binding agreements. If member states are allowed to opt-out at any time or choose not to implement agreed actions, integration is hardly achievable. However, this is exactly what happens under the ASEAN-Minus-X-formula which guides almost every aspect of liberalisation and integration. Essentially, the principle allows AMS to join the bandwagon in their own time.

The member states of ASEAN are trying to achieve far-reaching visions of economic community-building, which are not that much dissimilar to European integration, without the necessary modifications to the traditional ASEAN Way of cooperation. Yet, AMS have made a commitment to establishing the AEC with all of its detailed and explicitly spelled out targets and action plans. Hence, the argument that 'binding decision-making and supra-nationality are alien concepts in the Southeast Asian context' is no longer a convincing excuse for the delay in the implementation process.

## RECOMMENDATIONS

### **ASEAN should take more ownership of the integration process**

International donors, mainly the EU, USAID, AusAID and JICA, have invested millions of USD in support of all areas in regional economic integration. While many bottlenecks have been effectively addressed as a result, the massive presence of donors has also created a dependence of ASEAN as a whole and the AMS on external funding for the implementation of AEC. Regardless of whether one wants to see donor involvement as a blessing, a necessity or a curse, there is no way around the requirement that AMS will have to show more responsibility and commitment in the shaping of the economic community and develop a stronger sense of ownership. Sooner or later, this will have to include larger financial contributions from the more developed AMS.

### **Rethinking the ASEAN Way**

It would not be realistic to recommend – as has been done in other studies – that AMS should accept the idea of supra-nationality and transfer autonomous decision-making authority to the AEC, enabling it to steer the process of economic integration. This is unachievable in the presence of young nation states which – for legitimate reasons – are eagerly protecting their national sovereignty.

ASEAN has worked well as an inter-governmental organisation based on the core norms and principles of the ASEAN Way. However, this approach to regional cooperation does not and cannot facilitate deep, European-style integration as envisioned by the AEC. The decisive issue is that ASEAN will not be able to deliver on the expectations that have been created.

### **Expectation of AEC 2015 needs to be corrected**

Many extra-regional and ASEAN stakeholders, and, above all, large parts of the private sector stakeholders take the AEC 2015 at face value. These expectations need to be corrected. ASEAN needs to concentrate on those areas in which closer economic interaction and an increase in transactions can be achieved, on the basis of the proven structures and institutions of inter-governmental interaction.





# FULL REPORT



## 1. RATIONALE, OBJECTIVES AND APPROACH

Signed by the Association of South East Asian Nations (ASEAN) Leaders at the 13th ASEAN Summit on 20 November 2007, the ASEAN Economic Community (AEC) Blueprint lays the foundation for realising the goal of ASEAN as an integrated economic region by 2015. The AEC is based on four characteristics:

- **Single market and production base:**  
Comprises of five core elements: (i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) free flow of capital; and, (v) free flow of skilled labour. In addition, the single market and production base also includes two important components, namely, the priority integration sectors, and food, agriculture and forestry.
- **Competitive economic region:**  
The main objective of competition policy is to foster a culture of fair competition. Institutions and laws related to competition policy have recently been established in some ASEAN Member States (AMS). There is currently no official ASEAN body for cooperative work on Competition Policy and Law (CPL) to serve as a network for competition agencies or relevant bodies to exchange policy experiences and institutional norms on CPL.
- **Equitable economic development:**  
Covers SME development as well as collective efforts to narrow the development gap within ASEAN and between ASEAN and other parts of the world, as expressed in the Initiative for ASEAN Integration (IAI).
- **Integration into the Global Economy:**  
Aims to enable ASEAN businesses to be internationally competitive, to make ASEAN a more dynamic and stronger segment of the global supply chain, and to ensure that the internal market remains attractive for foreign investment.

Each characteristic is defined by various detailed implementation objectives, timelines and specific action points. The 19th ASEAN Economic Ministers Meeting, held in Hanoi on 8 March 2013, reaffirmed ASEAN's determination to establish the AEC by 31 December 2015.

Unlike most other regional organisations in the world, ASEAN has a clearly defined and well-outlined economic integration agenda. This finding is regularly confirmed by independent expert reports commissioned by the European Union (EU)<sup>1</sup>. The EU supports economic integration processes in virtually all regions in the world which have established

regional organisations or communities for this purpose. Thus, the European Commission is one of the most authoritative sources, not just for analyses on European integration, but also with regard to assessments of regional integration elsewhere.<sup>2</sup> Overall, ASEAN's economic community-building process looks strong on paper and there is no lack of regularly expressed strong political commitment to the implementation of AEC among the AMS. For example, the Malaysian government sees "the AEC as a fundamental building block for Malaysia's future - one of the strategies that will help us to break free from the middle-income trap."<sup>3</sup>

However, the crucial question is: where does ASEAN stand in achieving its well-defined objectives and targets under the AEC Blueprint?

### ASEAN Trade in Goods Agreement (ATIGA)

Based on the Blueprint and forming an important core of the AEC is the ASEAN Trade in Goods Agreement (ATIGA), which came into force on 17 May 2010. On paper, ATIGA is comprehensive in its scope and aims to bring transparency to regional trade liberalisation, thereby consolidating all commitments related to trade in goods. It focuses not only on tariff liberalisation and non-tariff measures, but also includes matters related to simplification of Rules of Origin (RoO) and its implementation. Various agencies and regulatory bodies dealing with entry of goods, such as the Customs, and health and agricultural authorities, are supposed to operate jointly in ensuring smoother operations at Customs entry points. At the time of ATIGA's entry into force, the then Secretary-General of ASEAN Surin Pitsuwan praised the agreement as "a major achievement towards the establishment of a single market and production base under the ASEAN Economic Community 2015." The agreement would help facilitate trade by simplifying processes and procedures, thereby reducing transaction time and cost of doing business, hence benefitting the business community and the public.<sup>4</sup>

Similar to almost all other regional treaties which serve as stepping stones to the full realisation of an integrated economic community, there is no doubt that ATIGA covers the central and substantial matters of regional economic integration and is generally well thought through.

### AEC Scorecard and other monitoring mechanisms

Progress towards achievements of the agreed goals is monitored through the Scorecard mechanism, which was established in 2008. The ASEAN Integration Monitoring Office (AIMO) at the ASEAN Secretariat (ASEC) provides regular updates for the benefit of officials at the ASEC and in the AMS. Annual summary reports are also made publicly available. The most recent report – covering the AEC implementation phases 2008-2009 and 2010-2011 – was published in March 2012.<sup>5</sup> Further statistical information that allow for some assessment of the state of economic integration in ASEAN is available in the official publications by the ASEAN Secretariat, including ASEAN Community in Figures 2011 (ACIF 2011)<sup>6</sup>; ASEAN Economic Community Chartbook 2011<sup>7</sup>; ASEAN Statistics Leaflet. Selected Key Indicators 2012<sup>8</sup>; and from the ASEANStats website.

### Weaknesses of the AEC Scorecard

However, while these and other official ASEAN publications provide useful general data, they are only of limited value to private-sector stakeholders who would like to gain a better and deeper insight into the real state of regional economic integration and the related specific opportunities and challenges. For example, the data for the Scorecard is provided by the AMS based on self-assessment and thus does not often withstand the test of objectivity. Understandably, member states want to present themselves in a positive light and demonstrate that they have made significant progress towards reaching the AEC benchmarks. Economic facts and political spin easily get mixed up as a result. Furthermore, neither the Scorecard nor other official reports cover key aspects of regional economic integration that are of particular relevance and importance for the private-sector.

### Objective of study

Therefore, it is the objective of this report to provide an independent and unbiased assessment of the achievements, hurdles and challenges in the process of AEC implementation that goes beyond political window dressing.

### Methodology

This report was conducted as a desk study between January and March 2013, but it also draws on research carried out in the second half of 2012. While exchanges with government officials and non-state stakeholders with insight and knowledge of ASEAN economic integration were used to verify information and gather additional analysis, this report is based mainly on documents and data which are already in the public domain and, to a smaller extent, on unpublished material.

In particular, the study draws on reports, statistics, project evaluations, press releases, academic papers etc. of different stakeholders, including:

- ASEAN Secretariat and related regional bodies
- ASEAN member states
- Bilateral and multilateral donor organisations (mainly EU, AusAID, USAID, JICA, Asian Development Bank, World Bank)
- International organisations (UN, IMF)
- Foreign Embassies in ASEAN member states
- Chambers of commerce and industry
- Universities and Think Tanks.

Many of these materials are hidden away on specialised websites and have been largely neglected by researchers. The project team has systematically compiled and synthesised relevant data and analyses on the status and progress of the implementation of the AEC with the aim of presenting:

- (1) Reliable and verifiable data on – and analysis of – the progress towards economic community building for the benefit of both government stakeholders and the private sector;
- (2) Information and data on sectors that are not covered by the Scorecard and other ASEAN reports; and,
- (3) Sound analysis of the bottlenecks, hurdles and challenges in the AEC implementation process that does not shy away from political sensitivities and paints a realistic picture of what has and can be achieved.

In particular, the report addresses the following key integration agendas:

- Implementation and utilisation of the ASEAN Free Trade Agreement (AFTA) under the Common Effective Preferential Tariffs (CEPT) and now ASEAN Trade in Goods Agreement (ATIGA) schedule;
- Customs procedures, especially improvements (and remaining challenges) with regards to customs harmonisation, transit times, and the efficiency of national customs regimes;
- Elimination of impediments to investment and liberalisation of investment rules and policies;
- The state of the implementation and utilisation of the ASEAN Framework Agreement on Services (AFAS), with particular emphasis on financial services;
- The status and enforcement of Competition Policy and Law (CPL) across ASEAN;
- Progress towards regional standards and the prevalence of non-tariff barriers; and
- Regional and national measures taken in support of SMEs.

For easy reference, each of these sections begins with a summary of the most important provisions on the respective issues in the AEC Blueprint.

### **Free flow of skilled labour**

The only major agenda of the AEC Blueprint which is not covered in detail in this report is the “free flow of skilled labour”. The Blueprint outlines (p. 15-16), “In allowing for managed mobility or facilitated entry for the movement of natural persons engaged in trade in goods, services, and investments, according to the prevailing regulations of the receiving country, ASEAN is working to ... facilitate the issuance of visas and employment passes for ASEAN professionals and skilled labour who are engaged in cross-border trade and investment related activities.”

The movement of skilled labour within ASEAN is already largely unproblematic. The issuing of work visas can be a lengthy process in some AMS – and there is certainly room for improvement – but this does not constitute a significant bottleneck or hurdle in the economic community-building process.

ASEAN's substantially more pressing challenge is how to deal with the cross-border movement of unskilled labour, illegal migration and human trafficking. The AEC remains silent on these dimensions but they are partly addressed by the ASEAN Socio-Cultural Community Blueprint.

As a first step, the analysis reflects briefly the weaknesses and challenges of ASEAN's monitoring system before assessing progress towards implementing the AEC in the following sectors:

- Implementation and utilisation of the ASEAN Free Trade Agreement (AFTA) under the Common Effective Preferential Tariffs (CEPT), and now ASEAN Trade in Goods Agreement (ATIGA) schedule;
- Customs procedures, especially improvements (and remaining challenges) with regards to customs harmonisation, transit times, and the efficiency of national customs regimes;
- Elimination of impediments to investment and liberalisation of investment rules and policies;
- The state of the implementation and utilisation of the ASEAN Framework Agreement on Services (AFAS) with particular emphasis on financial services;
- The status and enforcement of Competition Policy and Law (CPL) across ASEAN;
- Progress towards regional standards and the prevalence of non-tariff barriers; and,
- Regional and national measures taken in support of SMEs.

## **2. THE ASEAN MONITORING SYSTEM**

### **2.1 Background**

ASEAN has established its own monitoring system to keep track of its progress towards regional economic integration. This system is based on two institutional pillars: the ASEAN Integration Monitoring Office (AIMO) and its subordinated statistical unit (ASEANStats).

#### **ASEAN Integration Monitoring Office (AIMO)**

AIMO was the initiative of ASEAN Finance Ministers to enhance the monitoring capacity of the Secretariat in tracking the progress of regional economic integration. AIMO takes the lead in various aspects of the enhanced ASEAN Surveillance Process, including:

- regular monitoring of developments in individual ASEAN, regional and global economies to support the regional economic integration;
- maintaining a surveillance database;
- developing and implementing surveillance models and monitoring tools;
- conducting independent research and assessments, preparing policy and issues papers, and facilitating regional discussions on regional macroeconomic and financial issues, and economic integration issues and;
- assessing the state of financial integration in ASEAN, including periodic monitoring of various initiatives related to regional integration of financial markets.

#### **ASEANStats**

ASEANStats, the statistical service of ASEAN modelled on EU statistical office EUROSTAT (as a much smaller version though), focuses on the development of regional indicators, data frameworks and systems for monitoring ASEAN Community goals and initiatives, and more specifically:

- the compilation, consolidation, dissemination and communication of statistical information about ASEAN and its Member States;
- the provision of statistical services to the ASEC, ASEAN bodies and all ASEAN stakeholders;
- the harmonisation of ASEAN statistics – standardisation and documentation of concepts, definitions, classifications and approaches and;



- the initiation, coordination and facilitation of regional programs within the ASEAN Framework of Cooperation in Statistics and Plan of Action in Statistics, with guidance from the ASEAN Heads of Statistical Offices Meeting (AHSOM).

#### **Funding of AIMO and ASEANStats**

Both AIMO and ASEANStats came into being and have been funded with the substantial financial assistance from international donors, including the European Commission, the Australian Agency for International Development (AusAID), the German agency GIZ, the World Bank and the International Monetary Fund (IMF). The European Commission alone committed nearly EUR 5 million for the development of ASEANStats through the EU-ASEAN Statistical Capacity Building Programme (2009-2013). In fact, both AIMO and ASEANStats are dependent on external funding as the ASEC would not be able to fund the work of these offices from its own budget. Generally, external support for the increasing tasks and workload of the ASEC in the economic community-building process is crucial as ASEAN's official annual budget of around USD 16 million (15.76 million in 2012 – slightly increased to USD 16.2 million in 2013) – covers little more than the operational costs of the ASEC.

## **2.2 Achievements and Challenges**

Despite being a very small and understaffed unit, ASEANStats has been able to generate important and useful regional statistics, including core trade data, such as 8 digit merchandise trade data, which is available from the ASEANStats Database.<sup>9</sup> Until recently, this data had only been used for internal purposes (for ASEAN officials) and was not publicly available. However, an agreement among AMS on data dissemination was recently reached. The delay was related to confidentiality issues as some AMS consider trade data in specific sectors (for example, telecommunications) as sensitive or because this kind of trade data is sold commercially by some national statistical agencies.

As far as the monitoring of ASEAN economic integration is concerned, ASEC is currently neither mandated nor in the position to assess the process of AEC implementation independently. Instead, it prepares and publishes the Scorecard based on data provided by the AMS. Consequently, the current approach to monitoring and the dissemination of data on regional economic

integration is largely driven by political motives and incentives, i.e. the need for national governments and ASEAN collectively to demonstrate substantial progress towards the implementation of the AEC.

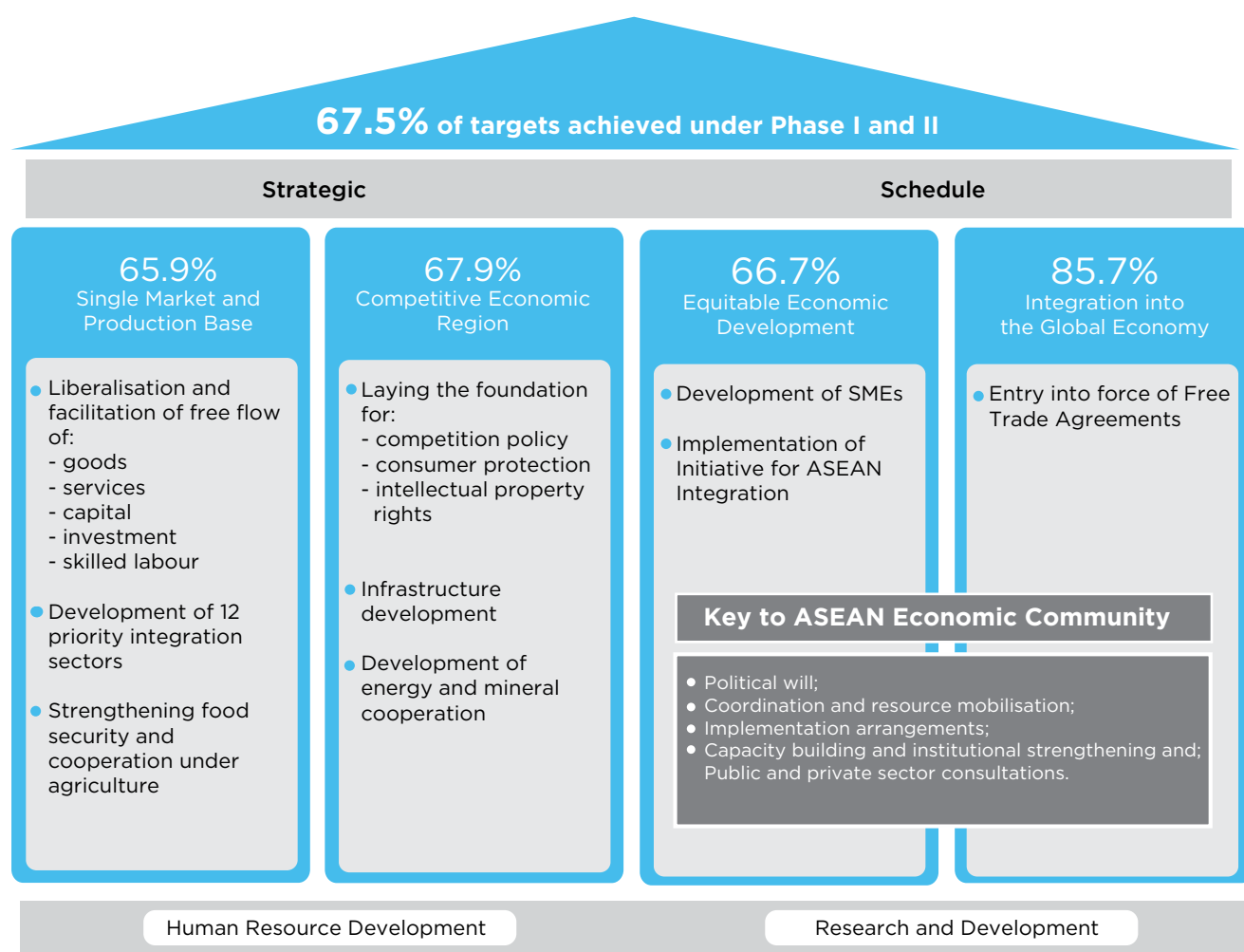
Headlines in the media such as “ASEAN 75% ready for 2015 economic integration”<sup>10</sup> suggest impressive progress towards establishing the community but reports seldom provide robust analysis of what exactly has been achieved and how companies – as the main beneficiaries of economic integration – can take advantage of already implemented regional agreements. Neither do the media delve into the reasons for delays of, and the clearly existing political and economic limits to, community building. Unlike in Europe or Latin America where processes of regional economic integration have been continuously and thoroughly scrutinised by an investigative media, Southeast Asian journalists mainly use the information provided by the PR departments of the ASEC and national governments without additional investigation.

### 2.3. Limitations of the Scorecard and its implications

As already outlined above section, progress towards achievements of the agreed goals under the AEC is monitored through the ASEAN Scorecard mechanism. Data disseminated by the ASEC in the context of the Scorecard are useful as an entry point towards gaining a general understanding of the process of economic building.

However, charts such as the following example have very limited value in the absence of any analysis of the data. Simply put, how can private sector stakeholders use information like “67.5% of targets achieved under Phase I and II”? How is a region characterised that is “67.9% competitive” and to 65.9% a “single Market and Production Base”?

CHART 1: IMPLEMENTATION OF THE ASEAN ECONOMIC COMMUNITY, ACCORDING TO THE AEC SCORECARD



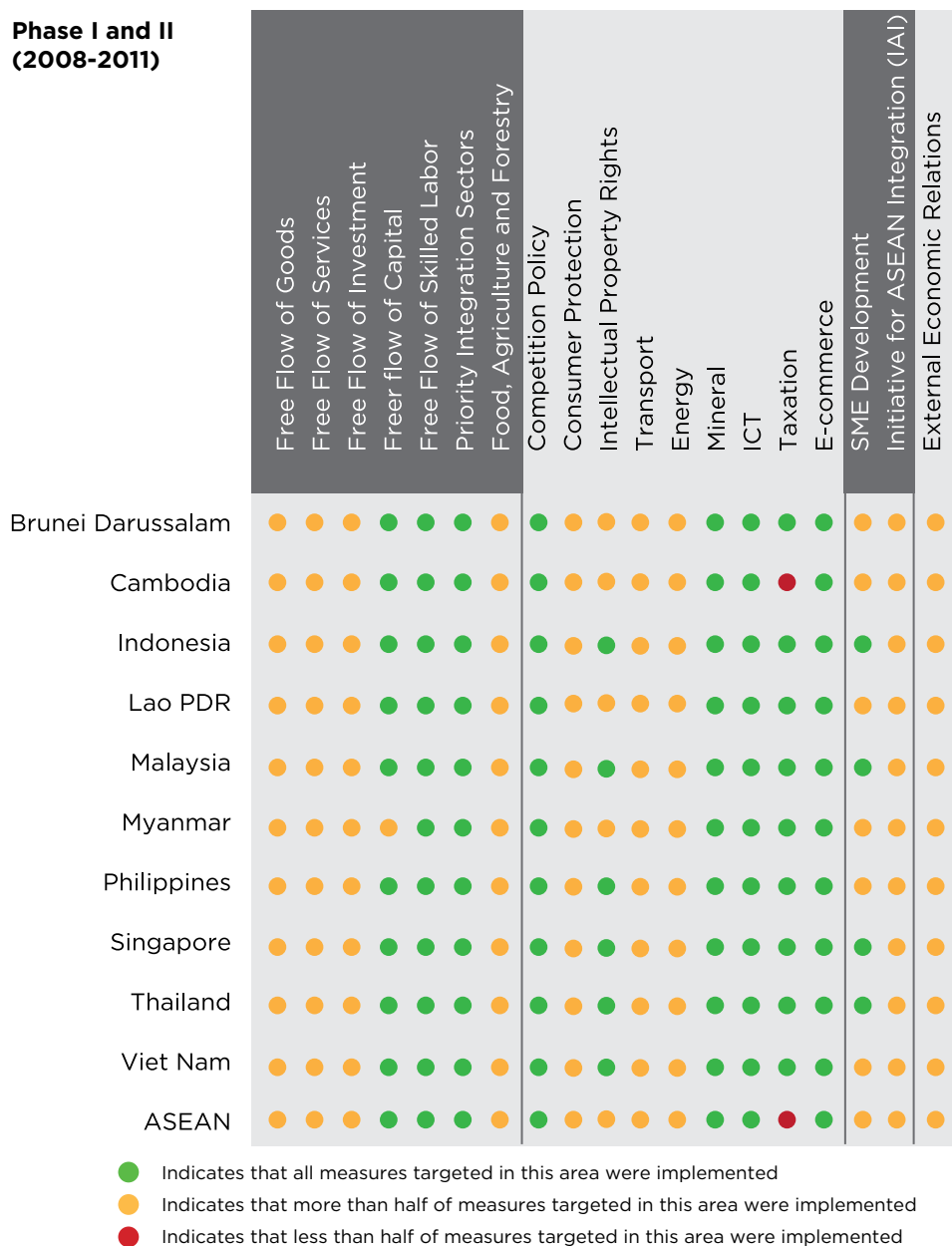
**Note: As of December 2011, the implementation rates under Phase I and Phase II are 86.7% and 55.8%, respectively.**

Source: AEC Scorecard 2012, p. 16

The Scorecard's traffic light system (Chart 2) is misleading as it suggests that benchmarks have already been achieved or that AMS are at least on track of achieving them on time for the full implementation of the AEC by 31 December 2015. The Scorecard glosses over significant differences regarding the state of implementation in individual AMS. Competition policy, which is explained in more detail in Section 3.3, is a case in point. In this sector, all AMS are "on green" suggesting that "all measures targeted in this area were implemented." This self-assessment, however, could not be further away from reality. The AMS are at different stages in the development of competition policy and law (CPL) and, hence, ASEAN

is still far away from a "highly competitive economic region" based on a harmonised regional competition regime. In other words, there is not a level playing field for all companies in the region. While Malaysia Indonesia, Singapore, Thailand and Vietnam already have CPL in place, Cambodia and the Philippines are currently in the process of drafting their respective CPL, while Lao PDR plans to introduce national CPL soon. Brunei Darussalam and Myanmar are in various stages of consideration and development regarding the introduction of nation-wide CPL but have not finalised any provisions yet. Furthermore, the Scorecard does not measure actual enforcement of completion acts and similar legal instruments.

**CHART 2: IMPLEMENTATION OF THE AEC BY COUNTRY UNDER PHASE I (2008-2009) AND PHASE II (2010-2011), ACCORDING TO THE AEC SCORECARD**



Source: AEC Scorecard 2012, p. 24.



- **Low awareness of the private sector due to lack of access to data**

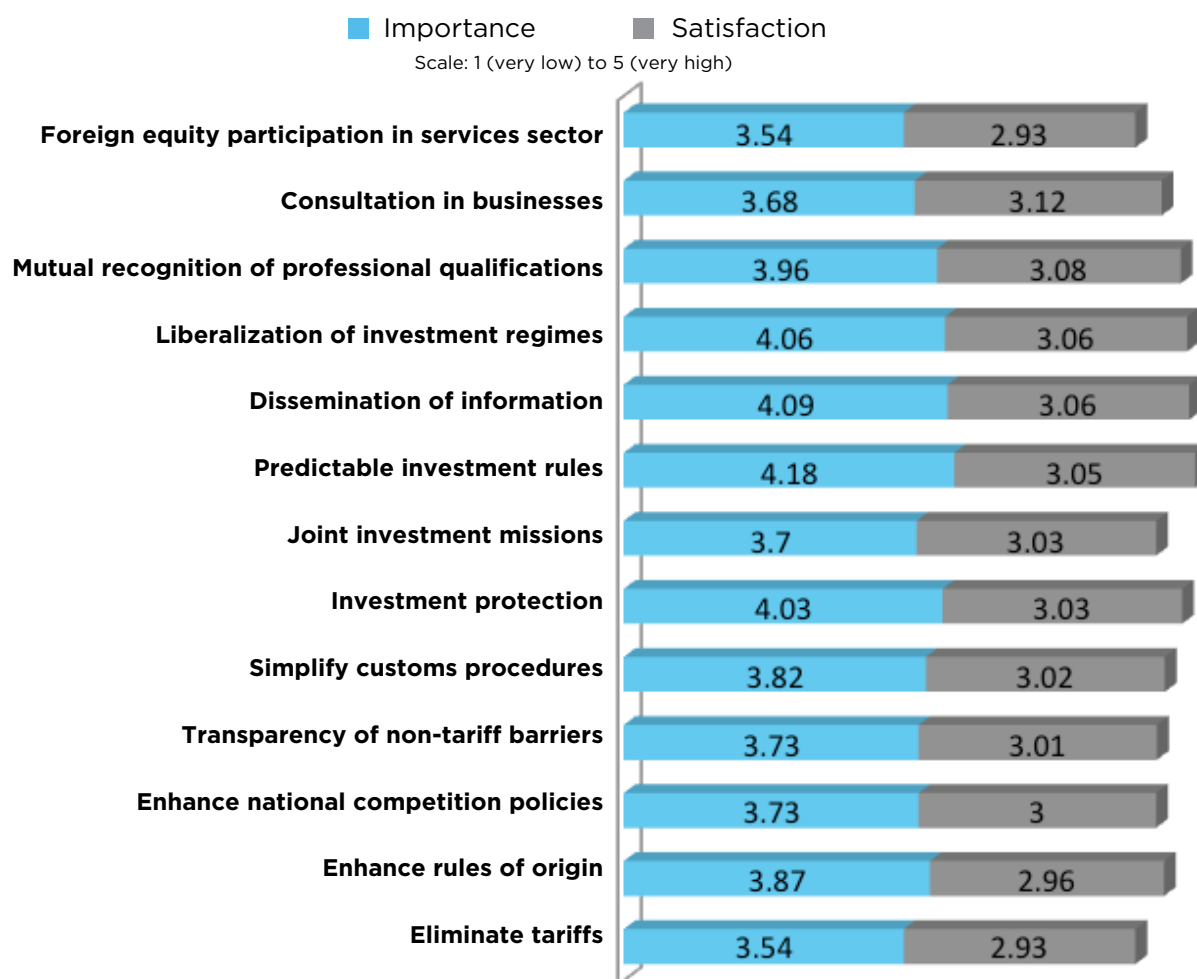
Given the lack of independent and reliable information and data on AEC implementation, it is hardly surprising that there is a certain level of frustration in the private sector. The perception of shortcomings in ASEAN's progress towards economic community-building among ASEAN nations is reflected by the 2011-12 ASEAN Business Advisory Council (ASEAN-BAC) Survey on ASEAN Competitiveness. The Survey – the second of its kind; the first was published in 2010 – collated responses from businesses across all ten ASEAN countries, comprising a mix of small, medium and large firms. The survey is based on 405 “usable responses”. The majority of the surveyed businesses had been in operation for more than ten years, had trade or investment linkages within ASEAN and had at least general knowledge of ASEAN policy initiatives.

The survey found that there is a clear gap between

the relatively high importance attached by businesses to AEC Blueprint implementation and their average level of satisfaction with the actual achievements towards implementation. The areas that businesses identified as being among the least satisfactory related to increasing foreign equity participation in services sectors, consultation with businesses, development and implementation of mutual recognition of professional qualifications, development or enhancement of national competition policies and dissemination of information. The areas where the gap between importance and satisfaction was widest were investment protection, simplification of customs procedures and enhancing the transparency of non-tariff barriers.<sup>11</sup>

Respondents were asked to rate the importance of 14 of the policy areas in the AEC Blueprint to enhancing trade and investments in ASEAN as well as their level of satisfaction with ASEAN's implementation of measures in these areas on a scale of 1 (very low) to 5 (very high).

**CHART 3: THE IMPORTANCE OF AEC BLUEPRINT BY POLICY AREAS FOR ORGANISATIONS AND THEIR SATISFACTION LEVELS WITH ITS IMPLEMENTATIONS**



Source: M-H Wong & A. Wirjo, 2012, p. 13.

- **Low public awareness of the AEC 2015**

In March 2013, ASEAN released a Survey on ASEAN Community Building Efforts, which was funded by the Japan-ASEAN Integration Fund. The study is based on in-depth interviews with 261 business leaders in 11 sectors and a survey of the general public, comprising of 2,200 respondents, across the ten AMS.

The survey found that the overall understanding of ASEAN among the peoples of Southeast Asia is relatively low. While 81% of those living in the capital cities can recognise the name ASEAN, 76% lack a basic understanding of what ASEAN actually does.

On the AEC, the survey notes that

Businesses and the general public both perceive ASEAN integration as having positive impacts to ASEAN. Businesses express the view that AEC will improve the overall ASEAN economy and this will aid them in competing with the global arena. The general public... believe that the integration will create more employment opportunities and allow them to travel more freely within ASEAN... However, there are some negative perceptions of ASEAN integration. Businesses and the general public are afraid that labour migration might be intensified to the extent that it could cause local employees to lose their jobs. Another concern is that local producers could face greater competition from companies of other ASEAN countries and beyond.<sup>12</sup>

The survey makes a useful contribution to better understanding of current perceptions of ASEAN. However, while it claims to “measure current effectiveness of ASEAN Community Building Efforts”, the publicly available summary version of the report sheds little light on the issue of effectiveness.

### 3. KEY INTEGRATION AGENDAS

#### 3.1 Free Trade: Implementation and Utilisation

##### Key Provisions

##### Free flow of goods:

One of the principal means by which the aims of a single market and production base can be achieved [...] through the ASEAN Free Trade Area (AFTA)

##### Elimination of Tariffs:

Tariffs on all intra-ASEAN goods will be eliminated in accordance with the schedules and commitments set out in the CEPT-AFTA Agreement and other relevant Agreements/Protocols.

##### Elimination of Non-Tariff Barriers:

ASEAN has achieved significant progress in tariff liberalisation. The main focus of ASEAN towards 2015 will be placed on the full elimination of nontariff barriers (NTBs).

##### Rules of Origin (RoO):

Putting in place RoO which are responsive to the dynamic changes in global production processes so as to: facilitate trade and investment among ASEAN Member Countries; promote a regional production network; encourage development of SMEs and the narrowing of development gaps; and promote the increased usage of the AFTA CEPT Scheme.

##### Trade facilitation:

Simple, harmonised and standardised trade and customs, processes, procedures and related information flows are expected to reduce transaction 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.

AEC Blueprint, p.6-8

In the following section, two main indicators for the effectiveness of ASEAN's free trade regime are considered: the actual level of goal achievement under the existing agreement and the utilisation of rules that have already been implemented.

### 3.1.1 The Process of Implementing AFTA

In 1992, the ASEAN Heads of State and Governments agreed on the gradual implementation of the AFTA. The main objective was to increase ASEAN's competitive edge as the production base for the world market by decreasing intra-regional tariff rates to 0–5% through the Common Effective Preferential Tariff (CEPT) scheme within a 15-year period. The completion date was, however, progressively advanced. AFTA succeeded in lowering the average tariff rates from 11.44% in 1993 to 2.39% in 2003 for the ASEAN-6 countries. In 2000, the original goal of 0–5% was changed to zero tariff on all products by 2010 for the ASEAN-6 and by 2015 for Cambodia, Laos, Myanmar and Vietnam (CLMV).

By 2010, the ASEAN-6 had eliminated the import duties on 99.65% of their traded tariff lines under CEPT, bringing their average tariff rate to 0.05%. On the other hand, 98.86% of the tariff lines of CLMV have been reduced to 0–5%. The AEC Blueprint stipulated a review and enhancement of the CEPT-AFTA Agreement “to become a comprehensive agreement in realising free flow of goods and applicable to ASEAN needs for accelerated economic integration towards 2015.” To this end, the ATIGA was signed in 2009. ATIGA consolidates and streamlines all provisions in CEPT-AFTA and other protocols related to trade in goods into one single legal instrument. It was entered into force in 2010 and supersedes CEPT-AFTA.<sup>13</sup>

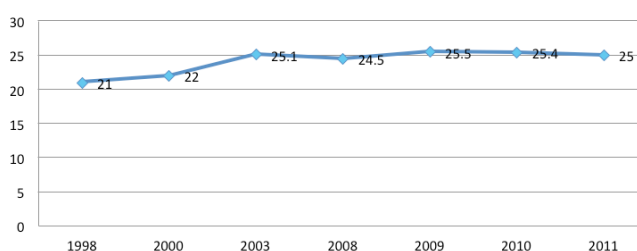
One of the main focal points has been the improvement of the ATIGA Rules of Origin (RoO). Two pilot projects for a Regional Self-Certification System were launched with the aim of simplifying documents needed for claiming preferential tariff treatment and to improve utilisation of tariff concessions offered under ATIGA.<sup>14</sup>

### 3.1.2 Intra-ASEAN Trade

The AEC Scorecard indicates that more than half of the measures targeted under free flow of goods were already implemented between 2008 and 2012. Despite the – on paper – impressive achievements in implementing AFTA and now ATIGA, intra-ASEAN trade (as a percentage of the overall trade of the AMS) has not markedly increased since 2003 and only by a mere 4.4% since 1998. While official statistics on intra-ASEAN trade in 2012 are not yet available, national trade data for the AMS suggest that the figure is around 25%. It is also important to note that two AMS account for roughly 60% of the intra-ASEAN trade volume; Singapore's exports and imports within ASEAN represent about 40%, while Malaysia's trade makes up 20%.

## CHART 4: INTRA-ASEAN TRADE 1998-2010

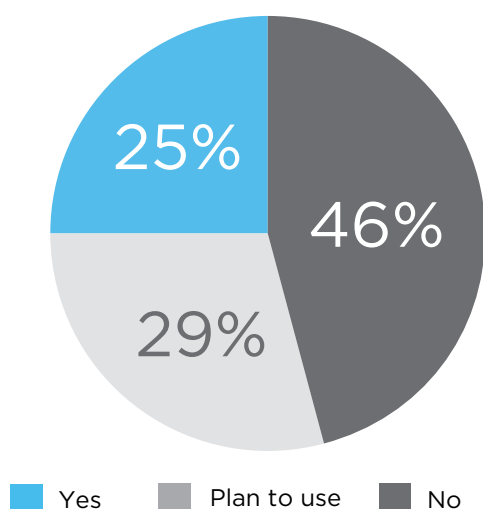
Intra-ASEAN trade in % of total ASEAN trade



Source:

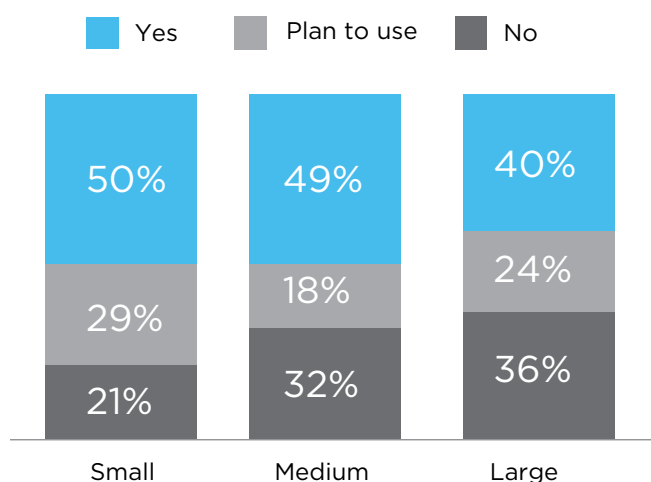
Data compiled from ASEAN Secretariat 2012, ASEAN Community in Figures 2011, Jakarta, p. 15; ASEAN Statistics Leaflet, Selected Key Indicators 2012.

Not only has the relative volume of intra-ASEAN stagnated, the ASEAN-BAC survey finds that the utilisation of the free trade agreement provisions remains low. Only 29% of respondents indicated that their organisations used preferential provisions in ASEAN and/or ASEAN-plus economic agreements, (ASEAN agreements with other economies) such as the ASEAN-China Free Trade Area (ACTFA). This value was higher than the 22% in the 2010 Survey but still a low figure given that ASEAN claims the virtually full implementation of AFTA.<sup>15</sup> However, particularly striking is the fact that nearly half of the survey firms (46%) stated that they were not planning to use preferential provisions in the future.<sup>16</sup>

**CHART 5: USE OF PREFERENTIAL PROVISIONS IN ASEAN AGREEMENTS AMONG FIRMS**

Source: M-H. Wong & A. Wirjo, A. 2012, p. 11.

A higher share (36%) of large firms were users of trade agreement provisions compared with small firms (21%). Companies with some degree of foreign equity ownership (34%) were more likely to be users than wholly locally-owned companies (28%). Across country subsamples, a larger proportion of businesses in Thailand and Vietnam were users of FTAs (47% and 45% respectively) compared with businesses in other ASEAN countries, where the share ranged from 20% (Brunei and Indonesia) to 30% (Cambodia).<sup>17</sup>

**CHART 6: UTILISATION OF TRADE AGREEMENT PROVISIONS BY SIZE OF FIRMS**

Source: M-H. Wong & A. Wirjo, A. 2012, p. 11.

### 3.1.3 The Gap between Political Vision and Economic Reality

The hurdles in the process of liberalising regional trade, and generally deepening economic integration, are primarily of a general political and macroeconomic nature but also the result of the way the private sector is structured and operates in Southeast Asia.

In 2004, an often-cited McKinsey Report on the state of ASEAN integration noted that “investors expressed frustration over the way certain policies are implemented and doubted ASEAN’s willingness and ability to integrate”.<sup>18</sup> Almost a decade later, this finding is still valid to a large extent.

This is confirmed by an independent evaluation of the EU-ASEAN cooperation programme. Since the EU – or more precisely the European Commission – is by far the largest supporter of economic community building in Southeast Asia through financial and technical assistance, officials in Brussels tend to cast a close eye over developments in ASEAN. While AMS governments regularly praise the benefits of deeper regional economic integration and have enthusiastically signed dozens of ASEAN agreements to this end, the establishment of national policy and legislative frameworks to implement the agreed provisions lags behind. And even if the right policies are in place, they are not necessarily fully enforced. Hence, the main hurdle is the mismatch between political ambitions and the capacities, capabilities and often political will of several member states to walk the talk.<sup>19</sup>



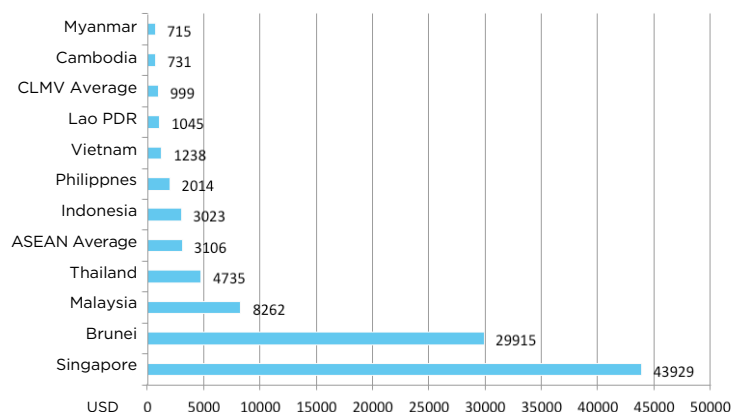
### 3.1.4 Development Gap and Diversity

Any analysis of ASEAN progress towards economic community-building sooner or later touches upon the economic and political diversity of the Member States and identifies this situation as the main structural problem. AMS are at different stages of economic development within the region, ranging from Singapore, as one of wealthiest nations in the world, to Laos, Cambodia and Myanmar, as three of the poorest. The ratio between the largest and smallest national GDP per capita is 1:61; in the EU it is only 1:8.

Even these stark numbers do not capture the vast gap between the wealthiest and poorest ASEAN members (Chart 7). “Singapore, Thailand, and Malaysia boast some of the finest public transport systems of any urban area, nearly universal wireless coverage, extensive access to broadband Internet, national pension and health plans, and well-equipped hospitals.

In contrast, in many parts of Myanmar, Laos, and Cambodia, rural men and women have no access to modern health care, healthy foods, or modern communications. Many parts of Myanmar lack electricity completely, and the country today is more similar to a sub-Saharan African nation recovering from civil war than to Thailand, Malaysia, or Singapore.”<sup>20</sup> These significant structural differences among AMS “appear to create a reluctance to give up their national policies; for instance, in relation to the huge discrepancies between the member states in their average external tariff levels.”<sup>21</sup>

### CHART 7: GDP PER CAPITA 2010 (USD) IN ASEAN



Source:  
Data compiled from ASEAN Secretariat 2012, ASEAN Community in Figures 2011, Jakarta, p. 1.

Furthermore, Southeast Asia is characterised by a broad spectrum of different systems of government which makes it difficult to agree on binding regional norms, rules and procedures. In fact, ASEAN has never pretended to be a homogenous regional grouping and, acknowledging the high degree of diversity, deliberately rejected the legalistic approach to regional integration based on stringent regulatory frameworks that has characterised European integration. For several decades, it was common place for Southeast Asian politicians to clarify that ASEAN never tried or intended to emulate the EU. Instead, ASEAN developed an alternative approach to regional community building which is widely known as the “ASEAN Way” and rests on the pillars of informal, non-binding and consensus-oriented inter-governmental cooperation.

### 3.1.5 The “ASEAN Way”: Implications for Economic Integration

Since most AMS are relatively young nation states, they reject the idea of supra-nationality, i.e. the concept of transferring decision-making authority from the level of sovereign national governments to a new layer of political power above the nation state. The ASEC, is not comparable to the European Commission. The former is a coordinating and advisory body that, while having legal personality as invested by the ASEAN Charter, can only act within the limits set by the Member States. The latter is an autonomous and sovereign organisation whose decision-making power often supersedes national policy and legislation.

There can be no doubt whatsoever that the ASEAN Way has served the organisation well and provided a suitable foundation for the effective inter-governmental cooperation in a large number of policy fields. However, while there are good reasons for ASEAN not to move into the direction of supra-nationality, economic integration always impacts national sovereignty. Even the lowest level of economic integration, a free trade area, deprives governments of using tariff barriers to protect national industries. Economic integration cannot work on the basis of non-binding agreements. If Member States are allowed to opt out at any time or choose not to implement agreed actions, integration will not be achievable.

This is exactly ASEAN's dilemma: The member states are trying to achieve far-reaching visions of economic community-building, which are not that much dissimilar to European integration, without the necessary modifications to the traditional ASEAN Way of cooperation. Yet, AMS have made a commitment to establishing the AEC with all its detailed and explicitly spelled out targets and action plans. Hence, the argument that binding decision-making and supra-nationality are alien concepts in the Southeast Asian context no longer sounds convincing as an excuse for delays in the implementation process. No-one has ever suggested that ASEAN should fully adapt to the EU model of integration (not even the EU itself has ever put forward such an idea) but ASEAN will have to be measured against what it has – without any external pressure – created for itself: the goal of an “integrated economic region.”

AFTA was the first stepping stone towards economic integration and whether or not ASEAN is able to fully implement the regional free trade area, can be considered the most crucial test

case for ASEAN's capacity to achieve the broader and more ambitious visions of a regional single market and production base.

### 3.1.6 The Status of Free Trade

#### 3.1.6.1 Exclusions of Free Trade

To-date, regional free trade is not fully achieved, not even among ASEAN-6. As quoted, “By 2010, the ASEAN-6 had eliminated the import duties on 99.65% of their traded tariff lines under CEPT”. In other words, import duties no longer exist for goods and products which are included under CEPT, now ATIGA. This, however, does not equal total trade as most AMS have made use of an extensive exclusion system and placed products on the Temporary Exclusion List, the Sensitive and Highly Sensitive List (for example for agricultural products) or the General Exclusion List (if goods need to be protected due to “national security, public morals and health reasons”).

When ASEAN first experimented with preferential trading agreements in the 1970s, much energy and creativity went into the negotiation of “inclusion lists” that would show the Member States' commitment to free trade while at the same time making sure that national industries remained protected behind high tariff walls. The classic, often-cited example for a product that could be traded under preferential rules was snow ploughs.

ASEAN has come a long way since then and the significant achievements towards tariff reduction and elimination should not be belittled. However, official ASEAN figures showing the scope of regional free trade are misleading as they neither include trade in exempted goods nor shed any light on non-tariff barriers (NTBs). Whilst the CEPT and now ATIGA regime has effectively brought down the tariff rates of ASEAN members, “it seems that this measure has limited impact on increasing trade flows within the region. This is largely attributed to the presence of non-tariff barriers to trade”<sup>22</sup> (see section 3.7). In addition to NTBs and carve-outs for dozens of protected “sensitive” industries, poor dispute resolution mechanisms have also prevented AFTA from fully coming into effect.<sup>23</sup>

At least, however, there is transparency on NTBs. An updated list of each member state's NTBs is accessible on the ASEAN Secretariat.<sup>24</sup>

### 3.1.6.2 Stagnation of intra-ASEAN Trade

However, the main reason for the stagnation of the relative volume of intra-ASEAN trade is not the implementation delay but both the relatively small size of the ASEAN market and the outward-orientation of the AMS economies. In fact, most analysts believe that intra-ASEAN trade is unlikely to grow any further. Intra-ASEAN trade has grown at a much slower pace than ASEAN's total trade. This can be attributed to the relatively small intra-ASEAN market and the related fact that AMS constantly look towards extra-ASEAN trade for economic growth.<sup>25</sup>

### • Subscale markets

The 2004 McKinsey study was the first to address ASEAN's structure as a subscale market.

The challenge for ASEAN's companies is to reach production levels allowing them to operate at an economically efficient and globally competitive scale. Every carmaker in the region, for example, has production runs of fewer than 150,000 units a model – the low end of the minimum efficient scale for auto manufacturing.<sup>26</sup>

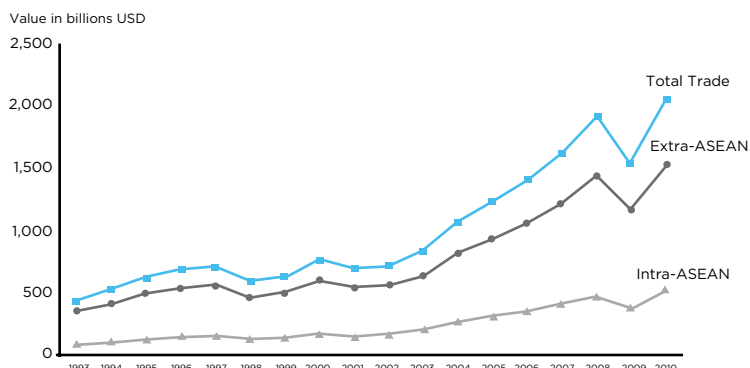
Regardless of whether or not the specific example is still valid, similar assessments have been made since then on a regular basis. For example, Nathan Associates referred to “ASEAN's subscale markets” and the fact that “Companies cannot manufacture and market goods for the whole region” as a major concern voiced by businesses.<sup>27</sup>

### • ASEAN's outward oriented economies create competition

Overall, the AMS economies are more competitive than complementary in structure. They are producing a narrow range of similar primary products and labour-intensive manufactured goods for export. The intra-industry specialisation and regional division of labour is not yet well developed, although there have been some recent improvements. FDI entering the region is closely associated with intra-industry trade, especially in the automotive and electronics industries. There is also a divergence effect of ASEAN's external FTAs with China, Japan, Korea and India, as well as Australia and New Zealand.<sup>28</sup> In addition, many members are increasingly active in arranging bilateral FTAs with external countries. For example, Malaysia has established FTAs with Japan, Pakistan, New Zealand, India, Chile, and Australia. Singapore has 18 FTAs in force with other nations.

Since 2000, the general trend has been (a) as outlined, only marginal growth of intra-ASEAN trade as a percentage of ASEAN's total trade, (b) a decrease of ASEAN's relative trade volume with the US and the EU, and (c) a substantial increase of ASEAN's trade with Asian economies, except Japan. This is particularly the case for China, which is now ASEAN's largest trading partner.

CHART 8: TREND OF ASEAN INTERNAL AND EXTERNAL TRADE 1983-2010



Source:  
ASEAN Economic Community Chartbook 2011, p. 18.

TABLE 1: ASEAN TRADE BY SELECTED PARTNER COUNTRY/REGION, 2011

Partner country/region	Value (USD Millions)			Share to total ASEAN trade in percent		
	Exports	Imports	Total trade	Exports	Imports	Total trade
ASEAN	327,531.8	270,710.4	598,242.2	26.4	23.6	25.0
China	127,908.5	152,497.1	280,405.5	10.3	13.3	11.7
Japan	145,197.7	128,149.4	273,347.1	11.7	11.2	11.4
EU-27 <sup>1</sup>	126,593.5	108,182.6	234,776.2	10.2	9.4	9.8
USA	106,305.6	92,480.3	198,785.9	8.6	8.1	8.3
Republic of Korea	54,468.0	70,002.9	124,470.9	4.4	6.1	5.2
India	42,754.7	25,674.1	68,428.8	3.4	2.2	2.9
Australia	37,253.9	22,220.5	59,474.4	3.0	1.9	2.5
Russia	2,689.4	11,278.5	13,967.9	0.2	1.0	0.6
Canada	5,292.7	5,478.4	10,771.1	0.4	0.5	0.5
New Zealand	4,569.3	3,667.5	8,236.7	0.4	0.3	0.3
Pakistan	6,001.8	765.7	6,767.4	0.5	0.1	0.3
Total selected partner countries/regions	986,566.9	891,107.3	1,877,674.2	79.4	77.7	78.6
Others <sup>2</sup>	255,719.5	255,198.6	510,918.0	20.6	22.3	21.4
<b>Total ASEAN</b>	<b>1,242,286.4</b>	<b>1,146,305.9</b>	<b>2,388,592.3</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

**Notes**

Some figures may not add up to totals due to rounding off errors.

All figures are preliminary; data exclude Cambodia and Lao PDR as they are not available

1 Includes Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, and United Kingdom

2 Includes of all other countries and those that could not be attributed to specific countries.

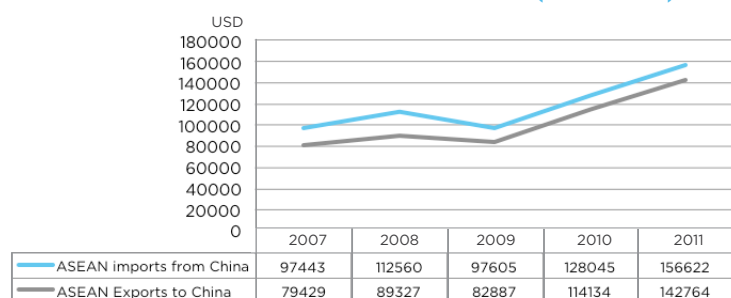
Source: ASEAN Secretariat, External Trade Statistics.



### 3.1.6.3 Significant Increase of ASEAN-China Trade

While AFTA has not resulted in a significant increase of intra-ASEAN trade, ACFTA has resulted in a sharp increase in ASEAN-China trade. ACFTA has been gradually implemented since 2003 under the “Early Harvest Programme” and came into full effect in January 2010. This is not the place to discuss as to whether or not ACFTA has been entirely beneficial for AMS, but the case shows that while a lot of political rhetoric focuses on intra-ASEAN integration, significant developments towards economic integration are taking place in the wider Asian region, covered under the fourth characteristic of the AEC, ASEAN’s integration into the global economy.

**CHART 9: ASEAN’S TRADE WITH CHINA 2007–2011:  
USD AT CURRENT PRICES (MILLIONS)**



Source: Data compiled from WTO Trade Statistics.

### 3.1.7 Rules of Origin: A major bottleneck

There are also strong intra-regional reasons for the stagnation of the relative importance of intra-ASEAN trade. The two most important ones are the under-utilisation of AFTA, particularly related to the Rules of Origin (RoO), and the general structure of the private sector in Southeast Asia.

RoO are the criteria used to define where a product was made, and are essential to any FTA. Their importance stems from the fact that duties and restrictions are often determined based on the country of origin. RoO have been recognised by ASEAN as an important and challenging issue with considerable impact on business activities and regional economic integration efforts. In 2004, a study found that uncertainty about the RoO hindered businesses from taking advantage of AFTA.<sup>29</sup>

A more recent analysis comes to the same conclusion: The cost of proving origin is high—computation of costs, invoicing, and other documentation while demands inherent in Value Added (VA) rules are complex, especially for SMEs from less developed economies. The VA rule is simple in principle but difficult to comply with and AMS exporters, especially in CLMV, are often unable to cumulate the necessary local/regional content, partly due to the high degree of production fragmentation, with half of its trade in electronics and machinery where production networks are widespread. The import content (from non-ASEAN sources) of exports is high, making it difficult to comply with the 40% VA rule.<sup>30</sup> The scheme for exporters to prove RoO and to benefit from preferential tariff treatment is called “Form D”. However, as confirmed by the Malaysian Ministry of International Trade and Industry, “most business sectors are unaware of the existence of this scheme.”<sup>31</sup>

However, comprehensive guidance on RoO for the private sector has recently been made available. ASEC, with the substantial assistance of the German development agency GIZ, published a Handbook on Rules of Origin for the business community. The Handbook provides a simple understanding of the various RoO being used in ASEAN, namely the revised and improved AFTA Rules of Origin as well as the RoO in ASEAN’s FTAs with Dialogue Partners. It explains to users how to determine the origin of a good in ASEAN, how to apply for a preferential Certificate of Origin in order to enjoy tariff concessions, as well as provide useful information on the applicable RoO and tariff concessions for goods.<sup>32</sup>

### 3.1.8 Is the Private Sector reluctant to regionalise?

In an effort to be more competitive, like other AMS, the Malaysian government is “nurturing more Malaysian firms to be regional champions – companies that truly understand the importance of regionalizing their businesses.”<sup>33</sup> However, this is not an easy task. As aptly explained by Murray Hunter,

Although companies like Air Asia, CIMB Bank, Bangkok Bank, SingTel, and Siam Cement are taking advantage of the region as a market, they are the exception. The majority of ASEAN conglomerates are ... building up their empires along common models of trading, real estate, finance and insurance, retail, and banking activities. These firms are well connected in their own countries and haven’t historically done well business wise in countries within the region where their connections are weak. Consequently these firms prefer to diversify business interests within their home country rather than expand across the region.

One can easily get the impression when visiting Bangkok, Jakarta, Kuala Lumpur, and Manila that business there is a widely diversified ownership of business, where in fact region businesses in ASEAN countries today are still in the hands of a small number of families. Many of these companies are yet to develop the regional mindset necessary to take up the opportunities that the AEC offers. They may actually enjoy the current protection that is afforded them from outside competition.

The ASEAN region is dominated by SMEs which account for approximately 98 per cent of all enterprises [95% according to other sources] and some 75-85 per cent of total employment. Many of these are subsistence based enterprises employing no innovation in their business models. ... AEC will provide very few opportunities to these enterprises, except in the area of tourism.<sup>34</sup>

Regional economic integration is as much a top-down approach as it is a bottom-up phenomenon. In a mutual reinforcing process, governments create the structural frameworks to facilitate a widening and deepening of cross-border economic interactions, while companies take their own initiatives to create business opportunities for themselves beyond national markets. ASEAN’s problem is that both dimensions are not fully developed.

However, it would be wrong for governments to blame the private sector for not taking advantage of existing rules. The emergence of “regional mindsets” among businesses is an important step, but this mindset can only translate into a substantial expansion of regional activities if governments establish the appropriate regulative structures. In no other area is this more visible and crucial than with regards to customs regimes as a direct factor in trade facilitation. The time and cost of doing business across borders is a main determinant of regional trade.

## 3.2 Customs Regimes

### Key Provisions

#### Trade facilitation:

Simple, harmonised and standardised trade and customs, processes, procedures and related information flows are expected to reduce transactional 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.

#### Customs Integration:

In light of the acceleration of AEC, the realisation of ASEAN Customs Vision 2020 is brought forward to 2015. In particular, the 2005-2010 Strategic Plan of Customs Development aims to: (a) integrate customs structures; (b) modernise tariff classification, customs valuation and origin determination and establish ASEAN e-Customs; (c) smoothen customs clearance; (d) strengthen human resources development; (e) promote partnership with relevant international organisations; (f) narrow the development gaps in customs; and (g) adopt risk management techniques and audit-based control (PCA) for trade facilitation.

#### ASEAN Single Window (ASW):

The implementation of measures to simplify, harmonise and standardise trade, customs, processes, and procedures and the application of ICT in all areas related to trade facilitation would be paramount in the ultimate creation of an ASEAN Single Window. The ASW is an environment where ten National Single Windows of individual Member Countries operate and integrate. National Single Window enables a single submission of data and information, a single and synchronous processing of data and information and a single decision making for customs clearance of cargo, which expedites the customs clearance, reduce transaction time and costs, and thus enhance trade efficiency and competitiveness.

AEC Blueprint, p. 8-9

The ASEAN Single Window is the regional integration of the respective National Single Window – a system which enables: (i) a single submission of data and information; (ii) a single and synchronous processing of data and information; and, (iii) a single decision-making for customs release and clearance (i.e. a single point of decision for the release of cargoes by the Customs).

Based on the AEC Blueprint the gradual implementation of the ASEAN Single Window, ASEAN Customs Declaration Document (ACDD) and Certificates of Origin are the steps on the way of a fully computerised ASEAN Customs Transit System (ACTS) under the ASEAN Framework Agreement on the Facilitation of Goods in Transit. The development of the ACTS “will provide a regional customs procedure that will enable traders to move goods seamlessly across multiple ASEAN member states using a single regional customs document and single guarantee for transit. This will reduce the hassle of having to negotiate multiple national-level customs procedures and paperwork to clear goods along the ASEAN supply chain.”<sup>35</sup> The overall objective is to reduce average clearance times per container to less than 30 minutes, and to lessen the burden of goods crossing national borders.

This goal remains aspirational. Customs sector reforms face the same challenges as all other initiatives of the AEC. Some AMS have been reluctant to enforce new customs regimes. The widely publicised and donor-endorsed ASEAN Single Window initiative is a case in point. The system can only be established once all ten AMS have implemented the necessary reforms at the respective national levels so that all ten national single windows are operating in an integrated manner. However, the 2005 Agreement and 2006 Protocol on the ASEAN Single Window are non-binding and it is doubtful that all AMS will stick to the agreed implementation deadlines.

### 3.2.1 The Role of Donors in Customs Reforms

Since 2005, up to 2,000 technical assistance and capacity building projects in about 50 different sectors have taken place to achieve the customs-related goals as set out in the AEC Blueprint and related agreements. Virtually all of these interventions have been funded through multi-million-dollar donor programmes, including the ASEAN Programme for Regional Integration Support (APRIS), Phase II (EU), the ASEAN Trade Pilot Program: Single Window (USAID), the ASEAN-Australia Development Cooperation Program Phase II (AusAID) and Support for ASEAN Integration (JICA). “No other aspect of economic integration has attracted more donor attention than customs harmonisation as it is in the natural interest of donors to ease the access of exporters to the Southeast Asian markets and thereby strengthen trade relations.”<sup>36</sup>

For example, ACDD was entirely driven by APRIS. ASEAN does not seem to have developed much ownership of the programme. Even today, three years after the termination of APRIS, the only information available about ACDD on the ASEC website is the APRIS project flyer for ACDD.<sup>37</sup> No information could be obtained on progress towards the ACDD target of reducing the average clearance times per container to less than 30 minutes.

In a similar vein, ACTS, also significantly supported by APRIS, has not taken off due to delays in the signing of protocols, which form the legal framework for ACTS, and the implementation of pilot projects. As of late 2012, protocol 7 (on the procedure and technical aspect of ACTS) had been finalised but had not been signed by all AMS. Protocol 2 (on the Designation of Frontier Posts) had not yet been finalised, as the discussion on what customs houses should be included was still on-going. Since the end of APRIS II (December 2010), only two special meetings of the Customs Procedures and Trade Facilitation Working Group (CPTFWG) on ACTS have taken place and no major developments were reported.

### 3.2.2 Case Study: The Philippines

Donor support has been most successful where it has directly targeted national customs facilities and procedure to increase efficiency and transparency. The Philippines is a case in point.

Since 1 April 2000, imports into the Philippines have no longer been subject to Pre-Shipment Inspection (PSI). All imports are now processed by the Bureau of Customs (BOC) in accordance with the Automated Customs Processing System. Under the PSI program, foreign inspectors verified the tariff classification and value of individual incoming shipments before they left their origin countries. In nearly all cases, however, the responsibility for collecting customs duties remained in the hands of the importing country's customs officials, who often chose to ignore PSI reports on specific shipments.

Under the new Automated Customs Processing System, the Philippine Customs adopts a risk classification management system of imported goods, and all importers must submit the customs declaration form through the Automated Customs Operating System, which determines the risk level of imported goods. Low-risk shipments go through the "green lane" and are generally subject to "post-audit review" instead of a spot check; moderate-risk shipments go through the "yellow lane" and are subject to documentary review only. High-risk shipments channel through the "red lane" and are subject to both documentary review and physical inspection prior to its release. The Philippine Customs also provides a "super green lane" (SGL) for importers of extremely low-risk goods to improve customs clearance efficiency. Customs was a main target of the EU-funded project Trade-Related Technical Assistance (TRTA 1, 2005-2008). As a result of TRTA 1, the customs process has improved markedly; cargoes or shipments targeted for yellow or red-lane inspection have declined from 80% to 20% over the duration of the project. Moreover, clearance time has been reduced to less than 8 hours for "green lane" entries.<sup>38</sup>

### 3.2.3 Has the Cost of Doing Business across Borders Declined?

While developments towards customs integration have been slower than anticipated, some progress should be expected in view of the magnitude of activities in this area. A useful tool for measuring the effectiveness of customs procedures is the World Bank Logistics Performance Index (LPI). The international score uses six key dimensions to benchmark a country's performance and also displays the derived overall LPI index. The first key dimension is the efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies, including customs. For ASEAN, the results are inconclusive. The following AMS were able to improve their LPI scores for customs between 2007 and 2012 (in some cases only marginally though): Cambodia, Lao PDR, Malaysia, Myanmar and Singapore (the global top performer in 2012). However, the LPI scores of Indonesia, Vietnam, the Philippines and Thailand slightly declined over the 2007-2012 period.<sup>39</sup>

Data provided by the Global Enabling Trade Report ("The Enabling Trade Index"), which has been published by the World Economic Forum since 2008, allows for a more detailed assessment. Of particular interest is the Border Administration Subindex, which assesses the extent to which the administration at the border facilitates the entry and exit of goods through the following pillars:

- Efficiency of customs administration
- Efficiency of import-export procedures
- Transparency of border administration

A comparison of the scores (Chart 10) in the 2009 and 2012 reports (based, in most cases, on 2008 and 2011 data respectively) for overall border administration efficiency and transparency shows improvements for Cambodia, Indonesia, the Philippines and Vietnam. Malaysia and Singapore maintained their scores. Only Thailand's 2012 score was lower than in 2009.



CHART 10: BORDER ADMINISTRATION\*



\*Data for Brunei, Laos and Myanmar were not available

The higher the score, the more efficient and transparent is the respective border administration. 7 indicates perfect efficiency and transparency while 0 stands for a complete ineffectiveness and intransparency.

Source:

Data compiled from World Economic Forum: The Global Enabling Report 2009 and 2012.

All ASEAN states included in the index were able to improve the efficiency of customs administration (the first pillar of the Border Administration Subindex). Cambodia and Indonesia registered the most notable progress (Chart 11).

CHART 11: EFFICIENCY OF CUSTOMS ADMINISTRATION\*



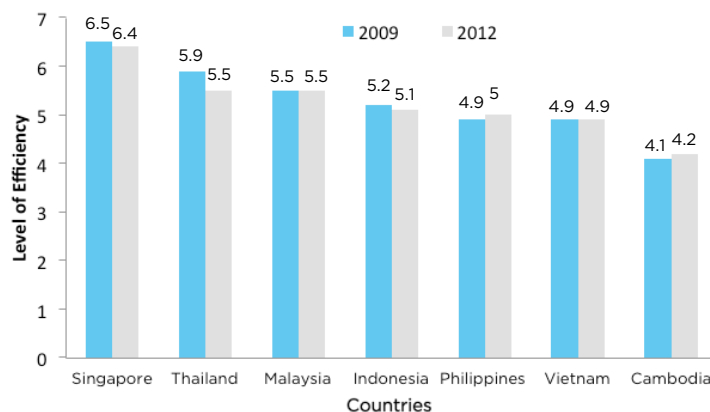
\*Data for Brunei, Laos and Myanmar were not available

Composite index of "Burden of customs procedures" (1 = extremely inefficient; 7 = extremely efficient) and "Customs services index" (Extent of services provided by customs authorities and related agencies, maximum score 12)

Source:

Data compiled from World Economic Forum: The Global Enabling Trade Report 2009 and 2012.

CHART 12: EFFICIENCY OF IMPORT-EXPORT PROCEDURES\*



\*Data for Brunei, Laos and Myanmar were not available

The score 7 indicates perfect efficiency while 0 stands for complete ineffectiveness

Source:

Data compiled from World Economic Forum: The Global Enabling Trade Report 2009 and 2012.

Overall scores for the pillar efficiency of import-export procedures do not show any significant changes between the years 2009 and 2012 (Chart 12).

TABLE 2: EFFICIENCY OF IMPORT-EXPORT PROCEDURES, DETAILED INDICATORS\*

	Efficiency of the clearance process 1-5 (best)		No. of days to import		No. of documents to import		Cost to import, US\$ per container		No. of days to export		No. of documents to export		Cost to export, US\$ per container	
	2009	2012	2009	2012	2009	2012	2009	2012	2009	2012	2009	2012	2009	2012
<b>Cambodia</b>	2.2	2.3	30	26	11	10	872	872	22	22	11	9	732	732
<b>Indonesia</b>	2.7	2.5	27	27	6	7	660	660	21	17	5	4	704	644
<b>Malaysia</b>	3.4	3.3	14	14	7	7	450	435	18	17	7	6	450	450
<b>Philippines</b>	2.6	2.6	16	14	8	8	819	730	16	15	8	7	816	630
<b>Singapore</b>	3.9	4.1	3	4	4	4	439	439	5	5	4	4	456	456
<b>Thailand</b>	3.0	3.0	13	13	3	5	795	750	14	14	4	5	625	625
<b>Vietnam</b>	2.9	2.7	23	21	8	8	901	670	24	22	6	6	734	580

Note:

■ Significant improvements   
 ■ Slight improvements   
 ■ Slight worsening   
 ■ Worsening

\*Data for Brunei, Laos and Myanmar were not available

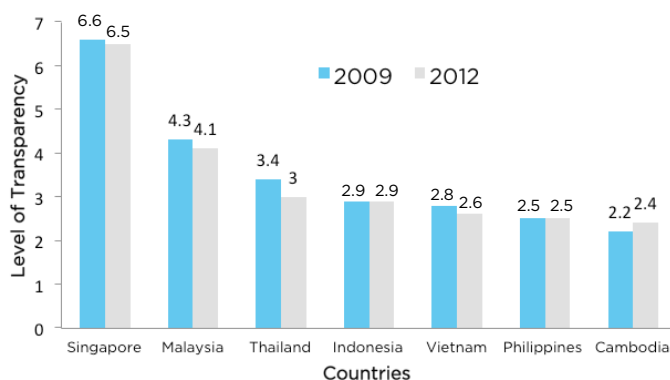
Source:

Data compiled from World Economic Forum: The Global Enabling Report 2009 and 2012 (colour codes added by the authors of this report).

However, a closer look at individual indicators under this pillar (Table 2, page 29) demonstrates significant improvements (green fields) or slight improvements (yellow fields) in many areas, while standards dropped only a small number of instances (orange fields). There is no evidence of any significant worsening of conditions. The time and cost of doing business across borders still varies significantly within ASEAN. For example, the cost of importing one container ranges from USD 435 (Malaysia) to USD 872 (Cambodia).

Striking differences between countries also characterise the pillar transparency of border administration, which measures the degree of corruption and bribery involved in customs procedures. There was no visible trend of improvement between 2009 and 2012 and most AMS achieved rather low scores by international comparison – except for Singapore, which has one of the most transparent border administrations in the world, and, to a somewhat lesser extent, Malaysia.

CHART 13: TRANSPARENCY OF BORDER ADMINISTRATION\*



\*Data for Brunei, Laos and Myanmar were not available

Composite index of "Irregular payments in exports and imports", 1-7 (best); and Transparency International Corruption Perceptions Index, 0-10 (best)

The higher the score, the more transparent is the respective border administration. 7 indicates complete transparency while 0 stands for a complete intransparency.

Source:

Data compiled from World Economic Forum: The Global Enabling Trade Report 2009 and 2012

### 3.3 Competition Policy and Law (CPL)

#### Key Provisions

##### Competition Policy

The main objective of the competition policy is to foster a culture of fair competition. Institutions and laws related to competition policy have recently been established in some ASEAN Member States (AMS). There is currently no official ASEAN body for cooperative work on CPL that is able to serve as a network for competition agencies or relevant bodies to exchange policy experiences and institutional norms on CPL.

##### Actions:

- i. Endeavour to introduce competition policy in all ASEAN Member Countries by 2015;
- ii. Establish a network of authorities or agencies responsible for competition policy to serve as a forum for discussing and coordinating competition policies;
- iii. Encourage capacity building programmes/ activities for ASEAN Member Countries in developing national competition policy; and
- iv. Develop a regional guideline on competition policy by 2010, based on country experiences and international best practices with the view to creating a fair competition environment.

Source: AEC Blueprint, pp. 18-19.

CPL and competition regulatory bodies have a positive and influential role to play in facilitating economic development, promoting consumer welfare, and improving micro-level efficiency and productivity. Competition policy has been included as one of the elements of the AEC Blueprint under its key characteristics of promoting a highly competitive economic region. However, the action points under competition policy are soft targets and modest in their ambition.

The relevant sectoral body to work on competition policy in ASEAN, the ASEAN Experts Group on Competition (AEGC), was endorsed at the 39th ASEAN Economic Ministers (AEM) Meeting in August 2007. The ASEC – through its Competition, Consumer Protection and IPR Division (CCPID) – provides the necessary secretariat and technical support to the AEGC, and coordinates AMS contributions and requests in this process.

The AEGC has focused on developing the ASEAN Regional Guidelines on Competition Policy and Law in ASEAN for Business, among other activities. The Guidelines set out different policy and institutional options that serve as a reference guide and non-binding general framework for AMSs in their efforts to create a fair competition environment.<sup>40</sup> The Handbook illustrates CPL and CPL-related legislation in each AMS. The country chapters provide an overview of the national CPL framework and descriptions of legal provision as well as relevant procedures and enforcement tools.<sup>41</sup>

#### 3.3.1 Not a Level Playing Field for Companies

**While the Guidelines and the Handbook (adopted by ASEAN in August 2010) constitute an important first step, ASEAN is far from being able to create a level playing field for companies with regards to a harmonised regional competition regime. “Encouraging capacity building programmes” or “endeavouring to introduce competition policy in all AMS”<sup>42</sup> is unlikely to result in a regional regulatory framework.**

The following table summarises the status of competition law in AMS and also shows that the number of anti-monopoly or anti-cartel cases is small.

TABLE 3: COMPETITION LAW IN ASEAN

	Law and Enactment	Coverage	Exemptions	Enforcement
<b>Brunei</b>	<p>The Monopolies Act (since 1932). It has not been used or updated.</p> <p>There are no generic competition laws in force. Laws are sector-based.</p>	<ol style="list-style-type: none"> <li>1. Technology Industry of Brunei Darussalam Order 2001 (AITI 2001) and Telecommunications Order 2001, telecommunication sectors.</li> <li>2. Autoriti Monetari Brunei Darussalam (AMBD), Banking and Finance Sectors.</li> <li>3. Energy Division (Prime Minister's Office), Oil and Gas Sectors.</li> </ol>		
<b>Cambodia</b>	<p>There are no generic competition laws in force.</p> <p>Specific sectors are regulated.</p>	<ol style="list-style-type: none"> <li>1. Telecommunications overseen by the National Information Communications Technology Development Authority.</li> <li>2. Banking, oversight by the National Bank of Cambodia.</li> <li>3. Article 22 and 23 of Chapter 7 of Laws concerning Marks, Trade names, and Acts of Unfair Competition provide premise of acts of unfair competition.</li> </ol>		
<b>Indonesia</b>	<p>Indonesian Competition act 1999 under Law no.5 on the Prohibition of Monopoly and Unfair Business Competition Practices</p>	<ol style="list-style-type: none"> <li>1. Any individual or entity engaging in business or commercial activities.</li> <li>2. Business Competition Supervisory Commission (KPPU) regulates competition law in Indonesia.</li> </ol>	<ol style="list-style-type: none"> <li>1. Agreements intended to implement applicable laws and regulations (Article 50a).</li> <li>2. Agreements relate to intellectual property (Article 50b).</li> <li>3. Agreements related to standard setting (Article 50c).</li> <li>4. Agency agreements that do not include resale price maintenance (Article 50d).</li> <li>5. Agreements for the purpose of research and development (Article 50e).</li> <li>6. International agreements ratified by the government (50f).</li> <li>7. Export agreements (Article 50g).</li> <li>8. Activities of small-scale enterprises (Article 50h).</li> </ol>	<p>2008 &amp; 2012, KPPU initiated an investigation into an alleged cartel by soybean importers.</p>



			<p>9. Activities of cooperatives aimed at serving their members (Article 50i).</p> <p>10. State action exception – permitting monopoly if it is a result of a law and if those activities are carried out by a state-owned enterprise or institution formed or appointed by the government.</p>	
<b>Laos</b>	<p>There are no generic competition laws.</p> <p>Laos Decree on Trade Competition 2004.</p>	<ol style="list-style-type: none"> <li>1. Applies to the sales of goods and services in business activities by business persons or business entities.</li> <li>2. Prohibits mergers and acquisitions leading to monopolisation, elimination of other business entities, collusion and arrangements and cartels with foreign business persons.</li> <li>3. No distinction between national and foreign business persons.</li> <li>4. The Trade Competition Commission within the Ministry of Industry and Commerce would be enforcers of the Competition law; however it has not been established.</li> </ol>		
<b>Malaysia</b>	Competition Act 2010	<ol style="list-style-type: none"> <li>1. Prohibits anti-competitive activities and abuses of dominance.</li> <li>2. Applies to any commercial activity within and transacted outside of Malaysia.</li> <li>3. Malaysia Competition Commission (MyCC) enforces the Act.</li> </ol>	<ol style="list-style-type: none"> <li>1. Energy Commission Act 2001.</li> <li>2. Communications and Multimedia Act 1998.</li> </ol> <p>Individual and block exemptions are based on:</p> <ol style="list-style-type: none"> <li>1. Significant identifiable technological, efficiency or social benefits arising directly from the agreement.</li> <li>2. The benefits could not reasonably have been provided by the parties to the agreement without the agreement having the effect of preventing, restricting or distorting competition.</li> <li>3. The detrimental effect of the agreement on competition is proportionate to the benefits provided.</li> </ol>	<p>2012, MyCC announced an investigation against Cameron Highlands Floriculturist Association for alleged price fixing of flowers.</p>

			4. The agreement does not allow the enterprise concerned to eliminate competition completely in respect to a substantial part of the goods or services.	
<b>Myanmar</b>	No generic competition laws in force.			
<b>Philippines</b>	<p>No generic competition laws in force, but provide competition-related provisions:</p> <ol style="list-style-type: none"> <li>1. Article XII of the 1987 Constitution.</li> <li>2. Article 186 of the Revised Penal Code (Act no.3815).</li> <li>3. Article 28 of the New Civil Code (R.A. no. 386).</li> <li>4. The Act to Prohibit Monopolies and Combinations in Restraint of Trade (Act no. 3247).</li> </ol>	<p>Industry-based laws, with own enforcement agencies:</p> <ol style="list-style-type: none"> <li>1. Trade</li> <li>2. Maritime Industry</li> <li>3. Civil Aviation</li> <li>4. Port Services</li> <li>5. Telecommunications</li> <li>6. Energy</li> <li>7. Water</li> <li>8. Privatisation of state enterprises</li> <li>9. Insurance</li> <li>10. Sugar</li> <li>11. Garments and textile</li> <li>12. Investments</li> <li>13. Land transportation</li> <li>14. Coconut</li> </ol> <p>Agencies implementing and enforcing competition laws:</p> <p>Tariff commission</p> <ol style="list-style-type: none"> <li>1. Bureau of import services</li> <li>2. Bureau of trade regulation and consumer protection</li> <li>3. Securities and exchange commission</li> </ol>		
<b>Singapore</b>	Singapore Competition Act 2004	<ol style="list-style-type: none"> <li>1. Prohibits anti-competitive agreements, decisions and practices, the abuse of dominant position, and mergers and acquisitions that substantially lessen competition.</li> <li>2. Competition Commission of Singapore (CCS), a statutory board under Ministry of Trade and Industry enforces the competition law.</li> </ol>	<p>Block exemptions are based on:</p> <ol style="list-style-type: none"> <li>1. The improvement of production or distribution</li> <li>2. The promotion of technical or economic progress</li> </ol> <p>The most current block exemption is the block exemptions for liner shipping agreements in 2006, amended in 2010.</p>	<ol style="list-style-type: none"> <li>1. 2012, CCS issued a Proposed Infringement Decision against 13 motor vehicle traders allegedly engaged in bid-rigging.</li> <li>2. 2012, CCS imposed financial penalties on 2 ferry operators for unlawful sharing of price information.</li> <li>3. 2011, CCS issued an Infringement decision against modelling agencies for colluding to increase modelling rates.</li> </ol>

<b>Thailand</b>	The Trade Competition Act 1999	<ol style="list-style-type: none"> <li>1. Governs anti-competition agreements, abuse of dominance mergers and other unfair trade practices.</li> <li>2. The competition act applies to agricultural, industrial, financial, insurance, and other service businesses</li> <li>3. The Trade Competition Commission (TCC) under the Ministry of Commerce, work concurrently or overlaps sectoral regulatory authorities.</li> </ol>	<p>Businesses exempted are:</p> <ol style="list-style-type: none"> <li>1. Central, provincial or local government agencies.</li> <li>2. State-owned enterprises.</li> <li>3. Agricultural cooperatives established by the law.</li> <li>4. Other businesses as prescribed in the Ministerial Regulations from time-to-time.</li> </ol>	<ol style="list-style-type: none"> <li>1. 2001, United Broadcasting Corporation in Thailand was investigated for cable television monopoly.</li> <li>2. Surathip Group, manufacturer of Chang Beer and Elephant Brand beer, was investigated for abuse of dominance.</li> <li>3. 2004, TCC issued a "Retail Industry Code of Ethics" for retailers.</li> <li>4. 2004, TCC found Honda associated with unequal bargaining power.</li> </ol>
<b>Vietnam</b>	The Law of Competition, 2005	<ol style="list-style-type: none"> <li>1. Co-exists with a number of sectoral laws.</li> <li>2. Vietnam Competition Administration Department (VCAD), under Ministry of Industry and Trade, in charge of regulating the competition law, as well as the Vietnam Competition Council (VCC).</li> </ol>	Vietnam has not approved any exemptions thus far.	<ol style="list-style-type: none"> <li>1. 2009, VCC fined Viet Nam Air Petrol Co, a state-owned monopoly supplying aircraft fuel, for abusing its market position by refusing to supply fuel to a domestic carrier.</li> <li>2. 2010, 19 automobile insurers were fined for entering into a price-fixing agreement.</li> <li>3. 2010, investigation by the VCAD against a company called Megastar for alleged abuse of its market position in the distribution of imported films.</li> </ol>

Sources: compiled from :

<http://www.lexology.com/library/detail.aspx?g=8ab91430-05dd-40bc-9afe-41692dfd1ddd>;

**Brunei**, <http://www.myc.gov.my/files/publication/Brunei%20Darussalam%20Legislation%20and%20Jurisdiction.pdf>;

**Cambodia**, <http://www.globalcompetitionforum.org/regions/asia/Cambodia/02Iw-TrademarCompet1.pdf>;

**Indonesia**, [http://www.jftc.go.jp/eacpf/05/AOTS/indonesia\\_ningrum.pdf](http://www.jftc.go.jp/eacpf/05/AOTS/indonesia_ningrum.pdf);

**Malaysia**, <http://www.skrine.com/exemptions-under-the-competition-act-2010>;

**Philippines**, <http://www.apeccp.org.tw/doc/Philippines/Competition/phcom1.html>;

**Singapore**, <http://www.ccs.gov.sg/content/ccs/en/Legislation/Block-Exemption-Order.html>;

**Thailand**, <http://www.bakermckenzie.com/files/Uploads/Documents/Supporting%20Your%20Business/Global%20Markets%20QRGs/DBI%20>

[Thailand/bk\\_dbi\\_thailand\\_tradecompetitionlaw.pdf](http://www.thailawforum.com/articles/Competition-law4.html), <http://www.thailawforum.com/articles/Competition-law4.html>,

**Vietnam**, <http://vietnamnews.vn/Economy/209156/law-on-competition-sees-stricter-enforcement-.html>.

**Overall, AMS have made progress towards strengthening CPL but the differences between individual countries are significant. Furthermore, the adoption of national competition acts does not necessarily imply swift implementation and**

**enforcement of the legal framework. Enforcement is often hindered by a lack of political will of national governments.**

### 3.4 Investment Regimes

#### Key Provisions

##### Free Flow of Investments

A free and open investment regime is key to enhancing ASEAN's competitiveness in attracting external foreign direct investment (FDI) as well as intra-ASEAN investment. Sustained inflows of new investments and reinvestments will promote and ensure dynamic development of ASEAN economies.

ASEAN investment cooperation is being implemented through the Framework Agreement on the ASEAN Investment Area (AIA) 1998, while investment protection is accorded under a separate agreement i.e. the ASEAN Agreement for the Promotion and Protection of Investment 1987, commonly referred to as the ASEAN Investment Guarantee Agreement (IGA).

To enhance regional integration as well as to maintain a competitive investment area, both the Framework Agreement on the AIA and the ASEAN IGA will be reviewed.

ASEAN aims to provide enhanced protection to all investors and for their investments to be covered under the comprehensive agreement.

##### Actions:

To strengthen among others the following provisions:

- investor-state dispute settlement mechanism;
- transfer and repatriation of capital, profits, dividends, etc.
- transparent coverage on the expropriation and compensation;
- full protection and security; and
- treatment of compensation for losses resulting from strife.

ASEAN aims to adapt more transparent, consistent and predictable investment rules, regulations, policies and procedures.

##### Actions:

- i. Harmonise, where possible, investment policies to achieve industrial complementation and economic integration;
- ii. Streamline and simplify procedures for investment applications and approvals;
- iii. Promote dissemination of investment information: rules, regulations, policies and procedures, including through one-stop investment centre or investment promotion board;
- iv. Strengthen coordination among government

- ministries and agencies concerned;
- v. Strengthen coordination among government ministries and agencies concerned;
- vi. Consultation with ASEAN private sectors to facilitate investment; and
- vii. Identify and work towards areas of complementation ASEAN-wide as well as bilateral economic integration.

AEC Blueprint, pp. 12-13.

As mentioned in the AEC Blueprint, the promotion of investment in ASEAN was guided initially by the Framework Agreement on ASEAN Investment Area (AIA) signed in October 1998. The AIA aimed to establish a competitive investment area with a more liberal and transparent investment environment among the member economies. The scheme included gradual elimination of impediments to investment, liberalisation of investment rules and policies, granting of national treatment and most favoured nation (MFN) treatment to investors and investment of member economies, and opening up of industries to ASEAN investors by 2010 and to all investors by 2020.

The Blueprint stipulated a review of the existing agreements and as a result of this, AMS negotiated and ratified the ASEAN Comprehensive Investment Agreement (ACIA). The existence of this new agreement is the main achievement in the process of creating a free and more open investment regime in the region. The AEC Scorecard 2012 is silent on any specific implementation achievements and just generally outlines:

"The ACIA Schedule (the so-called "reservation lists") has been developed and is expected to be finalized in the first quarter of 2012. In line with the objective of ACIA, ASEAN has developed a modality to further eliminate investment restrictions and impediments and improve investment regulations. In addition, ASEAN has intensified efforts on investment promotion and facilitation, through such initiatives as the linking of investment agencies' websites, development and dissemination of investment publications, and conduct of investment roadshows and seminars."<sup>43</sup>

As in other areas of AEC implementation, AMS's main focus of investment integration has been on the sharing and dissemination of information. As stated before, this is an important starting point but not enough to achieve the ambitious goals of the AEC Blueprint.



While some progress has been achieved, the overall liberalisation of investment regimes has not kept pace with the liberalisation of the free trade of goods. The ASEAN governments are cautious to make binding commitments and there is a lack of a monitoring and compliance mechanism that requires members to be committed to the implementation of the set targets.

None of the actions points under “Provide enhanced protection to all investors and their investments to be covered under the comprehensive agreement” (see the summary section of provisions above) has yet been addressed in any comprehensive manner. Particularly, the establishment of investor-state dispute settlement mechanisms is key to stimulating intra-ASEAN investments. The simple fact is that in the absence of reliable and transparent dispute settlement mechanisms, companies often feel that their investments are not safe.

There is also less concern about investment flows than with regard to other fields of the economic community-building process as ASEAN has done generally well in attracting FDI and is considered one of top FDI destinations in the world. According to a report by the US International Trade Commission’s (USITC), “There will be no shortage of funding coming from within ASEAN, the Asia Pacific or even the US and Europe. These investments can bring about badly needed capital for some countries, allowing them to leapfrog from the 20th century into the 21st in terms of competition in mature countries such as Thailand and Malaysia.”<sup>44</sup>

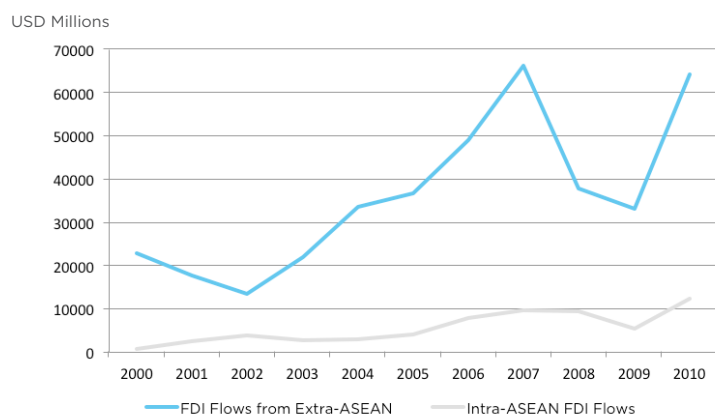
Despite some ups and downs, mainly due to the 2008-09 global financial crisis, the development of FDI since 2010 shows a strong upward trajectory for both investments from non-ASEAN stakeholders and – although a lower level – for intra-ASEAN investment flows.

### 3.4.1 The bottlenecks to intra-ASEAN FDI

The generally well-looking FDI figures overshadow the fact that AMS still compete with each other to attract FDI. Low-cost education and medical hubs have been set up to attract international customers. How the paradigm of collaboration rather than competition can be developed remains to be seen.<sup>45</sup> In addition, as demonstrated in the case of competition law, each AMS is at a different stage of legal system development, which is very important as the legal system creates the framework upon which business is conducted. “Even if the common market is pronounced to be in existence by 2015, this factor alone will be a major impediment for companies within the region. There is too much folklore within the business communities about specific ASEAN country legal systems that make them shy away from direct investment.”<sup>46</sup>

The ASEAN-BAC Survey on ASEAN Competitiveness provides detailed insights into what companies perceive as the most important bottlenecks for investment activities in other ASEAN countries. Respondents were requested to rate the degree of constraint posed by a range of business environmental factors such as infrastructure, laws and regulations and anti-competitive practices to their organisation’s operations in the country in which they were based on a scale of 1 (very low) to 5 (very high). In the table below, the top two constraints for each AMS are in red while the lowest two constraints are in the green. Constraints differ markedly for the respective AMS with Singapore (2.32) and Brunei (2.71) achieving the lowest constrained score, with Vietnam (3.64) and Indonesia and the Philippines (3.50 each) the highest.

CHART 14: ASEAN FDI FLOWS 2000-2010 IN USD MILLIONS



Source: Data compiled from ASEANStats.

TABLE 4: DEGREES OF CONSTRAINTS POSED BY BUSINESS ENVIRONMENTAL FACTORS IN EACH ASEAN COUNTRY

Factor	BN	CMB	ID	LS	MYS	MYM	PHL	SGP	THL	VTM
Infrastructure	3.20	3.87	3.61	3.32	2.53	3.91	3.89	2.23	3.11	3.78
Tax rate and Administration	3.00	3.64	3.64	3.46	3.41	3.59	3.64	2.42	3.59	3.92
Laws and regulations	2.92	3.41	3.80	3.58	3.47	3.36	3.75	2.54	3.68	3.82
Customs administrations	3.24	3.58	3.74	3.29	2.75	3.05	3.38	2.42	3.42	3.65
Business licensing and operating permits	3.28	3.36	3.45	3.72	3.24	3.57	3.44	2.55	3.27	3.65
Political instability	2.04	3.33	3.22	3.54	2.94	3.50	3.33	2.19	3.76	3.12
Corruption	2.17	3.24	3.90	3.10	3.63	3.77	3.86	2.10	3.78	3.29
Crime, theft and disorder	1.92	2.70	3.33	2.27	3.12	2.68	3.38	2.04	2.86	3.25
Anti-competitive practices	2.33	3.62	3.27	2.87	3.18	3.50	3.35	2.18	2.97	3.96
Access to financing	3.00	3.55	3.04	3.08	3.12	3.48	3.00	2.52	2.72	3.92
<b>Overall Business Environment</b>	<b>2.71</b>	<b>3.43</b>	<b>3.50</b>	<b>3.22</b>	<b>3.14</b>	<b>3.44</b>	<b>3.50</b>	<b>2.32</b>	<b>3.32</b>	<b>3.64</b>
No. of respondents	24	21	97	23	16	20	34	51	37	51

Notes: (1) The rating on the constraint posed by the overall business environment is calculated for each country as the simple average of the ratings across the ten factors. (2) The top two constraints for each country are in red while the lowest two constraints are in the green. The scale is from 1 (very low) to 5 (very high). Source: M.-H Wong & A. Wirjo, 2012, p. 9.

The 2013 ASEAN Survey on ASEAN Community Building Effort identifies infrastructure as the most crucial issue: "... the development of infrastructure is necessary to facilitate business needs for smooth logistics... The ten ASEAN countries currently have

significant variations in their country's development and infrastructure sophistication. The ability to address these issues would determine the level of success after integration".<sup>47</sup>

### 3.5 Trade in Services

#### Key Provisions

##### Free Flow of Investments

Free flow of trade in services is one of the important elements in realising ASEAN Economic Community, where there will be substantially no restriction to ASEAN services suppliers in providing services and in establishing companies across national borders within the region, subject to domestic regulations. Liberalisation of services has been carried out through rounds of negotiation mainly under the Coordinating Committee on Services. Negotiation of some specific services sectors such as financial services and air transport are carried out by their respective Ministerial bodies. In liberalising services, there should be no back-loading of commitments, and pre-agreed flexibility shall be accorded to all ASEAN Member Countries.

For the **financial services sector**, liberalisation measures of the financial services sector should allow members to ensure orderly financial sector development and maintenance of financial and socio-economic stability.

Member Countries would be guided by the following principles in pacing their liberalisation measures:

- (a) Liberalisation through ASEAN Minus X formula where countries that are ready to liberalise can proceed first and be joined by others later; and
- (a) The process of liberalisation should take place with due respect for national policy objectives and the level of economic and financial sector development of the individual members.

AEC Blueprint, pp. 11-13.

AMS have committed themselves to liberalising trade in services by expanding the depth and scope of liberalisation beyond those undertaken under the GATS (WTO) with the aim of realising a free trade area in services. AFAS was signed at the Fifth ASEAN Summit held in Bangkok in December 1995. The first schedule of commitments was agreed on in 1997 and the seventh in 2009. The schedule of commitments is based on the GATS with its four modes of supply, namely, cross-border supply (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3) and movement of natural persons (Mode 4). Under each mode, there are commitments dealing with market access and national treatment.

Of the four modes, the most restrictive one - Mode 3 - is applied to financial services. Each and every country requires that any financial institution operating in its territory has a license or permission from a central financial institution, such as the Central Bank, the Ministry of Finance, or a Board of Investment.

Quantitative measures that permit estimation of the growth effects of services liberalisation are difficult to obtain because, unlike the price wedge effects that can be obtained for several measures that impede market access for goods, there is no equivalent measure available for trade in services.<sup>48</sup>

#### 3.5.1 CASE STUDY 1: ASEAN OPEN SKIES

As in other sectors, the main challenge to integration is the voluntary nature and the lack of clear timeframes regarding Member State's participation. Liberalisation is governed by the ASEAN Minus X formula where AMS countries which are ready to liberalise can go ahead and might be joined by others later. A good example is the ASEAN Open Skies policy which is based on the Roadmap for the Integration of the ASEAN Air Travel Sector. The Roadmap was endorsed by the ASEAN Transport Ministers in October 2003 and has been gradually rolled out since. In late 2007, the signing of the agreement on the ASEAN's Single Aviation Market (ASAM) marked an important step forward. Full implementation of the ASAM is scheduled to coincide with the establishment of AEC in 2015. The original agreement foresaw:

1. the lifting of all restrictions on flights between capital cities by December 2008; and,
2. the so-called "fifth freedom" and "beyond" rights (according of the Convention on International Civil Aviation of 1944 or Chicago Convention) by

Indira Hapsari and Donald Maclaren have comprehensively summarised the ASEAN approach to regional integration in the service sector:

Liberalisation in the services sector is believed to benefit a country through creating efficiency and economic growth. The removal of barriers to entry, such as the licensing of foreign service providers, may increase competition between domestic and foreign suppliers, thereby leading to economic benefits such as higher rates of economic growth.

Liberalisation is undertaken through the ASEAN Framework Agreement on Services (AFAS). The objective is to eliminate substantially restrictions to trade in services among Member States. The

2010 – which will enable, for example, Singapore Airlines to fly to Kuala Lumpur, and from there continue onward to Bangkok, Jakarta or any other destination.<sup>49</sup>

Even if fully enforced, the ASAM would be modest in scope. The “seventh freedom” of the Chicago convention – allowing, for instance, a Malaysian carrier to connect Singapore and Manila without the flight originating or terminating in Kuala Lumpur – is not included. The sensitive right of cabotage – the ability of a foreign airline to connect two domestic points in a country – is also excluded.

Neither the first nor the second goal of the ASAM has been achieved yet. Indonesia and the Philippines have not signed the protocols of the Multilateral Agreement on Air Services (MAAS) on reciprocal access among the ASEAN capital cities; while Indonesia, Brunei, Laos and Cambodia have yet to accept the Multilateral Agreement for the Full Liberalization of Passenger Air Services (MAFLPAS) that lifts restrictions among all other ASEAN cities.

No AMS can be forced to join a regional agreement. ASAM is no exception. While the objective of the Roadmap is “to advance the full liberalisation of air transport services in ASEAN”, Appendix 1 of the agreement reiterates the familiar *modus operandi*: “In the implementation, two or more ASEAN Member Countries who are ready can negotiate, conclude and sign implementing agreements/ arrangements in line with the ASEAN-X Formula, on a plurilateral, multilateral or sub-regional basis. The other Member Countries could join in the implementation when they are ready. ASEAN Member Countries can also conclude more liberal bilateral arrangements for air services liberalisation.”<sup>50</sup>

Indonesia’s resistance is the highest hurdle on the way to “Open Skies” in ASEAN. Indonesia accounts for almost half of the entire ASEAN population and its decision to stay out hampers the project significantly.

Between Malaysia and Thailand, for example, each country’s airlines can now make as many flights as they like to the other country, assuming there is room at the airport. “But adding flights to or from Indonesia can take months of bilateral discussions. There are established airline interests in Indonesia that prefer to see restrictions being kept in place.”<sup>51</sup> To protect themselves from foreign competition “Garuda and other Indonesian carriers lobby their government aggressively to steer clear of the ASEAN agreements. In turn, this restricts the other ASEAN carriers’ operations into Indonesia, subjecting them to finite capacity that remains negotiated bilaterally.”<sup>52</sup> The Wall Street Journal

quotes Garuda Chief Executive Emirsyah Satar as saying that Indonesia is willing to open up to more flights from other ASEAN countries but that it needs to be assured that other countries won’t use other regulations to block Indonesian airlines. Indonesia’s reluctance to open its airspace to more competition is just another indication that shows the difficulty ASEAN will have as it tries to push through more economic integration in the next two years.<sup>53</sup>

### 3.5.2 CASE STUDY 2: FINANCIAL SERVICES

Financial sector integration is mainly based on the Roadmap for Monetary and Financial Integration of ASEAN (RIA-Fin) of 2003. The Roadmap consists of steps, timelines and indicators of activities in four areas: (a) Capital Market Development, (b) Liberalisation of Financial Services, (c) Capital Account Liberalisation and (d) ASEAN Currency Cooperation.<sup>54</sup>

As recently as 2010, the Malaysian Ministry of International Trade and Industry stated: Ministries and government agencies “are not prepared to make commitment. Most stakeholders in the services sectors are not fully aware of the impact of services liberalisation.”<sup>55</sup> A main concern for policy makers in Malaysia and elsewhere is that there are only a limited number of service suppliers which are competitive by international standards.<sup>56</sup> Against this backdrop, the regional liberalisation of financial services is a particular challenge. However, expectations are high.

According to Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, “Financial institutions with a regional footprint in ASEAN have the potential to contribute to the development of the financial systems in countries where they operate. There will be tremendous payoffs to be reaped from pursuing such sustainable strategies. Such long-term commitments to ASEAN will not only contribute to mutually reinforcing regional growth, but will become an important source of stability to the region.”<sup>57</sup>

In anticipation of increasing integration of financial services, several Thai banks, for instance, are expected to acquire or enter joint ventures with banks in ASEAN to take advantage of increasing trade and investment between Thailand and new frontier markets such as Vietnam, Cambodia, Laos and Myanmar. The following statement by Sushil Saluja, managing director of the consultancy Accenture, shows that the AEC 2015 vision is often taken at face value within the private sector: “There

is a great opportunity in the financial-service marketplace for Thai banks as ASEAN moves towards deeper economic integration in 2015, leading to a significant increase in trade finance and trade flows... We're very excited about the opportunity."<sup>58</sup>

The private sector's optimism about the AEC is perhaps inflated as many believe integration to be further along than it really is.

Closely linked to financial services is the capital market, another freedom required to form a single market and production. The AEC Blueprint envisages a regionally integrated capital market where: capital can move freely within the region; issuers are free to raise capital anywhere within the region; and investors can invest anywhere within the region. Particularly in the financial services sector, it means to substantially remove restrictions for the insurance, banking and capital market sub-sectors by 2015.<sup>59</sup>

Private-sector driven financial sector integration is visibly taking place. In a bid to increase their size and profitability, many leading banks in the region are expanding their operations beyond national borders to become regional banks. Prime examples of this trend are Maybank and CIMB of Malaysia, and DBS Bank of Singapore. DBS is the largest bank by assets in Singapore offering the full gamut of financial services and it has made its intent of being a regional player very clear. Through acquisitions of Bank of Southeast Asia in the Philippines and Thai Danu in Thailand, it has established its presence across all of the key markets in ASEAN.

A comprehensive study on "Finance Sector in ASEAN: Implications of the Liberalisation of Financial Services for Labour in the Region" by Nguyen Xuan Huong Mai provides a detailed country-by-country assessment showing that there has been only limited progress by each country on the schedule of commitments to financial service liberalisation under AFAS: "the level of commitment among ASEAN countries is varied, due to respect for national policy objectives and the level of economic and financial sector development of the individual members. Second, the content of services trade liberalisation in most of the ASEAN countries is still weak."<sup>60</sup> The most tangible results are in the area of information sharing and a more systematic approach to the monitoring of national financial markets. According to the study, there is recognition among ASEAN governments that the future financial market architecture should be based on greater private sector participation, proper standards for transparency and disclosure, dissemination

of necessary information, early warning systems and a well-sequenced approach to capital account liberalisation depending on a country's degree of development and macroeconomic stability.<sup>61</sup> However, this is a wish-list and does not guarantee implementation.

The study implicitly suggests that **financial services integration will continue to be essentially private-sector driven**: "The wide network of branches of ASEAN banks is of strategic value as distribution channels for a range of banking, insurance, mutual funds and capital market products. If ASEAN banks can work together to distribute high quality products suited to their customers' needs, it would help residents in all ASEAN economies to invest their savings appropriately, with proper diversification and returns."

**Government-led integration requires strong political will and commitment and certain favourable framework conditions. The example of the European Monetary Union (EMU)** shows that effective regional financial sector integration requires: (i) high trade interdependencies; (ii) the common acceptance of basic political and social values; (iii) fairly even economic development and comparable living standards, despite divergences among its poorest members; and, (iv) a strong commitment to solidarity.<sup>62</sup> None of these factors are present within ASEAN. Again, it should not be suggested here that ASEAN should follow the European model but it is legitimate to ask how AMS envision achieving regional integration in a highly complex field on the basis of non-binding agreements and the ASEAN-X formula that does not require AMS to firmly commit themselves to implementation targets.



### 3.6 SME Support

#### Key Provisions

##### SME development

The ASEAN Policy Blueprint for SME Development (APBSD) 2004-2014 outlines the framework for SME development in the ASEAN region. It comprises strategic work programmes, policy measures and indicative outputs. Its objectives are to:

- Accelerate the pace of SME development, optimising on the diversities of ASEAN Member Countries;
- Enhance the competitiveness and dynamism of ASEAN SMEs by facilitating their access to information, market, human resource development and skills, finance as well as technology;
- Strengthen the resilience of ASEAN SMEs to better withstand adverse macroeconomic and financial difficulties, as well as the challenges of a more liberalised trading environment; and
- Increase the contribution of SMEs to the overall economic growth and development of ASEAN as a region.

Source: AEC Blueprint, p. 24.

Between approximately 95% and 98% of all enterprises in ASEAN are SMEs and they provide, depending on the respective AMS, between 50-95% of all employment. SMEs contribute between 30 and 53% to national GDPs and 13-31% to exports. In 2009, the AEC Council decided to develop an ASEAN Action Plan for SME Development 2010-2015.<sup>63</sup> The Plan defines the mission, objectives, guiding principles, current status, and future policies and programs for ASEAN SME Development. The ASEAN SME Agencies Working Group (SME WG) steers respective activities and adopted a “Work Programme for 2011-2012”. The ASEAN Secretariat supports SME WG in a coordinating role and also liaises with dialogue partners and donors providing additional assistance.

Crucial questions underpinning ASEAN's SME support include:

- How are SMEs defined and how is the specific definition related to the support provided?
- How can SMEs obtain information on policies and regulations and business opportunities related to specific SME-support?
- Which SME programmes or SME promotion activities are most successful in AMS and could be used as examples for “good practise”?
- What are the most innovative SME programmes or SME promotion activities in individual AMS?

To-date, there is no generally agreed definition of SMEs in ASEAN, but there are two basic approaches to defining SMEs: based on number of employees and/or asset value.

**TABLE 5: DEFINITION OF SMES IN ASEAN COUNTRIES BASED ON NUMBER OF FULL-TIME EMPLOYEES**

Country		Micro	Small	Medium
Brunei		1-5	6-50	51-100
Cambodia		1-10	11-50	51-100
Indonesia		1-5	6-50	51-100
Lao PDR			1-19	20-99
Malaysia	Manufacturing	<5	5-50	51-150
	Services	<5	5-19	20-50
Myanmar		<9	10-50	51-100
Singapore		<200		
Philippines		1-9	10-99	100-199
	Production	1-5	<=50	51-200
Thailand	Service	1-5	<=50	51-200
	Wholesale	1-5	<=25	26-50
	Retail	1-5	<=15	16-30
Vietnam		<300		

Source:

Kenan Institute Asia, The ASEAN SME Regional Development Fund Conceptual Framework, 2012, p. 79

**TABLE 6: DEFINITION OF SMES IN ASEAN COUNTRIES BASED ON ASSET VALUE**

Country		Micro	Small	Medium
Cambodia	Excluding land	Less than USD50,000	USD50,000 - 250,000	USD25,000 - 500,000
Indonesia		<IDR.50mil	> IDR.50 mil & < IDR.200 mil	IDR.200 mil - IDR. 10 bio
Lao PDR			< LAK 250 mil	< LAK 1200 mil
Myanmar			< MMK 1 mil	MMK 1 - 5 mil
Philippines	Excluding land	Up to PHP 3mil	> PHP 3 mil - 15 mil	> PHP 15 mil - 100 mil
Singapore		<SGD 15 mil Fixed Productive Asset		
Thailand	Production	-	<=THB 50 mil	>THB 50-200 mil
	Service	-	<= THB 50 mil	> THB 50-200 mil
	Wholesale	-	<= THB 50 mil	>50-100 mil THB
	Retail	-	<= THB 50 mil	> THB 30-60 mil
Vietnam		<=10 billion Vietnam Dong(=USD620.000)		

Source:

Kenan Institute Asia, The ASEAN SME Regional Development Fund Conceptual Framework, 2012, p. 80.

**The real challenge is not the definition of SME, but rather, in organising a coordinated and effective ASEAN approach to “enhance SMEs’ competitiveness and resilience” as prescribed by the Action Plan, which explains:**

A strong, dynamic and efficient SME sector will ensure the sustainable, inclusive and broad-based economic and social development. A vibrant SME sector is critical in supporting closer regional integration through the establishment of the ASEAN Community, particularly the ASEAN Economic Community (AEC). Thus, the encouragement and promotion of competitive and innovative SMEs is necessary in contributing to greater economic growth and social development towards more inclusive and broad-based integration of the ASEAN region (p. 2).

The emphasis so far has mainly been on encouragement. For example, the then ASEAN Secretary General Surin Pitsuwan, urged SMEs “to venture beyond their national borders as intra-regional trade accounts for only 25 per cent of gross domestic product, compared to up to 70 per cent for other blocs”

SMEs should cross borders and change their mindset. “Don’t feel just comfortable staying here. Go out, explore and examine the landscape. It’s been built, it’s been open,” Surin said. Multinational corporations are taking more advantage of all the rules and regulations, or de-regulations, than Asean companies are. “We feel that investors from around the world are coming to Asean. Swarovski just opened up its office in Bangkok, looking forward to the Asean Economic Community market. AIA changed its name from an Asian branch to an Asean office,” he said. Asean countries may have to push their SMEs outside their territories to gain advantages from the combined market of 600 million. SMEs constitute the bulk of local companies in this regional bloc. In Thailand, they account for 99.6 per cent.<sup>64</sup>

It seems hardly realistic to suggest that, for example, a small Thai company in the agriculture processing or retail sector with a total of ten employers can and should approach the emerging regional ASEAN market in a similar way as the global giant Swarovski with some 25,000 employers does.

It goes without saying that ASEAN is not in the position to create a level playing field for all SMEs in the region or to single-handedly increase their competitiveness. Pitsuwan was right to implicitly blame a part of the problem on a lack of entrepreneurial spirit. A related issue is the insufficient managerial skills that prevent SMEs to venture across borders. Yet, the ASEAN

Action Plan for SME Development is extremely ambitious – some would say unrealistic – when it outlines its objective:

By 2015, ASEAN SMEs shall be world-class enterprises, capable of integration into the regional and global supply chains, able to take advantage of the benefits of ASEAN economic community building, and operating in a policy environment that is conducive to SME development, exports and innovation (p. 3).

The related five major deliverables targeted for SME under the AEC Blueprint are equally bold:

- (1) a common curriculum for entrepreneurship in ASEAN (2008-2009);
- (2) a comprehensive SME service centre with regional and sub-regional linkages in AMSs (2010-2011);
- (3) SME financial facility in each AMS (2010-2011);
- (4) a regional program for an internship scheme for staff exchanges and visits for skills training (2012-2013); and,
- (5) a regional SME development fund for use as a funding source for SMEs that are undertaking business in ASEAN (2014-2015).

Progress has been made to put structures and institutions in place in support of achieving deliverables 1-4, but neither the curriculum, nor the SME service centre, nor a SME financial facility in each AMS, are in place. As in other areas, most AMS have shown little enthusiasm to work towards the agreed goals. If achievements – in the broadest sense of encouraging exchanges among SME and providing some kind of information sharing and support – are evident, they are the often the result of initiatives taken by extra-regional partners or the private sector itself. Good examples are the EU-ASEAN SME Forum 2012 (November 2012 in Jakarta)<sup>65</sup> and the CIMB ASEAN SME Forum, a regional roadshow that took place in Kuala Lumpur, Bangkok and Jakarta in September and October 2012.<sup>66</sup>

It would be wrong to suggest that AMS have been completely inactive on the issue of SME support. As the following two tables show, several SME promotional activities have been successful and innovative. However, they resemble a patchwork as they are not usually part of a coordinated regional strategy and not well-aligned with the AEC Blueprint or the Action Plan. Overall, the ASEAN Action Plan for SME Development has not been given the necessary attention by the ASEC and related regional bodies. Yet, accelerating process in this area should not be too challenging as SME support is a matter of technical and financial assistance and capacity-building that, unlike free trade and customs integration, can be facilitated in a purely inter-governmental manner and thus does not touch upon the sensitive political issue of national sovereignty.

TABLE 7: FOCAL AREAS FOR SME PROMOTION PROGRAMMES IN AMS

	Brunei	Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam	No. of entries
SME Regulation & Information		X	O	X	O		O			O	6
Innovation & Technology	O	O	O		x			O	X		6
HRD / Skills Development			O		O	O		X		O	5
SME Exports & Internationalisation	O			O	O		X	X	x	O	7
SME Clusters & Value Chains		O	X	O	x	X	X		x	X	8
Business Services	O	O									2
Incubation & Start-ups	X		O					O			3
Access to Finance		O	X	O	O	O	X	O	O	O	9

o – Has been identified as a focal area of SME promotion activities in the country.

x – Specific SME promotion programmes are considered particularly successful.

Source:

Karl Bartels, Stock-taking & proposals for SME-enabling activities in the context of ASEAN's regional economic integration, Presentation for 30th Meeting of the ASEAN Small and Medium Enterprises Agencies Working Group, 2012.

TABLE 8: SUCCESSFUL AND INNOVATIVE SME PROMOTION PROGRAMMES

SME Regulation & Information	<ul style="list-style-type: none"> <li>Regulatory facilitation activities (Cambodia)</li> <li>Business Registration System (Lao PDR)</li> <li>Provincial public-private dialogue forums - PPPD (Lao PDR)</li> </ul>
Innovation & Technology	<ul style="list-style-type: none"> <li>SME Competitiveness Rating for Enhancement - SCORE (Malaysia)</li> <li>Industrial Technology Assistance Program - iTAP (Thailand)</li> </ul>
HRD / Skills Development	<ul style="list-style-type: none"> <li>HR Capability Package (Singapore)</li> </ul>
SME Exports & Internationalisation	<ul style="list-style-type: none"> <li>Product Design and Development Center - PDDCP (Philippines)</li> <li>Export Technical Assistance Centre - ETAC (Singapore)</li> <li>Thailand SME Expo (Thailand)</li> </ul>
SME Clusters & Value Chains	<ul style="list-style-type: none"> <li>One Village One Product (Indonesia; Philippines)</li> <li>Malaysia-Japan Automotive Industries Cooperation - MAJAICO A-1 (Malaysia)</li> <li>Industrial Zones (Myanmar)</li> <li>BOI Unit for Industrial Linkage Development Programme - BUILD (Thailand)</li> <li>SPX (Vietnam), database on capacity and skills of local suppliers</li> </ul>
Incubation & Start-ups	<ul style="list-style-type: none"> <li>iCentre (Brunei)</li> </ul>
Access to Finance	<ul style="list-style-type: none"> <li>People Business Credit - KUR (Indonesia)</li> <li>People's Credit and Finance Corporation - PCFC (Philippines)</li> </ul>

Source:

Karl Bartels, Stock-taking & proposals for SME-enabling activities in the context of ASEAN's regional economic integration, Presentation for 30th Meeting of the ASEAN Small and Medium Enterprises Agencies Working Group, 2012.

### 3.7 Standards and Non-Tariff Barriers

#### Key Provisions

##### Standards and Technical Barriers to Trade:

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

##### Actions:

- i. Harmonise standards, technical regulations and conformity assessment procedures through their alignment with international practices, where applicable; 1
- ii. Develop and implement sectoral Mutual Recognition Arrangements (MRAs) on Conformity Assessment for specific sectors identified in the ASEAN Framework Agreement on Mutual Recognition Arrangements
- iii. Enhance technical infrastructure and competency in laboratory testing, calibration, inspection, certification and accreditation based on regionally/internationally accepted procedures and guides;
- iv. Promote transparency in the development and application of standards, technical regulations and conformity assessment procedures in line with the requirements of the World Trade Organisation (WTO) Agreement on Technical Barriers to Trade and the ASEAN Policy Guideline on Standards and Conformance;
- v. Strengthen post market surveillance systems to ensure the successful implementation of the harmonised technical regulations; and
- vi. Develop capacity building programmes to ensure smooth implementation of the work programme.

AEC Blueprint, pp. 9-10.

company that served both the Indonesian and Thai soap markets needed different production runs to manufacture 100-gram (0.22-pound) soap bars because in Indonesia weight is measured at the factory while in Thailand it was measured on the shelf. Evaporation during transport meant that soap bars had to be produced at 104 grams for the Thai market. Thailand ended this anomaly last year, but countless similar cases remain across the ASEAN region. An executive at a processed-foods company, for example, told us that different product standards for ice cream routinely add three months to intraregional deliveries, thereby lengthening factory-to-shelf times, causing stock-outs in shops, and ultimately raising consumer prices and the company's cost of working capital.<sup>67</sup>

A 2011 study suggests that different product standards across Member States still add 10% to 15% to the production costs.<sup>68</sup>

A related problem is that product standards are non-tariff barriers (NTB) to trade and therefore potentially undermine ASEAN's free trade efforts. Maintaining and introducing NTB is a popular political tool (not just in ASEAN) to mediate the effects of tariff reductions or elimination on national industries which are still perceived to be in the need of protection from international production. In this context, Malaysian Prime Minister Datuk Seri Najib Tun Razak asked other ASEAN members to "refrain from taking new non-tariff measures that can impede greater regional integration."<sup>69</sup>

Nevertheless, in the little publicised areas of product standards, Sanitary and Phyto-Sanitary (SPS) measures and Technical Barriers to Trade (TBT) some remarkable progress towards harmonisation can be reported – achieved only with substantial support from the EU, UNITAR and other donors and organisations – showing that ASEAN has come a long way since the findings of the McKinsey study in this area.

The 2004 McKinsey Study identified a lack of standards as a main obstacle in the regional integration process:

Different product standards across member countries prevent businesses from standardizing products—a problem that can add 10 to 15 percent to operating costs. Until recently, for instance, a

### 3.7.1 Tangible Achievements: Harmonisation of Standards in key Areas

Standards harmonisation is an important goal worth pursuing, as is shown by the substantial support from extra-ASEAN stakeholders, such as the EU and UNITAR, and other various donor organisations. Notable success stories to date include the achievements in standards harmonisation in the cosmetics sector and the electrical and electronics sector. With cosmetics, progress has been achieved via the ASEAN Cosmetics Directive, an ASEAN legal instrument modelled closely on the EU's namesake counterpart which requires ASEAN Member States to voluntarily initiate a formal "transposition" into their national laws. Together with the ASEAN Harmonized Cosmetic Regulatory Scheme, these instruments provided for a policy shift in many areas including customs, trade, and technical operations. The electrical and electronics sector in ASEAN is taken care of by the ASEAN Harmonised Electrical and Electronics Equipment Regulatory Regime (EEERR) which has harmonised standards for electrical appliances, electrical safety and electromagnetic components, streamlining production and trade in ASEAN. This has also laid steady groundwork for the harmonisation of standards in many other sectors including rubber-based, automotive, medical devices, pharmaceuticals, traditional medicine and health supplement sectors.

The ASEAN Trade in Goods Agreement (ATIGA) makes further headway in standards harmonisation in the areas of TBT and SPS. Whilst previously these sectors were governed by WTO Agreements and the provisions of individually negotiated Mutual Recognition Agreements between ASEAN Member States, ATIGA ushers in reforms. Now, AMS are obligated to follow the TBT Agreement's "Code of Good Practice", use international standards where possible and ensure that technical regulations are not adopted in ways that frustrate trade in ASEAN. Where applicable, technical regulations must be applied in ways that facilitate the implementation of any ASEAN sectoral MRAs and conformity assessment procedures are expected to be consistent with international standards and practices. Efforts have also been made for ASEAN to harmonise their standards on an international scale, adopting and adhering to the UN Globally Harmonised System of Classification and Labelling of Chemicals.

Whilst this progress shows encouraging signs, overall progress on this front is unsatisfactory. The process of building quality infrastructure related to SPS and TBT is still far from being completed, there is a clear lack of information on how regional standards affect businesses across the region and to what extent agreed standards have actually been implemented nationally. In the SPS area specifically, ATIGA obligates members of ASEAN to be guided by international norms and standards in their SPS-related activities and encourages ASEAN member governments to develop equivalence agreements and explore additional opportunities for intra-ASEAN cooperation.<sup>70</sup>

Overall, however, the process of building quality infrastructure related to SPS and TBT is still far from being completed. **There is a clear lack of information on how regional standards affect businesses across the region and to what extent agreed standards have actually been implemented nationally.**



## 4. SUMMARY FINDINGS

ASEAN has established a monitoring system to assess progress toward regional economic integration. The most visible part of the monitoring process is the AEC Scorecard which charts the implementation of the AEC Blueprint. However, data and facts for the scorecard are provided by the AMS based on self-assessment and thus often do not stand the test of objectivity. Understandably, Member States want to present themselves in a positive light and demonstrate that they have made significant process towards reaching the AEC benchmarks. Economic facts and political spin easily get mixed up as a result. Therefore, this study attempts to form an independent assessment of the level and status of economic community building in ASEAN based on verifiable data and comprehensive analyses.

**A clear finding is that ASEAN scores high on the political, legal, institutional and technical frameworks that govern regional economic integration.** The AEC and a multitude of related agreements in facilitation of the free flow of goods and services, intra-regional investments, customs harmonisation, SME support, standards and non-tariff barriers to trade and other fields. If implemented, these agreements would indeed lead to an economic community characterised by a: (i) a single market and production base; (ii) a competitive economic region; (iii) equitable economic development; and, (iv) a coherent approach towards external economic relations – the four pillars of the envisioned AEC.

**However, there is ample evidence to prove that actual implementation lags significantly behind the stated objectives and timelines.** A suitable starting point in this regard is the ASEAN-BAC survey of companies' view of economic integration. It identified a clear gap between the relatively high importance attached by businesses to AEC Blueprint implementation and their average level of satisfaction with the actual achievements towards implementation. The areas that businesses identified as being among the least satisfactory related to increasing foreign equity participation in services sectors, consultation with businesses, development and implementation of mutual recognition of professional qualifications, development or enhancement of national competition policies and dissemination of information. The areas where the gap between importance and satisfaction were widest are investment protection, simplification of customs procedures and enhancing the transparency of non-tariff barriers.

### 4.1 How does ASEAN score in the key areas of AEC Blueprint implementation?

- **Free Trade:**

The AEC Scorecard indicates that more than half of the measures targeted under free flow of goods were already implemented between 2008 and 2012. Despite the – on paper – impressive achievements in implementing AFTA and now ATIGA, intra-ASEAN trade (as a percentage of the overall trade of the AMS) has not increased markedly since 2003 and only by a mere 4.4% since 1998. Intra-ASEAN trade has hovered around 25% between 2003 and 2011. Furthermore, the ASEAN-BAC survey finds that the utilisation of the free trade agreement remains low. Only 29% of respondents indicated that their organisations used preferential provisions in ASEAN agreements and nearly half of the survey firms (46%) stated that they were not planning to use preferential provisions in the future. While AFTA has not resulted in a significant push to intra-ASEAN trade, extra-regional FTAs, especially the one with China (ACFTA), have resulted in a sharp increase in trade volumes.

- **Customs Harmonisation:**

While developments towards customs integration have been slower than anticipated, some progress can be reported. Data provided by the Global Enabling Trade Report (“The Enabling Trade Index”), which has been published by the World Economic Forum since 2008, allows for a detailed assessment. Of particular interest is the Border Administration Subindex, which assesses the extent to which the administration at the border facilitates the entry and exit of goods as measured by (i) efficiency of customs administration; (ii) efficiency of import-export procedures; and, (iii) transparency of border administration. A comparison of the scores in the 2009 and 2012 reports for overall border administration efficiency and transparency shows improvements for Cambodia, Indonesia, the Philippines and Vietnam. Malaysia and Singapore maintained their scores. Only Thailand's 2012 score was slightly lower than in 2009.

- **Competition Law and Policy:**

While the Regional Guidelines on Competition Policy and the Handbook on Competition Policy and Law in ASEAN constitute an important first step towards the dissemination of information and providing concrete guidance to the private sector, ASEAN is far from being able to create a level playing field for companies with regards to a harmonised regional competition regime. ASEAN aims at “Encouraging capacity building

programmes” and “endeavouring to introduce competition policy in all AMS”.

However, these ‘soft objectives’ are unlikely to result in a regional regulatory framework. AMS have made progress towards strengthening CPL but the differences in individual countries are significant. While Malaysia, Indonesia, Singapore, Thailand and Vietnam already have CPL regimes in place, Cambodia and Philippines are currently in the process of drafting their respective CPLs, while Lao PDR plans to introduce national CPLs soon. Brunei Darussalam and Myanmar are at various stages of consideration and development as regards the introduction of nation-wide CPLs but have not finalised any provisions yet. Furthermore, the adoption of national Competition acts does not necessarily imply swift implementation and enforcement of the legal framework. Often enforcement is hindered by a lack of political will among national governments.

- **Investments:**

Despite some ups and downs, mainly due to the 2008-09 global financial crisis, the development of FDI since 2010 shows a strong upward trajectory for both investments from non-ASEAN stakeholders and – although at a lower level – for intra-ASEAN investment flows. The signing of the ASEAN Comprehensive Investment Agreement (ACIA) is the main achievement to-date in the process of creating a free and more open investment regime in the region.

However, as in other areas of AEC implementation, AMS’s main focus has been on the sharing and dissemination of information. The liberalisation of investment regimes has not kept pace with the liberalisation efforts on goods. The ASEAN economies are cautious to make binding commitments and there is a lack of a monitoring and compliance mechanism that requires members to be committed to the implementation of targets. Furthermore, the generally well-looking FDI figures overshadow the fact that AMS still compete with each other to attract FDI.

- **Free Flow of Services:**

Liberalisation is undertaken through the ASEAN Framework Agreement on Services (AFAS). The objective is to eliminate substantial restrictions to trade in services among Member States. The AMS have committed themselves to liberalising trade in services by expanding the depth and scope of liberalisation beyond those undertaken under the GATS (WTO) with

the aim of realising a free trade area in services. The level of commitment among ASEAN countries is varied, due to respect for national policy objectives and the level of economic and financial sector development of the individual members.

Besides, the content of liberalisation of trade in services among most ASEAN countries is still weak. There is no sign yet of the emergence of a regionally integrated capital market, as envisioned by the AEC Blueprint, where capital can move freely within the region, issuers are free to raise capital anywhere within the region, and investors can invest anywhere within the region.

If financial sector integration is taking place, it is mainly private-sector driven. In a bid to increase their size and profitability, many leading banks in the region are expanding their operations beyond national borders to become regional banks. While there is recognition among ASEAN governments that the future financial market architecture should be based on greater private sector participation, proper standards for transparency and disclosure, dissemination of necessary information, and early warning systems, this is a wish-list and does not guarantee implementation. Government-led integration requires strong political will and commitment and certain favourable framework conditions as the example of the European Monetary Union (EMU) shows.

- **SME Support:**

More than 95% of all enterprises in ASEAN are SMEs and they provide, depending on the respective AMS, between 50-95% of all employment. SMEs contribute between 30 and 53% to national GDPs and 13-31% to exports. In 2009, the AEC Council decided to develop an ASEAN Action Plan for SME Development 2010-2015. The ASEAN Action Plan for SME Development is extremely ambitious when it outlines its objective: “By 2015, ASEAN SMEs shall be world-class enterprises.”

ASEAN’s current approach to “enhance SMEs’ competitiveness and resilience” as prescribed by the Action Plan, mainly follows a strategy of encouragement, which regularly materialises in the recommendation that SMEs should change their mindset and cross borders. Nevertheless, it would be wrong to suggest that AMS have been completely inactive on the issue of SME support. Several SME promotional activities have been successful and innovative. However, they resemble a patchwork as they are not usually part of a coordinated regional strategy and not well-aligned with the AEC Blueprint or the Action Plan.

- **Standards and Non-Tariff Barriers to Trade:**  
In this little publicised area, some remarkable progress towards harmonisation is evident and has been achieved with substantial support from the EU, UNITAR and other donors and organisations. The cosmetics sector was the first success story. The AMS introduced a common regulatory framework in the form of a Directive (closely modelled on that of the EU) requiring formal “transposition” into the law of participating states. In the electrical and electronics sector, the ASEAN Harmonised Electrical and Electronics Equipment Regulatory Regime (EEERR) was signed in December 2005 and has resulted in 139 harmonised standards for electrical appliances, electrical safety and electromagnetic components. Harmonisation of technical regulations is also underway for rubber-based, automotive, medical devices, pharmaceuticals, traditional medicine and health supplement sectors. ASEAN has also worked towards implementing the UN Globally Harmonised System of Classification and Labelling of Chemicals (GHS). Until recently, in respect of SPS and TBT, the AMS did not have generally applicable obligations amongst them apart from the WTO Agreements, and relied instead on the negotiation and implementation of sectorial mutual recognition agreements. This changed with ATIGA which contains new obligations in both the TBT and SPS areas. Overall, however the process of building quality infrastructure related to SPS and TBT is still far from being completed. At the same time, there is a clear lack of information on how regional standards affect businesses across the region and to what extent agreed standards have actually been implemented nationally.

#### 4.2 Economic and political hurdles to the implementation of the AEC

The general observation is that while AMS governments regularly praise the benefits of deeper regional economic integration and have enthusiastically signed dozens of ASEAN agreements to this end, the establishment of national policy and legislative frameworks to implement the agreed provisions is not following suit. Even if the right policies are in place, they are not necessarily fully enforced. Hence, the main hurdle is the mismatch between political ambitions and the capacities, capabilities and often political will of several member states to walk the talk. The basic conditions for creating common regimes or even for harmonising national legislative frameworks and enforcement practises among ASEAN countries are not yet in place,

owing to considerable disparities in technical and institutional capacities, economic development and political priorities. The reasons for the slow and insufficient process towards AEC implementation can be broadly divided into economic and political arguments.

- **Developmental gap between member states**  
As for general economic factors, AMS are at different stages of economic development within the region, ranging from Singapore, as one of wealthiest nations in the world, to Laos, Cambodia and Myanmar, as three of the poorest. The ratio between the largest and smallest national GDP per capita is 1:61; in the EU, it is only 1:8. The structural differences among ASEAN members appear to create a reluctance to give up their national policies; for instance, in relation to the significant discrepancies between the member states in their average external tariff levels.
- **Competitive nature of ASEAN economies**  
The relatively small size of the ASEAN market and the outward-orientation of the AMS economies are important factors that do not create a fertile ground for regional economic integration. Furthermore and equally important, the AMS economies are more competitive than complementary in structure. They are producing a narrow range of similar primary products and labour-intensive manufactured goods for export. Intra-ASEAN trade is higher than in most other regional groupings but still significantly lower than in Europe and North America.

Two important regional factors that shed some light on the reasons for the stagnation of, and bleak growth potential for, intra-ASEAN trade are the under-utilisation of AFTA, particularly related to the Rules of Origin (RoO), and the general nature and structure of the private sector in Southeast Asia. As for RoO, the cost of proving origin is high; computation of costs, invoicing, and other documentation demands inherent in Value added (VA) rules are complex, especially for SMEs from less developed economies.

- **Majority of ASEAN businesses are not regional players**  
The observation that large, multi-national companies such as Air Asia, CIMB Bank, Bangkok Bank, SingTel, or Siam Cement are taking advantage of the region as a market can easily distract from the fact that the majority of companies in the region are anchored in their own countries and do not have a history of venturing out beyond borders. The bulk of these firms prefer to diversify business interests within their home country rather than expand across the region, as shown in an analysis by Murray Hunter (see earlier

citations). At the same time, the ASEAN region is dominated by SMEs for which AEC is unlikely to provide very many opportunities for regional expansion, except perhaps in tourism.

- **Governments and private sector lack the dimensions of deep economic integration**

**Regional economic integration is as much a top-down approach as it is a bottom-up phenomenon. In a mutual reinforcing process, governments create the structural frameworks to facilitate a widening and deepening of cross-border economic interactions, while companies take their own initiatives to create business opportunities for themselves beyond national markets. ASEAN's problem is that both dimensions are not fully developed.** However, it would be wrong for governments to blame the private sector for not taking advantage of existing rules. The emergence of "regional mindsets" among businesses is an important step, but this mindset can only translate into a substantial expansion of regional activities if governments establish the appropriate regulative structures. The delay or even failure in doing so is primarily related to political factors.

- **The ASEAN way may not be the best way**

**Southeast Asia is characterised by a broad spectrum of different systems of government, making it difficult to agree on binding regional norms, rules and procedures. Furthermore, the prevalence of bilateral disputes, mainly related to conflicting territorial claims and border conflicts between AMS across ASEAN hinders the emergence of strong mutual trust as a decisive precondition for any type of regional community building.** ASEAN has never pretended to be a homogenous regional grouping and, acknowledging the high degree of diversity, deliberately rejected the legalistic approach to regional integration based on stringent regulatory frameworks that has characterised European integration. For several decades, it was customary for Southeast Asian politicians to state that ASEAN never tried or intended to emulate the EU. Instead, ASEAN developed an alternative approach to regional community building which is widely known as the "ASEAN Way" and rests on the pillars of informal, non-binding and consensus-oriented inter-governmental cooperation.

- **Non-binding agreements undermines effective integration**

There can be no doubt whatsoever that the ASEAN Way served the organisation well and provided a suitable foundation for the effective inter-governmental cooperation in large number of policy fields. However, while there are good reasons for ASEAN not to move into the direction of supra-nationality, economic integration always impacts on national sovereignty. Even the lowest level of economic integration, a free trade area, deprives governments of using tariff barriers to protect national industries. **Economic integration cannot work on the basis of non-binding agreements. If Member States are allowed to opt out at any time or choose not to implement agreed actions, integration is hardly achievable. However, this is exactly what happens under the ASEAN Minus X formula which guides almost every aspect of liberalisation and integration. In a nutshell, the principle allows AMS to join the bandwagon in their own time.**

In summary, the Member States are trying to achieve far-reaching visions of economic community-building, which are not that much dissimilar to European integration, without the necessary modifications to the traditional ASEAN Way of cooperation. Yet, AMS have made a commitment to establishing the AEC with all its detailed and explicitly spelled out targets and action plans. Hence, the argument that binding decision-making and supra-nationality are alien concepts in the Southeast Asian context no longer sounds convincing as an excuse for delays in the implementation process. No-one has ever suggested that ASEAN should develop into a second EU (not even the EU itself has ever put forward such an idea) but ASEAN will have to be measured against what it has – without any external pressure – created for itself: the goal of an "integrated economic region". To be very clear, it is not recommended here that ASEAN should follow the European model, but it is legitimate to ask as to how AMS envision to achieve regional integration in a highly complex field on the basis of non-binding agreements and the ASEAN-X formula that does not require AMS to firmly commit themselves to implementation targets.



## 5. RECOMMENDATIONS: WHAT CAN ASEAN REALISTICALLY ACHIEVE?

How can ASEAN overcome the expectation-capabilities dilemma in the community building process?

- **ASEC's capabilities: not the main hurdle**

While many studies on ASEAN community building recommend the strengthening of the ASEC, such a move – as useful as it would be – would not address the main hurdle towards AEC implementation. Although small in size, the ASEC clearly does have the technical and institutional capacity and capabilities to move ASEAN forward. There can be no doubt about the high level of expertise and determination among the officials at all echelons of the Secretariat.

- **AMS must have the political will to close the implementation gap**

The decisive capacity and implementation gaps are to be found at the national level of the AMS. **The Member States, not the ASEC, are the bottlenecks in the process of economic community building and creating a more open and liberal trade and investment environment.** It would not be realistic to recommend that AMS should accept the idea of supra-nationality and transfer autonomous decision-making authority to the ASEC, enabling it to steer the process of economic integration. This is not going to happen against the backdrop of young nation states which – for all the right and legitimate reasons – are eagerly protecting their national sovereignty.

- **ASEAN should rely less on foreign support and take ownership of the integration process**

International donors, mainly the EU, USAID, AusAID and JICA, have invested millions of USD in support of all areas in regional economic integration – the European Commission alone provided some EUR 100 million between 1997 and 2007.<sup>71</sup> While many bottlenecks have been effectively addressed as the result, the massive presence of donors has also created a dependence of ASEAN as a whole and the AMS on external funding for the implementation of AEC. Annual external support for the ASEAN's community building process is on average approximately four times higher than the total contributions of the AMS. **The generous external support that has been provided for many years with the objective of strengthening regional integration in Southeast Asia has apparently led to an expectation among ASEAN stakeholders that even core obligations of the AMS under the AEC can and should be externally funded. This has limited ASEAN's ownership of its own integration process.** As outlined above, key activities for example in the field of customs integrations have slowed down since donor support seized.

**Regardless of whether one wants to see donor involvement as a blessing, a necessity or a curse, there is no way around the requirement that AMS will have to show more responsibility and commitment in the shaping of the economic community and develop a stronger sense of ownership. Sooner or later this will have to include larger financial contributions from the more developed AMS.** There is no working alternative if ASEAN wants to be serious about bridging the development gap within the grouping which, in turn, is one of the crucial factors of community building.

- **Rethinking the ASEAN Way**

**The pessimistic message is that there is no plausible solution to ASEAN's dilemma.** ASEAN has worked well as an inter-governmental organisation based on the core norms and principles of the ASEAN Way. However, this approach to regional cooperation does not and cannot facilitate deep integration as envisioned by the AEC. A single market and production base, comprising the (i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) freer flow of capital; and (v) free flow of skilled labour, by definition, requires firm and binding rules and procedures. **The decisive issue is that ASEAN will not be able to deliver on the expectations that have been created.**

- **Expectations of AEC 2015 need to be corrected**

**Many extra-regional and ASEAN stakeholders, especially large parts of the private sector, take the AEC 2015 at face value. These expectations need to be corrected.** The AMS's prevailing approach of signing far-reaching agreements in the hope that they can somehow be implemented without requiring governments to compromise on their national interests will inevitably lead to disappointment and frustration. AEC 2015 is not presented as an aspirational project, it is a definite goal. Yet, several government officials have told this author that ultimately it would not matter if AEC was indeed implemented in 2015 or two, three or five years later. The fact that ASEAN was working towards implementing the vision would be the most important feature of AEC; the exact date of the full establishment of the Economic Community would be of secondary importance. This approach is likely to backfire as it might result in an international downgrading of ASEAN should AEC turn out to be a "Potemkin Village" on 31 December 2015. ASEAN stakeholders need a reality check and align their expectations with the reality. Meanwhile, **ASEAN needs to concentrate on those areas in which closer economic interaction and an increase in transactions can be achieved on the basis of the proven structures and institutions of inter-governmental interaction.** 🌐



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#### CONNECT WITH US

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Level 6, Menara SBB, Plaza Damansara,  
Bukit Damansara, 50490 Kuala Lumpur,  
Malaysia

**P** +603 2087 3000

**F** +603 2087 3770

**E** [enquiries@cariasean.org](mailto:enquiries@cariasean.org)



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