

THE ASEAN ECONOMY IN THE REGIONAL CONTEXT: OPPORTUNITIES, CHALLENGES, AND POLICY OPTIONS

Giovanni Capannelli

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The ASEAN Economy in the Regional Context: Opportunities, Challenges, and Policy Options

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Contents

Abstract	v
1. Introduction	1
2. The ASEAN Economy in the Regional Context	2
2.1 Dealing with pronounced ASEAN diversity	4
2.2 Strengthening regional trade and Investment	4
2.3 Evolving macroeconomic policies	9
3. ASEAN Toward 2030	13
3.1 Aspirations moving forward	14
3.2 Economic growth projections	15
4. Opportunities and Challenges	17
4.1 Opportunities arising from regional economic interdependence	17
4.2 Key challenges for the ASEAN economy	18
5. Conclusion: Recommendations for ASEAN Economies	23
5.1 National policies and structural reforms	23
5.2 Regional infrastructure policies for a borderless economic community	25
5.3 Regional free trade and investment agreements	25
5.4 ASEAN centrality and institutional reforms	28
References	30
ADB Working Paper Series on Regional Economic Integration	32
Figures	
1. Trade Openness Ratio in 2012 (Total Exports plus Imports as a ratio of GDP)	6
2. ASEAN and PRC Shares in World's Exports and FDI (1992-2012)	6
3. ASEAN Trade by Regions and Economies (1991 and 2011)	7
4. ASEAN Trade by Technology Intensity (1996 and 2011)	8
5. Distribution of Foreign Direct Investment (FDI) to ASEAN by Economy of Origin and Destination	9
6. GDP Growth Rates Trend for ASEAN, PRC, India (1995-2017)	13
7. ASEAN Economies' Average Yearly GDP Growth to 2030: Aspiration Targets vs. Negative Scenario	15

8. GDP Growth of ASEAN, the PRC, India, and the World	16
9. Trend of Tourist Arrivals in ASEAN Economies (2007-2011)	19
10. ASEAN Centrality	22
11. Average Expenditure on Research and Development	
Selected Asian Economies' % Share of GDP, 1996-2010 Average	24
12. Exponential Growth of ASEAN Trade and Investment Agreements	
Total Number of Agreements Signed, Under Negotiation, or Being proposed (1991-2013)	27
Tables	
1. Selected Indicators for ASEAN and other Asian Economies, 2012	3
2. ASEAN Economies' Development Indexes: Global Ranks' Comparison	5
3. Vulnerability Indicators for ASEAN Economies	11
4. ASEAN Financial Sector Indicators	12
5. Status of ASEAN Free Trade Agreements (as of July 2013)	26

Abstract

The Association of Southeast Asian Nations (ASEAN) was created to address political and security issues. Over time, the economy has taken center stage and the ASEAN Economic Community (AEC) is going to be launched in 2015. The AEC is a milestone promoting ASEAN economic integration and centrality, but it alone is insufficient for the group to retain relevance in an increasingly multipolar world. This paper suggests that ASEAN needs an ambitious plan for economic integration beyond the AEC to achieve its economic development aspirations. As ASEAN designs its post-2015 agenda with a view to strengthening its role as a hub of Asian dynamism, its members need to adopt an appropriate policy mix including deep domestic structural reforms and bold actions to further deepen regional integration—transforming the AEC into a truly borderless economic community.

Keywords: ASEAN, regional economic integration, development aspirations, post-2015 agenda

JEL codes: F4, F55, O53, R11

1. Introduction

As the global economy recovered from the 2008/09 financial crisis, analysts converged on the notion that Asia has emerged as the growth engine of the world. A recent study commissioned by the Asian Development Bank (ADB) projected the possibility that by 2050 Asia's gross domestic product (GDP) will exceed 50% of the world's total, making this century an "Asian" century (Kholi et al. 2011). While a debate on the foundations of the Asian century is still ongoing, the region's economies continue to perform far better than the world's average. Within Asia, Japan may have finally exited a deflationary trap and seems to be ready to enter a new era of growth. At the same time, despite huge internal and external challenges, the People's Republic of China (PRC) and India continue to perform as two giant poles for economic dynamism in Asia and the world (ADB/ADB I 2014). The Republic of Korea; Taipei, China; and Hong Kong, China are also on track of sustained development with great improvement in people's quality of life.

In this context, the economies of the Association of Southeast Asian Nations (ASEAN) are showing strong macroeconomic fundamentals and robust economic growth. As a group, they have a large internal market, with a rapidly expanding middle class. They are also implementing an ambitious plan to create an ASEAN Economic Community (AEC)—a single market and production base—by 2015. Although marked by great diversity within and across member economies, since its establishment in 1967 the group was able to strengthen its role to maintain peace and security in the region, eventually gaining centrality in Asia's architecture for economic and political cooperation.

As Asia's economy continues its rapid growth, ASEAN member economies will be facing both opportunities and challenges. In particular, the rise of the PRC and (more recently) India has generated serious concerns among some economists and political scientists who, conscious of ASEAN's internal weaknesses, warned against the possible erosion of competitive advantages and loss of the region's central position.

This paper takes, however, a more positive view. It argues that the rise of the PRC and India creates potentially much higher opportunities for ASEAN member economies than the challenges it poses. Increasing economic interdependence with the PRC and India creates opportunities to expand ASEAN's markets for goods and services and improve economic and financial stability through diversification of risk outside traditional economic partners such as the United States (US) and the European Union (EU). At the same time, however, the rising weight of the PRC's and India's economies creates a threat to ASEAN, imposing a shift in comparative advantages and causing the possible erosion of the pivotal role ASEAN has been playing in Asia's architecture for integration.

To address these challenges, ASEAN economies need to introduce a two-track strategy including domestic reforms to facilitate economic restructuring and liberalization, and initiatives to deepen and widen regional integration, leading to higher productivity and cost reductions through economies of scale and network externalities. Domestic policies need to enhance competitiveness and productivity by leveraging on regional production networks and substantially

increasing investment in human capital and research and development (R&D) to upgrade their technological capabilities. In turn, such investment will also help ASEAN economies from falling into the middle-income trap, which remains a major threat for economies such as Thailand, Malaysia, Indonesia, the Philippines, and Viet Nam.

In order to remain relevant in a region increasingly dominated by the PRC and India, and where Japan and the Republic of Korea maintain technological leadership, ASEAN member economies need to close their ranks, strengthen regional institutions, and move beyond the AEC by creating a truly borderless economic community. Free trade and investment agreements (FTAs), which have proliferated in the last few years, can also greatly help binding the region together and promote further improvements in competitiveness and productivity.

2. The ASEAN Economy in the Regional Context

ASEAN was established almost 50 years ago mainly for political and security reasons. Economic and social issues started attracting the attention of its members only after the first leaders' Summit in 1976. Today, ASEAN constitutes an overarching regional institution with several activities and initiatives in a wide-range of functional areas (ADB 2010). Its member economies are working to accomplish the ambitious plan to create an ASEAN Community by the year 2015, formed by three pillars: (i) the political-security community, (ii) the socio-cultural community, and (iii) the AEC.

Today, the ten ASEAN member economies form a major economic bloc. In 2012, their combined GDP was above \$2.3 trillion, or 3.2% of the world's total—a share which doubled from 1990. In the same year, with a total population of 620 million (around 9% of the world's total), ASEAN's average per-capita income at market prices was close to \$3,800, between that of India (\$1,600) and the PRC (\$6,100), or to about one-third the global average—up from one-fifth in 1990 (Table 1).¹

A relatively large and still young population, with a growing middle class of well over 100 million people, represents one of ASEAN's major strengths. Its member economies are also strategically located in the heart of Asia, connected to the PRC and India through maritime and land routes, and blessed with abundant natural resources—including oil, gas, hydropower, and minerals—a large biodiversity, and a substantial agricultural base.

¹ ASEAN's total land mass in 2012 was more than 4,300 square kilometers (about 1.5 times that of India and 0.5 times that of the People's Republic of China).

Table 1. Selected Indicators for ASEAN and other Asian Economies, 2012

	Gross Domestic Product			Land Area (*) (Thousand sq km)	Population (million persons)	Exports	Imports
	\$ billion	at PPP (\$ billion)	per capita (\$)			\$ billion	
Brunei Darussalam	17.0	21.6	42,380	5.77	0.4	11.9	6.5
Cambodia	14.1	36.5	926	181.04	15.3	7.8	15.3
Indonesia	878.5	1,203.6	3,594	1,904.57	244.5	190.0	191.7
Lao PDR	9.2	18.9	1,380	236.80	6.6	3.3	6.4
Malaysia	304.7	494.7	10,345	330.80	29.5	227.6	196.8
Myanmar	55.3	102.6	868	676.59	63.7	8.3	16.9
Philippines	250.2	419.6	2,612	300.00	95.8	52.0	61.7
Singapore	276.5	323.0	52,056	0.72	5.3	409.7	380.0
Thailand	366.0	645.2	5,390	513.12	67.9	228.2	249.1
Viet Nam	155.6	336.2	1,753	330.96	88.8	110.8	111.6
ASEAN	2,327.0	3,602.0	3,767	4,480.37	617.7	1,249.6	1,235.9
ASEAN+6	2,092.9	3,107.7	4,721	3,054.98	443.3	1,119.4	1,085.7
CLMV	234.1	494.3	1,343	1,425.39	174.3	130.2	150.2
Other Asian Economies							
PRC	8,221.0	12,261.3	6,071	9,596.96	1,354.0	2,050.1	1,817.3
Hong Kong, China	263.3	365.6	36,676	1.10	7.2	443.1	504.7
India	1,841.7	4,715.6	1,501	3,287.26	1,227.2	297.3	490.4
Japan	5,960.3	4,575.5	46,707	5,960.27	127.6	798.6	886.0
Korea, Republic of	1,129.5	1,597.6	22,589	99.90	50.0	547.9	519.6
Taipei, China	474.1	894.3	20,336	36.19	23.3	301.2	270.5
World	72,216.4	83,193.4	10,249	129,710.34	7,046.0	17,854.8	18,414.3

ASEAN = Association of Southeast Asian Nations; ASEAN6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand; CLMV = Cambodia, Lao PDR, Myanmar, Viet Nam; Lao PDR = Lao People's Democratic Republic; PPP = purchasing power parity; PRC = People's Republic of China.

Notes: Population and GDP figures are estimates for 2012, exports and imports figures are actual data in 2012; land area are 2011 data.

Sources:

International Monetary Fund, *World Economic Outlook Database, October 2013*. Available: <http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/index.aspx> (accessed October 2013).

World Bank, *World Development Indicators Database*. Available: http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&SdmxSupported=Y&CNO=2&SET_BRANDING=YES (accessed October 2013).

Balance of Payments Statistics. Available: <http://www.cbc.gov.tw/content.asp?Cultem=2071>.

Central Intelligence Agency, *The World Factbook*. Available: <https://www.cia.gov/library/publications/the-world-factbook/index.html> (accessed October 2013).

Directorate-General of Budget, Accounting and Statistics, Executive Yuan, Taipei, China. Available: <http://eng.stat.gov.tw/ct.asp?xItem=25763&CtNode=5347&mp=5> (accessed October 2013).

International Monetary Fund, *Direction of Trade Statistics* (<http://elibrary-data.imf.org/DataExplorer.aspx>); Directorate General of Budget, Accounting and Statistics, Taipei, China. Available: <http://www.stat.gov.tw/mp.asp?mp=4> (accessed October 2013).

Dealing with pronounced ASEAN diversity

Regional averages mask, however, the great extent of diversity which characterizes the group, in terms of economic development, competitiveness, as well as quality of life. The differences across and within ASEAN economies are indeed huge. For example, in 2012 Singapore's per-capita GDP (at market prices) was almost 60 times that of Myanmar, while Indonesia had a population more than 611 times bigger than that of Brunei Darussalam—with a land area 340 times larger. Development gaps within and across ASEAN economies are indeed remarkable, particularly between rural and urban areas, as well as in archipelagic regions such as Luzon and Mindanao in the Philippines or the Western and Eastern provinces of Indonesia.

Disparities remain pronounced in governance systems and in the capacity to effectively implement the rule of law. Indicators of economic and social development, such as the human development index, the infrastructure efficiency index, and the ease of doing business index, all show pronounced diversity in individual economies' performance (Table 2), with important implications in meeting the targets to form the AEC by 2015. Needless to say, the challenges to create a “single market and production base” expand with greater regional diversity, which makes it difficult for member economies to proceed along similar tracks of liberalization and integration, using similar timeframes.

Four ASEAN member economies (Indonesia, Malaysia, the Philippines, and Thailand) have achieved middle income status a few years ago, positioning themselves along a wide range of per-capita GDP levels from \$2,500 in the Philippines to more than \$10,000 in Malaysia. Viet Nam has recently entered the lower middle income status, with a per-capita income above \$1,500, while Cambodia, the Lao People's Democratic Republic (PDR), and Myanmar remain low income economies, with major pockets of poverty—although in these economies economic growth has been accelerating with a fast improvement in living standards.

All ASEAN economies have rapidly internationalized during the past decades. Viet Nam has shown, in particular, a dramatic increase in its degree of trade openness (total exports plus imports over GDP), from 24% in 1985 to 160% in 2012. During the same period, trade has risen from 42% to 47% of GDP in the PRC, while in India it has more than doubled from 17% of GDP to 40%—both very large shares given the large size of these two economies² (Figure 1).

Strengthening regional trade and investment

Continuous progress in trade and investment liberalization and the creation of regional production networks are two main factors driving the trend toward ASEAN economies' increased global and regional interdependence. Within East Asia, the PRC has been expanding its role as a major assembly site for manufactures, which has contributed to a continue rise in its share of global trade from 2% in 1990 to 11.5% in 2012. As the corresponding share for ASEAN has stagnated

² In 2012 the trade openness ratio was 107% for ASEAN as a whole, against 51% for the world.

**Table 2. ASEAN Economies' Development Indexes:
Global Ranks' Comparison**

Economy	Human Development (2012)	Infrastructure (2013/14)	Ease of doing business (2012)
Singapore	18	2	1
Brunei Darussalam	30	58	79
Malaysia	64	29	12
Thailand	103	47	18
Philippines	114	96	138
Indonesia	121	61	128
Viet Nam	127	82	99
Lao PDR	138	84	163
Cambodia	138	101	133
Myanmar	149	141	na

ASEAN = Association of Southeast Asian Nations; Lao PDR = Lao People's Democratic Republic; na = not available.

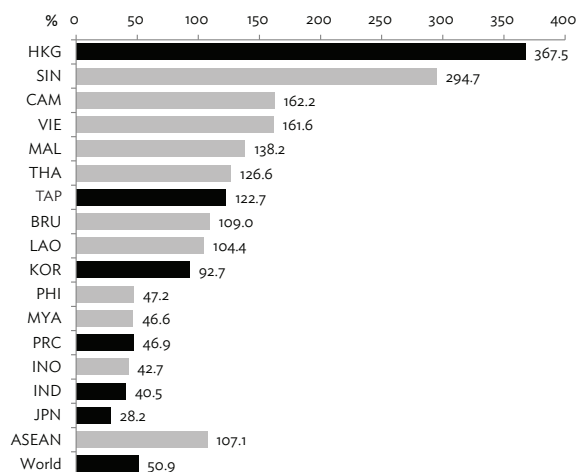
Note: The rank for the 2012 Human Development Index is calculated by the United Nations based on data from 187 economies. The rank for the "infrastructure index" is part of the World Economic Forum's Global Competitiveness report and it is based on a sample of 148 economies. The "Ease of doing business" index is calculated as a simple average of 10 sub-indices dealing with issues such as starting business, getting permits, paying taxes, and resolving legal issues. Rankings are based on 185 economies. Lower values indicate better performance for the indexes.

Sources: (i) Human Development Index--<http://hdrstats.undp.org/en/indicators/103106.html> (accessed October 2013); (ii) Infrastructure Index--World Economic Forum, The Global Competitiveness Report 2013-14. Available: http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf (accessed October 2013); (iii) Ease of doing business index--World Bank, Doing Business, various issues. Available: <http://www.doingbusiness.org/reports/global-reports/Doing%20Business%202013> (accessed October 2013).

since the mid-1990 to around 6%-7%, during the last few years Southeast Asian economies have been constantly worrying of the increasing competitive pressures created by the PRC.

Similar concerns are related to the share of foreign direct investment (FDI) the PRC has been attracting from multinational firms, which has constantly been higher than that of ASEAN over the last couple of decades (Figure 2). A rapidly increased competition from the PRC in export markets, combined with PRC's expanding internal market, could further deflect FDI toward the PRC, accelerating the trend in place since the mid-1990s. Removing existing barriers to intraregional trade and investment is therefore a vital step for ASEAN to reduce production costs, enabling investors to compete with companies based in the PRC, and strengthening regional production networks.

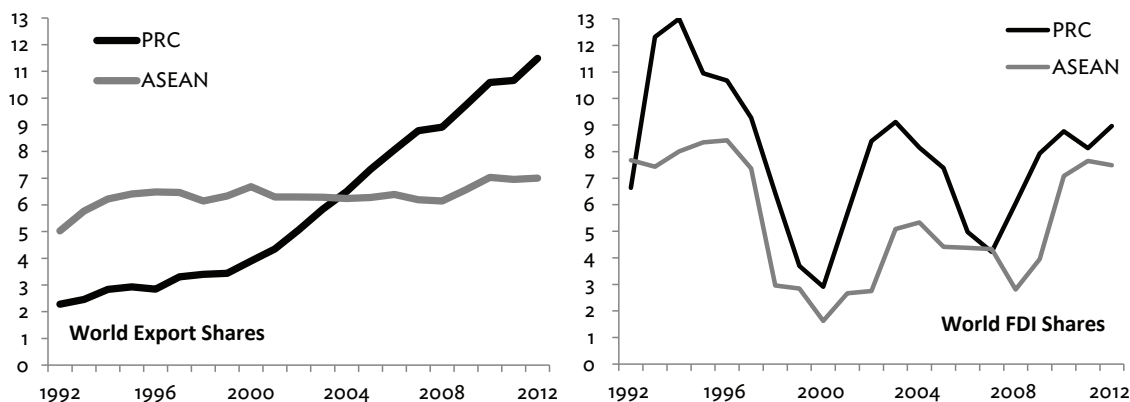
Figure 1. Trade Openness Ratio in 2012
(Total Exports plus Imports as a ratio of GDP)



ASEAN = Association of Southeast Asian Nations; GDP = Gross Domestic Product.
 BRU = Brunei Darussalam; CAM = Cambodia; HKG = Hong Kong, China; IND = India;
 INO = Indonesia; JPN = Japan; KOR = Republic of Korea; LAO = Lao PDR; MAL = Malaysia;
 MYA = Myanmar; PHI = Philippines; PRC = People's Republic of China; SIN = Singapore;
 THA = Thailand; TAP = Taipei, China; VIE = Viet Nam.

Sources: International Monetary Fund, *Direction of Trade Statistics* (<http://elibrary-data.imf.org/DataExplorer.aspx>); Directorate General of Budget, Accounting and Statistics, Taipei, China. Available: <http://www.stat.gov.tw/mp.asp?mp=4> (accessed October 2013).

Figure 2. ASEAN and PRC Shares in World's Exports and FDI (1992-2012)



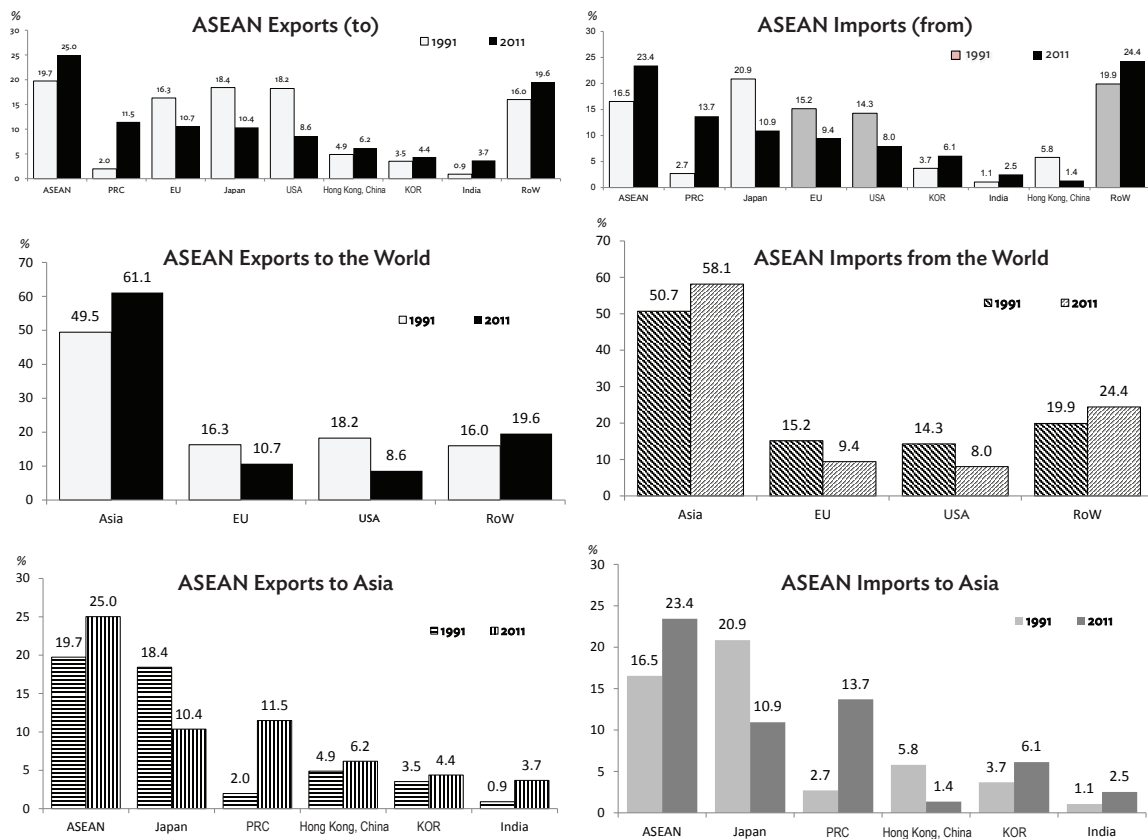
ASEAN = Association of Southeast Asian Nations; FDI = Foreign direct investment; PRC = People's Republic of China.

Source: International Monetary Fund, various years. *Direction of Trade Statistics*. Available: <http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=170921> (accessed September 2013).

In terms of the overall trade pattern, ASEAN’s main partners have structurally changed over the last two decades. While the relative importance of traditional markets such as the US and the EU has been declining, the share of exports and imports with Asia has basically increased from 50% to 60% of the total between 1991 and 2011. In particular, intra-ASEAN trade has largely risen to reach about one fourth of total trade, while the relative share of Japan on both exports and imports has considerably declined by 8-10 percentage points over this period to about one-tenth of the total. At the same time, however, trade with the PRC—but also India and the Republic of Korea—has increased considerably (Figure 3).

The importance for ASEAN economies of regional production networks, especially in industries such as electronics, automotive, and machinery, can be captured by the rise in intermediate goods’ trade, which has been the glue for binding East Asia together, and linking it to international markets (Athukorala 2010). Overall, during the period 1996-2011, the share of parts and

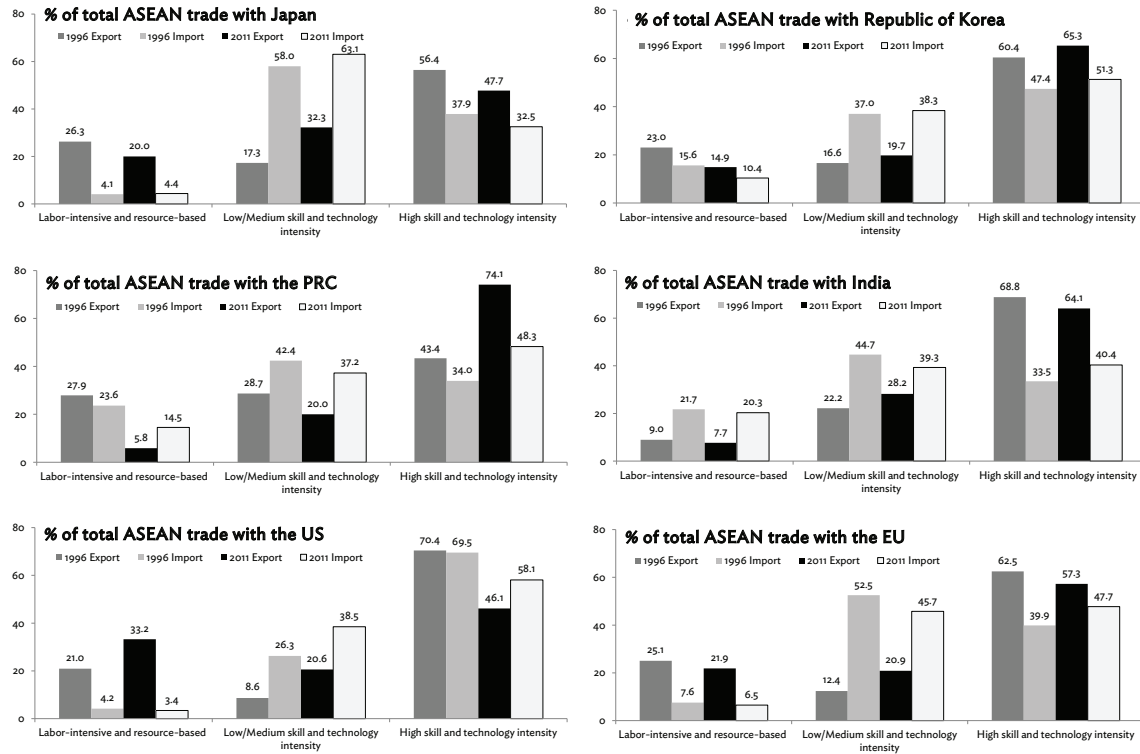
Figure 3. ASEAN Trade by Regions and Economies (1991 and 2011)



ASEAN = Association of Southeast Asian Nations; EU = European Union; KOR = Republic of Korea; PRC = People’s Republic of China; RoW = Rest of the World; USA = United States.

Source: International Monetary Fund, *Direction of Trade Statistics*, <http://elibrary-data.imf.org/FindDataReports.aspx?d = 33061&e = 170921> (accessed October 2013).

Figure 4. ASEAN Trade by Technology Intensity (1996 and 2011)



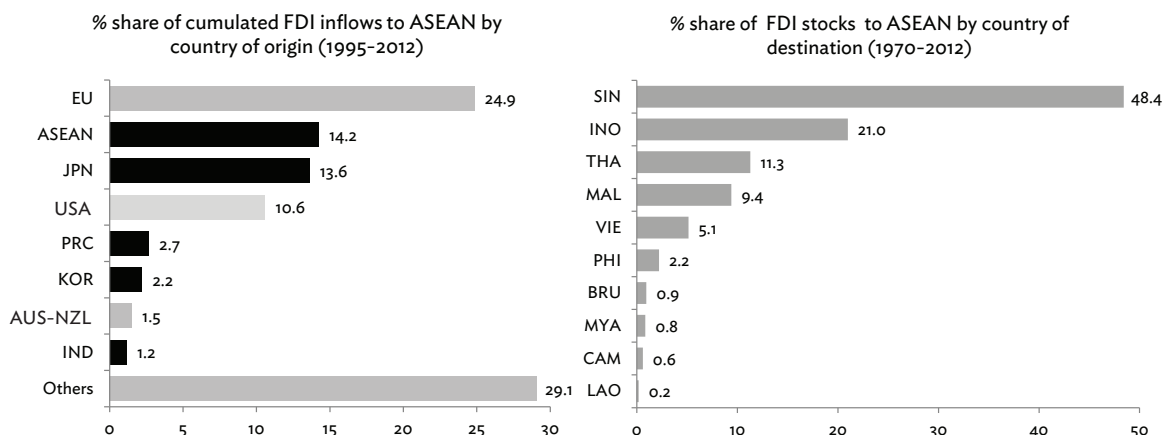
ASEAN = Association of Southeast Asian Nations; EU = European Union; PRC = People’s Republic of China; US = United States. Notes: UNCTADstat applies the Standard International Trade Classification Revision 3 for classification of products, manufactured goods by degree of manufacturing. Classification was done as of 8 July 2011.

Source: United Nations Conference on Trade and Development (UNCTAD)Stat. Available: <http://unctadstat.unctad.org> (accessed April 2013).

components in manufacturing trade with other Asian economies has been rising, as it is reflected in the rapid increase in ASEAN’s exports of high skill and technology intensity products to the PRC and the Republic of Korea, while exports to the US have basically shifted towards labor-intensive, resource-based, and low/medium skill and technology intensity goods (Figure 4).

The fast growth in regional production networks is also reflected in FDI data. The ASEAN Secretariat has been working for several years to construct a reliable database on the origin of incoming FDI flows in the ten ASEAN economies. Based on this source, during the period 1995–2012 the cumulated FDI inflows to ASEAN amounted to a total USD 879 billion—about 75% of which were received during the 2003–2012 period alone, as production networks expanded considerably. Approximately one-fourth of such investment originated from the EU, one-tenth from the US, and more than one-third from Asia. As Figure 5 shows, Singapore is the most popular recipient of FDI among ASEAN economies, as it received more than 48% of FDI stocks

Figure 5. Distribution of Foreign Direct Investment (FDI) to ASEAN by Economy of Origin and Destination



ASEAN = Association of Southeast Asian Nations; AUS = Australia; BRU = Brunei Darussalam; CAM = Cambodia; EU = European Union; IND = India; INO = Indonesia; JPN = Japan; KOR = Republic of Korea; LAO = Lao PDR; MAL = Malaysia; MYA = Myanmar; NZL = New Zealand; PHI = Philippines; PRC = People's Republic of China; SIN = Singapore; THA = Thailand; US = United States; VIE = Viet Nam.

Notes: (i) Data for destination economies is compiled from submission of ASEAN Central Banks and National Statistical Offices through the ASEAN Working Group on Foreign Direct Investment Statistics; (ii) Philippine's data excludes reinvested earnings; (iii) Intra- and extra-ASEAN breakdown for 2010 and 2011 are estimated by the ASEAN Secretariat.

Sources: For data on economies of origin—ASEAN Secretariat, ASEAN FDI Database. Available: <http://www.aseansec.org/stat/Table26.pdf> (accessed: October 2013). For data on destination economies—United Nations Conference on Trade and Development Statistics (UNCTADSTATS), Foreign Direct Investment Database. Available: <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed October 2013).

to the region for the period 1970–2012. Indonesia (21% of the total), Thailand, Malaysia, and Viet Nam were, in order, the other most preferred destinations.³

Evolving macroeconomic policies

Following the rapid economic growth experienced by Asian economies over the 15 years after the financial crisis of 1997/98, the center of global economic gravity has been shifting toward Asia (ADB 2008). This trend, accompanied by a rebalancing of the sources of growth from exports toward the region's internal demand, is likely to continue over the coming decades. This process was hastened by the 2008/09 global financial crisis and the eurozone crisis. While advanced economies have entered a prolonged period of subdued growth, emerging Asia is expected to continue its expansion, even as the region remains vulnerable to external shocks and economies continue facing the challenges of adopting more sustainable and inclusive development strategies.

³ The recipient economies' shares of total FDI to ASEAN is calculated from data available at the United National Conference on Trade and Development (UNCTAD), which estimates the total FDI stock to ASEAN for the period 1970–2012 at USD 1.4 trillion.

In the aftermath of the 2008/09 global financial crisis, advanced economies' central banks used unconventional monetary easing policies to spur activity in their economies as they were facing long-term sluggish growth, high unemployment, and debt restructuring. These policies resulted in a significant surge in global liquidity, sudden exchange rate re-alignments, and large swings in liquidity generating spillover effects on emerging markets exposed to potential volatility. High liquidity and low interest rates in advanced economies led to large capital outflows, leaving ASEAN economies, as well as other emerging markets, exposed to possible overheating, excessive growth of credit, greater exposure to bank loans, and weakening overall macroeconomic and financial stability.

The capacity to use appropriate macroprudential policy has become therefore a critical element in managing ASEAN economies (Sussangkarn 2003). Similar to the events unfolding after the crisis of 1997/98, ASEAN member economies—and India—have largely pursued market-based exchange rate regimes, whereas the yuan appreciation against the US dollar has been tightly managed. With current account surpluses and capital inflows, it is possible that ASEAN currencies will continue to appreciate vis-à-vis the dollar as well as the yuan, thus weakening their competitiveness against other regional currencies. Overall, sluggish export demand from advanced economies increases competitive pressure from the PRC, India, and other emerging markets. As they react to changing external conditions, ASEAN economies' possible intervention in currency markets needs to be closely coordinated as it may eventually distort price competitiveness and disrupt the underlying stability that is the foundation for smooth functioning regional production networks.

The various levels of macroeconomic vulnerabilities ASEAN economies are exposed to reveal other important dimensions of the group's pronounced diversity. Macroeconomic conditions in ASEAN+6⁴—with far better data availability and reliability than in Cambodia, the Lao PDR, Myanmar, and Viet Nam (CLMV economies)—are in general quite robust, with current account surpluses in all economies but Indonesia, relatively strong external reserve positions, low-to-moderate public debt (with the notable exception of Singapore), and relatively sound banking sectors in terms of capital adequacy ratios and non-performing loans. CLMV economies, however, show greater vulnerability than the ASEAN6 due to high external and fiscal deficits, with moderate-to-low gross official reserves. Cambodia, Lao PDR, and Viet Nam have also limited degrees of freedom in using monetary policy tools, due to the high degree of dollarization of their economies.

At the same time, fiscal sustainability is a potential policy issue for several ASEAN economies given their high public deficits. A number of ASEAN economies where monetary indicators have grown rapidly are also facing a challenge in managing the risk of asset bubbles, as reflected in monetary growth indicators. Data show Viet Nam, Cambodia, and Lao PDR must pay special attention to monitor their macroeconomic developments going forward, while Malaysia, the

⁴ ASEAN+6 refers to Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand—the first six ASEAN member states. Brunei Darussalam joined the group in 1986, while the other five economies were founding members in 1967.

Philippines, and Thailand will likely face a medium-term fiscal challenge given their relatively high budget deficits (Table 3).

A snapshot of ASEAN's financial landscape reveals again a great deal of diversity across economies, as summarized by the ratio of total financial assets to GDP—obtained summing-up total domestic credit from banks, plus the capitalization of equity and bond markets. Table 4, which compares key financial sector indicators for ASEAN economies with other major Asian economies in 2002 and 2012, shows that Malaysia, Singapore, and Thailand rank close to Japan and the Republic of Korea, while Viet Nam and the Philippines fall next to the PRC and India, with

Table 3. Vulnerability Indicators for ASEAN Economies

	Current Account Balance (% of GDP)	Gross Reserves (no. months of imports)	Public Debt (overall balance; % of GDP)	Fiscal Balance (overall balance; % of GDP)	Monetary Growth (M2 year-on-year % growth)	Capital Adequacy Ratio^{1, 3}	Non-performing Loans (as % of total loans) ³
ASEAN6							
Brunei Darussalam	52.4 ²	12.2 ²	na	17.5	0.9	19.4	5.4
Indonesia	-2.8	7.5	24.5	-1.8	14.9	17.5	1.8
Malaysia	6.4	9.0	55.5	-4.5	9.0	14.3	2.0
Philippines	2.8	16.4	41.9	-2.3	10.9	17.8	3.1
Singapore	18.6	8.3	111.0	9.5 ²	7.2	16.3	0.9
Thailand	0.7	10.0	45.4	-2.3	10.4	16.3	2.4
CLMV							
Cambodia	-8.6	7.4	28.8	-2.3	20.9	28.8	2.2
Lao PDR	2.3	3.8 ²	52.8	-1.4	31.0	21.6	2.2
Myanmar	-1.0	10.7	48.0	-3.2	55.0	na	na
Viet Nam	5.8	1.7 ²	51.3	-4.0	12.6	8.2	3.0

ASEAN = Association of Southeast Asian Nations; ASEAN6 = Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand; CLMV = Cambodia, Lao PDR, Myanmar, Viet Nam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic; na = not available.

Notes: Data as of 2012 or latest available; (1) The Capital adequacy ratio is calculated as "regulatory capital to risk-weighted assets" (%). (2) 2011 data. (3) Data for ASEAN6 are most updated 2013 figures, except for Thailand (2012); data for CLMV are latest available data from International Monetary Fund (IMF) Economy Reports Article IV Consultation—the capital adequacy ratio for Viet Nam, is calculated using non risk-weighted assets.

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

Table 4. ASEAN Financial Sector Indicators

	Domestic credit by banks/GDP		Stock market capitalization/GDP		Private bond market capitalization/GDP		Total financial assets/GDP	
	2002	2012	2002	2012	2002	2012	2002	2012
Indonesia	52.4	42.6	15.3	45.2	1.2	2.3	68.9	90.0
Malaysia	143.6	134.5	122.8	156.9	34.2	42.8	300.7	334.3
Philippines	55.1	50.9	48.0	105.6	0.1	5.0	103.2	161.5
Singapore	74.7	99.5	112.5	150.8	29.6	31.6	216.8	281.9
Thailand	127.8	168.9	36.4	104.7	5.1	15.5	169.3	289.1
Viet Nam	44.8	115.4	na	23.2	na	0.8	44.8	139.4
ASEAN	83.1	102.0	67.0	97.7	11.7	16.3	150.6	216.0
PRC	143.5	152.7	31.9	44.2	0.6	12.5	175.9	209.4
India	57.1	76.6	25.1	68.6	na	na	82.1	145.2
Japan	302.1	346.2	53.4	61.8	21.4	18.0	377.0	426.0
Korea, Rep. of	141.9	168.7	43.3	104.5	53.2	75.2	238.4	348.4

ASEAN=Association of Southeast Asian Nations; GDP=gross domestic product; PRC=People's Republic of China; na=not available. Note: Figures for ASEAN are unweighted averages. Bond market refers to size of local currency bond market (local sources).

Sources: World Bank, World Development Indicators online database. Available: <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed October 2013); Asian Development Bank, AsianBondsOnline database. Available: <http://asianbondsonline.adb.org/> (accessed October 2013).

Indonesia positioned on the lower side. Data also show that ASEAN financial systems are largely bank-based, with stock markets expanding in terms of their relative importance, especially in the six economies shown in the table.⁵ Although ASEAN equity markets are more developed than bonds', none of the regional exchanges—except for Singapore—are among the world's 20 largest financial centers in terms of either trading value or capitalization. Overall financial systems in Brunei Darussalam, Cambodia, the Lao PDR, and Myanmar are still underdeveloped, especially in terms of size and quality of equity and bond markets.

The need to strengthen macroeconomic resilience and deepen local financial markets has been a major policy focus of ASEAN economies since the financial crisis of 1997/98, when it became evident that major regional shocks required region-wide responses. As a matter of fact, the combination of sound macroeconomic policies at national level and effective initiatives for regional cooperation started since the late 1990s enabled ASEAN economies to contain the negative effects of the 2008/09 global financial crisis. While it took about 6 years for ASEAN as a group to recover from the 1997/98 crisis and reach yearly average GDP growth rates about

⁵ The ratio of stock market capitalization to GDP in 2012 was about 160% for Malaysia and 150% for Singapore. Though smaller by comparison, well-developed capital markets also exist in the Philippines, and Thailand.

Figure 6. GDP Growth Rates Trend for ASEAN, PRC, India (1995-2017)



ASEAN = Association of Southeast Asian Nations; GDP = Gross Domestic Product; PRC = People's Republic of China.

Note: The growth rates for 2013-2017 are International Monetary Fund's estimates.

Source: International Monetary Fund, *World Economic Outlook Database*, April 2012. Available: <http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx> (accessed October 2013).

6%, ASEAN economies were still able to grow around 1.5%, on average, in 2009 and re-bounced to close to 8% in 2010, before stabilizing again at a 6% level, which is where estimates of the International Monetary Fund (IMF) suggest they will position themselves between 2013 and 2017. During the same period, the PRC economy is expected to grow at an average 8.6% per year and India's at an average 7.9% per year (Figure 6).

3. ASEAN Toward 2030

A recent Asian Development Bank Institute (ADBI) study conducted in collaboration with the ASEAN Secretariat and the Asian Development Bank (ADB) projects the growth of the ASEAN economy to 2030, analyzing individual member economies' aspirations and challenges moving forward (ADBI 2014). The study also provides recommendations for policymakers—its main message is that ASEAN urgently needs a plan beyond the AEC and that the strategy ought to be in the direction of strengthening regional integration and creating a truly borderless economic community. The study suggests that ASEAN member economies need not only to further liberalize the movement of goods, services, capital and people across their economies as well as harmonize and standardize rules and regulations region-wide: they also need to strengthen regional institutional bodies, with national agencies delegating more powers to enable them to

effectively implement regional cooperation initiatives, including fully implementing the AEC Blueprints.

With pressing competition from the PRC and India—as well as other Asian emerging economies—ASEAN economies need to close their ranks and boost competitiveness and productivity by forming a tighter regional block able to generate sizeable economies of scale and capture network externalities. They must ensure the ability for firms and individuals to trade and travel across ASEAN borders, allowing information to flow through a seamless network of communications. ASEAN member economies have to more efficiently manage scarce natural resources, protect the environment, and ensure food and energy security. Eventually, they also need to develop a stronger sense of community among themselves, with ASEAN acting as a closely-knit family of nations.

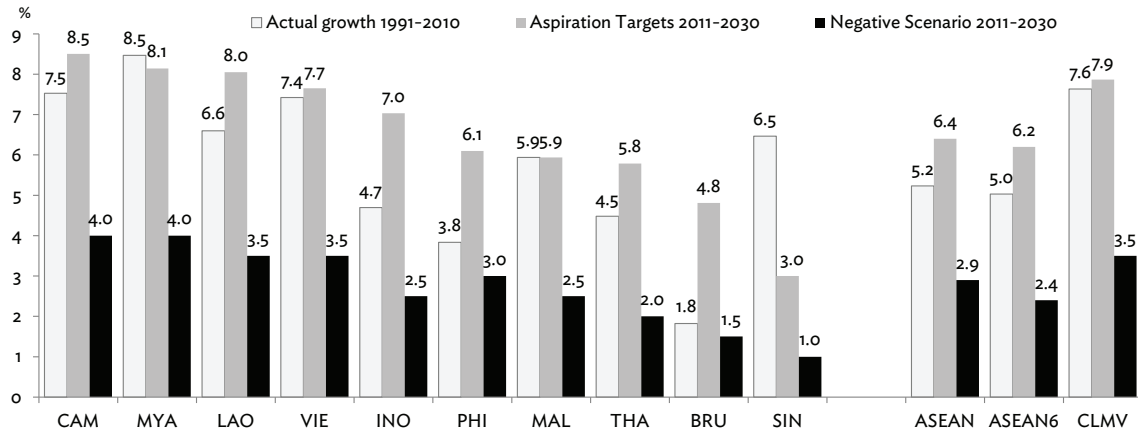
Aspirations moving forward

2030 economic perspectives are provided by a set of projections prepared by the ADB and individual economies' aspirations obtained through stakeholders' consultations and analysis conducted by local experts, including economies' own development strategies.

The outcome of this exercise indicates that ASEAN economies have reached a major crossroads. By introducing deep structural reforms domestically and through more determined efforts for regional economic integration, they can enter the path of a positive scenario (defined by aspiration targets) leading to tripling per-capita incomes between 2010 and 2030 and raising citizens' quality of life to levels enjoyed today by average members of the Organisation for Economic Cooperation and Development (OECD). In the absence, however, of such policies, ASEAN economies will face a negative scenario with subdued GDP growth to an average 3% per annum over the two decades, and several economies falling in the middle-income trap as they fail to invest in R&D and education (ADBI 2014). This negative scenario is also defined by the inability to manage pressing challenges posed by climate change and increasing natural disasters, and to solve mounting political tensions, both within and across economies. The average yearly GDP growth rates over 2010-2030—by ASEAN economies and groups—under the positive and negative scenarios, are shown in Figure 7.

The still uncertain economic recovery in the US and the eurozone, combined with the volatility of natural resources' prices (particularly oil and gas) and the PRC's declining pace of growth since 2011, may make it difficult for the ASEAN economy as a whole to reach such its ambitious 2030 aspiration targets. But ASEAN can count on several factors supporting the region's sustained economic growth once it becomes a truly borderless community as individual economies' GDP can expand faster by capturing economies of scale, playing a more significant role as regional industrial hubs, and enhancing economic integration with the rest of the world—i.e. growing according to the positive growth scenario.

Figure 7. ASEAN Economies' Average Yearly GDP Growth to 2030: Aspiration Targets vs. Negative Scenario



ASEAN = Association of Southeast Asian Nations; BRU = Brunei Darussalam; ASEAN6 = Brunei Darussalam; Indonesia; Malaysia; Philippines; Singapore; and Thailand; CAM = Cambodia; INO = Indonesia; CLMV = Cambodia, Lao People's Democratic Republic, Myanmar, and Viet Nam; LAO = Lao People's Democratic Republic; MAL = Malaysia; MYA = Myanmar; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Notes: Aspiration targets are from the "ASEAN 2030" study. The "negative scenario" is based on simulations calculated for this study on the basis of projections prepared by ADB's Economics and Research Department.

Sources: ADBI Forthcoming 2014. *ASEAN 2030: Toward a Borderless Economic Community*. Tokyo. Data for the 1991–2010 period are from the International Monetary Fund (IMF). *World Economic Outlook, April 2012 Edition*. Available: <http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx> (accessed September 2013).

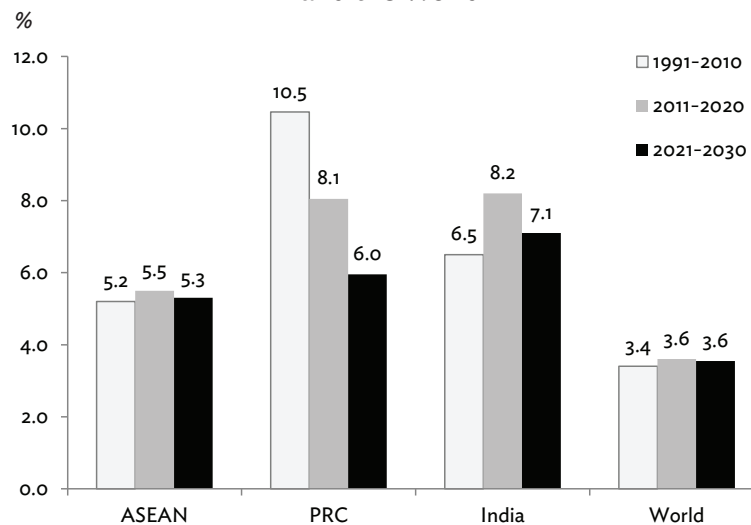
Economic growth projections

The fifteen years leading to 2030 will be critical for large ASEAN economies such as Indonesia, Malaysia, the Philippines, Thailand and Viet Nam to make a substantial leap to higher-income status. If these economies will introduce the right policies allowing them to follow a development path similar to that of Japan in the first decades after the Second World War and of the Republic of Korea more recently, they may avoid the middle-income trap and join the group of economies driving global growth and prosperity. This may in turn inspire Cambodia, the Lao PDR, and Myanmar entering a similar growth path following the example of other ASEAN member economies. In this context, adopting the two-track strategy suggested in the ADBI study—domestic structural reforms and bold initiatives for regional integration—is important to strengthen ASEAN economies' competitive edge and leverage at the same time on the opportunities created by growth in other Asian economies.

ADB's projections for GDP growth in the current decade and the next suggest that while ASEAN may expand at an average 5.4% during 2010–2030, India's economy will likely grow at an average 7.7% every year, and the PRC by 7.0% over the same period. While GDP growth in ASEAN is expected to remain quite stable during these years, both India and the PRC will likely slow down their average rates in the second decade, with the PRC entering a new growth normal within the 6% level (Figure 8).⁶

⁶ The level for ASEAN economies is approximately 1 percentage point below the aspiration target shown in Figure 7.

Figure 8. GDP Growth of ASEAN, the PRC, India, and the World



ASEAN = Association of Southeast Asian Nations; GDP = Gross Domestic Product; PRC = People's Republic of China.

Source: Data for the 1991-2010 period are from the International Monetary Fund (IMF). *World Economic Outlook, April 2012 Edition*. Available: <http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx> (accessed September 2013). Projections for the period 2011-2020 and 2021-2030 are provided by ADB's Economics and Research Department, January 2013.

While GDP growth rates are an important measure to assess economic development, improvement in citizens' quality of life should be observed through a broader set of concepts and indicators. Malaysia has already developed its own "quality of life" index, including measurements of several elements such as income and distribution, health, education, transport and communication, housing, work-life balance, environment, public safety, social participation, culture and leisure, and family life. Several other ASEAN economies are in the process of introducing similar indexes in preparing their long-term economic development strategies.⁷ The ADBI study analyzed four dimensions of quality of life (income, health, education, and governance) to conclude that entering a positive growth scenario will imply reaching, by 2030, a quality of life similar to that enjoyed in 2010 by average OECD economies (ADBI, 2014).

4. Opportunities and Challenges

Asia's rapid growth and closer economic integration implies opportunities as well as challenges for ASEAN member economies. On balance, the potential benefits outweigh the costs, as the

⁷ The Human Development Index (HDI), shown in Table 2, is an early attempt to measure some key components of quality of life, started by the United Nations Development Programme (UNDP) back in 1980.

income effect and creation of new markets induced by sustained economic expansion remains large compared with the substitution effect related to the evolving structures of comparative advantages across the region, erosion of ASEAN economies' international competitiveness, and shrinking shares in exports and FDI inflows.

Opportunities arising from regional economic interdependence

ASEAN's strategic location at the center of Asia offers the group the opportunity to serve as a natural land bridge between East and South Asia—especially between two of the world's most dynamic markets: the PRC and India.⁸ Such role has been strengthened since the dramatic changes recently occurred in Myanmar, which led to the economy's opening up and normalization through deep political and economic reforms, enhancing regional connectivity. In the years running up to 2030, opportunities for ASEAN member economies to further grow through trade and investment will be enormous as the group creates its single market through the AEC and new regional demand is generated by other Asian economies.

A growing middle class, an aging population, and an increasing percentage of people living in urban areas are major trends defining Asia's future growth (Kholi, et al. 2011). Increased intraregional economic interdependence creates a unique chance for ASEAN economies to exploit the PRC's and India's huge and rising domestic markets. The rapid expansion of a vast middle class in both economies creates large opportunities for goods and services made in ASEAN, catering local consumption. Recent estimates suggest that, by 2030, more than 1.2 billion people in the PRC and 1 billion people in India (respectively 85% and 70% of the population) will have reached medium- or high-income levels (ADB/ADBI 2014).

Closer interdependence is also important for ASEAN member economies to benefit from buyer-supplier relations in production and distribution networks and technology transfer from economies such as Japan, the Republic of Korea, and Taipei, China, which continue to invest in the region's productive capacity and maintain leadership in many product and process technologies. Indeed, participation in regional supply chains helps create robust and competitive export sectors and offer significant opportunities for local SMEs' internationalization. As a matter of fact, one of key tenets to bypass the middle-income trap is to reduce reliance on foreign technologies by building a business climate that promotes investment in R&D and creates incentives for innovation (Kholi, et al. 2001). Without progress in these areas, it will be hard for ASEAN to become a highly competitive region, also given the generally low educational attainment and the relatively large proportion of unskilled labor in the total workforce.

Beside manufacturing exports, changing patterns of Asian consumers are expected to benefit resource and agriculturally rich ASEAN economies. Rapidly rising energy and food demand from the region hold large potential gains. Indeed, ASEAN maintains vast potential to increase the production and export of energy and food, allowing it to play an increasingly strategic role in

⁸ Aside from the geographic position, ASEAN economies hold deep historical, cultural, and trade links with the rest of Asia, which facilitate gains from international relations.

response to potential crises in their supply. By improving connectivity across the region (including hard and soft infrastructure plus institutions), ASEAN economies can also develop regional hubs in sectors such as tourism, health, education, logistics services, and financial services.

Tourism, in particular, is one of the areas offering enormous potential for further growth. As shown in Figure 9, the number of tourists entering ASEAN economies has increased by 30% from 2007 to 2011, with a significant increase in the share of Asian tourists on the total. A recent report of the United Nations' World Tourism Organizations (United Nations, 2012) suggests that between 2010 and 2030 ASEAN will experience an average 5.1% yearly increase in international tourist arrivals, surpassing the 3.3% global average growth over the same period of time. This trend is expected to translate into a yearly average increase of close to 6 million tourists visiting ASEAN economies. As an outcome, by 2030 ASEAN economies are expected to attract more than 10% of total international tourism (estimated at 1.8 trillion people). Data from the PRC suggest that the total number of tourists from the PRC going abroad has doubled between 2006 and 2011, and that those visiting ASEAN economies have tripled, from 2.6 to 8 million over the same period.

Ultimately, Asia's growth can also be seen as a positive balancing factor for ASEAN in the sense of improving economic and financial stability through risk diversification. In the past, Western partners such as the US and the EU had very large shares of ASEAN economies' international transactions, as shown in the trade and FDI data, creating in turn economic dependence on them. However, during the last decade or so the combined relative share of Asian economies has been increasing considerably, thus giving ASEAN member economies an opportunity to diversify the economic risk related to financial and economic crises across regions. The relatively limited impact on ASEAN economies of the 2008/09 global financial crisis can also be attributed to the increase Asian economies' share in the group's overall economic transactions.

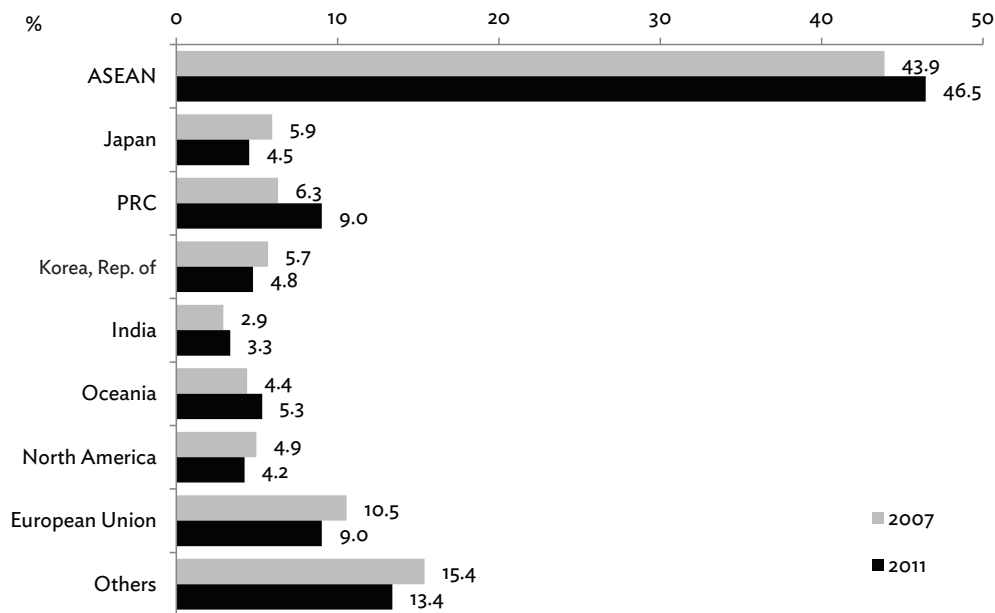
Key challenges for the ASEAN economy

Asia's economic growth—focused on the PRC and India—is also a major cause of concern for ASEAN. In particular, the loss of centrality in the institutional architecture for regional cooperation is a diffused threat among ASEAN economies. Closing intra-ASEAN development gaps, being ready to complete the AEC by 2015, and moving on to form a borderless economic community by 2030 are other main challenges, as ASEAN needs to strengthen its unity against rising competition from within and outside the region.

As a matter of fact, the notion of centrality is a strategic concern for policymakers. Every ASEAN Summit's Leaders' Statement explicitly mentions the importance for the group to “maintain centrality” since the 12th Summit held in Cebu, the Philippines, in January 2007.⁹ Even Article

⁹ Actually the 13th Summit's Leaders Statement (held in Singapore) does not explicitly mention the words “maintaining centrality”, but the theme itself of the Summit was: “One ASEAN at the Heart of Dynamic Asia”. The Leaders' Statement at the 18th Summit in Jakarta, Indonesia (May 2011) is the one with the highest frequency of explicit references to maintaining ASEAN centrality (7 times).

Figure 9. Trend of Tourist Arrivals in ASEAN economies (2007-2011)



	(thousands)					2007-11	% change
	2007	2008	2009	2010	2011		
Asia	40,322	43,014	43,662	49,351	55,286	14,965	37.1
ASEAN	27,341	30,276	31,694	34,820	37,733	10,392	38.0
Japan	3,701	3,624	3,214	3,351	3,664	(37)	(1.0)
PRC	3,926	4,471	4,202	5,416	7,316	3,389	86.3
Korea, Rep. of	3,539	2,657	2,449	3,286	3,862	323	9.1
India	1,814	1,985	2,104	2,478	2,711	898	49.5
Oceania	2,735	3,224	3,301	3,757	4,317	1,581	57.8
North America	3,081	3,162	3,009	3,179	3,432	351	11.4
European Union	6,566	6,936	6,669	6,971	7,326	760	11.6
Others	9,581	9,270	9,040	10,495	10,868	1,287	13.4
Total	62,285	65,605	65,680	73,753	81,229	18,944	30.4

ASEAN = Association of Southeast Asian Nations; PRC = People's Republic of China.

Notes: European Union refers to its first 25 members; North America includes Canada and the United States.

Source: ASEAN Tourism Statistics Database. Available: <http://www.asean.org/news/item/tourism-statistics>. Accessed: October 2013

1, comma 15, of the ASEAN Charter introduced in 2007 states that one of the association's purposes is to:.. *“Maintain the centrality and proactive role of ASEAN as the primary driving force in its relations and cooperation with its external partners in a regional architecture that is open, transparent, and inclusive”*.

ASEAN as a group has been performing an important role as ‘honest broker’ in Asia’s regionalism, especially the security and economic areas. The Asian Regional Forum, which gathers 17 members (including the EU) around ASEAN economies, is a clear example of success in the diplomatic and security area (Wihardja 2011). As far as economic relations are concerned, over the years ASEAN was able to create an articulated system of dialogue partnerships with many economies including Australia, Canada, Japan, India, the Republic of Korea, New Zealand, the USA, and economies of the EU. In the aftermath of the Asian financial crisis of 1997/98, it also developed a framework of *“ASEAN-Plus”* relationships, starting from the ASEAN+3 group with the PRC, Japan, and the Republic of Korea, and later on the ASEAN+6 group (adding Australia, India, and New Zealand) at the time the East Asia Summit (EAS) was established in December 2005 in Kuala Lumpur.¹⁰

ASEAN has also established a strong network of ASEAN+1 free trade and investment agreements with Australia and New Zealand, the PRC, Japan, India, the Republic of Korea.¹¹ In addition, various transregional, regional, and subregional groups are de-facto centered on ASEAN. Asia-Pacific Economic Cooperation (APEC) connects, for example, East Asia with the Americas, and the Asia-Europe Meeting (ASEM) with Europe, while the Forum for East-Asia Latin America Cooperation (FEALAC), promotes international relations with Latin America. At the subregional level, ASEAN economies are linked with South Asia through the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) and with Pacific island economies such as Papua New Guinea and Timor-Leste through the Coral Triangle Initiative (CTI).

Figure 10 shows the importance of ASEAN as a pivotal group for transregional and subregional cooperation. By bringing together large and small powers, it serves as a catalyst for different interests in the wider Asian region. Through its ability of following a pragmatic approach to problem-solving, ASEAN has placed a pivotal role in Asia’s architecture for cooperation. Many analysts see ASEAN centrality as a default way to maintaining peace and stability when other major regional powers such as Japan, the PRC, or India have been lacking either political legitimacy or the human and financial resources needed to providing regional public goods and promoting economic cooperation (Kesavapany, 2010; Caballero-Anthony 2012, Acharya 2012).

¹⁰ The East Asia Summit (EAS) gathers today the 10 ASEAN economies plus Australia, the PRC, India, Japan, the Republic of Korea, and New Zealand, While the first 16 economies joined the EAS since its establishment in 2005, the Russian Federation and the US. The Russian Federation and the US joined the group at a later stage.

¹¹ India, Japan, the Republic of Korea and the US have also created bilateral programs in support of economic cooperation for ASEAN’s Mekong River economies—Cambodia, Lao PDR, Myanmar, Thailand, and Viet Nam—including the Mekong-Ganga Cooperation (with India), the Japan-Mekong Cooperation, the Mekong-Republic of Korea Comprehensive Partnership for Mutual Prosperity, and the Lower Mekong Initiative (with the US). In 1992, ADB launched the Greater Mekong Subregion (GMS) program including as areas of operations the Yunnan Province and Guangxi Zhuang Autonomous Region of the People’s Republic of China in addition to Cambodia, the Lao PDR, Myanmar, Thailand, and Viet Nam.

However, as the PRC and India continue to rise and the process of Asian integration broadens, it remains unclear whether ASEAN can maintain its centrality. ASEAN's key role can be eroded not only by external powers, but also internally due to an institutional setting which have become in some aspects obsolete and needs reform. On the one hand, ASEAN's informal approach has the virtue of enabling members with diverse interests to remain nominally united. On the other hand its informality is also a great limitation as it inhibits taking operational decisions and renders strengthening regional cooperation more difficult by giving a de facto veto power to member economies favoring the status quo under consensus-based decision making. The threat of losing centrality provides therefore a strong rationale pushing for institutional reform and innovation.

Other key challenges for ASEAN economies moving forward, as they aspire to meet 2030 challenges, were identified by the ADBI study as: (i) promoting competitiveness and innovation; (ii) supporting equitable growth; (iii) enhancing macroeconomic stability; and (iv) protecting the environment (ADBI, 2014). Improving competitiveness vis-à-vis the PRC, India, and other emerging regional markets, while maintaining stable macroeconomic and financial conditions emerge indeed as the two major challenges. At the same time, given the large discrepancy in development outcomes existing across ASEAN economies, pursuing an inclusive, equitable, and sustainable development path while ensuring the proper management of existing natural resources and the capacity to grow in harmony with the environment and neighboring economies are identified as the two other major 2030 challenges. Although their emphasis may differ across economies, existing long-term development strategies of ASEAN governments typically touch upon all these challenges.

The study also recognizes the importance of four growth-enabling factors: (i) developing financial markets; (ii) harnessing human capital; (iii) building seamless connectivity; and (iv) strengthening governance. Ultimately, overcoming the above four challenges and ensuring sufficient progress in the enabling factors will allow ASEAN economies receive net benefits from their increased interdependence with the PRC, India, and other Asian economies, paving the way for the formation of a truly borderless economic community in the region by 2030.

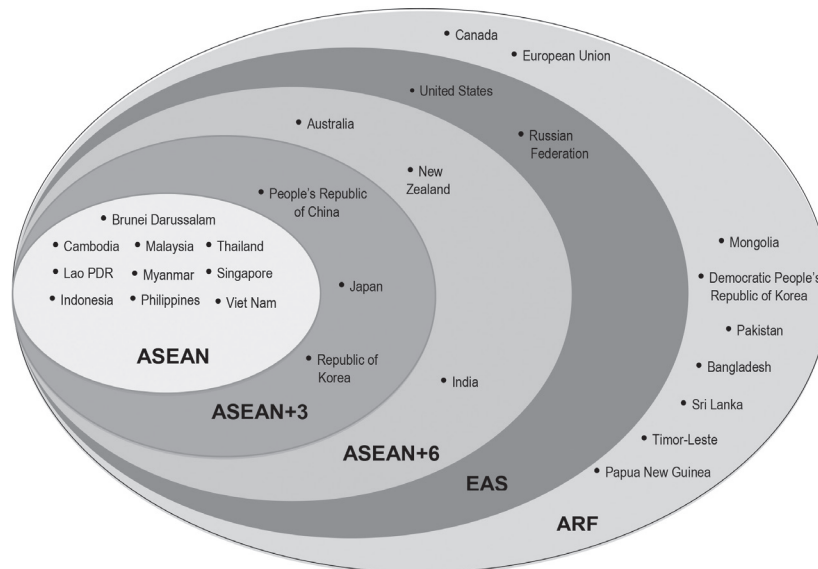
5. Conclusion: Recommendations for ASEAN Economies

In order to benefit from the opportunities created by the increased interdependence with the PRC, India, and other Asian economies, ASEAN economies need to adopt a two-track strategy based on the introduction of deep structural reforms at national level, together with broad and deep initiatives for regional cooperation. As ASEAN policymakers plan the region's future development they should aim at further liberalizing and restructuring their economies, lowering costs while increasing competitiveness, ultimately avoiding falling in the middle income trap.

National policies and structural reforms

The experience of economies such as Japan and the Republic of Korea, which were able to see their per-capita incomes reach their current high levels, suggests the importance to strengthen

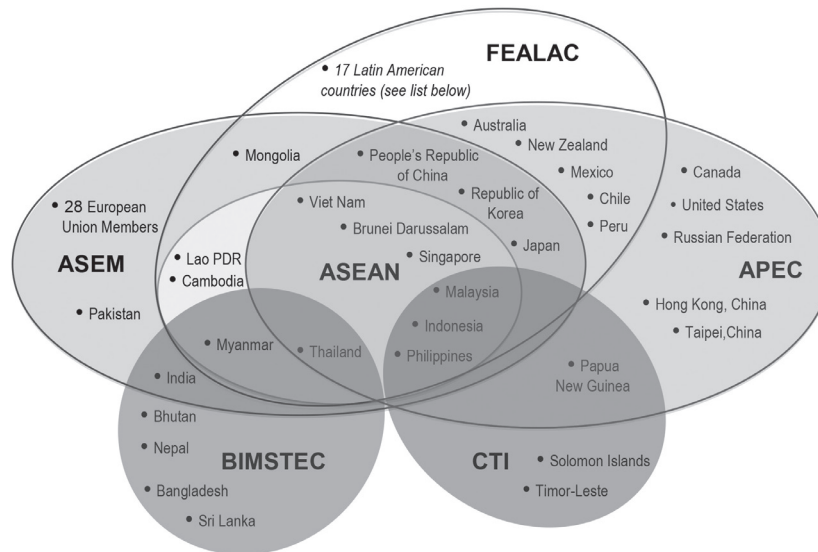
Figure 10: Panel A - ASEAN Centrality: Major Groups Focused on ASEAN



ARF=ASEAN Regional Forum; ASEAN=Association of Southeast Asian Nations; ASEAN+3=ASEAN plus the People's Republic of China, Japan, and the Republic of Korea; ASEAN+6=ASEAN+3 plus Australia, India, and New Zealand; EAS=East Asia Summit.

Source: ADBI 2014.

Figure 10: Panel B - ASEAN Centrality: Major Transregional Groups involving ASEAN Economies



APEC=Asia-Pacific Economic Cooperation (21 members); ASEAN=Association of Southeast Asian Nations (10 members); ASEM=Asia-Europe Meeting (44 members); BIMSTEC=Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (7 members); CTI=Coral Triangle Initiative (6 members); FEALAC=Forum for East Asia-Latin America Cooperation (36 members).

Note: The list of additional 17 Latin American members of FEALAC includes: Argentina, Bolivia, Brazil, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Paraguay, Suriname, Uruguay, and Venezuela.

Source: ADBI 2014.

innovation through investment in R&D, to reduce business costs through a policy environment that encourages the development of a dynamic private sector, to expand the reach of information and communication technology (ICT), including its infrastructure and institutions, and to improve governance, particularly in areas related to regulation and trade (Habito, 2012; Tran, 2011).

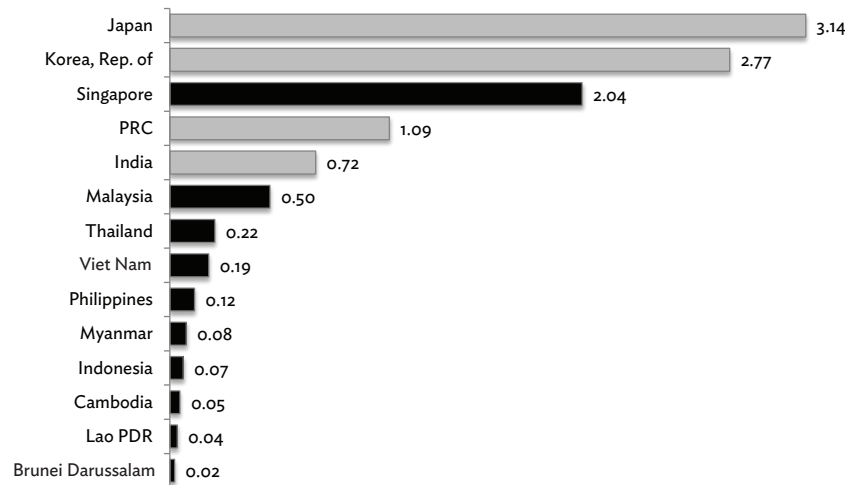
Increasing investment in R&D to a level close to 2% of GDP (or more) is the first important step in avoiding the middle-income trap. R&D investment can be directed to create new product and process technologies, but also to expand economies' absorptive capacity of existing technologies. Sadly, ASEAN member economies have been spending only very small fractions of their national incomes on R&D, and in many cases trends have declined. During the 1996-2010 period only Malaysia shows constantly increasing shares of R&D spending as a portion of GDP. As Figure 11 indicates, businesses and governments spend well-below 1% of GDP on R&D in middle-income ASEAN economies. Without the realization that R&D investments are of utmost importance to promote innovation and competitiveness, ASEAN economies may not be able to show a marked improvement toward high-income status, and related increases in quality of life.

Based on the economy-level analysis conducted by the ADBI study, the set of national policies and structural reforms needed to reduce costs and improve competitiveness and productivity should be geared to improve the overall business environment, nurture SMEs, and develop human capital (ADBI, 2014). In particular, improvement in the business environment can be obtained by removing regulatory bottlenecks required to encourage business start-ups, streamlining regulations to reduce the time needed for opening and closing businesses, and easing market entry and exit of firms. Facilitating the provision of venture capital and lowering the penalty of failure in bankruptcy law can also help promote innovation and entrepreneurship. As several ASEAN members are still lacking competition laws and policies, institutional progress in this area, as well as in curbing monopolies and leveling the playing field, are urgently needed.

Given the fact that SMEs represent the backbone of production systems in all ASEAN member economies, policies aiming to increase competitiveness and productivity would include the promotion of business incubators for SMEs, strengthening trade and logistic networks, and providing targeted financial support for R&D development of SMEs and for attracting venture capital through enhanced equity markets. Training programs are also needed to develop SMEs skills, encourage innovation, and eventually upgrade the positioning of ASEAN SMEs in regional production and distribution networks.

In general, ASEAN economies need to strengthen their education and training systems to improve matching between labor supply and demand, especially of skilled labor, at national and regional level. Reforms are needed to improve the overall quality of education and to increase the number and quality of technical and vocational schools, also by promoting a more active participation of private institutions in this sector. Health care, tourism and engineering are areas which offer increasing opportunities. R&D activities should become more institutionalized in tertiary education, which needs to become more closely linked with the demand for skills coming from the private sector. Although the labor market situation differs quite substantially

Figure 11. Average Expenditure on Research and Development Selected Asian Economies' % share of GDP, 1996-2010 Average



ASEAN = Association of Southeast Asian Nations; GDP = gross domestic product; Korea, Rep. of = Republic of Korea; Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.

Source: World Bank, *World Development Indicators Database*. Available: http://databank.worldbank.org/ddp/home.do?Step = 2&id = 4&DisplayAggregation = N&SdmxSupported = Y&CNO = 2&SET_BRANDING = YES (accessed October 2013).

from economy to economy, in general labor markets should become more efficient and flexible, facilitating female workers' participation in the workforce. Reforms aimed at improving social safety nets and financial inclusion are also important to foster human capital in ASEAN.

Regional infrastructure policies for a borderless economic community

Creating the AEC is an important step to form an environment conducive to generate productivity and competitiveness increases and to build ASEAN's distinct brand of integration (ERIA 2010). But the AEC will be insufficient to remove all barriers to internal trade. More needs to be done to cope with its ASEAN's future challenges. A deeper initiative is needed to create a truly borderless economic community in order to further reduce production costs and take advantage of regional synergies, enabling investors to compete as well as strengthen trade and investment links with firms based in the PRC, India, and other Asian economies.

Establishing a borderless ASEAN economy by 2030 implies a number of coordinated initiatives at the regional level, which eventually require national action such as eliminating remaining barriers to the flow of goods, services, capital and labor, enhancing regional connectivity, further advancing standardization and harmonization, promoting free trade and investment agreements, and strengthening regional institutions.

In this context, the 2010 Master Plan for ASEAN Connectivity, which covers physical infrastructure, software and institutions, and people-to-people exchanges, provides an excellent example. The development and maintenance of efficient infrastructure such as airports, ports, railways, and roads, require a set of policies and institutions to facilitate coordination between regional agencies as well as national and local governments. Strengthening public-private partnership (PPP) is also of utmost importance to develop and modernize infrastructure and logistic systems and lower transport costs throughout the region. In particular, initiatives are needed to simplify PPP procedures required for infrastructure's projects approvals and to promote ICT development.

As far as policies related to improving labor market conditions are concerned, the use of a regional approach is complicated by the fact that issues largely differ economy by economy. Brunei Darussalam, Malaysia, Singapore, and Thailand are net importers of (particularly unskilled) labor, while Indonesia, the Philippines, Myanmar and Viet Nam are large net exporters. Cambodia and Lao PDR are net exporters, although to a lesser degree due to their smaller labor force size. While the AEC aims to introduce free mobility of skilled labor across member economies by 2015, progress is slow and limited to very few professions as mutual recognition agreements are yet to be signed and ratified by member economies, including on educational standards and qualifications. Immigration policies also create significant barriers, limiting progress in ASEAN productivity increases to achieve higher levels of economic competitiveness.

Regional free trade and investment agreements

With ASEAN economies being very open, agreements meant to facilitate global and regional trade and FDI are of strategic importance to boost competitiveness and promote GDP growth. By mid-2013, ASEAN economies had signed 40 such agreements, while 29 were under negotiations and 21 being proposed for further discussion. The majority of such agreements were of bilateral nature (i.e. between two economies), with 10 plurilateral agreements under negotiation (mostly between individual ASEAN economies and the EU or the European Free Trade Association). Notably, the signed multilateral agreements include the ASEAN Free Trade Area (AFTA) of 1992, and the five ASEAN+1 FTAs, signed more recently with Australia and New Zealand, the PRC, India, Japan, and the Republic of Korea (Table 5).¹²

As a matter of fact, most of these FTAs materialized after the year 2000, with an increasing number involving non-Asia economies (Plummer and Chia 2009, ADBI 2014), as shown in Figure 12. A main reason behind the exponential growth in ASEAN FTAs experienced during the last decade derives from the stalled multilateral Doha Round of the World Trade Organization and the approach to embrace regional cooperation as a second-best, yet feasible solution. A

¹² The first trade agreement among ASEAN member states, the ASEAN Preferential Trade Agreement (APTA) was signed in 1977, following the first ASEAN Summit organized in 1976. But not much progress in trade liberalization was experienced until AFTA came into place and a Common Effective Preferential Tariff (CEPT) scheme was introduced in 1993 to ultimately eliminate all intra-ASEAN tariffs. To further eliminate restrictions on trade in services, the ASEAN Framework Agreement on Services (AFAS) was adopted in 1995 and to liberalize intra-ASEAN FDI and attract additional FDI flows from abroad the ASEAN Investment Agreement (AIA) was signed in 1998.

Table 5. Status of ASEAN Free Trade Agreements
(as of July 2013)

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

Bilateral—between two economies: one ASEAN and one non-ASEAN economy (with the exception of the Lao PDR-Thailand Preferential Trading Agreement).

Multilateral—between two or more ASEAN economies and one or more non-ASEAN economies (includes ASEAN+1 agreements).

Plurilateral—between one ASEAN economy and two or more non-ASEAN economies.

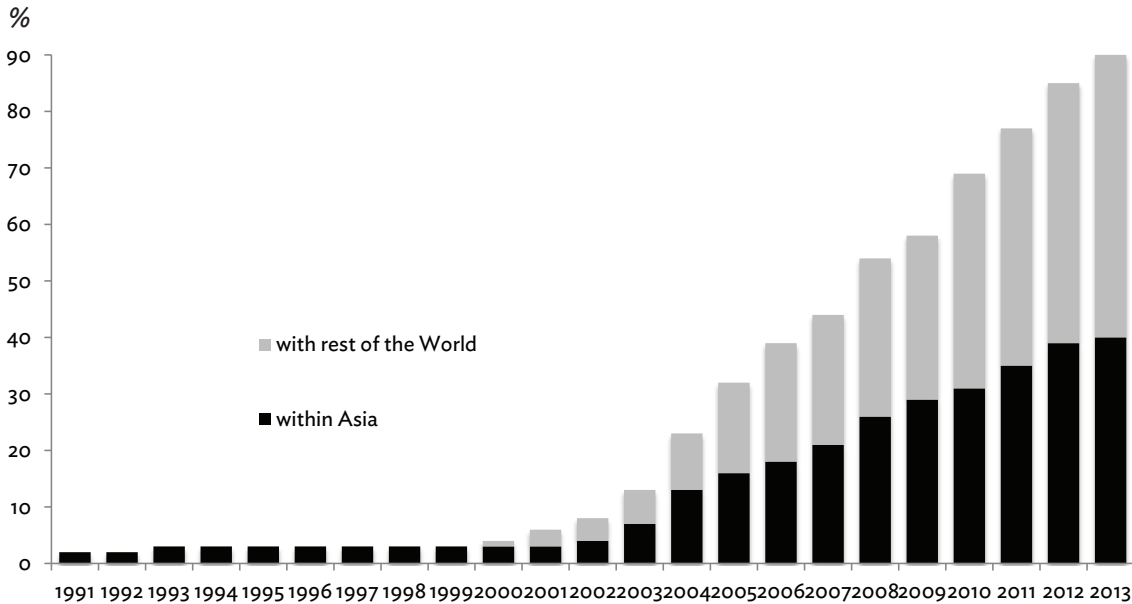
Source: ADBI staff and Asian Development Bank. *Asia Regional Integration Center*. Available: <http://aric.adb.org/ftatrends.php> (accessed September 2013).

number of proposals have been put on the table to create, for example, an ASEAN+3 FTA, a Comprehensive Economic Partnership for East Asia (CEPEA) among ASEAN+6 economies, as well as a Free Trade Area of the Asia-Pacific (FTAAP) covering all APEC members.

While these proposals for region-wide FTAs did not see any concrete follow-up toward their practical realization, negotiations involving ASEAN member states are currently ongoing on two “partnerships”, the Trans-Pacific Partnership (TPP), and the Regional Comprehensive Economic Partnership (RCEP). TPP negotiations, which began in 2007 and are perceived to be largely US-drive, are expected to be concluded soon. It currently involves twelve economies, of which only four from ASEAN are members – Brunei Darussalam, Malaysia, Singapore, and Viet Nam. Hopefully more will join in the near future as the benefits of being part of TPP are potentially quite large. In fact, TPP is a comprehensive, modern, high-standard agreement covering more than 20 areas with sectors often excluded from FTAs, such as agriculture and the environment. It addresses issues related to technical trade barriers, sanitary and phyto-sanitary measures, government procurement, service trade, intellectual property rights, competition policy, and investment. Other economies participating in TPP negotiations are Australia, Canada, Chile, Japan, Mexico, New Zealand, Peru, and the US. For now key Asian economies such as the PRC and India are not involved in the TPP (Das 2012, Wu and Mealy 2012).

In contrast, RCEP is a clearly an ASEAN-based initiative, which many experts believe was proposed in response to the possibility of losing centrality, and the threat that TPP could divide ASEAN member states—between those joining and those remaining out of it. RCEP is designed to be more comprehensive, but has less stringent requirements than TPP (i.e. adopting a more flexible approach for economies requiring temporary exclusion for sensible sectors and longer time for implementing liberalization schemes), and development-oriented, including provisions

Figure 12. Exponential Growth of ASEAN Trade and Investment Agreements
 Total number of agreements signed, under negotiation, or being proposed (1991-2013)



ASEAN = Association of Southeast Asian Nations.

Source: Asian Development Bank, *Asia Regional Integration Center*. Available: <http://aric.adb.org/ftatrends.php> (accessed September 2013).

for economic and technical cooperation.¹³ It currently involves all 10 ASEAN economies plus economies which signed ASEAN+1 FTAs (i.e. Australia, the PRC, India, Japan, the Republic of Korea, and New Zealand)—a group that overlaps with ASEAN+6 (or CEPEA) members. In principle, however, more economies, either from Asia or outside the region, could join RCEP. Its negotiations started in 2011 and are expected to be concluded by 2015.

An intense debate was started on TPP and RCEP which focused on membership’s pros and cons and whether the two agreements are complementary or if they compete with each other. While proponents of the competitive view focus on the fact that the US is not part of RCEP and the PRC and India are excluded from TPP, in reality both agreements are open for new members to join and should be regarded as complementary. In particular, it is easier for developing economies which are ready for some degree of liberalization to join RCEP, while economies which intend to undertake deeper liberalization can aim to be TPP members. Eventually, the two FTAs could converge to form a wide and deep regional agreement, with large income gains for its members. As more ASEAN economies will be ready to join TPP negotiations, benefits for the region (and the world) are expected to increase (Petri, Plummer, and Zhai, 2010).

¹³ The RCEP aims to rationalize rules of origin by using a simplified approach to their definition and to focus on non-tariff barriers, streamlining and harmonizing custom procedures, and making them more consistent and predictable. It covers trade in goods and services, plus investment, intellectual property rights, investment, a dispute settlement mechanism, as well as economic and technical cooperation.

In addition to TPP and RCEP, ASEAN economies could largely benefit from signing FTAs with the EU. Currently, Malaysia, Singapore, Thailand, and Viet Nam are independently negotiating FTAs with the EU (with Singapore close to conclude a deal), while individual negotiations with other ASEAN member economies may also start soon.¹⁴ An ASEAN-EU FTA is also being discussed. Although negotiations have remained suspended for some time, such FTA would consolidate and replace individual economy agreements and, if concluded, generate large gains for its members.

ASEAN centrality and institutional reforms

A successful conclusion of the RCEP will greatly boost ASEAN centrality in the regional institutional architecture for cooperation, confirming the ability of the association to develop mechanisms and processes that deliver a strong sense of ownership from a large number of stakeholders around a core group of economies that are not perceived as threats by others (Capannelli and Kawai 2014). The expansion of RCEP to include other economies beyond the ASEAN+6 members may form the core component of an Asia-wide economic community. Closer regional and global linkages can also be forged by RCEP and TPP converging into a wide cross-regional agreement.

ASEAN members may find merit in adopting a broad approach to regional cooperation with a perspective to create an economic community embracing the entire region, from East, South, and Central Asia to the Pacific. ASEAN's ability to deal with pronounced intraregional diversity gives the association the potential to continue acting as an honest broker to knit the region together. The 23rd ASEAN Summit concluded in Brunei Darussalam in October 2013 tasked the Coordinating Council to identify a post-2015 strategy for the group, moving beyond the AEC. Hopefully, such strategy will be focused on creating a truly borderless economic community, which could eventually constitute the core of an Asia-wide economic community in the future (ASEAN 2013).¹⁵

While ASEAN's centrality in the wider regional architecture is compelling, some of the group's governing principles have become obsolete and need to be urgently updated to increase institutional efficiency. When ASEAN was established in 1967 its focus was on regional security. Reflecting the wide diversity of member states, the group chose a pragmatic approach based on informal, nonbinding rules and noninterference in economies' domestic affairs—the ASEAN Way. After the first ASEAN summit in 1976 the regional dialogue shifted to economic and social

¹⁴ The negotiations for a Singapore-EU FTA were finalized in December 2012. While discussions on investment protection are still on-going, both parties seem to be ready to sign the agreement very soon.

¹⁵ The idea of an Asian economic community as a region-wide overarching institution, gathering all Asia's subregions, covering areas such as infrastructure, trade and investment, money and finance, and the provision of regional public goods was discussed in a recent ADB study (ADB 2010). The study clarified that given Asia's pronounced diversity, the region's institutional architecture is expected to maintain a much greater degree of flexibility than Europe's, without the implementation of a grand plan for Asian regionalism. While there is large scope to strengthen existing Asian institutions for regionalism given their current "lightness", Asian opinion leaders' surveys confirmed the lack of appetite in the region for centralized, strong institutions à-la EU.

issues. Since then, reflecting the rapid growth of Southeast Asian economies, and in line with the plan to create the ASEAN Community by 2015, economic and socio-cultural issues have gained great momentum.

While the ASEAN Way has served the region well so far, efficiency-boosting reforms are needed to some of the group's governing principles. Handling economic and social issues requires flexibility, and timely decisions, which the current institutional system is often unable to provide. Without institutional reform ASEAN will be unable to maintain its centrality and to strengthen its competitive edge against the rise of the PRC, India, and other emerging regional economies.

The need for institutional reform covers several key areas: (i) delegating more power to regional institutions to manage the new markets generated by the AEC and ensure that member states comply with their commitments; (ii) allowing for a qualified majority in decision making on operational issues; (iii) upgrading the principle of equal budget contribution to one of diversified contributions based on the capacity as well as willingness of member states to pay; (iv) greatly increasing human and financial resources devoted to the ASEAN Secretariat (currently supported only by some 70 professional staff, operating on an annual budget of only about US\$16 million against a disproportionate volume of tasks to be accomplished); and (v) creating an ASEAN Academy to form a regional civil service on ASEAN affairs.¹⁶

A coherently integrated, not a fragmented, Asia is needed to realize an “Asian” century. ASEAN should maintain its centrality in the regional architecture for cooperation to allow an Asia-wide economic community to emerge. The association has a very important role to play in ensuring that other major Asian economies such as the PRC, India, and Japan will be able to work together to create such a community. ASEAN and its AEC can play a core central function in this process, as no regional member wants other groups to take leadership. Eventually, a more closely integrated and coordinated Asia is of strategic importance to ensure sustained global economic integration, growth, and shared prosperity.

¹⁶ A detailed discussion on these reforms is included in the ASEAN 2030 study (ADB 2014).

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The ASEAN Economy in the Regional Context: Opportunities, Challenges, and Policy Options

This paper suggests that the Association of Southeast Asian Nations (ASEAN) needs an ambitious plan for economic integration beyond the ASEAN Economic Community (AEC), which is going to be launched in 2015. As ASEAN designs its long-term development agenda with a view to strengthening its role as a hub of Asian dynamism, its members need to adopt an appropriate policy mix including domestic structural reforms and bold actions to deepen regional integration—transforming the AEC into a truly borderless economic community.

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ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to approximately two-thirds of the world's poor: 1.6 billion people who live on less than \$2 a day, with 733 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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