

# ASEAN 2030

## Toward a Borderless Economic Community

**DRAFT**

**HIGHLIGHTS**

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Printed in Japan.



Printed using vegetable oil-based inks on recycled paper; manufactured through a totally chlorine-free process.

#### Cataloging-In-Publication Data

Publication Stock No. XXXXXXXX

ISBN XXXXXXXXXXXX

ASEAN 2030 Toward a Borderless Economic Community — DRAFT HIGHLIGHTS

Tokyo, Japan: Asian Development Bank Institute, 2012

1. Borderless economy
2. Regional cooperation and integration
3. Economic community
4. ASEAN
5. Asian Development Bank.

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# Foreword

**F**or the last 45 years, the Association of Southeast Asian Nations (ASEAN) has been an integral part of Asia’s ongoing socio-political and economic transformation and remains an example for other regional groups of how carefully crafted cooperation can benefit all members—even if extremely diverse in size, geography, culture, income level, and resource endowment. Today, ASEAN needs to think how to move to new stages of integration. As it approaches the target for the creation of an ASEAN Economic Community by 2015, it will find merit in forging a longer term strategy for shared prosperity of its members, the wider Asian region, and the world at large.

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

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

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

A handwritten signature in black ink, appearing to read 'H. Kuroda', written in a cursive style.

Haruhiko Kuroda  
President  
Asian Development Bank

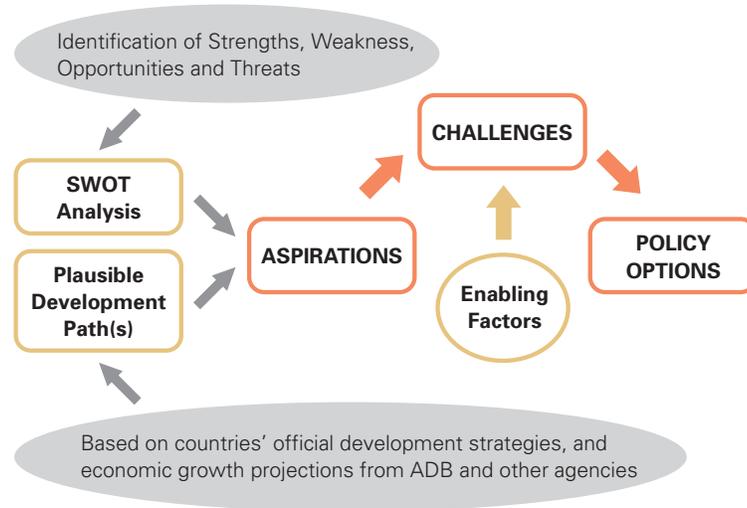
# About the Study

**T**his study was begun in November 2010 by the Asian Development Bank Institute (ADBI), in collaboration with the ASEAN Secretariat and ADB's Southeast Asia Department. It is part of a wider study on the “great transformation” brought about by the emergence of the Association of Southeast Asian Nations (ASEAN), the People's Republic of China and India as major global economic players. Its aim is to articulate ASEAN's aspirations, challenges, and policy options for the next two decades of the region's economic development.

## Consultative approach

The study has taken a bottom-up approach to identifying the region's growth aspirations and development challenges. A brainstorming meeting was held in November 2010 at ADB headquarters and consultations were held in January 2011 in Jakarta with the management of the ASEAN Secretariat. An inception workshop followed at ADBI in Tokyo. Seminars were then held at the ASEAN Studies Centers in Washington D.C. and Jakarta. The study organized consultation missions in each ASEAN member between February and June 2011 and engaged with local stakeholders in all ASEAN members. Workshops were held with experts, scholars, think tanks and the civil society, and meetings organized with various ASEAN bodies and agencies. ADB resident missions were involved in organizing meetings and provided inputs.

# Analytical Framework



# Inputs and Governance

Eleven background papers were prepared on country perspectives (one for each ASEAN member plus one for Timor-Leste) and other 29 background papers were commissioned on thematic issues. The ADB Economics and Research Department prepared growth projections. During May – December 2011, five internal workshops were held to enable study team members to finalize background papers and shape the structure and content the report. A team of reviewers checked the quality of papers. Guidance was regularly received from the ASEAN High-Level Task for on Economic Integration and from the study's Steering Committee and its External Advisory Board.

# Website and Survey

A website has been prepared for internal use of study team members and a discussion forum will be started in April – May 2012 to discuss preliminary findings with a broader audience. In the same period, a survey to ASEAN opinion leaders will be conducted with the objective of asking their views on ASEAN 2030 and to confirm the aspirations, challenges, and policy options identified by the study.

## Output and Dissemination

The study will produce a final report consisting of two volumes — one of papers on country perspectives and one discussing ASEAN 2030 aspirations, challenges, and policy options. The report will include a highlights volume and an executive summary.

The report draft highlights and executive summary will be discussed with members of the ASEAN Councils on the sidelines of the 20th ASEAN Summit in Phnom Penh in early April 2012. Suggestions received from the Council members will guide the report's finalization. The ASEAN 2030 report is expected to be launched during the 21st ASEAN Summit (about November 2012) in Cambodia. The report will be disseminated during the first half of 2013 in all ASEAN member countries and in several other countries.

### Background Papers on Country Perspectives

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Brunei Darussalam	David J. Green and Teo Siew Yean
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Lao PDR	Leeber Leebouapao and Phouphet Kyophilavong
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Philippines	Josef Yap and Ruperto Majuca
Singapore	Chia Siow Yue
Thailand	Somchai Jitsuchon
Viet Nam	Vo Tri Thanh and Duong Anh Nguyen
Timor-Leste	Joao M. Saldanha

## Background Papers on Thematic Issues

Title	Author(s)
A Regional Perspective on ASEAN 2030	Monica Wihardja
ASEAN Competition Policy and Law	Pande Radja Silalahi
ASEAN 2030: Challenges of Building a Mature Political and Security Community	Amitav Acharya
ASEAN Institutional Reform and Strengthening	Amitav Acharya
ASEAN Integration in 2030: US Perspectives	Pek Koon Heng
Assessing the Implementation of AEC Blueprint: Some Insights from the ERIA Analytical Scorecard Studies	Ponciano Intal, Dionisius Narjoko, and Hong Hin Lim
Closing the Development Gap: the Case of Indonesia	Erina Azis and Budi Resosudarmo
Creating an ASEAN Payment System	Tanai Khiaonarong
Dealing with Dollarization in ASEAN: Issues and Challenges	Eric Girardin
Developing a Competitive Tourism Sector in ASEAN	Maria Cherry Lyn S. Rodolfo
Developing a Competitive Service Sector towards 2030	Ben Shepherd
Empowering the ASEAN Secretariat	Ajit Singh and Suthad Setboonsarng
Energy Needs towards ASEAN 2030	Chira Achayuthakan and Weerakorn Ongsakul
Environmental Protection in ASEAN: Issues and Challenges	Thammarat Koottatep, Atitaya Paanuvatvanich, and N Htay Yin
Evolution of ASEAN Economies' Competitiveness	Marn Heong Wong
Governance Indicators for ASEAN Economies	Raymond Atje
Going Regional: How to Deepen ASEAN's Financial Markets	Maria Socorro Gochoco-Bautista and Eli Remolona
Is ASEAN Prone to another Financial Crisis?	Bandid Nijathaworn
Managing Demographic Transition in ASEAN	Gavin Jones
Measuring Quality of Life in Asia: Issues and Discussions	Minquan Liu
R&D Investment and Innovation Challenges in ASEAN	Albert Guangzhou Hu
Strengthening ASEAN Infrastructure	Atsushi Masuda
Strengthening ASEAN's Institutional Mechanisms	Ajit Singh and Suthad Setboonsarng
Strengthening the Agricultural Sector's Productivity and Food Security	Larry Wong
The 2030 Architecture of ASEAN Free Trade Agreements	Suthiphand Chirathivat and Piti Srisangnam
The Impact of AEC on ASEAN Production Network	Chayodom Sabhasri and Kornkarun Cheewatrakoolpong
The Middle-Income Trap: Issues for ASEAN Countries	Tran Van Tho
Understanding ASEAN's Centrality	Mely Caballero Anthony
Urbanization Trends and Their Economic Implications	Wong Tai Chee

### ASEAN Think Tanks involved in the study

Country	Think Tank
Cambodia	Cambodia Development Resource Institute
Lao PDR	National Economic Research Institute
Indonesia	Center for Strategic and International Studies
Malaysia	Institute of Strategic and International Studies
Myanmar	Myanmar Development Resource Institute
Philippines	Philippine Institute for Development Studies
Singapore	Institute of Southeast Asian Studies
Thailand	Thailand Development Research Institute
Viet Nam	Central Institute for Economic Management

# Acknowledgments

**T**he study was conducted under the direction of a Steering Committee co-chaired by the Secretary General of the Association of Southeast Asian Nations' (ASEAN), Surin Pitsuwan, and the Dean of Asian Development Bank Institute (ADBI), Masahiro Kawai. Members of the committee included ADB's Managing Director General, Rajat M. Nag, Southeast Asia Regional Department (SERD) Director General, Kunio Senga, Economics and Research Department Chief Economist, Changyong Rhee, and the Head of the Office of Regional Economic Integration, Iwan J. Azis.

Overall guidance to the study was provided by an External Advisory Board chaired by ASEAN Deputy Secretary General Pushpanathan Sundram, co-chaired by United Nations' Economic and Social Commission for Asia and the Pacific, Noeleen Heyzer, and including: (i) for *Brunei Darussalam*, Dato' Lim Jock Hoi, Permanent Secretary, Ministry of Foreign Affairs and Trade; (ii) for *Cambodia*, Dr. Hang Chuon Naron, Secretary of State, Ministry of Economy and Finance and Deputy Chairman, Supreme National Economic Council; (iii) for *Indonesia*, Prof. Emil Salim, Special Adviser to President Yudhoyono; (iv) for the *Lao People's Democratic Republic*, Bounleua Sinxayvolavong, Alternate Executive Director, ADB; (v) for *Malaysia*, Tan Sri Ajit Singh, Chairman, Nam Fatt Corporation Berhad, and former ASEAN Secretary General; (vi) for *Myanmar*, Dr. U Myint, Chief, Economic Advisory Unit, President's Office; (vii) for the *Philippines*, Amb. Rodolfo Severino, Head, ASEAN Studies Centre, Institute of Southeast Asian Studies, Singapore, and former ASEAN Secretary General; (viii) for *Singapore*, Amb. Ong Keng Yong, High Commissioner of the Republic of Singapore to Malaysia, and former ASEAN Secretary General; (ix) for *Thailand*, Dr. Suthiphand Chirathivat, Professor, Chulalongkorn University; and (x) for *Viet Nam*, Dr. Tran Van Tho, Professor, Waseda University.

This study was managed by an ADBI team comprising Research Director Mario Lamberte and Principal Economist and Senior Research Fellow Giovanni Capannelli, who served as team leader and project task manager. ASEAN and SERD contributed to the study through various inputs and ideas. The ASEAN team was coordinated by Lim Chze Cheen and the SERD by Erick Sidgwick. From the ASEAN Secretariat, Rony Soerakoesoemah offered ideas and suggestions to improve the study. From ADB, Deputy Chief Economist, Juzhong Zhuang, Director Arjun Goswami, Adviser Jun Tian, Lead Economist Jayant Menon, and Principal Economist Sabyasachi Mitra contributed with papers and discussion. Comments were also provided by Douglas Brooks, Ba Hung Nguyen, and Biswa Nath Bhattacharyay.

The team of international consultants who conducted the study was led by Dr. Chalongsob Sussangkarn, Distinguished Fellow, Thailand Development Research Institute and former Minister of Finance of Thailand. David Jay Green and Jean-Pierre Verbiest served as principal consultants. Srinivasa Madhur assisted the team as special economic consultant.

Many regional experts contributed to drafting the study's final report: Reza Siregar from the ASEAN+3 Macroeconomic Research Office contributed especially on issues related to macroeconomic stability — Cielito Habito from the Ateneo de Manila University on equity and inclusiveness; Chia Siow Yue from the Singapore Institute of International Affairs on competitiveness; Weerakorn Ongsakul and Thammarat Koottatep from the Asian Institute of Technology, Bangkok, on energy and the environment; Shinji Takagi from the Osaka University and Choong Lyol Lee from the Korea University on financial markets; Dante Canlas from University of the Philippines on human capital; Shankaran Nambiar from the Manipal International University, Kuala Lumpur, on governance and institutions; and Djisman Simandjuntak from the Prasetiya Mulya Business School, Jakarta, on the regional architecture for cooperation.

A team of reviewers including Mohamed Ariff, Michael Plummer, and Subash Bose Pillai checked the quality of background papers and outputs being produced for the study. The following experts provided comments during workshops and conferences: Dr. Medhi Krongkaew, Commissioner, National Anti-Corruption Commission of Thailand; Dr. Anwar Nasution; Professor, University of Indonesia; Mr. Nazmi Mohamad, Deputy Permanent Secretary, Ministry of Foreign Affairs and Trade, Brunei Darussalam; Dr. Ooi Sang Kuan, Special Adviser, Bank Negara Malaysia; Amb. Manasvi

Srisodapol, Permanent Representative of Thailand to ASEAN; Amb. I Gede Ngurah Swajaya, Ambassador, Permanent Representative of the Republic of Indonesia to ASEAN; Amb. Wilfrido Villacorta, Permanent Representative of the Philippines to ASEAN; and Mr. Prasetijono Widjojo MJ, Deputy Minister, Economic Affairs, Ministry of National Development Planning (Bappenas), Indonesia.

Guy Sacerdoti and Richard Niebuhr served as economics and manuscript editors. The report and highlights were typeset and printed in Tokyo by Urban Connections under the coordination of an ADBI editorial team comprising Alastair Dingwall, Stefan Wesiak, and Kurt Hanson.

The following ADBI research associates and staff were involved with the study, providing inputs and assisting with administrative matters: Zhihai Xie, Fithra Faisal Hastiadi, Shanawez Hossain, Angga Pradesha, Khoirunurrofik, and Allan Layug, who contributed to research inputs and data collection and analysis, Chiho Hasegawa, who took care of administration and finance, and Maho Sasai, who designed the book cover.

# Abbreviations and Acronyms

ABF .....	Asian Bond Fund
ABMI.....	Asian Bond Markets Initiative
ACIA .....	ASEAN Comprehensive Investment Agreement
ADB .....	Asian Development Bank
ADB I .....	Asian Development Bank Institute
ADF .....	ASEAN Development Fund
AEC.....	ASEAN Economic Community
AIF .....	ASEAN Infrastructure Fund
AFAS .....	ASEAN Framework Agreement of Services
AFTA.....	ASEAN Free Trade Area
AIA.....	ASEAN Investment Agreement
AMRO .....	ASEAN+3 Macroeconomic Research Office
APEC.....	Asia-Pacific Economic Cooperation
APSC.....	ASEAN Political and Security Community
ASCC.....	ASEAN Socio-Cultural Community
ASEAN.....	Association of Southeast Asian Nations
ASEAN+3.....	ASEAN plus People’s Republic of China, Japan, and Republic of Korea
ASEAN-4.....	Indonesia, Malaysia, Philippines, and Thailand
ASEAN-6.....	Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand
ASEM.....	Asia-Europe Meeting
ATIGA .....	ASEAN Trades in Goods Agreement
ATM .....	Automated Teller Machine
AUN .....	ASEAN University Network
BIMP-EAGA ...	Brunei Darussalam-Indonesia-Malaysia- The Philippines East ASEAN Growth Area
BIMSTEC .....	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation

CEP.....	Comprehensive economic partnership
CGIF.....	Credit Guarantee and Investment Facility
CLMV.....	Cambodia, Lao People’s Democratic Republic, Myanmar, and Viet Nam
CO <sub>2</sub> .....	carbon dioxide
CMIM.....	Chiang Mai Initiative Multilateralization
CPR .....	Committee of Permanent Representatives
EAS .....	East Asia Summit
EU .....	European Union
FDI .....	foreign direct investment
FTA.....	Free trade agreement
GDP .....	gross domestic product
GMS .....	Greater Mekong Subregion
G20.....	Group of Twenty
HDI.....	Human Development Index
IAI .....	Initiative for ASEAN Integration
ICT .....	Information and communication technology
IT.....	Information technology
IMF.....	International Monetary Fund
IMT-GT .....	Indonesia-Malaysia-Thailand Growth Triangle
Lao PDR .....	Lao People’s Democratic Republic
MDG.....	Millennium Development Goal
NGO .....	Nongovernmental organization
OECD .....	Organization for Economic Co-operation and Development
PPP .....	Public-private partnerships
PRC .....	People’s Republic of China
RCEP .....	Regional Comprehensive Economic Partnership
R&D .....	Research and development
SEAMEO .....	Southeast Asia Ministers of Education
SME.....	Small and medium enterprise
SWOT .....	Strengths-Weaknesses-Opportunities-Threats
UNDP.....	United Nations Development Program
US.....	United States

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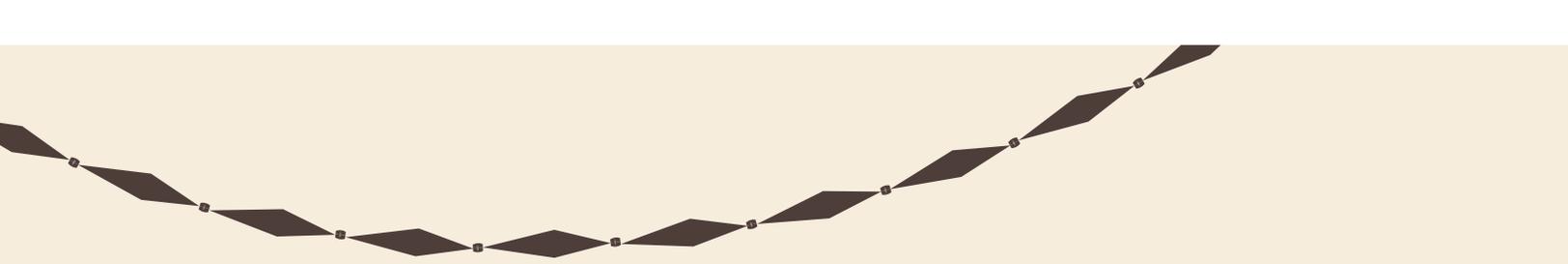
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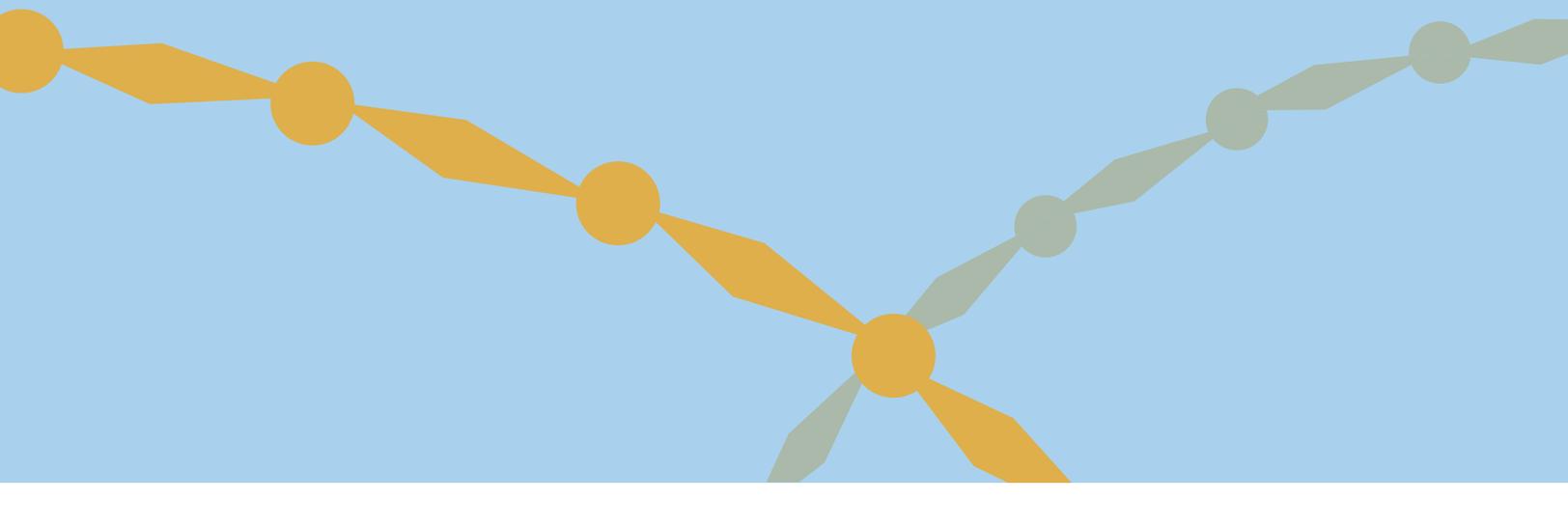


# ASEAN 2030

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## EXECUTIVE SUMMARY





# Executive Summary

## ASEAN Today

The Association of Southeast Asian Nations (ASEAN) aims to create a single market and production base—an ASEAN Economic Community (AEC)—by 2015. It is doing so at a time when the center of global economic gravity continues to shift toward Asia—and, within Asia, toward the two giant economies of the People’s Republic of China (PRC) and India. Their emergence as economic superpowers suggests that “economic size” bestows significant advantage in accelerating growth and fostering development.

Now in its mid-forties, ASEAN was created to address political and security issues. By using flexibility and consensus—the ASEAN Way—it helped move the region from conflict to cooperation. Over time, the economy has taken center stage. While the AEC is a milestone to cement ASEAN’s regional centrality, ASEAN must further deepen its integration to remain relevant in an increasingly multipolar global landscape. By 2030, ASEAN has to become a borderless economic community. It needs market size to compete as a region globally, and to ensure a higher quality of life for its citizens.

This study—a collaboration between the Asian Development Bank (ADB) Institute, the ASEAN Secretariat, and ADB Headquarters—looks to the future in answering three vital, interrelated questions: (i) What are the 2030 aspirations for individual ASEAN members and the region itself—*where do they want to be in 2030?* (ii) What are the key challenges to get there—*what does it take to meet these aspirations?* and (iii) What policy options can best make it happen—*how to get there?*

## Aspirations for a “RICH” ASEAN

Defining collective aspirations with highly diverse members is extremely difficult. National goals invariably differ across countries.

Besides, it is not easy to ensure that the aspirations espoused are “ambitious enough” for setting broad goals, while being “pragmatic enough” for countries’ development over a two-decade horizon. This study has therefore taken a holistic approach in formulating individual country aspirations and those of ASEAN itself.

In-depth background studies were prepared: one for each ASEAN member and more than 20 thematic papers on key issues and challenges the region will face. Goals from long-term national development plans were included and extensive consultations were held—in member countries, with the ASEAN Secretariat, and with national and regional think tanks. Surveys of opinion leaders were conducted. The study complemented these inputs with a “strengths-weaknesses-opportunities-threats” (SWOT) analysis. The conclusion is that by 2030 the region seeks to become *Resilient, Inclusive, Competitive, and Harmonious*—a “**RICH**” ASEAN.

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

These qualitative assessments were backed by quantitative measures to provide broad forecasts of per capita income trends over the next two decades. ASEAN members aspire to triple the region’s average real per-capita gross domestic product (GDP) to close to \$10,000 by 2030—from about \$3,000 (in 2010 prices) today. Average incomes are expected to grow faster in the least developed ASEAN economies—Cambodia, Lao People’s Democratic Republic, Myanmar, and Viet Nam (CLMV)—than in more advanced countries, narrowing development gaps. However, if ASEAN is unable to work together beyond the AEC toward a

borderless economic community, if a major external shock hits the region, or if countries get stuck in the middle income trap, growth will slow and aspiration targets will not be met.

A *RICH* ASEAN means further lowering economic barriers between countries. ASEAN needs to move toward a seamless economic community through better policy coordination, pooling resources to climb the technological ladder, freer but managed flows of labor and capital, mutual recognition of standards, regulatory harmonization, shifting responsibilities from national agencies to regional bodies, and further strengthening of ASEAN institutions. And ASEAN needs to build an efficient regional bureaucracy, which will require adequate financial resources. But ASEAN should not seek to create a heavily institutionalized union à-la Europe—it should maintain instead its pragmatic approach and flexibility.

## Key 2030 Challenges

Achieving a *RICH* ASEAN by 2030 through a borderless economic community requires meeting four key development challenges, both individually and collectively: (i) managing macroeconomic and financial stability; (ii) promoting economic convergence and equitable growth; (iii) forging a competitive and innovative region; and (iv) nurturing natural resources and sustaining the environment.

### Managing Macroeconomic and Financial Stability

National measures can best manage macroeconomic and financial stability for now. Yet, as national economic barriers are brought down over time, the macroeconomic framework will increase its regional dimension. Created in response to the 1997/98 Asian financial crisis, ASEAN+3—ASEAN plus the PRC, Japan, and the Republic of Korea—launched several initiatives for financial cooperation. The Chiang Mai Initiative Multilateralization (CMIM)—a foreign exchange liquidity support mechanism—is now in place, together with the ASEAN+3 Macroeconomic Research Office (AMRO)—its surveillance agency. By 2030, the CMIM and AMRO may well have evolved toward an Asian monetary fund.

ASEAN countries need to bolster internal cohesion to effectively cooperate in determining the strategic direction of existing and future institutions. Members must also enhance institutional effectiveness and capability by expanding resources and through peer-group review of national policies. To improve macroeconomic policy

coordination and ensure financial stability, an *ASEAN Financial Stability Dialogue*—composed of finance ministers, central bank governors, financial supervisors, and market regulators—should be established. Active dialogue with the private sector and coordination with the recently expanded ASEAN+3 Finance Ministers’ and Central Bank Governors Meeting should be encouraged.

Closer regional cooperation on exchange rate and fiscal policies would benefit member countries. As ASEAN economic interdependence deepens, policymakers must avoid the possibility of fiscal crisis contagion, which could jeopardize overall macroeconomic stability. Regular assessments of member countries’ fiscal sustainability by an independent institution—such as AMRO or a multilateral financial institution like ADB or the International Monetary Fund—could begin collaboration in fiscal policy management. Assessment results could initially be reported to the *ASEAN Financial Stability Dialogue*, eventually leading to a regional *Compact on Fiscal Sustainability*, which would define tolerable levels of fiscal deficit and public debt ratios.

Excessive exchange rate volatility is harmful to a functioning AEC—with its single market and production base. Volatility limits economic transactions, increases costs of cross-border business, and reduces the benefits of regional production networks. A flexible coordination mechanism can maintain fairly stable exchange rates between regional currencies in times of stability, while providing greater flexibility in times of stress—for example, when countries are hit by sudden foreign exchange liquidity shortages or balance of payments shocks.

### Promoting Economic Convergence and Equitable Growth

Narrowing the development gap within and across ASEAN economies is a critical step for deepening economic integration. Over the past two decades, CLMV countries have steadily caught up with the more advanced ASEAN economies: the ratio of average per-capita GDP of the ASEAN-6 to CLMV countries declined from over 11 times in 1990 to about 4 times in 2010. If 2030 per-capita GDP growth aspirations are met, the ratio would further fall to about 3 times.

Growth potential in CLMV countries is enormous, given their natural resources, a young and growing population, and their strategic position linking the PRC with India (more generally East Asia with South Asia). Myanmar’s recent moves toward political normalization and economic liberalization are a key factor in connecting these giant markets. CLMV countries need to build a

solid macroeconomic policy framework to ensure stability and development. Progress toward equitable economic growth and closer integration depends on the speed and quality of CLMV convergence toward the ASEAN average over a wide range of development indicators. Closer coordination of ASEAN-6 initiatives for helping overall CLMV development and channeling external assistance from development partners to support the Framework for Equitable Economic Development (adopted at the 19th ASEAN Summit)—and to the Initiative for ASEAN Integration—will greatly improve economic convergence.

Introducing an integrated system of freer, yet managed, unskilled labor movement across borders—while continuing the AEC commitment to free movement of skilled labor—is an important policy initiative in moving toward a borderless economic community. Large numbers of unskilled workers already cross borders in response to demand and supply gaps in ASEAN labor markets. However, such movements often remain undocumented, create unwarranted discrimination and social tension, and exacerbate inequalities. Proper regional management can reduce tensions, narrow inequalities, and promote overall ASEAN development.

The creation of an *ASEAN Convergence Fund* through voluntary contributions would be a more direct route to bridging the development divide—not only between countries but also within them. Substantial enlargement of the existing ASEAN Development Fund would be one way to develop a new fund promoting intraregional convergence. However, the only way to make such fund effective is to hire qualified professionals to administer it. Priority projects to be considered under the fund would be those reducing intraregional disparities, including through subregional initiatives.

### Forging a Competitive and Innovative Region

Large variations in global competitive rankings among ASEAN members need to narrow. Policies promoting competitiveness must be crafted nationally, given the different contexts and needs of individual countries. For countries such as Indonesia, Philippines, and Thailand, for example, incremental innovation should remain the priority over the next two decades. Malaysia is on the verge of innovating on its own, whereas Singapore's challenge is to strengthen its relatively well established indigenous innovation capability.

To complement national efforts, ASEAN countries should consider establishing an *ASEAN Competitiveness Institute*—or something similar—to promote adoption of a region-wide

innovation strategy, and construct a framework for a regional research and development (R&D) policy. Accelerating technology diffusion and absorption in key areas with large spillovers to the rest of the economy should be one policy goal. Exploiting synergies with science, R&D, and innovation in biotechnology and nanotechnology could make ASEAN a leader in emerging market niches.

A concrete initiative in developing a borderless economic community could be the creation of an ASEAN brand—a *Made-in-ASEAN* product label. For this purpose, a dedicated regional agency for certification and application of proper standards could be established. It could have a multiplier effect not only on industrial development, but also in terms of strengthening firms' and individuals' ASEAN identity.

ASEAN should also exploit its comparative advantage in tropical agriculture and its value chain, in parts and components related to regional production and distribution networks, and in services such as tourism. Here, establishing an *ASEAN Tourism Council* could help design and coordinate a variety of regional, multi-country tourism packages—from ecotourism to art and culture-related excursions. Such a Council should be introduced alongside adoption of a single ASEAN Visa for tourists, which has been under discussion for quite some time and should be in place well before 2030.

### Nurturing Natural Resources and Sustaining the Environment

Achieving a harmonious ASEAN requires countries to an environmentally sustainable development, given limited resource availability. Although natural resources are abundant in Southeast Asia, meeting the consumption needs of growing populations, they are depleting rapidly. Those transformed into energy unavoidably result in pollution. Policymakers must respond by designing and implementing “green growth” strategies for economic development. Without immediate, decisive action, by 2030 ASEAN's river quality, for example, will have seriously deteriorated and drinking water will likely be in short supply. Air quality, especially in fast growing urban areas—estimates suggest 50% of ASEAN's population will live in cities by 2030—will decline below acceptable levels.

This challenge has both national and regional dimensions. An ASEAN Ministerial Meeting on the Environment (AMME)—started in 1981 as part of the ASCC—introduced in 2010 a Blueprint comprising 10 priority areas to protect the environment. Over the years, AMME has adopted agreements and strategic plans to lower carbon emissions, reduce greenhouse gases, manage water

resources, and lower transboundary haze pollution. While ASEAN-level resolutions are non-binding at the national level, policymakers from member countries should proactively introduce long-term development plans that reflect decisions taken by ASEAN agencies and adopt an overall approach for mainstreaming green growth. They should also promote “green products,” which can provide new impetus for joint-development of niche sectors and the adoption of common standards across the ASEAN region.

As ASEAN implements its AEC Blueprint and becomes an integrated production area, the absence of a region-wide regulatory regime for environmental protection will cause firms to move to countries with weak environmental standards—regulatory arbitrage—worsening ASEAN’s overall environmental standards. ASEAN policymakers should thus encourage adoption of national policies that tax environmental “public bads” and eliminate harmful subsidies that encourage inefficient use of natural resources. Creation of a borderless economic community must go hand-in-hand with setting up a region-wide regulatory regime that protects the environment.

## Enabling Factors

The study identifies four factors to enable ASEAN countries and the region address the key 2030 challenges: (i) broadening and deepening financial markets, (ii) harnessing human capital, (iii) building seamless connectivity, and (iv) strengthening governance. These enabling factors can also be regarded as “secondary challenges,” which, like the four key challenges, are linked to a **Resilient-Competitive-Inclusive-Harmonious** ASEAN.

### Broadening and Deepening Financial Markets

Resilient, broad based, and efficient financial markets supporting the development of a robust real sector are vital to fulfill *RICH* ASEAN aspirations. While individual countries need to focus on national priorities, the integration of ASEAN financial markets is expected to increase the effectiveness of financial intermediation in the entire region—a process already driven by several ASEAN banks expanding operations within the region. ASEAN countries have been engaging within the PRC, Japan, and the Republic of Korea under ASEAN+3 to promote capital market development with the ultimate goal of better recycling regional savings into regional

investment. It also supports long-term financing through initiatives such as the Asian Bond Fund (ABF), the Asian Bond Markets Initiative (ABMI), and the recently-established Credit Guarantee and Investment Facility (CGIF). ASEAN policymakers could further broaden and deepen these initiatives. For example, ABMI and the newly-established ASEAN Infrastructure Fund (AIF) should be linked to support deeper and more liquid regional bond markets and begin financing priority connectivity projects.

In its quest for financial integration, ASEAN must balance its pace of liberalization with the amount of new regulations, requiring closer cooperation among the region's financial supervisors either through mutual recognition or regulatory harmonization of frameworks and prudential norms. Cross-border operations require financial supervision, eventually culminating in the creation of an *ASEAN College of Financial Supervisors*. Regional financial cooperation is also required in several other areas. For example, cooperation in banking and capital markets should be geared to establishing a regional payment and settlement system, which would greatly improve the efficiency of financial transactions across ASEAN. This is an important first step in creating better market infrastructure for easing capital flows. Cooperation initiatives are also needed to further develop corporate bond markets in several ASEAN countries and the sovereign bond market in others—by adopting effective and consistent regulatory frameworks. Finally, cooperation could help promote development of microfinance, especially in the CLMV countries, and in creating appropriate schemes for financing of small and medium enterprises.

### Harnessing Human Capital

The current trends of decelerating population growth and ageing societies are likely to continue across ASEAN countries over the next two decades. This implies slower workforce growth, unless an increase in the labor force participation rate more than offsets this trend. Given these changing demographics, ASEAN economies need to develop their human capital to generate stronger and more inclusive development as well as improve productivity and competitiveness. Investment in both urban and rural basic services (such as health care, safe water, and sanitation, among others) is important for inclusion and human capital development—especially in the CLMV countries and the least developed areas of ASEAN-6, such as Mindanao in the Philippines and Sulawesi or Irian Jaya in Indonesia.

Developing human capital is also important to improve the

overall quality of life for ASEAN citizens by investing in education, especially by improving the quality of education systems. In particular, ASEAN countries should invest more in basic education in science and mathematics and in tertiary education, especially in the CLMV countries. They should aim to raise scientific and technical skill levels to foster technological progress and innovation, also by increasing their investment in vocational schools and through public-private partnership projects. Regionally, ASEAN should also expand scholarships and exchanges among member countries to allow students to spend substantial time in other member countries, while receiving credit at their home university or other academic institution.

### Building Seamless Connectivity

A borderless economic community means that ASEAN countries will be seamlessly connected through land, sea, air, and communication. Connectivity is the ability to travel, trade, and transit. Expedient implementation of the ASEAN Connectivity Master Plan will upgrade existing facilities in transport and communications as well as harmonize rules, regulations, and standards. Various ASEAN subregional programs such as the Greater Mekong Subregion (GMS), the Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA), the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), and the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) also play an important role. For example, in the GMS, “economic corridors” reach out to neighboring countries such as the PRC and India—two important connectivity partners especially for CLMV countries.

The private sector is crucial in developing infrastructure. Public-private partnerships can avail of private sector administrative expertise and financing, especially as new business models are developed to address social issues. The AIF can effectively fund priority regional and subregional projects. It should enlarge its capital from the current \$700 million and expand its contributors, while maintaining ASEAN’s predominant voice in administration. In all these efforts at building ASEAN’s seamless connectivity, it is important to remember that it is not just the hardware—the physical component—that matters. The supporting software—harmonization of rules, regulations, and standards—is equally, if not more, important. A broader concept of connectivity includes people-to-people and institutional connectivity.

## Strengthening Governance

Good governance (broadly defined) implies transparent rules and regulations and the adoption of effective ways to manage institutions. Thus, improving governance is a key enabling factor for development and for achieving a *RICH* ASEAN by 2030. Over time, as ASEAN grows and its citizens become richer and better educated, they will likely demand better governance, and governance standards will likely improve. Yet in the absence of good governance structures it is very difficult for private sector institutions to flourish. There is merit in ASEAN countries proactively strengthening governance standards. Improving the effectiveness of existing institutions could be the point of departure. World Bank indicators suggest there is an urgent need in several ASEAN countries to strengthen governance. In particular, it is important to introduce regulatory institutions that are transparent, rule-bound, and work toward improving the economic welfare for all, rather than serving particular interests.

The success of institutional reform depends upon the strength and independence of the civil service. ASEAN governments need to undertake concerted efforts to train and develop an efficient and independent civil service; one which can advise governments on measures to improve economic welfare without sacrificing long-term development goals. ASEAN governments should also adopt a region-wide competition policy, or at least its legal framework, to avoid unfair competition across national markets, especially for attracting foreign direct investment or implementing free trade agreements with non ASEAN members. A good competition policy can ensure sound implementation of the AEC Blueprint and strengthen the international competitive position of ASEAN firms.

## Institutional Architecture

Strengthening ASEAN's institutional base is increasingly urgent—given the need to properly manage increased economic interdependence with other ASEAN members, with other Asian countries, and with the rest of the world. Improving the effectiveness and efficiency of the regional bureaucracy and ASEAN institutional governance are also important for ensuring proper functioning of a borderless economic community.

ASEAN should use its perceived “centrality” to assume a more active role when participating in international events (G20 and

similar forums). Members should entrust the ASEAN Chair and Secretary General with authority to articulate internally agreed regional agendas in international meetings, especially when only a few ASEAN members — if any — are invited as participants.

### New functional areas: Regional decentralization

With the Secretariat playing a coordinating role, ASEAN should reform its institutional architecture by forming new functional institutions decentralized across the region, based on individual country interest and capacity to host them. More active participation in defining the regional agenda would also provide a better sense of community, promoting the concept of a family of nations, and boost ASEAN's identity at the grassroots level. ASEAN already has several centers and regional bodies in energy and food security, biodiversity, communicable diseases, and financial surveillance. Areas for future development include natural disaster management, human and drug trafficking, services (tourism), education (tertiary and vocational education), and issues related to the environment and climate change, among others.

The funding approach used by newly-established ASEAN functional institutions has deviated from the equal contribution approach used in funding the Secretariat. Although adopted principles vary across agencies, in general, contributions are determined by financing capacity of members, the expected benefits to be received, or a combination of the two. When a new institution is established at the behest of one member, the proponent country usually offers to contribute a larger budget share than other members and usually acts as regional development champion in the concerned functional area.

### A stronger Secretariat

ASEAN member countries should also enable the Secretariat to better perform its mandated responsibilities — by enhancing its legal capability to attain trust, confidence, and respect in enforcing ASEAN agreements and commitments. Members need to invest more human and financial resources in the Secretariat. While the annual budget of the Secretariat currently runs at about \$15 million, it requires an urgent, substantial increase to enable the Secretariat and its staff to properly fulfill its expanding duties. This study estimates an expansion of the Secretariat's operational costs to \$50 million by 2015, \$100 million by 2020, and \$200 million by 2030. Additional resources from member countries should be commensurate with the

Secretariat's growing needs.

Funding Secretariat operations will require a serious re-think about how contributions are collected from member countries. Anchoring funding needs to the principle of “equal budget contribution” enormously hampers the ability to enlarge the budget as needed, because contributions from the smallest economies are limited. It creates an intrinsic dependency on external funding from international donors. Although funds are usually available, the issue is that priorities do not always match. ASEAN cannot independently accomplish its plans and realize its strategies if decisions are diluted by accommodating many other stakeholders.

One solution would be to allow diversified contributions from member countries based on successful examples of newly established functional institutions—able to act efficiently and effectively while remaining fully integrated within the ASEAN system. Although diversified contributions imply different weights in governing bodies, a positive bias can be introduced in favor of small countries (or minorities) as a balancing factor. The equal contribution principle could be updated by introducing a simple and periodically revised formula based on members' capacity and the extent of benefits they receive, reflecting the small country bias. Another way is to strengthen ASEAN Development Fund governance to play a more central role in driving the ASEAN community-building agenda, making it more effective in project funding by entrusting professionals for administration.

### Decision-making and coordination

Realizing 2030 aspirations also requires reassessing some of ASEAN's basic principles, as the association today, different from 45 years ago, needs to promote regional cooperation in a globalized world—where economic efficiency affects growth and development. In particular, ASEAN needs an “efficiency update” by introducing more formal rules and adopting a more flexible decision-making system—to govern more intensive integration and extensive external relationships. While consensus decision-making should remain as ASEAN's governing principle enshrined in its Charter, flexibility should be introduced to allow decisions on operational matters (which do not affect fundamental issues). This will avoid inefficiencies from unnecessary bureaucratic processes delaying simple decisions on day-to-day matters.

A stronger Secretariat, decision-making “efficiency updates,” and funding contributions are important steps to create a robust and

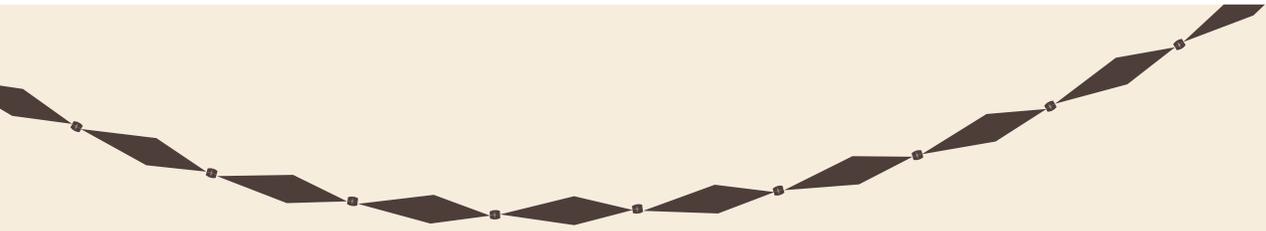
effective regional bureaucracy. The Secretariat can be more effective in coordinating its activities and functions with countries' national agencies and with external development partners. The recently established Committee of Permanent Representatives (CPR) should play an increasingly important role in providing a more effective interface between member states and the Secretariat, and in forging a new ASEAN approach to regional bureaucracy. An effective and dynamic CPR can greatly improve ASEAN in providing regional public goods by identifying efficient mechanisms for regional cooperation and strengthening the institutional base. As the CPR becomes fully integrated in a well-functioning ASEAN, member countries will easily realize that the costs of non-cooperation are in fact very high.

Improving coordination with external development partners requires better promulgation of ASEAN priorities and strategies—and better inclusion in projects and programs of bilateral and multilateral donor agencies. An *ASEAN Institute*—a new policy research facility—should be created within the Secretariat to undertake strategic policy work and capacity building programs. The Institute's activities would support ASEAN community-building and other cooperation priorities by pooling resources from member countries and development partners under the Secretariat's general guidance and coordination. Closer coordination is also needed with the private sector—business leaders and representatives of private sector organizations should be more actively involved in ASEAN-related activities and should be invited to participate in the ministerial meetings and Summits.

ASEAN has travelled far since 1967. Its milestone AEC 2015 is approaching fast. The path beyond—its aspirations of a *RICH* ASEAN by 2030—requires a solid vision of breaking down the barriers preventing the formation of a borderless ASEAN economic community. ASEAN needs to retain its “centrality” in emerging Asian regionalism. But to do so, it must keep its eye focused on elements of good macroeconomic management, inclusive growth, competitive business, and environmentally sustainable development. It needs to work for the coming generations of technologically savvy youth. Most of all, it requires a trust in ASEAN's current leadership to make the best commitments possible today for meeting the aspirations of a *RICH* ASEAN tomorrow.

## ASEAN 2030 Flow-Chart

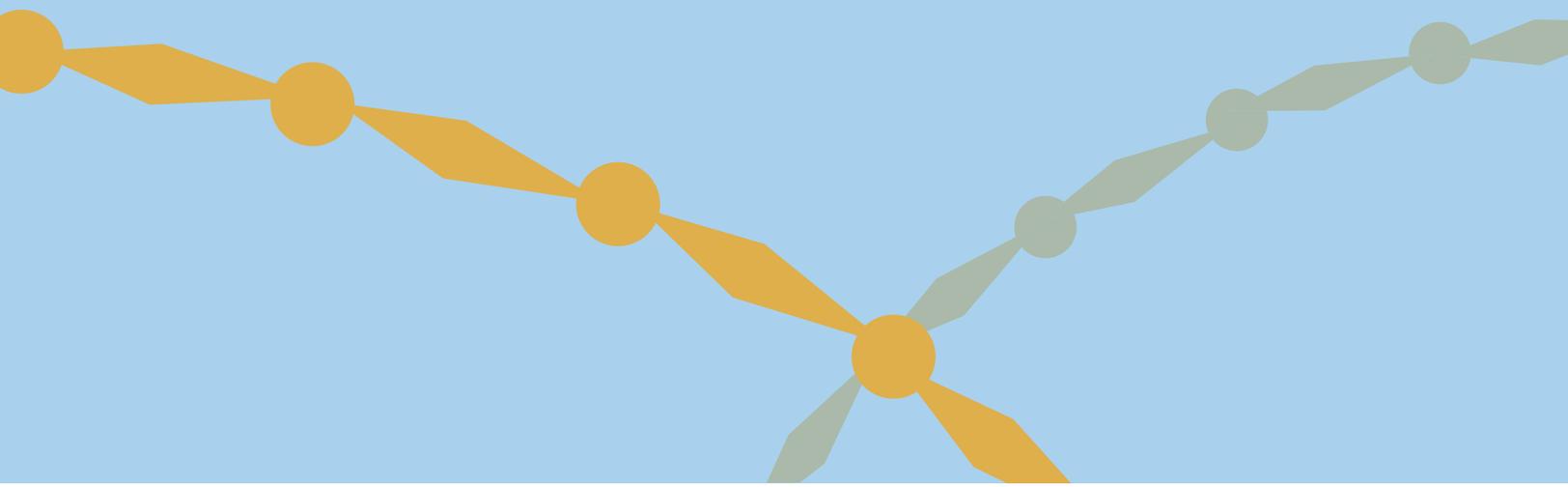
Aspirations			
Resilience	Inclusiveness	Competitiveness	Harmony
A <i>RICH</i> ASEAN: Improve Citizens' Quality of Life; Triple Average Per-Capita GDP			
Key Challenges			
Managing Macroeconomic and Financial Stability	Promoting Economic Convergence and Equitable Growth	Forging a Competitive and Innovative Region	Nurturing Natural Resources and Sustaining the Environment
Building a Borderless Economic Community			
Enabling Factors			
Broadening and Deepening Financial Markets	Harnessing Human Capital	Building Seamless Connectivity	Strengthening Governance
Enhancing ASEAN's Institutional Framework; Empowering the Secretariat			
Policy Options			
<p>1 – Strengthen ASEAN mechanisms to participate in wider regional initiatives and create an <i>ASEAN Financial Stability Dialogue</i></p> <p>2 – Start a dialogue and establish <i>regional guidelines on fiscal sustainability</i></p> <p>3 – Introduce a <i>flexible coordination mechanism</i> to maintain intraregional exchange rate stability in normal times, while allowing for flexibility in times of stress</p>	<p>1 – Improve coordination to channel external assistance to CLMV countries through the Framework for Equitable Economic Development</p> <p>2 – Introduce a region-wide system for freer managed movement of unskilled labor to reduce inequalities, social tensions, and discrimination</p> <p>3 – Establish an <i>ASEAN Convergence Fund</i> through the enlargement of the ASEAN Development Fund, entrusting professionals for its administration</p>	<p>1 – Create an <i>ASEAN Competitiveness Institute</i> to promote a region-wide yet country-specific R&amp;D strategy and innovation policy</p> <p>2 – Establish a regional agency for the certification and standardization of <i>Made-in-ASEAN</i> products</p> <p>3 – Form an <i>ASEAN Tourism Council</i> to promote multi-country tours and packages and adopt a single ASEAN Visa for qualified tourists</p>	<p>1 – Adopt long-term development strategies that mainstream green growth, reflecting regional priorities included in the ASCC Blueprint to protect the environment</p> <p>2 – Harmonize countries' environmental laws and standards and promote development of green products using common ASEAN standards</p> <p>3 – Encourage the adoption of national policies that tax environmental "public bads" and eliminate harmful subsidies that encourage inefficient use of natural resources</p>
<ul style="list-style-type: none"> <li>• Promote the development of new functional areas for cooperation through regional decentralization</li> <li>• Introduce an efficiency update of ASEAN's approach to resource funding and decision making</li> <li>• Enhance governance of the Asian Development Fund, expand its scope and activities, and improve its management</li> <li>• Create an <i>ASEAN Institute</i> to undertake strategic policy work and capacity building in coordination with member countries and development partners</li> </ul>			



# ASEAN 2030

Toward a Borderless Economic Community

**DRAFT**  
HIGHLIGHTS





# 1. ASEAN Today

**T**he Association of Southeast Asian Nations (ASEAN) — now in its mid-forties — is coming of age. Extremely diverse yet bound by a common desire for peace and prosperity for its people, it has gradually broken down barriers that hindered cooperation in fighting common problems. Today, it has reached a crossroads. ASEAN has begun the process of moving from cooperation by consensus to integration by choice. To move toward becoming a borderless economic community, it must strive to build a unique ASEAN brand of integration, one in which people believe beside their national identity. ASEAN as a whole needs to become more than the sum of its parts.

## 1.1. Evolution of Cooperation

Creating ASEAN in 1967 was a milestone decision to move from conflict to cooperation. The Bangkok Declaration was a landmark agreement among countries that long shared vibrant histories of kingdoms won and lost, but more recently had weathered little more than geographic proximity in a developing world shaped more by strong external influence. Its geopolitical *raison d'être* derived from Cold War conflict — outside analysts called it a defensive strategy against encroaching political ideology.

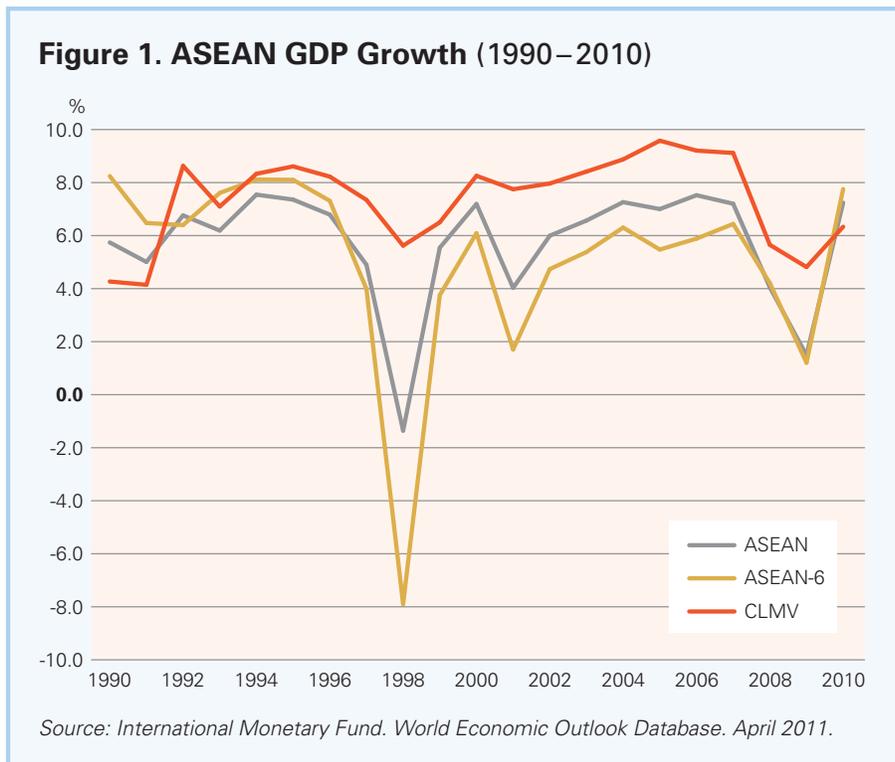
The leaders of the five original members — Indonesia, Malaysia, Philippines, Singapore, and Thailand — were mostly new to their jobs, and anxious to leave behind nagging nationalist disputes and get on with the herculean task of maintaining political stability and peace in the Southeast Asian region, and further shaping their national identities.

ASEAN's origin was primarily for political and security reasons. However, by 1976—when the 1st ASEAN Summit was finally arranged—economic development had become an integral part of the agenda. Import-substitution—which many adopted—just wasn't working. There were ample resources to tap, downstream industries to build, and demand to satisfy—domestic, within ASEAN, and external. The majority of the region was mired in poverty. People were suffering. The journey toward prosperity had to begin with earnest.

The creation of ASEAN heralded the start of the region's economic transformation. The “green revolution” brought greater agricultural productivity in the late 1960s and food security into the 1970s. As investment regimes liberalized, natural resource exploitation expanded, and with better partnerships—the precursor to a more even playing field. Easing the regulatory environment allowed foreign direct investment (FDI) to flourish, and benefits to workers were introduced. Rapid trade expansion soon followed. Multinational corporations saw significant opportunity in exploiting the region's comparative advantage—thus planting the seeds of what would develop into today's supply chains and production networks. ASEAN economies grew steadily, driven partly by FDI and exports, in addition to domestic investment. By the early 1990s, ASEAN was an important part of what the World Bank called the “East Asian Miracle” (World Bank, 1993).

After a quarter century, in 1992, ASEAN agreed to establish an ASEAN Free Trade Area (AFTA) by 2010. An ASEAN Framework Agreement on Services was adopted in 1995 to progressively eliminate restrictions on intraregional trade in services. In 1998, an ASEAN Investment Area was established to liberalize intraregional investment.

But shortly after Viet Nam entered ASEAN in 1995, and as the Lao People's Democratic Republic (Lao PDR) and Myanmar joined two years later, serious distortions began to appear, culminating in the 1997/98 Asian financial crisis. The crisis proved another watershed. ASEAN was taken by surprise. Initially thought as a short-term foreign-currency crisis limited to Thailand, contagion spread—a major setback for Indonesia, Malaysia, and the Philippines as well, with spillovers affecting other vulnerable East Asian economies, particularly the Republic of Korea. When Cambodia became 10th member in 1999, ASEAN had barely begun to recover (Figure 1).



At about the same time, the People’s Republic of China (PRC) was rapidly emerging from the economic shadows, drawing much attention away from ASEAN. This mammoth shift from relatively circumspect entity to regional giant rattled policymakers. India was soon to follow — embracing globalization after more than four decades of import substitution and State economic controls.

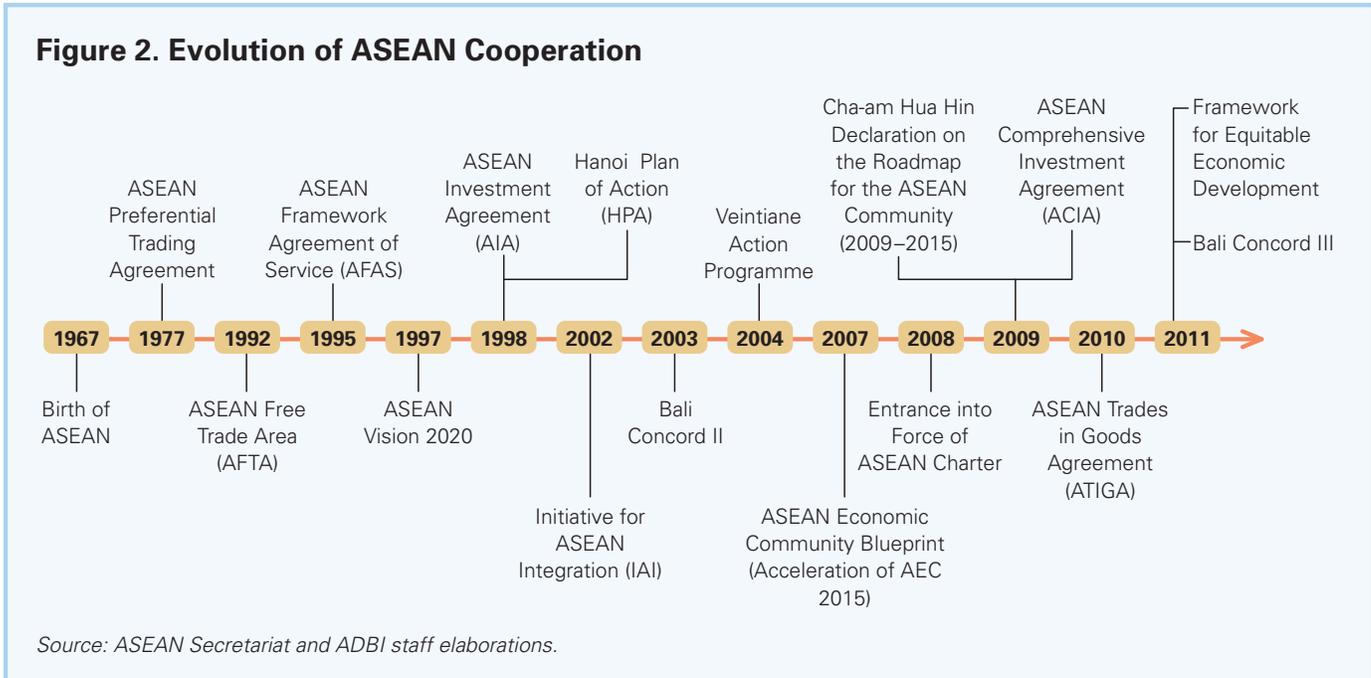
Could ASEAN retain its relevance into the new century? In particular, PRC’s economic phenomenon and India’s liberalization proved that “size matters.” ASEAN needed its combined market to compete. Without further integration, the region would be left behind. ASEAN needed to tap its vast competitive and diverse labor pool and potential consumer base. It also held the unique position of maintaining relatively good relations with both regional giants, while being a threat to neither. ASEAN was a key supplier to the PRC-centered “Factory Asia,” including Japanese multinationals and those from the Republic of Korea, while a good emissary for India’s “Look East” policy.

ASEAN’s gradual recovery from the 1997/98 crisis came as strong growth from advanced economies and competitive exchange rates powered exports — while the PRC growth juggernaut continued. In 2003, ASEAN boldly targeted 2020 to establish an ASEAN

Community — structured on its three pillars of economic integration, political and security cooperation, and socio-cultural cohesion. On its 40th anniversary in 2007, a Blueprint for an ASEAN Economic Community (AEC) was adopted, bringing the deadline forward to 2015. An ASEAN Charter was formally adopted as well — followed in 2009 by the establishment of an ASEAN Political and Security Community (APSC) and the ASEAN Socio-Cultural Community (ASCC) (Figure 2).

The AEC Blueprint and the Charter gave ASEAN integration strong strategic direction and a legal personality. While the AEC aims for a single market and production base — allowing the free flow of services, investment, skilled labor, and a “freer” flow of capital — the Charter gave ASEAN institutional teeth as a legal entity, edging it closer toward a rules-based organization.

After the initial shock of the 2008/09 global financial crisis and ensuing recession, ASEAN recovered rapidly, bolstering its own confidence as FDI returned and its importance in increasingly articulated global supply chains was cemented. Today, ASEAN remains a major economic bloc with strategic regional importance, security implications, and global standing.



Throughout this process, ASEAN’s vast diversity has remained (Box 1). Closing income gaps is critical for greater convergence in key economic indicators (Table 1)—a necessary condition for effectively establishing and managing the AEC. It is also crucial for spreading the concept of an ASEAN family of nations and enhancing social cohesion.

ASEAN today is well entrenched in regional production networks—especially where a large number of parts or components are needed for final assembly, whether within ASEAN or elsewhere. Although direct economic ties with India are less obvious than with Japan, the Republic of Korea, or the PRC, bilateral trade and investment are rising with India’s rapidly growing economy and its “Look East” policy—which includes the PRC. ASEAN is thus playing a key role in connecting Asia’s two regional giants.

**Table 1. ASEAN 2010 Baseline Data**

	<b>Population</b> (million, 2010)	<b>GDP Size</b> (US\$ billion, 2010 prices)	<b>GDP per capita</b> (US\$, 2010 prices)
Brunei Darussalam	0.41	12.4	30,173.2
Cambodia	15.27	11.2	733.5
Indonesia	234.18	708.0	3,023.3
Lao PDR	6.28	6.5	1,035.0
Malaysia	28.91	238.8	8,260.1
Myanmar	60.16	43.0	714.8
Philippines	94.01	189.3	2,013.6
Singapore	5.08	223.0	43,897.6
Thailand	67.31	318.7	4,734.8
Viet Nam	86.93	107.7	1,238.9
<b>ASEAN</b>	<b>598.54</b>	<b>1,858.6</b>	<b>3,105.2</b>

Lao PDR=Lao People’s Democratic Republic.

Source: ASEAN Database; International Monetary Fund, *World Economic Outlook Database*, April 2011 for Lao PDR and Myanmar; *World Population Prospects: The 2008 Revision*, United Nations, Available at <http://esa.un.org/unpp/index.asp>.

### **Box 1. ASEAN at a Glance: Openness and Diversity**

ASEAN is Southeast Asia's overarching institution for integration and Asia's longest standing regional group (ADB, 2010). In 2010, it was home to some 600 million people (nearly 9% of the world total) with a gross domestic product (GDP) of \$1.85 trillion, or about 3% of global GDP—up from 1.6% in 1990. In 2010, ASEAN's average per capita income (at market prices) was about \$3,100—between that of India and the PRC—or about one-third the global average. It was less than one-fifth the global average in 1990 (Table 2).

ASEAN continues to be widely diverse. Its regional averages mask huge differences across and within members—both in stage of development and quality of life. For example, in 2010, per capita GDP in Singapore was 60 times that of Myanmar. Indonesia is largest with a population of about 235 million (almost 40% of the ASEAN total). Singapore (population 5 million) is richest with per capita GDP of \$44,000—comparable to Western Europe. Brunei Darussalam, with a population of 400,000 is ASEAN's smallest member but boasts per capita income close to that of Singapore.

Four ASEAN members—Indonesia, Malaysia, Philippines, and Thailand—have held middle income status for some time (with per capita income ranging from \$2,000 in the Philippines to more than \$8,000 in Malaysia), while Viet Nam has just joined the lower middle income status with a per capita income above \$1,200. ASEAN's other three members—Cambodia, Lao People's Democratic Republic, and Myanmar—remain low income, underdeveloped, and with major pockets of poverty, even as economic growth is accelerating with a rapid improvement in living standards.

ASEAN is one of the most open economic regions in the world, with total merchandise exports over \$1.1 trillion (60% of total ASEAN GDP and 7.5% of global exports). Diversity again underlies this performance—Singapore and Malaysia are the two most open economies (with export to GDP ratios of over 100%), while Indonesia has the lowest export/GDP ratio of just over 10%. Exports account for over 60% of GDP in Brunei Darussalam, Thailand, and Viet Nam.

ASEAN maintains longstanding economic relations with Australia, the People's Republic of China, European Union, India, Japan, Republic of Korea, New Zealand, the United States, and is actively pursuing closer relations with Latin America and Africa.

**Table 2. Trends in Per-Capita GDP in ASEAN, Asia, and the World**  
(Market Prices, US\$, 1990–2010)

Economies	1990	1995	2000	2005	2010
Brunei Darussalam	13,913	16,495	18,465	25,759	30,173
Cambodia	106	297	288	455	733
Indonesia	699	1,144	807	1,300	3,023
Lao PDR	217	391	304	464	1,035
Malaysia	2,432	4,358	4,030	5,213	8,260
Myanmar	68	123	178	216	715
Philippines	718	1,105	987	1,159	2,014
Singapore	12,388	23,716	22,791	28,500	43,898
Thailand	1,521	2,826	1,983	2,825	4,735
Viet Nam	98	289	402	637	1,239
<b>ASEAN</b>	<b>805</b>	<b>1,415</b>	<b>1,166</b>	<b>1,630</b>	<b>3,105</b>
PRC	341	601	946	1,726	4,382
Japan	24,774	41,969	36,801	35,633	42,820
Republic of Korea	6,308	11,779	11,347	17,551	20,591
<b>ASEAN+3</b>	<b>2,329</b>	<b>3,868</b>	<b>3,575</b>	<b>4,196</b>	<b>6,715</b>
India	471	531	693	1,169	2,220
Australia	22,244	25,951	27,231	50,105	83,913
New Zealand	14,351	19,616	17,057	35,874	45,112
<b>ASEAN+6</b>	<b>1,813</b>	<b>2,825</b>	<b>2,624</b>	<b>3,198</b>	<b>5,098</b>
Timor-Leste	..	..	285	351	589
Hong Kong, China	15,196	28,504	33,423	35,133	44,467
Taipei, China	9,234	15,380	18,256	20,421	24,101
<b>Wider East Asia</b>	<b>1,886</b>	<b>2,944</b>	<b>2,761</b>	<b>3,336</b>	<b>5,244</b>
European Union	15,810	19,364	17,627	28,068	32,492
United States	23,198	27,827	35,252	42,681	47,284
OECD Countries	17,286	22,174	22,934	30,169	35,178
<b>World</b>	<b>4,422</b>	<b>5,326</b>	<b>5,386</b>	<b>7,093</b>	<b>9,226</b>

PRC=People's Republic of China; Lao PDR=Lao People's Democratic Republic.

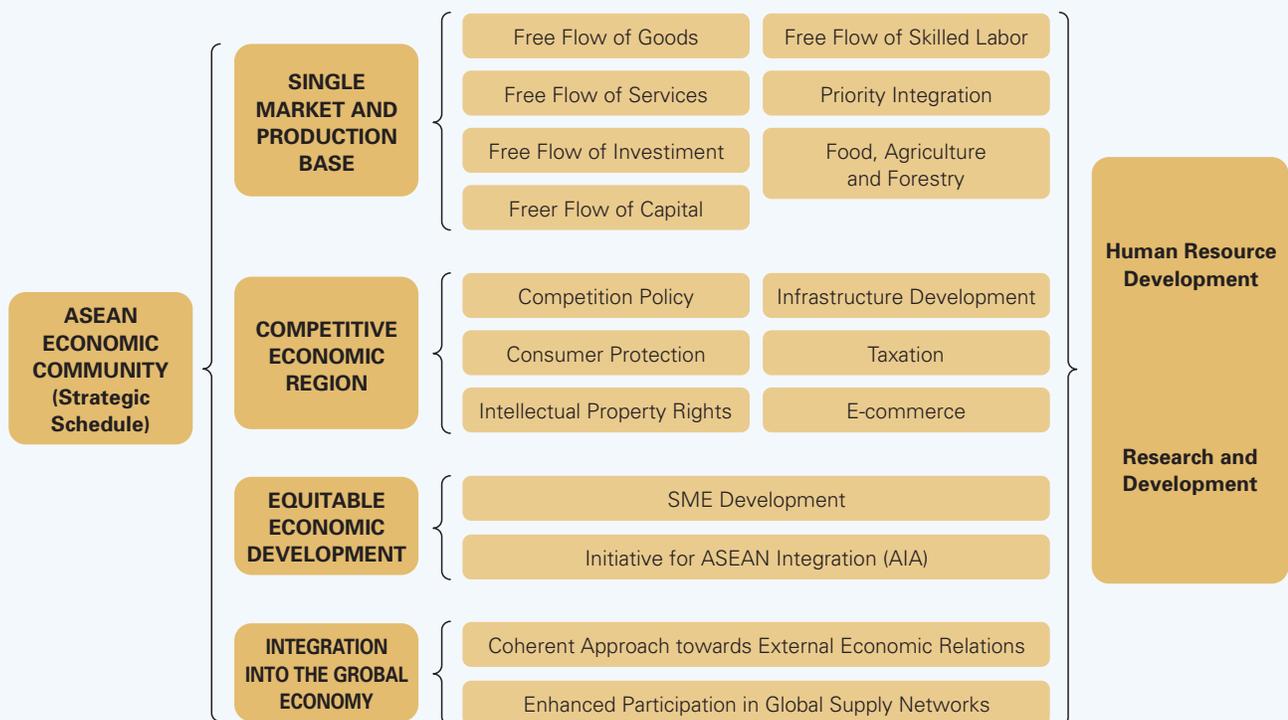
Source: International Monetary Fund, World Economic Outlook Database, April 2011.

## 1.2. Progress of the ASEAN Economic Community

The AEC Blueprint is a comprehensive — and ambitious — integration agenda which aims to transform ASEAN into a highly competitive, single market and production base by 2015 (Figure 3). It strives for equitable economic development, fully integrated with the global economy. To do so requires the free flow of goods, services, FDI, skilled labor, and a freer flow of capital.

Efficient infrastructure, transport and logistics — both within and across ASEAN borders — are essential. Fair and effective competition laws and policies, and ASEAN-wide standards are needed. The AEC Blueprint cites 17 “core elements” of integration and delineates 176 targets to be achieved over four sub-periods — 2008–2009, 2010–2011, 2012–2013, and 2014–2015. It sets milestones for each sub-period. As an integration “project,” its breadth and scope are perhaps

**Figure 3. ASEAN Economic Community (Structural Components)**



Source: ASEAN Secretariat and ADBI staff elaborations.

second only to that of the European Union (EU).

Essentially, a single market and production base offers consumers in the region a larger marketplace to fulfill consumption needs while giving producers wider space for setting up production — regardless of existing national (or administrative) boundaries within the region. This implies total removal of all trade barriers in goods, services, and investment. Removing these barriers completely still faces many hurdles: physically, technically, economically, politically, and culturally.

Today the business climate across ASEAN is as diverse as ASEAN itself. Pockets of excellence exist alongside economies steeped in red-tape. There are vast differences within countries as well — whether between processing zones, industrial estates and the general economy, or between urban centers and rural or geographical “outer” regions.

Can ASEAN create a borderless economic community?

Removing barriers to intra-ASEAN trade and capital flows — tariff, non-tariff, and as well as behind the border — are imperative if ASEAN is to become a single market and production base. Several agreements already provide rules and monitoring mechanisms to make the AEC adhere to international best practices using a rules-based system. Making all this happen by 2015 is a monumental challenge.

ASEAN’s vast diversity and the need to accelerate convergence could be its greatest challenge in creating a meaningful AEC. At the 19th Summit in Bali, Indonesia, in November 2011, ASEAN leaders endorsed a new Framework for Equitable Economic Development, which concentrates efforts on closing intraregional development gaps, both across and within borders. Indeed, an effective AEC should exploit diversity as an opportunity and use it to comparative advantage — for enhanced competitiveness, greater diversification of industry, and better integration between manufacturing and services through improved, borderless, logistics. After all, traditional trade theory underscores that the greater the diversity among countries, the greater the potential for gains from trade.

Doing so requires an increasingly borderless community, one in which individual ASEAN countries view themselves as part of the greater whole, a family that transcends national boundaries, not simply physical, but social and cultural as well. Common policies can also strengthen research and development (R&D) — a regional innovation strategy. An AEC must not simply be a glorified free trade area — an “AFTA plus” — but must find the best common

denominators that allow ASEAN to use the rapidly growing economic strength of the PRC and India to better capture the synergies created by increased regional and global economic interdependence.

How are ASEAN members faring in fulfilling their commitments to meet the 2015 deadline? A detailed ASEAN Economic Community scorecard — which tracks members compliance with the Blueprint — shows that progress has been below expectations, and uneven across countries and sectors.<sup>1</sup> However, what really matters more than punctuality is getting the “best” integration measures in place. Thus, indicators of compliance should focus more on quality than quantity.

The AEC is being established by ASEAN to accelerate economic integration — its full implementation will involve major changes in ASEAN and the way it works over the next two decades. Given its complexity and comprehensiveness, AEC implementation has been slower than planned, and it is unlikely to be fully realized by 2015. An estimate in 2010 showed that about 10% of what was to be completed during 2008–2009 under the AEC Blueprint was behind schedule.

For instance, implementing the AEC requires significant legal and institutional changes in ASEAN countries. This takes significant time. Eliminating non-tariff barriers, the establishment of an efficient trade facilitation system, full liberalization of services, free flow of skilled labor, and fully liberalizing capital flows are particularly complex and difficult to reach agreement on in general, particularly without a strong central institution to coordinate discussions. This is a critical issue that needs to be resolved if a borderless economic community and a competitive production base is to be created under the AEC.

By 2015, while many of the AEC core elements can be expected to be in place, much will remain to be done to address constitutional, legislative, and regulatory limitations impeding full implementation of agreements as well as intra- and extra-ASEAN commitments. Legislative processes take time, and procedures vary considerably across ASEAN countries. While member states need to strengthen their national coordinating agencies to effectively and timely implement ASEAN commitments, a strengthening of the socio-cultural community and public awareness (also among some

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<sup>1</sup> The ASEAN scorecard system only indicates whether or not a country has embarked on policies to implement AEC Blueprint measures; it does not indicate the actual status of implementation of each measure.

policymakers) of the benefits of integration is needed both within the context of the AEC and beyond.

Complete liberalization of capital flows and ASEAN capital market integration — as well as opening up financial markets within ASEAN — are all areas which need to be addressed beyond the AEC timetable. For example, the AEC Blueprint only addresses skilled labor. But cross-border migration of unskilled labor is bound to surface as ASEAN countries approach high income status by 2030. Also, by 2015, much remains to be done in building the infrastructure required to create an efficient and friendly climate for a multimodal intra-ASEAN transport system. Other areas where more progress is needed include competition policy and consumer protection.

## 1.3. Regional and Global Economic Context

There is a growing consensus that the center of global economic gravity is shifting toward Asia. This trend is likely to continue over the coming decades. The 2008/09 global economic crisis likely hastened this process, as emerging Asia maintained its growth momentum despite the external shocks and disruptions. A global “new normal” will likely include a slowly growing US and Europe — as they tackle sweeping structural adjustments — with emerging markets expanding more rapidly even given the challenges of sustained and more inclusive growth and development. Asia will likely be the driver of this growth. But the Middle East, Latin America, and Africa will also likely increase economic influence in an increasingly multipolar globalized world (ADB’s Asia 2050 Study, ADB 2011).

The impact of the 2008/09 global economic crisis brought ASEAN — along with other emerging markets — to a crossroads. The rising economic and political power of the PRC and India will provide huge opportunities for ASEAN. But they can also be a threat if ASEAN “centrality” is not reinforced. Over the next two decades, these two markets — with their huge and rapidly growing middle and higher income populations — will become more important ASEAN trade and investment partners, especially if ASEAN economies raise the competitiveness of their export industries through deeper integration and full AEC implementation.

Hence, the region’s sources of growth will likely undergo a

structural rebalancing away from reliance on exports to advanced economies. This will affect the current configuration of Asian production networks and supply chains. ASEAN must be a dynamic participant in this evolution. “Rebalancing” is often used as the “solution” to a myriad of problems — ranging from global payments imbalances; to sources of domestic growth; to economic convergence; to inclusive finance; to prioritizing small and medium enterprises over state-owned or private sector conglomerates. Acknowledging these seismic changes, many ASEAN countries have formulated longer term national visions.

In 2010, for example, Indonesia adopted a Master Plan for accelerating and expanding development; Malaysia adopted its New Economic Model; the Philippines a new Medium-Term Development Plan; Thailand the 11th Five Year National Economic and Social Development Plan (2011); Singapore had its Economic Strategies Committee Report; and Viet Nam a Socio-Economic Development Strategy. ASEAN members indeed need to define national and regional policy choices and options carefully if development momentum — properly attuned to the changing global environment — is to thrive.

ASEAN has steadily grown in global relevance — with greater political cooperation, economic integration, and social cohesion. This is particularly true as “ASEAN+” free trade agreements (FTA) — as well as bilateral FTAs between individual countries — have multiplied over the past few years. While ASEAN’s “centrality” to emerging Asian regionalism continues to be a topic widely debated, ASEAN leaders adopted the ASEAN Framework for Regional Comprehensive Economic Partnership (RCEP Framework). This sets out principles under which ASEAN will broaden and deepen engagement with FTA/CEP partners — and subsequently with other external economic partners — with the goal of creating a regional comprehensive economic partnership agreement. US Secretary of State Hillary Clinton described ASEAN as “the fulcrum of an evolving regional architecture.”<sup>2</sup> With ASEAN centrality as an often-heard refrain in the region, one wonders whether, in fact, ASEAN has already reached its apex as a regional organization. There are many experts worrying about ASEAN losing its centrality in the process of future Asian cooperation and integration.

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<sup>2</sup> Hillary Clinton, “America’s Pacific Century,” *Foreign Policy*, November 2011.

## 2. Aspirations for a “RICH” ASEAN

Coming to grips with defining aspirations of a regional entity that encompasses such a diverse set of nations is beset with difficulties. National goals invariably differ across countries. In addition, it is not easy to ensure aspirations can be “ambitious enough” for setting broad goals, while at the same time “pragmatic enough” for countries to realistically attain over a two-decade horizon. To help overcome these difficulties, a holistic approach in defining aspirations was used for each ASEAN member and ASEAN’s own collective aspirations.

In-depth background studies were carried out; one for each ASEAN country. More than twenty thematic studies were also prepared on key issues and challenges that ASEAN will face over the next 20 years. Goals from long term national development plans were taken into account and extensive consultations were held with the countries concerned, the ASEAN Secretariat, and national and regional think tanks. Surveys of opinion leaders across ASEAN were also conducted. These were complemented by a “strengths-weaknesses-opportunities-threats” (SWOT) analysis.

### 2.1. Strengths, Weaknesses, Opportunities, and Threats

The SWOT analysis helps identify internal and external factors critical to achieving 2030 aspirations. Internal factors were used as existing strengths or weaknesses, while external factors helped define future opportunities or threats.

The SWOT format was used for both individual ASEAN members and for ASEAN as a region (Figure 4). The SWOT analysis can also be used to match strengths to opportunities and weaknesses to threats. When aspirations were adjudged unrealistic, a new set was defined and the process repeated until a credible list took shape.

**Figure 4. ASEAN SWOT Diagram**

<p><b>Strengths</b></p> <ol style="list-style-type: none"> <li>1. Generally robust 2001–2010 economic growth</li> <li>2. Good macroeconomic fundamentals (especially among original ASEAN-5)</li> <li>3. Adaptable open export economies</li> <li>4. Wide-ranging productive capabilities (agriculture, manufacturing, services)</li> <li>5. Diversified exports—by destination and product</li> <li>6. Abundant natural resources (oil, gas, coal, hydropower, minerals, agriculture) and biodiversity</li> <li>7. Young, growing populations and expanding middle class</li> <li>8. Strong FDI with strong production networks</li> <li>9. Growing small and medium enterprises</li> <li>10. Track record of regional cooperation</li> <li>11. Strong regional architecture and core of regional initiatives—ASEAN+3, EAS, ASEAN Regional Forum, among others</li> <li>12. Solidifying regional cooperation initiatives via ASEAN Charter, Roadmap for an ASEAN Community, and Master Plan on ASEAN Connectivity</li> </ol>	<p><b>Weaknesses</b></p> <ol style="list-style-type: none"> <li>1. Development gaps between and within members— income, human capital, rule of law, institutions, infrastructure</li> <li>2. No “solidarity fund” (common resource pool) as redistributive mechanism among members</li> <li>3. Disparities in good governance and rule of law</li> <li>4. Generally weak education and large unskilled workforce</li> <li>5. Over ambitious 2015 AEC targets and vague integration plan beyond a single market/ production base</li> <li>6. Need for skilled labor integration</li> <li>7. Uneven trade conditions despite AFTA</li> <li>8. Excessive reliance on FDI—lack of industrial innovation</li> <li>9. Risk of middle income trap</li> <li>10. Delayed decisions due to need for consensus and non interference</li> <li>11. Weak ASEAN Secretariat; insufficient human and financial resources; equal budget contribution constrains institutional growth</li> <li>12. Need for strong regional civil service</li> <li>13. Weak links between ASEAN and sub regional programs—GMS, IMT GT, BIMP EAGA</li> </ol>
<p><b>Opportunities</b></p> <ol style="list-style-type: none"> <li>1. Central, strategic location</li> <li>2. Huge market potential—especially PRC and India</li> <li>3. Strong historical/cultural links throughout Asia</li> <li>4. Entrepôt for new ASEAN+1 FTAs markets—Australia New Zealand, PRC, India, Japan, and Republic of Korea</li> <li>5. Deep manufacturing and technology links with Northeast Asia</li> <li>6. Potential regional hub for education, health, tourism, R&amp;D, logistics, and financial services</li> <li>7. Financial cooperation with “Plus Three” countries in reserve pooling (CMIM) and surveillance (AMRO)</li> <li>8. Honest broker between Asian economies—Japan, PRC, India</li> <li>9. Potential for combined competitive ASEAN market</li> </ol>	<p><b>Threats</b></p> <ol style="list-style-type: none"> <li>1. Incomplete achievement of AEC by 2015</li> <li>2. Vulnerability to external shocks given high economic interdependence with US and Europe</li> <li>3. Erosion of export-driven development advantage</li> <li>4. Loss of cohesion/direction as focus shifts to competition rather than cooperation</li> <li>5. Unresolved intra and extra regional territorial conflicts/disputes</li> <li>6. Rise of PRC and India overshadow ASEAN relevance</li> <li>7. Lack of effective disaster management (drought, floods, earthquakes, volcanos)</li> <li>8. Lack of cohesion on climate change, water, energy, and food security</li> </ol>

Source: ADBI staff elaborations.

ASEAN’s major strengths include strong economic growth and export performance, good macroeconomic fundamentals, and generally abundant natural resources. Its population is relatively young and includes a rapidly growing middle class. It boasts strong production networks, enjoys a vibrant small and medium enterprise sector, and its economies continue to integrate. The region’s main weaknesses include relatively low levels of human resource development, a lack of sophisticated home-grown technology, difficulty in reaching AEC targets for a single market and production base, ponderous regional decision-making and weak ASEAN institutions. ASEAN is also often seen as the sum of 10 diverse countries with few truly integrated policies.

Opportunities are enormous — given ASEAN’s location in the world’s most dynamic region and astride critical trade routes. Its outward-oriented development strategy and commitment to “open regionalism” are important attributes. The region holds potential as a logistics hub, center to high-value production networks (already in electronics and motor vehicles) and as a hub for tourism and other valuable service industries (such as medical services). ASEAN nonetheless faces major threats over the coming two decades. It remains highly vulnerable to external economic and financial crises. Its strong trade component leaves it exposed to protectionism and intra- or extra-regional territorial conflicts and disputes. It faces the brunt of climate change and often copes with myriad natural disasters. Finally, the economic and political rise of the PRC and India — while a huge opportunity — could also overshadow ASEAN’s “centrality” as a core for Asian regionalism — and dynamism.

## 2.2. Ambitions and Pragmatism

From background papers, surveys, consultations and other inputs, four key aspirations were distilled for ASEAN. By 2030, ASEAN should strive to be *Resilient, Inclusive, Competitive, and Harmonious* — a “RICH” ASEAN. While not intended to define a new road map, these aspirations provide a window to an ambitious yet pragmatic future.

**Resilience** means the capacity to handle volatilities and shocks, from within or outside the region, reducing the likelihood of economic crises. It needs strong institutions and solid macroeconomic policies run by effective managers, capable of assessing risks and taking action. It also requires a regional framework for macroeconomic

cooperation and management. **Inclusiveness** implies making economic development equitable, providing opportunities through cooperation strategies that reduce income gaps within and across countries, and promoting citizen welfare. **Competitiveness** refers to the ability of competing economically with major global players, particularly large emerging economies, such as PRC and India. It requires ASEAN to focus on improving productivity and innovation capability, and harness the advantage of size by moving toward a borderless economic community. **Harmony** emphasizes the need for development to be sustainable and harmonious with nature. It also includes developing a clear sense of an ASEAN family, where member countries live in peace, working together to resolve common problems.

Achieving a *RICH* ASEAN by 2030 requires three development threads. First, growth must be sustained, with a broad set of indicators showing increased economic maturity. Second, sources of this growth must spread beyond traditional—if highly successful—export-led growth models. Domestic demand must be strengthened while avoiding the pitfalls of the “middle-income trap.” And third, given ASEAN’s pronounced diversity, there must be a clear trend of economic convergence both within and among ASEAN members to reduce disparities—growth and development in lower-income members must accelerate, while middle-income countries strive to reach developed nation status.

Related to this is the conscious drive to create an increasingly borderless community of nations. This is predicated on the capacity to trade and travel across borders; to ensure the free flow of information through a seamless communications network; to bring institutions that affect economic activity closer together through convergence; to construct common technical standards that apply throughout the region; and to work toward better management of economic resources so they are used most efficiently—whether raw materials, goods, services, capital, and labor (whether skilled or unskilled).

Supplementing these qualitative aspirations with quantitative measures give a broad trajectory of ASEAN’s per capita income over the next two decades. In real per capita GDP, aspirations at the country and regional level were calculated (Table 3). Broadly speaking, ASEAN aims to triple real per-capita GDP (calculated in US dollars, at 2010 market prices) to reach an average real value close to \$10,000 for the region by 2030. This implies average ASEAN per-capita GDP growth between 2010 and 2030 of 5.6%,

**Table 3. ASEAN Aspirations (2010–2030)**

	<b>GDP per Capita in 2010</b> (US\$, at 2010 market prices)	<b>2030 Target</b> (2030 value as a multiple of 2010 value)	<b>GDP per Capita in 2030</b> (US\$, at 2010 market prices)	<b>GDP per Capita 2010–2030 Average Yearly Growth</b> (%)
Brunei Darussalam	30,173.2	2.5	75,432.9	4.69
Cambodia	733.5	4.0	2,933.9	7.18
Indonesia	3,023.3	3.5	10,581.6	6.46
Lao PDR	1,035.0	3.5	3,622.6	6.46
Malaysia	8,260.1	3.0	24,780.4	5.65
Myanmar	714.8	4.5	3,216.4	7.81
Philippines	2,013.6	2.5	5,034.0	4.69
Singapore	43,897.6	1.8	79,300.0	3.00
Thailand	4,734.8	3.0	14,204.4	5.65
Viet Nam	1,238.9	3.5	4,336.2	6.46
<b>ASEAN</b>	<b>3,105.2</b>	<b>2.97</b>	<b>9,325.3</b>	<b>5.60</b>

Source: Population: World Population Prospects: The 2008 Revision, United Nations, Available at <http://esa.un.org/unpp/index.asp>; ASEAN 2030 background paper on country perspectives.

or—given the projected average ASEAN annual population growth of 0.9% over the next two decades—it implies an average annual real GDP growth of 6.5%. This is certainly an ambitious, though reachable, target when compared with ASEAN's average real GDP growth of 5.3% between 2000 and 2010. However, ASEAN will need to work hard to remain competitive as the global economic environment evolves with the competitive pressure from dynamic large economies such as the PRC and India.

If ASEAN cannot improve over the past decade—real GDP growth at an average 5.3% over the next 20 years—then instead of a tripling real per capita GDP by 2030, ASEAN can expect real per capita GDP to increase by about 2.37 times by 2030, to about \$7,345 (at 2010 prices) compared with \$9,325 if aspirations are reached. This translates into an additional 5 years before ASEAN attains real per capital GDP levels commensurate to its aspirations.

In a worse-case scenario, if ASEAN stumbles in moving beyond the AEC toward a more borderless economic community; or if a major external shock hits the region; or if countries get stuck in the middle income trap, then it is quite likely ASEAN growth will decelerate

compared with past decades — ASEAN 2030 aspiration targets will not be met. If this happens, ASEAN’s real GDP growth will possibly reach 4.5% on average, with the 2030 average real per capita GDP about twice the 2010 level, or about \$6,300 (at 2010 prices). In this low growth case scenario, it will be after 2041 before ASEAN’s real per capita GDP can reach the level of 2030 aspirations.

Of course, per capita GDP is not the only measure for assessing whether aspirations of individual countries or that of ASEAN as a whole are met. Progress toward achieving 2030 targets should be measured using a wide range of quantitative and qualitative indicators that can track improvement in a citizens’ quality of life. These include those measuring inequality, competitiveness, governance, tradition and non-traditional security (including food security) and human development. In the past, too much economic growth in ASEAN has occurred with little regard for environmental sustainability. Over the next decades, economic growth must come with far less damage to the natural resource environment.

Should ASEAN get all the proper policies in place, by 2030 Brunei Darussalam and Singapore could be among the richest countries in the world, Malaysia would have moved to high income status (slightly above the Republic of Korea today), Thailand would be close to high-income, while the rest of ASEAN would be positioned within middle income status, with Indonesia having higher per capita income than Malaysia today, followed by the Philippines and Viet Nam. Lao PDR, Myanmar, and Cambodia would have reached lower middle income status.

Many aspirations lie beyond numbers and economic indicators. Poverty reduction, better education, health, human development and lower income disparities — are all dimensions of inclusive growth which help improve citizens’ quality of life. These wider dimensions of national aspirations are central to building an inclusive and competitive ASEAN in an increasingly borderless environment. Other aspects related to quality of life relate to job security, political and social stability, security and personal safety, social cohesion, and leisure. Most countries also cite resiliency and harmony as important components.

Even under relatively optimistic economic growth assumptions for Cambodia, Lao PDR, Myanmar, and Viet Nam (the CLMV countries), and despite significantly higher per capita growth rates than the ASEAN average, the development gap between ASEAN members will remain large over the coming decades — particularly between Cambodia, Lao PDR, and Myanmar against the rest of

ASEAN. Narrowing this gap must be a top priority for ASEAN well beyond implementing the AEC.

Widening gaps could threaten meeting AEC targets and certainly slow further integration. As some countries reach higher income status and move toward achieving a higher quality of life, selective redistribution mechanisms might be examined. The development gap is not merely important between countries, but just as importantly within countries—where inequality has generally increased over the past decade. Widening domestic disparities threatens ASEAN integration. Reducing these should be an important component of building an ASEAN Community.

Other important ingredients for a *RICH* ASEAN include environmentally sustainable development together with mitigating and adapting to climate change. Preserving forest cover—and in many cases increasing it—are among the aspirations cited during consultations in Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, and Viet Nam. ASEAN holds tremendous biodiversity—it is one of the most diversified regions in the world—and building the right mix of biodiversity and rapid economic growth is a sign of good governance.

Most countries aspire to reduce CO<sub>2</sub> emissions and make growth more energy efficient to limit the impact on climate change. ASEAN countries—especially Viet Nam—are acutely aware of their vulnerability to climate change. Reduced pollution and improved water quality matter. Malaysia, Philippines, Thailand and Viet Nam cite “green growth” as part of their vision. And quality of life is important, whether quality urban living (Singapore), a balance between urban and rural development (Lao PDR), ethnic harmony (such as in Indonesia and Myanmar), smooth relations with neighbors (Thailand and Cambodia), well-functioning public institutions, and reduced corruption are often cited as important aspirations.

The Bali Concord III adopted at the 19th ASEAN Summit in November 2011 focused on the role of an ASEAN Community in the global community of nations. It calls for a “more coordinated, cohesive, and coherent ASEAN position on global issues of common interest and concern.” It stresses the importance of a political and economically coherent ASEAN.

Economic growth projections for 2030 require a definition of what is national, regional, and of global concern—and where ASEAN stands on each. There is clear confidence in lifting economic potential and the commitment to better share ambitions across different segments of society. ASEAN society will mature

as incomes rise — “quality of life” grows in importance, people are increasingly aware how unfettered growth can hurt the environment and health. Combined, individual country aspirations help shape the idea of a truly *resilient, inclusive, competitive* and *harmonious* ASEAN by 2030.

Reaching these aspirations will involve seismic shifts in policy direction, both domestic and regional. It will require close collaboration with development partners. Most importantly, it requires regional peace and stability. Conflicts may disrupt ASEAN integration and stymie aspirations. Potential sources of conflict must be brought upfront, and assuaged before confrontation erupts.

At all levels—as an institution or region—ASEAN must strengthen itself to effectively guide regional cooperation. This too is a major aspiration. Defining the limits of “core sovereignty” could become a unique ASEAN model for regional integration. People naturally tend to look at the European experience. But ASEAN is not Europe. Divergence is far wider than Europe’s; there is little discussion over the level of sovereignty that could be surrendered to achieve anything like an EU; and an ASEAN economic union is unlikely. Given Europe’s ongoing economic crisis, there would be little appetite—among ASEAN policymakers in particular and the public in general—to discuss economic union at this stage. Thus, as an aspiration, moving toward a borderless ASEAN economic community in 2030 pragmatically lies somewhere between the AEC and the EU.

## 3. Key 2030 Challenges

**T**here are several challenges the region will have to address — both at the national and the regional levels — to effectively meet ASEAN aspirations by 2030.

National needs drive economic policy. But as advantages of cooperation become more apparent, national priorities slowly meld into a more regional thrust. As discussed previously, ASEAN aspirations are multi-dimensional. Its challenges are thus equally multi-faceted, national and regional in scope. And in defining what it takes to have a *RICH* ASEAN by 2030, it helps to define not the “least” but the “highest” common denominators for individual countries and the region as a whole.

What do policymakers need to do — nationally and collectively — to reach the aspirations for a borderless, *RICH* ASEAN by 2030? The bottom-up approach identified four central prerequisites that underpin the *RICH* concept: (i) managing macroeconomic and financial stability for *resilience*; (ii) promoting economic convergence and equitable growth for ensuring *inclusiveness*; (iii) using and developing comparative advantage and innovation for *competitiveness*; and (iv) nurturing natural resources and sustaining the environment for *harmonious* growth.

### 3.1. Managing Macroeconomic and Financial Stability

The 1997/98 Asian financial crisis was more than a wakeup call about the crucial importance of ensuring sound macroeconomic policy management and stable financial systems — not simply for ASEAN countries, but for the East Asian region more generally. Ten years later this was proven true globally, as the entire world faced the 2008/09 financial crisis and ensuing economic recession. In a globalized world, where trade and capital move freely, sound macroeconomic management and financial stability are prerequisites for improving competitiveness and productivity.

Capital, goods, and services flow more efficiently across borders when the underlying system is predictable and macroeconomic policy management is credible and sound. For example, an active policy to coordinate exchange rates among East Asian countries can be an important tool for preventing systemic instability caused by the disruption of supply chains and regional production networks. Business benefits when exchange rates are predictable and properly aligned.

The rapid contagion during the Asian financial crisis of 1997/98 underscored the fact that East Asian economies were far more interdependent than previously thought. Not only did the crisis highlight the need for better macroeconomic management nationally: it also exposed the lack of tacit—let alone formal—mechanisms for regional policy cooperation and coordination. It left the region speeding along a development highway with no spare tire.

Maintaining macroeconomic and financial stability is primarily a national issue to build resilience to domestic and external shocks. Since the Asian financial crisis most governments in the region have done a reasonably good job of maintaining macroeconomic and financial stability. Many countries have shifted from pegged to flexible exchange rate regimes with inflation targeting guiding monetary policies, explicitly or implicitly. However, the less developed ASEAN members—Cambodia, Lao PDR, Myanmar, and Viet Nam (CLMV)—were not directly exposed to the crisis and are today in the process of building the technical and institutional capacity to make macroeconomic management more effective (Table 4).

Financial shocks are a fact of life. Aside from prevention mechanisms, governments must quicken reaction time, and learn to better mitigate the shock impact. One important way is to strengthen social protection systems, establishing contingent support systems allowing for cash transfers, small infrastructure projects, and additional funding for health and education. These would help improve economic resilience and ensure the burden of potential future shocks do not fall on the most vulnerable.

Drawing on the 1997/98 crisis lessons, ASEAN has gradually formed its own internal macroeconomic monitoring and surveillance system. ASEAN joined hands with the PRC, Japan, and Republic of Korea to establish cooperative regional arrangements to prevent future crises and for better managing them should they occur. As a result, two key initiatives are now in place: (i) the Chiang Mai Initiative Multilateralization (CMIM), a \$120 billion regional

**Table 4. ASEAN Economies: Indicators of Vulnerability (2010)**

	Current Account Balance <sup>1</sup>	Gross Reserves <sup>2</sup>	Public Debt <sup>1</sup>	Fiscal Balance <sup>3</sup>	Monetary Growth <sup>4</sup>	Capital adequacy <sup>5</sup>	Non-Performing Loans <sup>6</sup>
<b>ASEAN 6</b>							
Brunei Dar.	47	3.9	na	17	17.4	16.8	7.8
Indonesia	5.8	6.3	26.3	-0.2	13.9	19.3	3.2
Malaysia	7	6.9	62.3	-7	7.8	15.1	3.5
Philippines	4.8	NA	50.5	-3.6	11.6	15.3	4.5
Singapore	17.8	5.7	na	-1.9	10.6	16.5	2.3
Thailand	3.6	9.9	45.4	-3.6	6.6	15.7	5
<b>CLMV</b>							
Cambodia	-11.2	3.1	30.1 <sup>7</sup>	-7.4	12.9	27.8	5.2
Myanmar	-1	8.1	31.1 <sup>7</sup>	-3.5	22.3	na	na
Lao PDR	-15.4	2.6	53.9 <sup>7</sup>	-7.8	16.7	na	na
Viet Nam	-8.1	3.3	47.5	-8.2	19.6	8.2	3

Notes: 1. As percent of GDP; 2. Month of imports; 3. Overall balance, in percent of GDP, for 2009/10 budget year; 4. Broad Money Growth, year on year; 5. Regular capital to risk-weighted assets; 6. As ratio of loans; 7. External debt.

Brunei Dar.=Brunei Darussalam; Lao PDR=Lao People's Democratic Republic.

Source: International Monetary Fund and ADB Database.

reserve fund — expected to double in size in 2012 — supported by an ASEAN+3 Macroeconomic Research Office (AMRO), and (ii) the Asian Bond Markets Initiative (ABMI), launched by ASEAN+3 to promote local-currency bond markets. Both initiatives are beginning to bear fruit. Annual Summits of ASEAN and other regional leaders pepper the calendar.

The impact of the 2008/09 global financial crisis and the way ASEAN and other East Asian economies responded shows the region's resilience to financial crises has improved over the years. Yet, ASEAN should never take macroeconomic and financial stability for granted. It should build upon and capitalize from the painstaking negotiations that led to these agreements and use their structures as foundations for gradually constructing more formal forms of regional cooperation to enhance macroeconomic and financial stability. There are several areas where this can take place—exchange rates and fiscal policies being among the most important.

As mentioned, exchange rate policy coordination is particularly

important when market interconnectedness is high. This is because exchange rate stability—or at least its predictability—reduces the business costs within ASEAN and significantly contributes to enhancing regional production networks. The spirit of exchange rate policy cooperation in ASEAN has been market based. It will likely continue to be to establish a degree of stability between the bilateral nominal exchange rates of ASEAN currencies.

Given ASEAN's huge economic diversity, the aim of cooperation in exchange rate policy should not be monetary union, but rather to attain fairly stable intraregional exchange rates in normal times, while allowing for greater flexibility in times of stress. In fact, informal exchange rate cooperation appears already deep-rooted—ASEAN central banks and monetary authorities intervene regularly in the market to keep their currencies relatively stable against others in the region. Exceptions occur when some countries face foreign exchange liquidity shortages or balance of payments problems and need to allow their exchange rates to shift significantly in relation to other currencies in the region.

Some recent developments should go far in accelerating cooperation in the area of exchange rate policy. Starting in 2012, Central Bank Governors will participate in ASEAN+3 Finance Minister Meetings. This makes that forum appropriate to discuss exchange rate cooperation, as key ASEAN+3 policymakers are all sitting around the same table. ASEAN should also begin joint meetings between finance ministers and central bank governors to parallel the ASEAN+3 process. This will deepen the ASEAN surveillance process along with exchange rate and financial cooperation, contributing to greater economic resiliency and the ASEAN competitiveness.

As the architecture of regional financial cooperation evolves toward 2030, an Asian monetary fund will likely be centerpiece. Regular, frequent regional surveillance meetings among finance ministers, central bank governors and financial regulators in East Asia will become an important part of the region's architecture also to enhance institutional effectiveness and capability by expanding resources and peer-group review of national policies. These meetings should become the focal point for surveillance and financial cooperation initiatives, but with far wider global implications, given the large financial resources controlled by East Asia.

As for ASEAN, although its members are integral parts of the regional process, each country is too small to have a significant voice. Therefore, ASEAN needs to strengthen its own financial

cooperation and consultation processes in order to develop unified positions on major issues, speak with one voice and have its views reflected in regional decision making forums and in major global arenas, such as the G20 or what may evolve from the G20 over the next couple of decades. In particular, ASEAN members should consider establishing an *ASEAN Financial Stability Dialogue*, composed of Finance Ministers, Central Bank Governors, financial supervisors, and market regulators. Active dialogue with the private sector and coordination with the recently expanded ASEAN+3 Finance Ministers' and Central Bank Governors Meeting should also be encouraged.

On fiscal policy, coordination is significantly more complex than with exchange rates, given the pronounced diversity in economic structures, level of development, balance of payments positions, level of reserves, and national development priorities.<sup>3</sup> Nonetheless, as ASEAN economies become more deeply integrated, contagion from a fiscal crisis in one country to the entire region cannot be avoided. Therefore, pursuing fiscal discipline across the region is a critical aspect for a *RICH* ASEAN by 2030.

An annual joint assessment of fiscal sustainability by an independent institution such as AMRO—or a multilateral financial institution like the Asian Development Bank (ADB) or the International Monetary Fund (IMF)—would be one way to start collaboration in fiscal policy management. Members could share detailed fiscal and public debt positions and projections to enable analyses of fiscal sustainability. The issue could be first discussed during meetings of senior ASEAN finance and central bank officials to see where potential vulnerabilities lie. Assessment results could then be reported to the *ASEAN Financial Stability Dialogue*. Eventually, authorities could consider creating *regional guidelines on fiscal sustainability*, which would define tolerable levels of fiscal deficit and public debt ratios.

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3 In contrast to exchange rate or monetary policy, fiscal policy involves a wide range of decisionmakers. While monetary policy is often made within the halls of a central bank fiscal policy—increasingly in Southeast Asia—is conducted with the full participation of democratic, legislative institutions. This suggests that different regional collaborative mechanisms must be established, perhaps bringing legislative bodies together in consultative exercises. This may be a role for the ASEAN Political-Security Community or the ASEAN Socio-Cultural Community as much as for the AEC.

## 3.2. Promoting Economic Convergence and Equitable Growth

Over the past 20 years, sustained economic growth led millions of ASEAN citizens out of poverty. As a result, in most ASEAN countries a new middle class has emerged and continues to grow rapidly. Nonetheless, both income and non-income inequality has increased in many countries, while they have declined in others. Widening income disparity, an accentuated urban-rural divide, and social transformation derived from demographic change are among the major challenges ASEAN countries must face.

Islands of prosperity cannot survive in a sea of poverty. ASEAN collectively must pursue a development strategy that is both inclusive and narrows development gaps between middle and low income members. The gaps in ASEAN are often much wider than in comparable groupings in Europe, Latin America, North Africa, and other parts of Asia. Variations across countries in attaining the Millennium Development Goals (MDGs) are also huge—some have surpassed targets while others show little if any progress or even decline.

The income gap between ASEAN countries is severe (see Table 1). Even excluding Singapore and Brunei Darussalam, the next richest country in 2010, Malaysia, had per-capita GDP nearly 12 times that of Myanmar's and more than four times higher than the regional average. Myanmar's per-capita GDP was less than one fourth of the ASEAN average. A key 2030 challenge, which follows from the aspiration of achieving a *RICH* ASEAN and strengthening the idea of family, is to reduce these gaps to an acceptable level and achieve a more economically inclusive ASEAN.

If per-capita GDP aspirations delineated in this study (see Table 3) can be reached, by 2030 the Malaysia/Myanmar ratio will decline to 7.7 times, as Myanmar's per-capita GDP is expected to grow 4.5 times, at a yearly average of 7.8% between 2010 and 2030, while Malaysia's is expected to grow 3 times (a 5.7% yearly average). This is what needed for a more inclusive ASEAN.

When ASEAN countries are ranked by per-capital GDP, the most common distinction is that between CLMV countries and the other six, richer members. Yet these have been shrinking during the last two decades (Table 5). Average per-capita GDP of the ASEAN-6 was approximately 11 times above the CLMV countries in 1990. It

**Table 5. Evolution of GDP Per Capita in ASEAN Countries (1990–2010, US\$)**

	1990	2000	2010
<b>Value in US\$</b>			
ASEAN-10 Average*	805	1,166	3,105
ASEAN-6*	1,064	1,537	3,973
CLMV*	94	318	990
<b>Ratios</b>			
ASEAN-6/CLMV	11.32	4.83	4.01
ASEAN-10/ASEAN-6	0.76	0.76	0.78
ASEAN-10/CLMV	8.56	3.67	3.14

\*Weighted average by 2010 population shares.

GDP=Gross Domestic Product; ASEAN-6=Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand; CLMV=Cambodia, Lao People's Democratic Republic, Myanmar, Viet Nam.

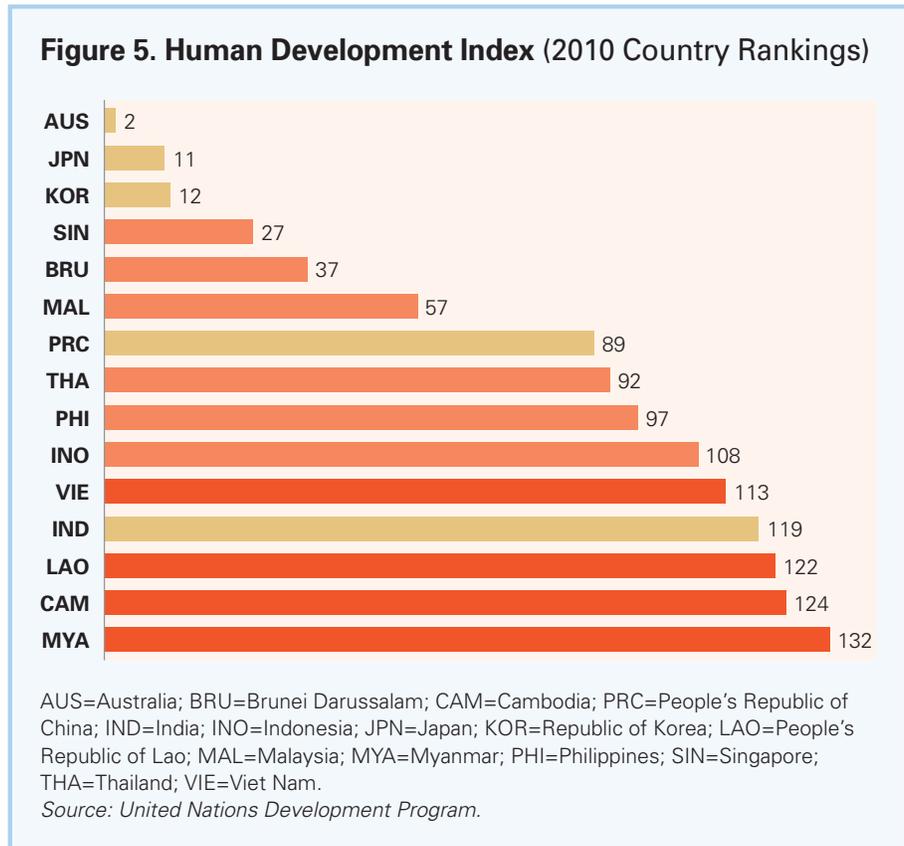
Source: International Monetary Fund and ADB Database.

was four times as high in 2010. The narrowing trend will continue if per capita GDP aspirations can be realized. By 2030, the ratio of average real per capita GDP (in 2010 prices) of ASEAN-6 would be about three times above the CLMV—an impressive narrowing of income gaps given the wide expanse that existed 20 years ago.

Despite this, the CLMV countries remain poorer than the ASEAN-6, not just in terms of GDP per-capita, but also vis-à-vis a large array of other economic and social indicators. The 2010 country rankings of the UNDP Human Development Index (HDI) shows the poor performance of CLMV countries compared with the ASEAN-6 (Figure 5).<sup>4</sup>

Thus, the agenda of ensuring equitable growth and economic convergence among ASEAN economies in many ways comes down to two intertwined challenges: generating robust growth while ensuring that it is inclusive and equitable. In short, ASEAN needs to

4 The HDI is a useful indicator of comparative development. Along with income, it measures attainment in health and education. Across these, CLMV countries exhibit poorer response to government programs. This creates a considerable gap between CLMV and middle-income ASEAN. It signals a lower quality of life in the CLMV, but also a need to invest in human capital to underpin faster, more inclusive growth.



grow strongly, but at the same time the benefits of that growth must be shared widely across member countries and their citizens.

In dealing with this challenge, ASEAN’s intraregional economic diversity represents both its strength and weakness. Diversity is an ASEAN strength in that, if well integrated, it supplies well-diversified factor and resource endowments across member countries. This implies promoting economic growth by exploiting the classic comparative advantages of the region’s 10 members. At the same time, diversity is a weakness in that the huge income differences across countries make it quite difficult for ASEAN to agree on a region-wide development agenda and in carving out a common, yet effective, growth strategy.

About 70% of ASEAN’s population today lives in the four middle-income countries, Indonesia, Malaysia, Philippines, and Thailand—with significant income differences across and within themselves. Another 28% live in CLMV countries, where there is greater equality in average incomes across countries than in the ASEAN-4, but with substantial in-country inequalities.

At the cost of oversimplification, ASEAN-4 needs a growth

strategy that avoids the “middle income trap.”<sup>5</sup> That strategy underscores the need for a shift from a mainly investment-led to an increasingly innovation-led growth strategy. Until now, these countries have been able to absorb technology — to varying degrees — developed elsewhere. Coupled with robust investment levels (which remain below their unsustainably high levels prior to the 1997/98 Asian financial crisis), this enabled them to reach middle-income status.

To avoid getting stuck in the “middle income trap,” these countries need to gradually shift their sources of growth from investment and technology adaptation to technology innovation, learning from countries such as the Republic of Korea, Singapore, and Taipei, China. Increasingly, this calls for greater focus on higher education and R&D investment (which remains miniscule — even in Malaysia — compared with other Asian countries).

For the CLMV countries, the key challenge is one of escaping the poverty trap and providing basic needs. For some time yet, a primarily investment-driven growth strategy (along with successful technology adaptation) remains most relevant. However, as incomes rise and CLMV countries reach middle income status (Viet Nam recently entered the lower middle income category), they too will need to increasingly focus on innovation to sustain growth.

Growth potential in CLMV countries is enormous, given their natural resources, a young and growing population, and their strategic position linking the PRC with India (more generally East Asia with South Asia). Myanmar’s recent moves toward political normalization and economic liberalization are a key factor in connecting these giant markets. CLMV countries need to build a solid macroeconomic policy framework to ensure stability and development. Progress toward equitable economic growth and closer integration depends on the speed and quality of CLMV convergence toward the ASEAN average over a wide range of development indicators. Closer coordination of ASEAN-6 initiatives for helping overall CLMV development and channeling external assistance

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<sup>5</sup> Growth and development are neither smooth nor uniform processes. Success, for instance, in generating growth to overcome mass poverty—to transform agricultural countries to industrialbased economies—does not guarantee a country can move beyond middle-income status. A background paper prepared for this study concludes that “Over the last four decades only [the Republic of] Korea and several small economies in East Asia have steadily converged to the income levels of the rich countries.” This is the “Middle-Income Trap.” One key factor to break out will be to enhance factor mobility, moving low productivity growth and growing new businesses in areas with higher growth potential.

from development partners to support the Framework for Equitable Economic Development (adopted at the 19th ASEAN Summit)—and to the Initiative for ASEAN Integration—will greatly improve economic convergence.

A key factor as to whether ASEAN—through the AEC—can meld higher and inclusive growth depends in part on improving “connectivity”—which refers to the ability to trade, travel, or transit between countries. ASEAN has based much of its development model on the ability to become a site for intermediate production, and to trade globally in electronics, garments, and household and consumer goods—often coordinated through PRC final assembly. This participation has increased income and growth for those involved.

But efficient connectivity requires regionally coordinated investment in infrastructure, such as cross-border roads and railroads, world-class ports and airports, telecommunications, and regional energy systems that diversify supply and lower costs. These systems are extraordinarily expensive. Regional cooperation in planning, financing, and operation can ease financial burdens and improve investments efficiency. Private sector involvement in financing and operations through public-private-partnerships (PPP) is critical. Finally, however, “soft infrastructure”—the policy environment that allows optimally planning, successful construction, and efficient operations—must complement the hard infrastructure of concrete structures. Tax systems, customs operations, quarantine and immigration procedures must all be in place to encourage travel and shipments. Throughout, regional cooperation can be a powerful asset to national programs.

Regional cooperation initiatives are an important set of policy tools for bridging the development divide within countries and across borders. Here countries work together to redress lagging growth in border areas on the mainland or on the poorer islands of archipelagic Southeast Asia, through joint programs providing infrastructure or reforming the policy environment, or by building capacity of the people and local governments.

Important subregional initiatives include (i) Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BMIP-EAGA), focusing on development across the islands of Borneo, Mindanao, and Sulawesi. Improving sea and air links is essential, but so is road transportation on Borneo—both through physical infrastructure and improving trade-related policies and institutions; (ii) Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT), an

effort to link Peninsular Malaysia to Sumatra and southern Thailand; focusing on private sector-led cross-border investment; (iii) the Greater Mekong Subregion (GMS) program—which comprises Cambodia, the PRC (Yunnan Province and the Guangxi Zhuang Autonomous Region), Lao PDR, Myanmar, Thailand, and Viet Nam.<sup>6</sup> Other initiatives include the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), linking mainland Southeast Asia to South Asia and several others focusing on the Mekong River.

All these initiatives attempt to bring nations together on specific regional and subregional issues and opportunities. Some have been quite successful—the GMS has transformed the economic landscape in mainland Southeast Asia. Today trucks can move from Bangkok to Kunming; Ho Chi Minh City to Nanning, on all-weather road systems that did not exist in the early 1990s. These transport networks—and their border facilitation installations—have allowed trade to grow rapidly, increasing regional GDP and employment. Other initiatives have struggled both to find a viable strategy or financially feasible projects. The challenge ahead is to meet the potential for these initiatives to help bring ASEAN together for improving equity, hastening convergence, and narrow development gaps.

Future development and advanced connectivity should capture emerging opportunities for the CLMV countries from economic interdependence with the PRC and India. The PRC and India can become “connectivity partners” to CLMV and to continental ASEAN generally. The PRC attaches high importance to smoothing its links south into ASEAN—such as using Nanning as PRC’s gateway to ASEAN through Viet Nam; and negotiating north-south linkages from Yunnan through Lao PDR to Thailand and beyond. These links are expected to accelerate the development of the PRC’s inner southern provinces and close the large development gaps between them and the eastern coastal provinces. Fortifying these links will likely generate many new economic opportunities for CLMV and help accelerate development, in effect supporting

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<sup>6</sup> Under the GMP program, since 1990, more than US\$10 billion of investments were mobilized by the Asian Development Bank, especially for roads, but also for bridges, airports, railroads, and related structures and facilities. Investments in electricity transmission lines have also allowed for cross border sales in electricity, balancing supply and demand in different countries—providing for connectivity in energy trading. These investments were the result of more than a decade of concentrated regional cooperation, cooperative planning and implementing multi-billion construction projects.

ASEAN's drive for more inclusive development. With Myanmar now initiating political normalization and working to normalize relations with the international community, the potential for PRC-Myanmar and India-Myanmar links are huge. This again will help accelerate regional development in border areas as well as accelerate Myanmar's development. Boosting connectivity between the PRC, India and CLMV will be win-win for both the PRC and ASEAN. Of course, huge amounts of infrastructure investment will be needed, in transportation, power, water supply, and telecommunications, among others.

Thus, aside from the challenge of further increasing per-capita GDP through increased productivity and economic diversification for Singapore and Brunei Darussalam — and improving the quality of life — the key challenge for ASEAN in ensuring inclusive growth is to smoothly adjust growth strategies at the national level that affect inequalities domestically — which would cover about 98% of the ASEAN population.

Even as ASEAN countries follow advanced, middle income, and lower income growth strategies, allowing the freer movement of capital and labor would help establish a borderless ASEAN and further help bridge development gaps. Freer movement of the two primary factors of production — labor and capital — could help people share more equitably the benefits of integrated development, irrespective of nationality. Of course, this would need to be complemented by promoting more equitable access to education and health care, which would enhance equality of opportunity, particularly for the most vulnerable, to share in the gains from growth.

While the AEC does target freer capital flows within ASEAN, it limits the scope of labor movement across borders to only certain types of skilled labor. Building on this experiment and looking beyond establishing the AEC, ASEAN would benefit from allowing freer movement of labor across its borders. Freer movement of unskilled labor would certainly accelerate development convergence between ASEAN countries. Millions of unskilled labor already migrates across ASEAN. However, most are undocumented labor migrants, and most of these face labor exploitation with little protection of the standards enjoyed by domestic unskilled labor. By 2030, ASEAN should develop an integrated system of managed labor movement, essentially moving toward a borderless labor market, in which more labor of all skills will be freer to work anywhere within ASEAN and enjoy labor protection equal to that of domestic workers.

There are, however, limits to bridging the development gaps

through freer movement of capital and labor — particularly unskilled labor. For one thing, the wide diversity in the quality of labor protection, social security and governance systems across ASEAN countries would make it difficult to impose common standards for labor and capital markets. Improving national governance standards for labor and capital markets will be crucial for freer movement of capital and labor within ASEAN.

Labor mobility can enhance the economies of both “exporting” and “importing” countries. Brunei Darussalam provides a stark example. It is far too small an economy to maintain the labor resources needed for either its public or private sectors to quickly respond to changing conditions or opportunities. Brunei Darussalam needs access to both skilled and unskilled labor. It would benefit from careful, institutionally structured liberalization of regional labor migration, a goal of ASEAN under the AEC. Part of this would require the establishment and strengthening of regulatory institutions in labor surplus countries to better match skills with those needed in labor deficit countries. This would also help control illegal labor migration. Even as the region works toward freer labor and capital movement and improving governance standards, more direct methods of bridging the development gap needs to be explored. Adopting the ASEAN Framework for Equitable Economic Development—endorsed by ASEAN leaders at the 2011 Bali Summit—is a welcome step in defining the process of reducing the development divide across ASEAN.

An *ASEAN Convergence Fund* could also be created to focus on intraregional disparities, including assistance to subregional initiatives such as GMS or BIMP-EAGA. A Convergence Fund would not be used on single-country projects or to address domestic inequality, but would focus on initiatives generating cross-country benefits. It could be structured on the existing (if small) ASEAN Development Fund, with administration left to professionals. As available funds will be small relative to the scope of investment, and small relative to ADB and World Bank assistance programs, the ASEAN Secretariat can help coordinate the many diverse development projects and programs that could help bridge the development divide.

ASEAN nations could address some of these issues through an expanded dialogue mechanism through which countries review each other’s development plans. Initially, this process could be under the purview of respective planning agencies, but eventually should move to the level of the executive or prime ministers offices. The

dialogue could examine (i) individual lessons learned applicable to the region; (ii) cross-border cooperation needs; (iii) opportunities to cooperate through ASEAN to better use the AEC; and (iv) the potential for cross-border finance. As individual country resources to fund development are limited, especially in the CLMV, active participation of development agencies like ADB and the World Bank should be pursued early in the planning for this dialogue.

### 3.3. Forging a Competitive and Innovative Region

Globalization has transformed the world and continues to do so. And Asia's liberalization was both a driver of that transformation and one of its most profound beneficiaries. Today more and more countries are integrating through open trade, capital flows, and labor mobility, whether in Asia, Latin America, or Africa. As an increasing number join the bandwagon, however, maintaining competitiveness has become a key challenge to ASEAN both regionally and nationally. It has taken on new urgency with the emergence of ASEAN's two neighboring giants, the PRC and India, let alone the competitive threat posed by the emergence of structurally distant economies such as Russia or Brazil.

What makes a country or region competitive? It depends on a variety of factors ranging from the business climate, quality of infrastructure, rule of law, political and economic institutions, the quality and availability of human capital, investment in R&D, a policy environment that exudes confidence in macroeconomic stability, and efficient resource mobilization through capital market development. It is difficult to piece together a multi-dimensional measure of a country's competitiveness into a single indicator, and even more so of a region as diverse as ASEAN.

Any measure of competitiveness is bound to have limitations, both conceptual and empirical. Nonetheless, the 2011 World Economic Forum's report on global competitiveness ranked ASEAN as a regional entity (excluding Lao PDR and Myanmar) 43rd out of its 139 sample countries. Individually, however, there is huge variation in competitiveness rankings—Singapore ranked second; Cambodia was 97th (Table 6).

Despite the pronounced diversity in world competitive rankings, as a region it shows some relative strength in promoting competitiveness

**Table 6. ASEAN Countries' Overall Competitiveness Rankings (2011)**

	Asia Pacific Rank (16)	Overall Rank (139)	Score (1–7)
<b>ASEAN average</b>		<b>43</b>	<b>4.57</b>
Singapore	1	2	5.63
Malaysia	6	21	5.08
Thailand	10	28	4.78
Brunei Darussalam	11	39	4.52
Indonesia	12	46	4.38
Viet Nam	14	65	4.24
Philippines	15	75	4.08
Cambodia	16	97	3.85

Notes: ASEAN's rank (score) is calculated as a GDP (PPP)-weighted average of the ranks Brunei Darussalam; Cambodia; People's Republic of China; Hong Kong, China; India; Indonesia; Japan; Republic of Korea; Malaysia; New Zealand; Philippines; Singapore; Taipei, China; Thailand; and Viet Nam. (scores) of eight ASEAN countries where data are available. Asia-Pacific includes Australia.

Source: World Economic Forum (2011), *Global Competitiveness Report 2011–12*.

and innovation — rather than stressing standardization. For ASEAN, several useful observations can be made.

First, technological development starts by learning and imitating technologies created elsewhere (usually advanced economies). Therefore, ASEAN's technology policy should focus on reducing barriers to technology diffusion. Viet Nam, for example, learned from others how to raise technological capacity, especially through foreign direct investment. However, as Viet Nam develops, it will become more difficult to stay as passive receptor of technology. There will be an increasing demand to take more responsibility for developing new technologies. Policies and institutions that help forge links between domestic producers and individuals and those from developed economies will likely expedite the transfer process for ASEAN. International trade, FDI, and the flow of human capital are some of the key purveyors of technology diffusion. It cannot be expected that all countries take an uniform approach; nor can they benefit from technological diffusion in the same manner and in the same sector. Thailand, for instance, holds comparative advantage in automotive parts and should thus develop capacity to innovate in

this niche manufacturing sector.

Second, mere exposure to opportunities for technology diffusion will not lead to technology development on its own. ASEAN countries need to consciously invest in building technological capabilities even to effectively absorb new technologies ready for adoption. Investments here are typically risky and generate higher social than private returns, even in developed countries. Thus, governments need to step in to fill the gap. However, effective government intervention needs to be sensitive to the institutional and technological context of the country and the industry to which it is applied.

Third, national innovation policies should be integrated with ASEAN-wide policies for economic integration, including freer movement of goods and services and factors of production. Higher degrees of economic integration expand opportunities for technology diffusion and new products and services markets. ASEAN countries should also capture potential opportunities from “South-South” cooperation.

Fourth, ASEAN economies should adopt policy priorities best suited to their development needs. CLMV countries should focus on strengthening capabilities and efficiency in labor-intensive industries. For Indonesia, the Philippines and Thailand, incremental innovation should remain the priority over the next two decades. Malaysia’s and Singapore’s challenge is to strengthen their indigenous innovation abilities.

Fifth, cross-country comparisons show that ASEAN economies invest less in R&D than those at similar development levels. With the exception of Singapore, ASEAN has a severe shortage of innovation resources. Researchers and scientists are in short supply despite the relatively high level of overall education. Many ASEAN scientists work in Organization for Economic Co-operation and Development (OECD) economies. This “brain drain” could be reversed if ASEAN countries, for example, improve working conditions for these highly skilled individuals. For middle income countries, there is an urgent need to boost investment in technological development to maintain or build dynamic comparative advantage against global competitors. Domestically this calls for restructuring post-secondary education systems to place more emphasis on teaching science and engineering, giving incentives to the private sector to increase spending on technological upgrading, and reorienting public research to applied R&D.

An important ASEAN priority is to introduce a region-wide policy to promote innovation through R&D investment. In particular, to complement national efforts, ASEAN countries should consider

establishing an *ASEAN Competitiveness Institute*—or some other institution with a similar name—to promote adoption of a region-wide innovation strategy, and construct a framework for a regional R&D and innovation policy. Given current trends, it is realistic to assume that most ASEAN industries will remain product imitators in 2030 unless they develop a concerted innovation policy soon. A region-wide innovation policy should focus on accelerating technology diffusion and absorption in key areas with large spillovers on the rest of the economy. Exploiting synergies with science, R&D, and innovation in biotechnology and nanotechnology could make ASEAN a leader in emerging market niches.

ASEAN should promote strengthening investment in R&D, not only in manufacturing, but in natural resources and services as well (particularly development and diffusion in information technology [IT]). This should be integrated with other regional policies, such as the promotion of a level playing field for large and small and medium enterprises (SMEs). In many Southeast Asian countries, including Indonesia and the Philippines, there are a wide range of barriers to the establishment and growth of SMEs. Competition policy, a reduction in corruption, lowered transport costs, and wider availability of financing would all help SMEs compete.

ASEAN policymakers should be careful not to cross the fine line between promoting technological development with public resources, which often involves picking “winners,” and encouraging entrepreneurship. A level playing field for both large enterprises and SMEs is needed to create a breeding ground for entrepreneurship and technological dynamism. Also, unifying technology standards across the region would be an important step forward in building a friendly environment for innovation.

ASEAN’s production strategy should focus on staying competitive where comparative advantages already exist; but also in building new sources of comparative advantage—whether in agriculture, industry, or services. And as Asia continues to transform, it will need to secure its competitive position alongside the PRC and India by ensuring the AEC works to create an effective single market and production base.

ASEAN can be inspired from examples of successful innovation and R&D strategies. It was agricultural science that created the “green revolution,” and it has remained at the cutting edge in a variety of fields—such as new end-uses for rubber, palm oil and rice. It is increasingly recognized that ASEAN has a marked competitive advantage in tropical agriculture, which boasts cross-

border investment across the region between public and private entities. These agencies should collaborate rather than compete with each other, deepening regional supply chains—from seed to the supermarket shelf. Continuing the extensive mapping of oil palm, rubber and rice genomes can further enhance ASEAN’s competitiveness into 2030 and beyond. Agricultural synergies with science, research and innovation have already spread to new industries like green biotechnology and IT.

Strengthening agricultural productivity would benefit from a holistic approach to integrating supply chains with trading networks under public-private partnerships. The context for agriculture production in ASEAN is changing, marked by an increasing connection with the food supply chain, including progress on the multi-functionality of production and the gradual marginalization of small farmers and stakeholders.

ASEAN has the potential to continue not only feeding itself, but more importantly, help supply the rest of the world beyond 2030. This helps tackle the issue of food security. ASEAN can also move into the forefront of helping solve the “food-feed-fuel-finance” conundrum as well as the food-water-energy nexus—the link between food-security and other non-traditional security issues and climate change.

Successful experiences should be collected and adapted across ASEAN economies to provide policymakers relevant reference and ideas to enhance and support industries where they enjoy comparative advantage. Aside from tropical agriculture and food, ASEAN competes well in automotive parts and components, electrical and electronic industries, tourism, garments, and personal services. Stronger regional strategies are needed to further develop these industries. Equally, as ASEAN economies mature, it will be the service sectors that come to dominate national economies. The AEC has targeted easing of trade in human services, which will be important in encouraging efficient, internationally productive service industries. This works for maintaining a low cost business environment, but also to encourage development of service industries that can export to global markets. These would include services related to Internet-based design and e-commerce.

Analyzing ASEAN competitiveness from a qualitative perspective, the region demonstrates strength in several areas of intermediate manufactured products and components. In the current, standardized configuration of production networks and supply chains in East Asia, the PRC imports capital goods from Japan; Republic

of Korea; and Taipei, China, raw materials and intermediate inputs from ASEAN markets, then assembles the final products, and exports them to Western markets (Box 2). In the process, ASEAN has successfully developed strong clusters of parts and components industries — an integral part of “Factory Asia.” Despite this strength, most of ASEAN remains quite weak in procedures for doing business and in the efficiency and effectiveness of institutions (customs for example). Corruption and lack of a clearly enforced rule of law contribute to weakening the overall business environment in some countries. Leveraging these strengths and addressing weaknesses is a key issue for ASEAN in fostering competitiveness and innovation.

Building on the competitive strength in intermediate industrial production, a key factor for ASEAN as a region moving toward 2030 will be diversifying economic structures to include production of more final goods within manufacturing and service sectors more generally. So far, ASEAN has not been particularly good at “branding” their products. In the next two decades, the region needs to move into brand-building, particularly in manufacturing.

Branding is more than having a successful advertising campaign. Branding must offer new products that inspire consumer confidence. This allows a company to build consumer loyalty, to receive the benefit of the doubt when problems surface or when new products are being introduced; to charge a bit more than competitors. A step toward building an ASEAN brand — a *Made-in-ASEAN* product label that can be marketed internationally — would be to build products that compete successfully within the ASEAN market first. For this purpose, a dedicated regional agency for certification and application of proper standards could be established. Testing ASEAN products requires a conscious effort, with Southeast Asian business groups sponsoring competitions within ASEAN for products that win the ASEAN seal of approval, so that can be leveraged to a broader audience. Eventually, branding ASEAN could have a multiplier effect not only for industrial development, but also in strengthening firms’ and individuals’ ASEAN identity.

Fostering ASEAN innovation implies the need to promote human capital development by improving the extent and quality of education — colleges, universities and vocational training schools. Economic institutions that promote innovation tend to be relatively weak, with the presence of infrastructure bottlenecks, or simply lack of infrastructure in some cases, and domestic markets, particularly financial markets, that are not deep and wide enough.

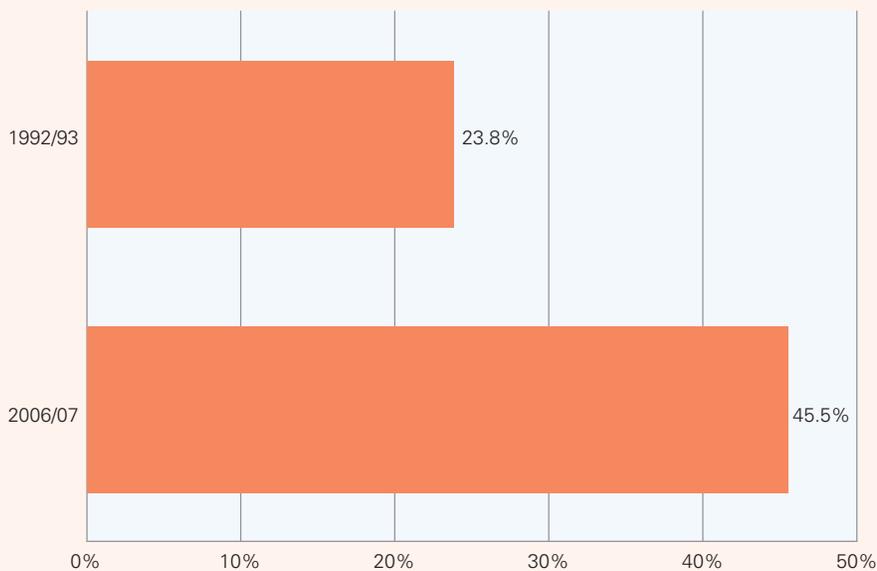
The 2011 earthquake and tsunami in Japan and the flooding in

## Box 2. Intermediate Processing: The New Trade

Historically, trade has been in natural resources and final products. The classic example was wheat being exchanged for wine. This trade was expected to be conducted on the basis of comparative advantage conveyed by nature. However, today the most dynamic element of trade is in intermediate goods, representing wide-spread and growing production-sharing networks. Intermediate trade has become more important in overall trade in less than two decades—Figure B1).

### Figure B1. Growing Importance of Intermediate Trade in Goods

World network trade/Total world exports



Source: Athukorala, Prema-chandra. 2010. *Production Networks and Trade Patterns in East Asia: Regionalization or Globalization?* Working Paper Series on Regional Economic Integration No. 56. Manila: Asian Development Bank, August.

This allows intermediate goods to be fashioned in different countries, moved along the production line through logistics systems that yield a low cost structure. Across Southeast Asia, especially in the electronics industries, but also in garments and household goods, firms work in a highly organized system, often coordinated in the PRC. These distributive processes depend on relatively small differences in production costs. This process is unforgiving a small changes in cost structures can result in production processes being moved. In this world, all countries compete to demonstrate that they can be the best place to situate a factory. All countries need to continually focus on lowering trade costs.

While many examples of distributed production processes, especially in electronics, have been found in middle-income ASEAN, an improved business climate, lower cost structures and transportation and logistics connectivity, CLMV countries can be increasingly drawn into these regional production networks.

Thailand have added a new element to business decision-making with respect to the location of production sites. While potentially any location can suffer a natural disaster, some areas are more prone than others. The Philippines, for instance, suffers recurrent typhoons. It is likely that multi-national firms, looking forward will attempt to diversify their production sites to reduce the overall risk from any particular natural disaster. This trend is likely to be exacerbated by global warming which will result in an increased frequency and intensity of storms, shifting weather patterns, and increased water levels and consequently flooding on coastal areas.

ASEAN countries are also highly competitive in tourism given its rich natural landscape and historical-cultural attractions. Promoting ASEAN tourism by establishing an *ASEAN Tourism Council* can help coordinate regional strategies. These could include packaging multi-country tourism trips for particular interests (for example, historical/cultural sites and food tourism) as well as introducing a single ASEAN visa for tourists, which has already been discussed for some time (ASEAN sector-specific bodies on tourism should be empowered), fast-tracked, and certainly long in place by 2030. Tourism is an essential industry for promoting a borderless ASEAN brand.

## 3.4. Nurturing Natural Resources and Sustaining the Environment

Improving natural resource management and ensuring environmental protection is prerequisite for achieving a better quality of life as well as harmonious and sustainable development.

Maintaining high GDP growth implies consuming an increasing amount of natural resources, where supply is limited and energy processing inevitably pollutes the environment. ASEAN economies are endowed with abundant natural resources—including forests, fresh water, maritime resources, and biodiversity—that need to be properly managed to ensure long-term economic growth for the region and the rest of the world. Unfortunately, the environmental resource base of forests and maritime resources is under increasing pressure from unsustainable extractive practices. Indeed, the importance of preserving the environment cannot be overstated. While some countries such as Lao PDR and Myanmar have strongly factored environmental impact into their national development strategies, ASEAN still lags behind in several environment-related

indicators (Table 7).

“Green products” can provide new market niches for ASEAN, which should introduce initiatives for “green technology innovations” in an integrated way, from R&D to product development, and deployment and diffusion of new technologies.

ASEAN should develop a “green growth strategy” to ensure environmental protection while promoting economic development. ASEAN must address climate-change-related challenges by adapting effective resilience and mitigation to promote a low-carbon

**Table 7. Environment Indicators for ASEAN countries (2009)**

Indicator	Air Pollution	Air Quality Satisfaction	Water Quality Satisfaction
Unit	micrograms per cubic meter	%	%
Brunei Darussalam	50.6		
Cambodia	41.2	96.0	88.0
Indonesia	72.4	76.0	82.0
Lao PDR	38.5	89.0	83.0
Malaysia	20.0	83.0	86.0
Myanmar	46.1	88.0	91.0
Philippines	18.7	87.0	84.0
Singapore	30.8	97.0	99.0
Thailand	55.3	82.0	84.0
Viet Nam	52.7	73.0	79.0
<b>ASEAN</b>			
PRC*	65.6	73.0	74.0
Japan	27.1	79.0	81.0
Republic of Korea	30.8	78.0	83.0
India	59.2	86.0	67.0
Australia	14.3	89.0	88.0
United States	19.4	85.0	87.0

Notes: PRC=People’s Republic of China. Data for PRC includes those for Taipei, China.

Sources:

**Air pollution**—Country-level micrograms per cubic meter of less than 10 micron particles which include sulphate, nitrate, elemental carbon, organic carbon matter, sodium and ammonium, source: World Development Indicators, 2011.

**Air quality**— % of all respondents who are satisfied with their air quality, source: Gallup World Poll database (2010), retrieved through [http://hdr.undp.org/en/media/HDR\\_2010\\_EN\\_Tables\\_rev.xls](http://hdr.undp.org/en/media/HDR_2010_EN_Tables_rev.xls).

**Water quality**— % of all respondents who are satisfied with their water quality, source: Gallup World Poll database (2010), retrieved through [http://hdr.undp.org/en/media/HDR\\_2010\\_EN\\_Tables\\_rev.xls](http://hdr.undp.org/en/media/HDR_2010_EN_Tables_rev.xls).

environment. National development strategies that encourage green growth must be developed in close coordination with regional initiatives, including implementing the ASEAN Strategic Action Plan to lower carbon emissions and reduce greenhouse gases — improving energy efficiency in buildings and industrial complexes; harnessing renewable energy resources; using more efficient and cleaner transportation; and harmonizing environmentally sound production standards.

ASEAN’s collective aspirations for 2030 include access to safe drinking water and adequate sanitation. By 2030, however, river quality across ASEAN will have seriously deteriorated if action does not start now. Fresh water and drinking water will likely be in short supply, with the possibility of entire ecosystems being disrupted. ASEAN countries must better control and monitor industrial waste and water discharge by implementing ASEAN’s strategic action plan on water resource management. This requires a decentralized waste water management approach and improved sanitation by controlling industrial discharge and continuously monitoring water quality.

The impact of urbanization is another major challenge. By 2030, more than 350 million ASEAN citizens (50% of the region’s total) are expected to live in urban areas. Therefore, countries need to promote green buildings, designed to reduce the effects on health and the environment from construction through occupancy. Efficient use of energy, water, and other natural resources in construction, operation and maintenance must be built into feasibility studies and architectural plans. Urbanization will also require the adoption of sustainable energy strategies — for example, using solar panels on rooftops. Solar, thermal, and wind energy can be used more extensively in rural areas, where lower yields can still supply less populated areas.

ASEAN holds enormous potential to develop commercial, cost-effective, and competitive energy-related (non-food) crops to produce biofuels — a green solution to power transportation and certain types of industry. However, this must be balanced against competing needs of land use for food production. ASEAN members could be enticed to develop national strategies alongside region-wide action plans on the environment. New green energy supplies — wind, biofuels, geothermal, solar — can be distributed through smart grids for wind and solar energy, which will help develop and further innovate energy storage technologies.

In general, the policy focus for ASEAN should be on pricing environmental “public bads” rather than subsidizing “public-

goods.” Tighter regulations are needed to further reduce emissions and improve air quality. Policies should also aim to remove environmentally harmful subsidies—particularly on fossil fuels as well as on agricultural production waste.

ASEAN environmental cooperation does not start from scratch. An ASEAN Ministerial Meeting on the Environment—started in 1981 and now part of the ASEAN Socio-Cultural Community (ASCC)—introduced in 2010 a Blueprint comprising the following 10 priority areas to protect the environment: (i) addressing global environmental issues; (ii) managing and preventing trans-boundary environmental pollution (haze pollution and movement of hazardous wastes); (iii) promoting sustainable development through environmental education and public participation; (iv) promoting environmentally sound technology; (v) promoting quality living standards in ASEAN urban areas; (vi) harmonizing environmental policies and databases; (vii) promoting the sustainable use of coastal and marine environment; (viii) promoting effective management of natural resources and biodiversity; (ix) sustaining freshwater resources; and (x) responding to climate change and addressing its impact.

Apart from ensuring that development is harmonious with the environment, development and promotion of “green products” can provide new niches for ASEAN industry and provide new impetus for growth. The “eco-car” project in Thailand, for example, has led to the development of new automobile models that are penetrating the domestic market and are likely to be exported globally. With ASEAN’s sizeable single market, there is certainly potential for ASEAN to jointly develop “green” product standards that will lead to new product development.

As ASEAN effectively grows into a single production area, the need to harmonize environmental regulations and production standards becomes crucial. Regulatory arbitrage to countries with weak environmental standards will be inevitable as the region integrates production. So ASEAN needs to move toward a borderless regulatory regime for environmental protection. A borderless production base needs to go in hand with an environmentally sensitive borderless regulatory regime.

## 4. Enabling Factors

**T**wo possible paths for ASEAN to integrate and grow seem plausible: (i) member countries do little for ASEAN integration and in practice guard their national economic sovereignty too zealously to integrate internally; or (ii) member countries take internal integration seriously and meaningfully work toward achieving a functioning AEC first and a *RICH* ASEAN by 2030.

The first path—the path of least resistance—would enable ASEAN to linger as a regional entity, but would most likely reduce its relevance to its people and Asia more generally. The second path is a path of most consequence. It would enable ASEAN countries to grow together for shared prosperity. ASEAN, a pioneer for Asian integration, could grow into a powerhouse of Asia’s future integration. Which path is taken could thus make a world of difference to ASEAN in particular and Asia in general.

It is relatively easy to identify what needs to be done. The critical issue is how to get it done. To reach ASEAN aspirations in 2030, four enabling factors are identified, including (i) broadening and deepening financial markets, (ii) harnessing human capital, (iii) building seamless connectivity, and (iv) strengthening governance.

### 4.1. Broadening and Deepening Financial Markets

As ASEAN countries strive to meet their 2015 targets for creating the AEC and look toward 2030, they need to deepen and broaden their financial markets. Markets are generally in their infancy in CLMV countries, while in most ASEAN-6 economies at least some capital markets—for example corporate bond markets—remain relatively underdeveloped. In general, the region needs to promote further sophistication of domestic banking systems: by 2030 it should aim to reach, in stages, an almost complete liberalization of banking services. It also needs to make substantial progress in developing microfinance, particularly in the CLMV countries. As the same

time Singapore remains a sophisticated global financial center and strives for further specialization as markets in Hong Kong, China, and other Asian financial centers expand their size and importance worldwide.

A key issue for the region's policymakers is to get the proper balance between liberalization and regulation, one that allows markets to grow and thrive—and thus deepen. Potential market players—both from within and outside ASEAN—must be reassured that financial markets are doing their job of effectively allocating resources, placing capital where it bolsters the real economy best and with returns that makes placing funds attractive.

A key challenge for ASEAN economies is to improve the efficiency and effectiveness in using regional savings to finance regional development. Given ASEAN's diversity, needs vary widely across countries. CLMV countries, for example, need to build institutions and banking systems while avoiding some of the pitfalls other ASEAN countries have experienced by building solid banking systems and later capital markets from the start.

For Indonesia, Malaysia, Philippines, and Thailand, the challenge is to further deepen capital markets without unduly exposing them to potentially severe shocks from abroad. To their credit, these countries have made great strides since 1997 (Box 3). Their equity markets—and to some extent government bond markets—have seen a remarkable increase in depth and liquidity. The issues they face are widening the issuer and investor base, building confidence in market infrastructure and harmonizing or standardizing accounting, settlement and other market mechanics.

For ASEAN as a whole, a two-speed track of market development seems in store: some countries making banking system development a priority, while others continuing to deepen their capital markets. In time, countries in the first group can catch up by emulating the more developed ones in the second group, by strengthening inclusive access to banking and lending vehicles such as microfinance and innovations that cater to better finance for small and medium enterprises, for example. For more established markets, the task is not so straightforward. As markets deepen and widen—especially bond markets—working toward synergizing ASEAN's markets may make sense. Liberalizing markets and allowing cross-border capital flows—both in and out—is a delicate and sensitive issue. Yet in the quest of borderless financial markets within ASEAN, the path toward 2030 will need to see financial markets promoting their own “ASEAN brand.”

**Box 3. ASEAN Financial Systems after the 1997/98 Crisis**

The 1997/98 Asian financial crisis exposed several important structural weaknesses in ASEAN financial systems. First, it showed the limitations of a bank-centric approach. With many of the region's large banks closely aligned with domestic industrial or agricultural conglomerates, there was little margin to respond to the currency crisis initially, and then to the ensuing banking crisis. Second, ASEAN tended to borrow excessively short-term—and in foreign currencies (mostly \$)—expecting that roll-overs and new borrowing for longer-term projects would continue. These mismatches in currencies and maturities exacerbated the crisis when liquidity became tight. It underscored the absence of viable debt markets as an alternative source of finance—the need to expand options by building deep and liquid local currency bond markets, for example.

In the aftermath of the crisis, affected countries were forced to grapple with restructuring and consolidating their banking systems, also in response to the third weakness—an inappropriate regulatory environment. In the process of cleaning up balance sheets and introducing better monitoring and surveillance mechanisms, national regulatory regimes were rationalized. And as the recovery took hold and economies returned to robust growth, another important element came into play—market and investment-driven capital flows came back to the region—increasingly in the 2000s in the form of potentially volatile portfolio investments, primarily in equities, but also in fledgling bond and money markets and other asset classes.

Against the backdrop of the crisis, policymakers acknowledged the need for national and regional initiatives to deepen financial markets, a generally agreed approach to increase long-term financing for development—not only within ASEAN but in the greater East Asian region as well. The PRC, Japan, and Republic of Korea joined ASEAN and created the ASEAN+3 group, which has greatly assisted strengthening supervision and expanding local-currency denominated bond markets.

Further development is needed for the Asian Bond Markets Initiative (ABMI) and Asian Bond Fund (ABF) at the ASEAN+3 level, as well as for operationalization of the Credit Guarantee and Investment Facility (CGIF). Countries should also capitalize on the recently-established ASEAN Infrastructure Fund to start financing priority connectivity projects (also through public-private partnerships) and to possibly expand it into an ASEAN+3 Infrastructure Fund.

Currently, much ASEAN savings is invested abroad, and inflows are sourced from outside investors in their “search-for-yield.” This asymmetry should be balanced by promoting more private ASEAN capital outflows, for example. In deep, more developed markets, this can reduce sudden bouts of volatility. At the same time, monetary and financial authorities should invite more local funding sources

to finance regional investment. On the road to 2030, a borderless economic community means freer capital mobility across ASEAN countries: closer financial integration is also needed to stand in competition against the PRC and India, and take better advantage of the increased economic interdependence with the rest of Asia and the world. More comprehensive capital account liberalization is needed, subject to the introduction of adequate safeguards. By 2030, almost all restrictions to intraregional capital flows could be removed.

The rise in financial integration, driven by ASEAN banks — which are already expanding their business presence into other markets in the region — along with deepening financial markets, requires closer cooperation between financial supervisors across the region. Cross-border banking requires cross-border supervision. At this stage, the region's banking supervisors for the most have bilateral memoranda of understanding to enhance supervisory capacities beyond borders. This could be more effective by establishing colleges of supervisors that cover regional banks and better monitoring of global banks operating within their jurisdiction.

Several stages of cooperation could be considered. Early on, exchange and sharing of vital information on financial institutions' balance sheets should be agreed to and implemented. This would include stress-test results and risk assessments done by various supervisors. Particular during a crisis, national agencies must be committed to disclose information on the vulnerabilities of financial institutions they supervise. In the event of bank run on one (or more) of the region's banks, regional financial authorities must be ready to come join together and pool resources. Later, harmonization of legal structures and rules to enhance consistency across ASEAN supervisory frameworks could become a target. As cross-border operations require cross-border financial supervision an ASEAN *College of Financial Supervisors* should have been formed well before 2030.

To support cross-border supervisory cooperation in particular and enhance the effectiveness of macroeconomic policy cooperation among ASEAN economies in general, closer regional cooperation in payment and settlement system is needed. Basic payment and settlement infrastructure, such as easy access to Automated Teller Machine (ATM), should be greatly improved. Greater reliance on cashless payments should be actively promoted.

## 4.2. Harnessing Human Capital

Human capital development underlies most aspects needed to achieve ASEAN aspirations. It relates directly to competitiveness, expanding inclusive development, being environmentally conscious and having the requisite skills for managing effective institutions. It is a key factor needed to avoid falling into the middle income trap.

As elsewhere in Asia, ASEAN population growth has been slowing for some time—from about 2.5% annually in the early 1970s to below 2% by the mid-1990s, and to barely 1.2% now. Demographic projections indicate a further drop in ASEAN population growth by 2030 to about 0.8%. So after growing 34% between 1990 and 2010, ASEAN's population will expand by about 18% between 2010 and 2030—from a total of some 600 million to slightly above 700 million.

ASEAN's population has also been ageing over time and will continue over the next two decades. Estimates show the proportion of persons over 65 years reached 5.6% in 2010, and will likely double to about 11% by 2030. Increasing job opportunities—plus those requiring higher productivity skills—should boost the labor participation rate. But there will be hundreds of millions of new workers to employ by 2030, receiving sufficient remuneration and benefits to drive growth in domestic demand.

Both these trends would imply a slower growth of ASEAN's labor force over the next two decades, unless they are more than offset by an increase in the labor force participation rate. In the face of these demographic trends and projections, the key challenge for ASEAN is to harness its human capital to improve competitiveness and generate stronger and more inclusive growth. Moreover, human capital development will also underpin a better quality of life for the region's populations. Hence human capital development is both a means to achieve several economic ends and an end in itself.

The extent of the expected population growth slowdown and the degree of population ageing will, however, vary widely across the ASEAN members. Between 2010 and 2030, the Philippines will post the highest annual population growth (1.5%), while Thailand and Lao PDR will post the lowest (0.4%). Similarly, population ageing is expected to be most pronounced in Singapore and Thailand, while more modest in other countries.

Given these changing demographics, ASEAN economies need to develop their human capital to generate stronger and more inclusive

development as well as improve productivity and competitiveness. Investment in both urban and rural basic services (such as health care, safe water, and sanitation, among others) is important for inclusion and human capital development—especially in the CLMV countries and the least developed areas of ASEAN-6, such as Mindanao in the Philippines and Sulawesi or Irian Jaya in Indonesia.

Added to this, the quality of human capital, as shown by health and education indicators, also varies widely across countries. Most of ASEAN has either attained, or is well on the way to achieve universal primary education (100% primary net enrollment rates). However, wide variations persist in terms of secondary and tertiary education. Singapore and Malaysia have achieved close to universal secondary education, while Indonesia, Philippines, and Thailand have a long way to go, with others remaining far behind.

Once again, this demographic and human capital diversity across ASEAN—as in the case of diversity in income levels—could be used to the region’s advantage, if countries adopt strategies and policies to harness human capital. National policies aimed at human capital development could be complemented by effective regional-level initiatives that allow freer mobility of labor across national borders (see section 3.2) and well-designed regional assistance programs for human capital development.

ASEAN needs to invest more in education, especially by improving the quality of education systems. An ASEAN-wide strategy for improving education and human capital development must stress educational quality—particularly basic education in science and mathematics. Introducing a wide mix of subjects amid ever-shifting labor market demand must be guided by public-private sector partnerships. Moreover, ASEAN should step up its support for tertiary education—key to creating a scientific and technical manpower base for technological progress and innovation.<sup>7</sup> Public-private partnership projects could also help at creating higher scientific and technical skills to support technological progress and innovation, also by investing more in vocational schools. Regionally,

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7 Within the context of the ASEAN University Network, member countries have just introduced an ASEAN Credit Transfer System to facilitate student mobility under AEC’s “free flow of skilled labor” scheme. Learning from Europe, ASEAN countries should introduce a regional scholarship program similar in nature to the Erasmus program, where undergraduate students can spend 6 months of their college time in one or two foreign universities in other ASEAN countries, while receiving full recognition of the subjects and grades for courses taken abroad. Other specific programs should be introduced in the field of vocational training.

ASEAN should also expand scholarships and exchanges among member countries to allow students to spend substantial time in other member countries, while receiving credit at their home university or other academic institution.

## 4.3. Building Seamless Connectivity

Connectivity is a key enabling factor for economic and social development. It is characterized by several dimensions, including physical (infrastructure), institutional, and people-to-people connectivity.

ASEAN needs to develop infrastructure—in energy, water, transport, and IT, among others—throughout the region with the goal of a seamless ASEAN. Given the huge costs involved, public-private partnerships are essential and should be promoted. The development of regional infrastructure offers many areas for collective ASEAN action, particularly to ensure all stakeholders share appropriate benefits (for example, with Lao PDR a key transit country for many cross-border corridors, a region-wide collective framework would help ensure that transit countries receive appropriate benefits).

Subregional programs such as the Greater Mekong Subregion can help in rationalizing ASEAN needs for infrastructure, especially in CLMV countries. It also needs to introduce proper mechanisms to share benefits arising from enhanced connectivity at the regional level. ASEAN should thus start using the newly created ASEAN Infrastructure Fund. Priority areas include transport, communication, energy, and water.

Effective implementation of the ASEAN Connectivity Master Plan through enhancing IT infrastructure, and widening and strengthening links between sectors and countries must be pursued. Two areas requiring special attention are container transportation and the development of carefully designed eco-cities.

The PRC and India could become ASEAN’s “connectivity partners,” and that would bring in significant benefits to the CLMV countries (see Section 3.2). This should be an area of win-win for all the three partners—ASEAN, the PRC, and India—as infrastructure connectivity holds the potential to accelerate development of low-income ASEAN countries as well as low-income regions within India and the PRC.

The private sector is crucial in developing infrastructure. Public-private partnerships can avail of private sector administrative expertise and financing, especially as new business models are developed to address social issues. The AIF can effectively fund priority regional and subregional projects. It should enlarge its capital from the current \$700 million and expand its contributors, while maintaining ASEAN's predominant voice in administration.

In these efforts at building ASEAN's seamless connectivity, it is important to remember that it is not just the hardware — the physical component — that matters. The supporting software — harmonization of rules, regulations, and standards — is equally, if not more, important. A broader concept of connectivity includes people-to-people and institutional connectivity.

## 4.4. Strengthening Governance

One of the key lessons that emerged from research on governance and development is that the quality of governance (encompassing such diverse elements as voice and accountability, justice and rule of law, and control of corruption) has a huge impact on development. And institutions play a large role in shaping the quality of governance. Moreover, within society, the impact of bad governance falls more heavily on the poor. The other side is that good governance not only promotes development, but also a more equitable sharing of its fruits.

Yet, progress has been quite uneven. The huge divergence in the quality of governance and the effectiveness of its institutions across countries is a problem. Countries with poor governance will be unable to deliver equitable development at the national level. That could further worsen development gaps between the better governed and the poorly governed. A worsening development divide would hamper further progress in ASEAN integration, which, in turn, would impact national development results. The goal of achieving a *RICH* ASEAN would be next to impossible without bridging these huge governance gaps. Governance reform in many ASEAN countries is thus a big challenge over the next two decades.

As incomes and socio-economic status grows among the ASEAN population, higher governance standards will be mandatory to retain social cohesion and political stability. ASEAN cannot ignore this trend and needs to institute measures to improve governance in line with levels of development. New regional institutions may be needed.

In-depth analyses of the functional needs of new institutions will be required, including an analysis of the gaps and various possible options — including whether new institutions are really needed.

Enhanced effectiveness of existing institutions (or new institutions) is necessary for ASEAN to avoid falling into the middle-income trap, and to grow into becoming a hub for investment. One priority is to improve governance first nationally, and then regionally. Allowing greater public expression of concerns (criticism) and accountability, political stability, rule of law and control of corruption, crime and violence, government effectiveness, and the regulatory burden depends on the specific country's level of economic development.

Regulatory institutions can be created that are transparent, rule-bound, and cater toward improving economic and personal welfare, rather than serving favored interests. Sound economic management cannot be done without good national regulatory institutions — two features that need special emphasis are procedural transparency and the rationality of decision-making. It is also necessary that these institutions are accountable with avenues for complaint and redress built in.

The success of institutional reform depends upon the strength and independence of the civil service. ASEAN governments need to take concerted efforts to train and develop an efficient and independent civil service; one which can advise governments on measures to improve the economic welfare without sacrificing long-term development goals.

ASEAN governments should also adopt a region-wide competition policy, or at least its legal framework, to avoid unfair competition across national markets, especially for attracting FDI or implementing FTAs with non ASEAN members. A good competition policy can ensure sound implementation of the AEC Blueprint and strengthen the international competitive position of ASEAN firms.

## 5. Institutional Architecture

**A**SEAN needs to introduce structural reforms to strengthen its institutional mechanisms, improve the capacity of its Secretariat and enable it to perform its mandated functions with more resources. It needs an “efficiency update” comprising a revision of governance principles and an improved mechanism to handle financial contributions. And critically, new ASEAN functional institutions which are being established in response to emerging needs should be decentralized across the region, allowing responsibilities to be equitably spread among members. New functional institutions can be domiciled in those countries where their impact is greatest, also allowing a wider sense of ASEAN community to spread across the region.

The creation of an effective ASEAN Community requires a new institutional architecture to cement recent gains, to maintain centrality among regional groupings, to increase internal cohesion and meet the challenges and opportunities presented by the rise of the PRC and India. ASEAN also needs an effective regional bureaucracy to manage its deepening and widening regional and global role over the next two decades.

Based on the findings of ADB/ADBI’s study on “*Institutions for Regional Integration: Toward an Asia Economic Community*” (2010), key principles ASEAN could adopt in shaping a new institutional architecture include (i) nesting ASEAN in the global economic architecture; (ii) deepening and widening regional integration; and (iii) ensuring efficiency and effectiveness of the Secretariat.

### 5.1. Bolstering ASEAN’s Global Role

The recently strengthened interdependence between ASEAN economies and the rest of the world suggests an increased need to

nest ASEAN in the global economic framework. This can be done by ensuring the compatibility of regional and global integration so measures adopted to cement ASEAN's integration complement rather than jeopardize links with the rest of the world.

The need to bolster ASEAN's global role has become even more evident since the recent global financial crisis. ASEAN's Chair and Secretary General are now invited the meetings of the Group of Twenty (G20). However, they lack sufficient delegated powers to represent ASEAN's voice in the meetings, but can only report back to ASEAN capitals. So ASEAN remains unable take full advantage of its increased global stature. Besides the fact that the ASEAN Chair's statement at the G20 Summit is prepared with inputs from other countries, there is no strategic ASEAN agenda being discussed in global forums. ASEAN should use its perceived "centrality" to assume a more active role when participating G20 and other similar forums.

So long as members do not empower the Secretariat and the ASEAN Chair with more delegation and resources, it will be difficult for the association to play an active role in global forums and multilateral institutions—their function in meetings would remain mostly symbolic. ASEAN can rely on individual member initiatives to unilaterally promote a regional agenda. For example, Indonesia, the only ASEAN member in the G20, was ASEAN Chair in 2011. Given its dual role, it was keen to consult with other ASEAN members before attending G20 meetings to represent a deeper and stronger voice from the region. But as other countries take over the ASEAN Chair, it will be difficult for them to play any active role in representing ASEAN globally. Members should therefore entrust the ASEAN Chair and Secretary General with authority to articulate internally agreed regional agendas in international meetings, especially when only a few ASEAN members—if any—are invited as participants.

Regionally, ASEAN enjoys a more important catalyzing role and it can speak with a louder voice. This is because (i) several other regional groupings have been built around it, and (ii) it has succeeded in developing the concept of a regional family of nations with a sense of shared values—based on informal and nonbinding rules, a multi-track and multi-speed approach to implementing regional commitments, and an institutional model governed by decision by consensus—often summarized as the "*ASEAN way*." Indeed, the *ASEAN way* is in itself a dynamic concept which has evolved over time and responded to emerging needs. But more must be done to

adapt the *ASEAN way* aspirations and challenges of 2030.

The ASEAN way has been emulated by other ASEAN-centered regional and subregional institutions for integration. In response to the 1997/98 financial crisis, East Asian economic cooperation was organized by bringing together ASEAN members with the PRC, Japan, and Republic of Korea (ASEAN+3). The East Asia Summit (EAS) process was also established around ASEAN, and today it includes ASEAN+3 members, plus Australia, India, New Zealand, Russia, and the US. Subregionally, the Greater Mekong Subregion (GMS), the Brunei Darussalam, Indonesia, Malaysia, Philippines—East ASEAN Growth Area (BIMG-EAGA), and the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT), are all examples of institutions created with reference to ASEAN.<sup>8</sup>

ASEAN plays a distinct role in the institutionalization of the Asia-wide integration process. By bringing together large and small powers, it serves as a catalyst for different interests in the region. And through its regular meetings and Secretariat, it provides a platform for channeling integration efforts. But whether ASEAN can continue to maintain its “centrality” as the process of Asian integration broadens is an open question. Its informal approach has the virtue of enabling members with diverse interests to remain nominally united. However, this is also ASEAN’s greatest limitation, as it inhibits operational decisiveness and renders strengthening regional cooperation more difficult by giving de facto veto rights to those favoring the status quo. Therefore, *the ASEAN way* needs an efficiency update by introducing more formal rules and adopting a more flexible decision-making system.

## 5.2. Enhancing the Regional Institutional Framework

Since the late 1990s, ASEAN has started several functional institutions over a wide range of areas. This is usually through initiatives managed by the Secretariat (or independent agencies) that implement regional programs under its umbrella.

The ASEAN Free Trade Area (AFTA) is probably the most successful functional initiative introduced so far. Launched in 1992

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<sup>8</sup> From inception, even APEC was ASEAN focused, with APEC Summits rotating between a non-ASEAN and ASEAN chair.

to increase the group's competitiveness, AFTA has been an effective tool in promoting trade liberalization, institutionalizing constructive dialogue among members—despite diversities in readiness to open up their systems—and introducing the practice of adhering to reciprocal commitments. At the time of its introduction, AFTA was seen as a way to lock in reforms through regional commitments, especially by its most advanced members. AFTA implementation was accelerated following the 1997/98 financial crisis and in response to the rise of the PRC first and India later.

Several ASEAN “centers” were created over the years to promote members' functional cooperation in different areas. Examples include the Centre for Energy and the Centre for Biodiversity, both of which are governed by boards made up of ASEAN Senior Officials and the Secretary General. Other bodies of this nature were created in areas related to the environment—Earthquake Information Centre, Coordinating Centre for Transboundary Haze Pollution, Meteorological Centre—and in areas related to industrial development—Centre for the Development of Agricultural Cooperatives, Council on Petroleum. In the area of education and capacity building, the group has also established the ASEAN University Network and the Insurance Training and Research Institute. Another important group active in the field of education is the Southeast Asian Ministers of Education Organization, which predates ASEAN. It should be stressed that some of these “centers” are dependent on external funding, so their sustainability has yet to be secured.

In addition to existing agencies, ASEAN should create new functional institutions—all properly funded and governed—in response to emerging needs. It should gradually absorb under its wing the large number of programs and initiatives which have been developed by the international donor community in assistance to ASEAN integration. These have been quite active in providing regional public goods in areas such as the environment, health, education and capacity building, disaster risk management, financial assistance and inclusion, human and drug trafficking, as well as infrastructure development.

In 2010, ASEAN members agreed to establish an ASEAN Infrastructure Fund to be administered by ADB, to implement regional infrastructure projects. In 2011, ASEAN+3 undertook new initiatives in food security by agreeing on the creation of an Emergency Rice Reserve in the region to ensure rice stocks expand through dedicated funds. ASEAN should remain central to similar future initiatives by

promoting policy research to identify emerging needs and adopting a flexible approach to funding operations. In particular, it should allow a bottom up approach and—given the variety of priorities, interests, and funding abilities of its members—promote a decentralized strategy when initiating new functional institutions.

While the Secretariat should maintain its crucial coordinating role, ASEAN countries should be allowed to host new regional functional institutions and be able to cover larger shares of their budgets than other ASEAN members. In principle, external funding agencies should also be allowed to contribute with their financial assistance gradually absorbed within the budgets of these institutions through proper governance frameworks, which emphasize transparency and accountability.

New ASEAN functional institutions should follow a decentralized approach and be allowed to spread throughout the region. Different ASEAN members should be ready to host different institutions, also based on available domestic resources and interests, while serving a regional agenda. Areas for future development include natural disaster management, human and drug trafficking, tourism, education (tertiary and vocational education), and issues related to environment and climate change, among others. This approach for regional decentralization in building new functional institutions would also be important to create national champions of regional issues and contribute to ASEAN's overall development—promoting the idea of an ASEAN family that operates in an increasingly borderless economic region.

ASEAN should be able to gradually internalize external contributions by absorbing them into an expanding body of functional institutions to cover a wide spectrum of activities in support of its regional cooperation and integration strategy. It is important that external funds be administered directly by the Secretariat or ASEAN members, so that priorities remain truly regional, instead of being set by external donors. A possible approach is to enhance the ASEAN Development Fund (ADF), which already receives contributions from external parties. Based on informal discussions with key ASEAN's development partners it is estimated that the yearly budget of ASEAN operations funded by external donors is currently around \$60 million (four times bigger than the ASEAN Secretariat's budget). Looking at the next two decades and the region's development needs, ASEAN-centered functional institutions could probably quickly expand—especially if flexible rules and proper governance is applied—to \$100 million by the year 2020, and \$150 million by 2030.

## 5.3. Strengthening the ASEAN Secretariat

During the last few years, an intense debate has been generated in ASEAN with regard to the need to strengthen the Secretariat. It is clear that Jakarta is not the Brussels of the East and the ASEAN Secretariat is not planning to emulate the European Commission. It is also quite evident that it is extremely difficult for ASEAN countries to conduct effective regional cooperation and integration in the absence of structural reforms that drastically bolster the Secretariat's position. Aside from financial and human resources, a revisit some basic governance principles is needed, in particular those related to decision making and contributions to the Secretariat's budget. Improved coordination is needed between the ASEAN Secretariat and member countries' national agencies, its functional institutions, external development partners, and the private sector.

Since its establishment in 1976, the ASEAN Secretariat has always been provided limited powers delegated by member governments due to a widespread unwillingness to give up national sovereignty in substantive areas. Also, the Secretariat has always been lightly funded and empowered with relatively few human resources. Over the years, more powers and resources were added to the Secretariat, also an effect of successive reports prepared by ASEAN "eminent-persons" groups arguing that regional cooperation ought to be strengthened. Today, although the Secretariat has a larger pool of resources than 10 years ago, the pool of professional staff and financial resources available to the Secretariat remain considerably shorter than the institution actually needs (in 2011, the Secretariat only had a total of 207 professional staff, including 74 openly recruited and 133 locally recruited. And the salaries the Secretariat is paying to its staff are fairly below international standards to attract highly qualified professionals from the region.

The introduction of the Charter has added weight to ASEAN, helping in turn to move toward stronger institutions and enhanced regional bureaucracy (although some observers argue that it has also introduced additional administrative procedures, which need to be streamlined). All in all, the Secretariat still lacks financial and human resources, while delegated powers from national agencies and capacity of the Secretariat remain limited — whether in managing the dispute-settlement mechanism or monitoring AEC implementation

through scorecards meant to exert peer pressure when member countries' performance falls short of their commitments. One of the bigger mandates given the ASEAN Secretariat is monitoring and evaluation. One area where member countries could consider expanding the Secretariat's functions is in legal affairs, in particular by enhancing its legal capability in the areas of procurement contracts, memorandum of understandings, etc. A more advanced function is sanctioning members when they do not respect regional agreements by enforcing their commitments, which would be important to attain the trust, confidence and respect of stakeholders and of external partners involved in such commitments.

In 2011, the ASEAN Secretariat budget—equally funded by its 10 members—was approximately \$15 million. This does not include several staff and consultant positions at the Secretariat funded by external donors: under the current budget principles and constraints, it will be difficult for the Secretariat to sustain these positions in the long-run as donor support becomes increasingly scarce. External donors, including multilateral institutions and bilateral agencies, provided additional funding for an estimated total of \$60 million, a small portion of which directly contributes to the Secretariat budget (approximately \$3 million per year), while the largest chunk was independently allocated to support activities designed by donors.

Consequently, ASEAN members had direct control over about one-fourth the overall amount of money being spent by the international community on ASEAN-related initiatives. This creates excessive dependency on external funding sources—which have their own logic and requirements. At times, donor priorities do not fully fall in line with ASEAN's, with efforts duplicated due to communication and coordination failures. This approach begs for urgent reform.

However, it is quite difficult to estimate the actual amount of institutionalization needed to properly manage the initiatives and operations of ASEAN and assess the need for financial and human resources. One has to first assess the extent to which ASEAN members are prepared to strengthen the Secretariat. Second, the answer also depends on the roles and functions the Secretariat will be asked to perform to realize the ASEAN Community, considering that requirements and expectations differ for different sectors. It is clear, in any case, that financial resources directly managed by the Secretariat must drastically increase.

It is plausible that over the next two decades, the Secretariat's functions will have to be increased considerably to satisfy several

needs: (i) governing the large amount of rules, regulations and standards introduced by creating the AEC; (ii) playing a major role in coordinating existing and new functional institutions established; (iii) managing emerging issues under the political-security and socio cultural pillars, such as food and energy security and disaster management, among others. To handle these additional functions, the Secretariat's budget should expand considerably. This study estimates an expansion of the Secretariat's operational costs to perform additional duties to \$50 million by 2015, \$100 million by 2020, and \$200 million by 2030. Additional resources to the budget of the Secretariat from member countries should be commensurate to its growing needs.

Funding Secretariat operations will require a serious re-think about how contributions are collected from member countries. Anchoring funding needs to the principle of "equal budget contribution" enormously hampers the ability to enlarge the budget as needed, because contributions from the smallest economies are quite limited. Indeed, a drastic increase in individual country contributions has limitations imposed by the contributing capacity of Lao PDR, Cambodia, or Myanmar. The equal contribution principle creates as well an intrinsic dependency on external funding from international donors. Although funds are usually available, the issue is that priorities do not always match. ASEAN cannot independently accomplish its plans and realize its strategies if decisions are diluted by accommodating many other stakeholders. Real improvement can only come from upgrading the principle of equal contributions to one of diversified contributions. One solution would be to allow diversified contributions from member countries based on successful examples of newly established functional institutions — able to act efficiently and effectively while remaining fully integrated within the ASEAN system. Although diversified contributions imply different weights in governing bodies, a positive bias can be introduced in favor of small countries (or minorities) as a balancing factor. The equal contribution principle could be updated by introducing a simple and periodically revised formula based on members' capacity and the extent of benefits they receive from ASEAN membership through the implementation of projects and activities, reflecting the small country bias.

Suggestions to revise the equal budget contribution approach were repeatedly made on several occasions. One view is that benefits vary according to individual members' economic size, so contributions must vary accordingly. Another way is to view financial contributions

as a “regional social responsibility” to support ASEAN’s collective action, so contributions should be decided on the ability to pay. But ASEAN leaders have shown persistent reluctance to change this approach, which has governed the association since its creation.

Other proposals focused on the establishment of a multi-donor fund—with contributions by members—managed by the ASEAN Secretariat to supplement financial needs beyond the basic Secretariat budget. As it may take time to establish this type of fund, one possibility is to pool all existing funds towards the ADF, which could be linked to operations in a wide range of functional areas in support of ASEAN’s strategy for regional economic development. Although the ADF activities have been limited and the Fund has often performed below expectations, its structure and administration can be improved by entrusting professionals for administration. The Fund should be made more effective in project funding, and it should also be allowed to play a more central role in driving the ASEAN community-building agenda.

The decision-making system could also be made more effective by allowing some flexibility for decision on operational matters—to govern more intensive integration and extensive external relationships. While consensus should continue to be used for fundamental issues, decisions on operational matters could be taken through a qualified majority (the initial aim should be to bolster the ADF and the decision-making process of the fund can be taken up later). Although ASEAN has traditionally followed consensus-based decision making, as group activities become more articulated and sophisticated, member countries need to adopt a more flexible system that maintains institutional effectiveness and efficiency. While ASEAN has successfully applied the so-called “*ASEAN minus X*” formula on several occasions to follow a multi-track and multi-speed approach to regional cooperation, more flexible decision-making is also needed to accommodate the needs from the expanding array of areas, types and level of decision intensity.

Typically, deciding on day-to-day matters by consensus creates unnecessary delays and may be governed by cumbersome procedures. ASEAN countries should be ready to separate issues between fundamental and operational ones, leaving an approach by consensus to the former and introducing a more flexible system—for example a qualified majority (usually two thirds of the total)—to operations. Such a system would be similar to decision-making in CMIM in which consensus is required for fundamental issues and a weighted majority—with a bias in favor of small countries—for

operational issues. Contributions in the CMIM are also unequal. The recently established Credit Guarantee Investment Facility (CGIF) and the AIF have adopted similar systems (Table 8).<sup>9</sup>

Realizing 2030 aspirations also requires reassessing some of ASEAN's basic principles, as the association today, differently from 45 years ago, needs promote regional cooperation in a globalized world—where economic efficiency affects growth and

**Table 8. Contributions and Voting Powers in CMIM and AIF**

Chiang Mai Initiative Multilateralization (CMIM)				ASEAN Infrastructure Fund (AIF)		
Members	% Capital Contributions	Voting Power (%)	Borrowing Power (%)	Members	% Capital Contributions	Voting Power (%)
BRU	0.03	1.16	0.17	BRU	2.06	2.06
CAM	0.10	1.22	0.50	CAM	0.02	0.02
INO	3.79	4.37	9.47	INO	24.73	24.73
LAO	0.03	1.16	0.50	LAO	0.02	0.02
MAL	3.79	4.37	9.47	MAL	30.92	30.92
MYA	0.05	1.18	0.25	MYA**	0.00	0.00
PHI	3.79	4.37	9.47	PHI	3.09	3.09
SIN	3.79	4.37	9.47	SIN	3.09	3.09
THA	3.79	4.37	9.47	THA	3.09	3.09
VIE	0.84	1.85	4.17	VIE	2.06	2.06
<b>ASEAN</b>	<b>20.00</b>	<b>28.42</b>	<b>52.92</b>	<b>ASEAN</b>	<b>69.08</b>	<b>69.08</b>
PLUS3*	80.00	71.58	47.08	ADB	30.92	30.92
Total	100.00	100.00	100.00	Total	100.00	100.00

\*PLUS3=People's Republic of China, Japan, Korea.

\*\*Myanmar is not contributing to AIF.

BRU=Brunei Darussalam; CAM=Cambodia; INO=Indonesia; LAO=Lao People's Democratic Republic; MAL=Malaysia; MYA=Myanmar; PHI=Philippines; SIN=Singapore; THA=Thailand; VIE=Viet Nam.

Source: ASEAN Secretariat, Asian Development Bank Institute staff elaborations.

<sup>9</sup> In the case of CMIM, for example, out of ASEAN's total contribution of \$24.0 billion, each of the original ASEAN-5 contributed \$4.552 billion, Viet Nam \$1.0 billion, Cambodia \$0.12 billion, Myanmar \$0.06 billion, and Brunei Darussalam and Lao PDR \$0.03 billion each. The ratio of the largest to the smallest contribution amounts therefore to more than 150 times, a major departure from the equal contribution principle. Even though contributions are very unequal, the sovereignty of all countries (including +3 countries) are protected by requiring that fundamental issues still need consensus, (with weighted majority for more operational issues).

development. In particular, a stronger Secretariat, decision making “efficiency updates,” and funding contributions are important steps to create a robust and effective regional bureaucracy. The Secretariat can be more effective in coordinating its activities and functions with countries’ national agencies and with external development partners.

Indeed, another important task for the Secretariat in the years ahead is to improve coordination with regional functional institutions and with national agencies of member countries. ASEAN’s decentralized functional institutions will require greatly improved coordination with the Secretariat. At the same time, greater coordination is needed between the ASEAN Secretariat and national agencies of its members. There remains room for improving coordination between the Secretariat and member countries in preparing the strategic agenda for key ASEAN meetings (especially Ministers meetings and the Summit) and defining ASEAN positions in dealing with non-ASEAN entities.

Intertwined with budget contributions, decision-making systems, and coordination issues is the power that national agencies decide to delegate to the Secretariat and other regional institutions. As discussed earlier, members should be ready to delegate more powers to the Secretariat — at least to govern the new regional market created by the AEC — and to coordinate decentralized regional functional institutions under its umbrella. Creating a “*RICH*” ASEAN by 2030 without substituting national sovereignty with shared sovereignty managed by regional institutions will be a very difficult task. To face increasing competitive pressures and opportunities for cooperation emerging from the PRC, India, and other Asian countries, ASEAN leaders must realize that it is in their interest to strengthen the Secretariat.

The recently established Committee of Permanent Representatives (CPR) should play an increasingly important role in providing a more effective interface between member states and the Secretariat, and in forging a new ASEAN approach to regional bureaucracy. An effective and dynamic CPR can greatly improve ASEAN in providing regional public goods by identifying efficient mechanisms for regional cooperation and strengthening the institutional base. As the CPR becomes fully integrated in a well-functioning ASEAN, member countries will easily realize that the costs of non-cooperation are in fact very high.

Improving coordination with external development partners requires better promulgation of ASEAN priorities and strategies — and

better inclusion in projects and programs of bilateral and multilateral donor agencies. An *ASEAN Institute*—a new policy research facility—should be created within the Secretariat to undertake strategic policy work and capacity building programs. The Institute’s activities would support ASEAN community-building and other cooperation priorities by pooling resources from member countries and development partners under the Secretariat’s general guidance and coordination. A new functional institution in this area linked to the Secretariat could be very effective in promoting the idea of the ASEAN Community, also by avoiding duplications and matching activities with ASEAN’s development strategy.

Closer coordination is also needed with business leaders and representatives of private sector organizations. The private sector has been the main engine in building industries and fostering growth and competitiveness across ASEAN. Leaders of the private sector operating in the region should be advised by the ASEAN Summit to thoroughly review their strategic position in achieving a *RICH* ASEAN by 2030 and assisting in the creation of a borderless economic community. Active involvement of the private sector in ASEAN integration could be organized by different industries to give a proper focus of suggested activities, starting perhaps from the AEC 12 priority integration sectors. One practical way to coordinate involvement of the private sector could be by asking representatives of private sector organization to submit applications for consultations during Ministerial Forums and the Summit, and the AEC Council could decide on the agenda based on Secretariat’s recommendations.

ASEAN economic integration has thus far been lightly institutionalized (ADB, 2008 and ADB, 2010). The need for a stronger institutional base—with an adequately empowered Secretariat and more effective regional bureaucracy—is increasingly important as ASEAN, moves beyond creating an AEC and enters the next phase of integration. The ultimate objective of institutional reform should be to increase responsibility and accountability for the ASEAN Secretariat and to facilitate member countries in better balancing their national interests with growing regional responsibilities. Member countries need to appreciate that growing together for shared prosperity requires considerably more sharing of their decision-making powers in a more flexible way. Political leadership is crucial in addressing this policy option successfully.

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