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ASEAN SERVICES INTEGRATION REPORT

A Joint Report by the ASEAN Secretariat and the World Bank

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ASEAN Services Integration Report

A Joint Report by the ASEAN Secretariat and the World Bank

The ASEAN Secretariat
Office of the Chief Economist, East Asia and Pacific Region, the World Bank

The Association of Southeast Asian Nations (ASEAN) was established on August 8, 1967. The Member States of the Association are Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. The ASEAN Secretariat is based in Jakarta, Indonesia.

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Abbreviations

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
ABIF	ASEAN Banking Integration Framework
ACIA	ASEAN Comprehensive Investment Agreement
ACMF	ASEAN Capital Markets Forum
ACPE	ASEAN Chartered Professional Engineer
ACPER	ASEAN Chartered Professional Engineers Register
AEC	ASEAN Economic Community
AEM	ASEAN Economic Ministers
AFAS	ASEAN Framework Agreement on Services
AGCM	ASEAN Central Bank Governors' Meeting
AMNP	Agreement on the Movement of Natural Persons
AMS	ASEAN Member States
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ATM	ASEAN Transport Ministers Meeting
ATM	automated teller machines
BIMP-EAGA	Brunei Darussalam, Indonesia, Malaysia, and the Philippines East ASEAN Growth Area
BPO	business processing outsourcing
CAFTA	Central America Free Trade Agreement
CCS	Coordinating Committee on Services
CLMV	Cambodia, Lao PDR, Myanmar, and Vietnam
EDSM	Enhanced Dispute Settlement Mechanism
EIA	economic integration agreement
EU	European Union
FDI	foreign direct investment
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GDP	gross domestic product
GMS	Greater Mekong Subregion
GTAP	Global Trade Analysis Project
GVC	global value chain
ICT	information and communication technology
IMS-GT	Indonesia, Malaysia, Singapore Growth Triangle
IMS-GT	Indonesia, Malaysia, Thailand Growth Triangle
INACA	Indonesian National Air Carriers Association
IOSCO	International Organization of Securities Commissions
ISO	International Organization for Standardization
IT	information technology
LMT	labor market test
M-ATM	ASEAN Tourism Ministers Meeting
MAAS	Multilateral Agreement on Air Services
MAFLPAS	Multilateral Agreement for Full Liberalization of Passenger Air Services
MALIAT	Multilateral Agreement on the Liberalization of International Air Transportation
MAS	Monetary Authority of Singapore
MFN	most-favored nation
MRAs	Mutual Recognition Agreements or Arrangements
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
PRA	Professional Regulatory Authority
QABs	Qualified ASEAN Banks
QFB	Qualifying Full Bank
RIATS	Roadmap for Integration of Air Travel Sector
SAR	special administrative region
SSE	service supplying employees
STRI	Services Trade Restrictiveness Index
TELMIN	Telecommunications and IT Ministers Meeting
TII	Trade Intensity Index
WC-FSL	Working Committee on ASEAN Financial Services Liberalisation
WTO	World Trade Organization

Countries

CHN	China
IDN	Indonesia
KHM	Cambodia
LAO	Lao People's Democratic Republic
MMR	Myanmar
MNG	Mongolia
MYS	Malaysia
PHL	Philippines
PNG	Papua New Guinea
SGP	Singapore
THA	Thailand
VNM	Vietnam

Regions

AFR	Sub-Saharan Africa
BRN	Brunei Darussalam
ECA	Europe and Central Asia
LAC	Latin America and Caribbean
MENA	Middle East and Northern Africa
SAR	South Asia Region

Foreword

With the services sector's increasingly significant contributions to the regional economy, supporting about half of its combined GDP and 60 percent of its total foreign direct investment inflows in recent years, ASEAN fully recognizes the opportunities for further growth and employment that the services sector creates. The liberalization of the services sector in the region has traditionally focused on two areas, specifically, the promotion of trade in services as well as the promotion of flows of skilled labor through the establishment of Mutual Recognition Arrangements (MRAs) for professional services. Under the ASEAN Framework Agreement on Services (AFAS), ASEAN has made concerted efforts to enhance cooperation among Member States, setting specific targets for the process of liberalizing and integrating the services sector in the region to enable the free flow of services envisioned in the ASEAN Economic Community (AEC).

This Report provides an in-depth assessment of the role of services trade in ASEAN's economic integration, analyzing the framework of ASEAN's services policies and the impact of services integration in the region. Aside from identifying prevailing challenges and potential opportunities, the Report provides a useful reference on ASEAN's progress and puts forward key recommendations to enhance regional trade in services.

The formal launch of the ASEAN Community and the endorsement by the Leaders of ASEAN of the forward-looking and ambitious ASEAN Community Vision 2025 this year will create greater impetus to further broaden and deepen ASEAN's services integration process with its benefits ultimately redounding to the people-oriented, people-centred ASEAN Community.

LE LUONG MINH
Secretary-General of ASEAN

Foreword

The Association of Southeast Asian Nations (ASEAN) brings together ten countries with over 620 million people and a combined gross domestic product of more than USD 2.5 trillion. These countries are well integrated into the global economy and have benefited from this integration. And, as evidenced by their adoption of the ambitious goal of forming an ASEAN Economic Community (AEC) by 2015, they are committed to even deeper regional integration.

An earlier report – the *ASEAN Integration Monitoring Report* (2013), which was jointly prepared by the ASEAN Secretariat (ASEC) and the World Bank, showed that ASEAN's regional integration agenda has provided important benefits to the Member States. In particular, ASEAN integration has helped boost regional trade flows without trade diversion, improve trade logistics, lower aggregate trade costs and increase regional investment flows.

This joint ASEC--World Bank report, which focuses on services integration within ASEAN, is timely for two reasons. First, as ASEAN prepares to launch the AEC at the end of this year, addressing services integration is clearly high on the agenda of policymakers. Second, Member States are now discussing a new services integration agreement to replace the previous ASEAN Framework Agreement on Services.

This report takes stock of ASEAN's achievements in services integration, delineates the potential gains from further integration and highlights the challenges that remain. Recognizing the role of services in spurring economic growth and job creation, including in manufacturing and agriculture, regional policymakers have committed to an ambitious plan for integrating their services sectors as a core element of the AEC. As the report highlights, there are successes in some sectors – such as in health in Thailand, education in Malaysia and finance in Singapore – on which future actions can build. Nevertheless, intra-ASEAN trade in services remains low relative to the economic size, complementarity and geographical proximity of ASEAN member states. As the report notes, there are still a range of policies in ASEAN economies that impede services integration. Overall, the data and analysis show that while there has been good progress in making commitments to integrate services trade, more needs to be done to fully realize the goals laid out in the AEC Blueprint.

The report reviews approaches to negotiations and institutional processes underlying services integration. It provides a range of specific recommendations on implementing commitments, enhancing transparency, and strengthening the institutional framework and negotiating modalities. Finally, it highlights priorities for regional regulatory reform and cooperation as a means of deepening services integration.

On behalf of the World Bank, my thanks to the ASEAN Secretariat for a productive partnership over the last three years in implementing the ASEAN Economic Community Monitoring and Evaluation program, of which this report is one output. Our thanks also to the Government of Australia for financing most of this work through their technical assistance program for ASEAN. I hope this report will contribute to the ongoing debate on services integration within ASEAN and will help inform policymaking aimed at enhancing regional cooperation.

Axel van Trotsenburg
Regional Vice President
East Asia and Pacific Region
The World Bank

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This report was written by a team of World Bank (WB) staff and consultants led by Ahmad Ahsan of the World Bank. Other team members were Aaditya Mattoo, Batshur Gootiiz, Sebastian Saez, Martin Molineuvo, and Peter Walkenhorst of the World Bank. The report benefited from extensive inputs and comments from Julia Tijaja, Tan Tai Hiong and Wai Mun Hong of the ASEAN Secretariat. Alan Khee-Jin Tan (National University of Singapore) and Saurabh Mishra (Consultant) contributed background papers for the study. Guillermo Arenas and Christina Busch contributed to the analysis of Chapter 1, 4 and 5 and Claire Hollweg contributed with gravity model analysis of Chapter 1.The team gratefully acknowledges comments by peer reviewers Siow Yue Chia (Senior Research Fellow, Singapore Institute of International Affairs), Ndiame Diop (Lead Economist, Macroeconomic and Fiscal Management), and Bernard Hoekman (Professor and Program Director, Global Economics, Robert Schuman Center for Advanced Studies, European University Institute) and other participants at the review meeting of the World Bank. Yan Sun (EAPCE) provided research assistance. Cecile Wodon (EAPCE) processed the report and Diane Stamm edited it. Okti Z. Maaruf of the ASEAN Secretariat helped to design the cover.

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Notes and Data Sources

The analysis on ASEAN's commitments under ASEAN Framework Agreement on Services (AFAS) contained in this Report is limited to the eighth AFAS package in a wide range of service sectors under the purview of ASEAN Economic Ministers. The policy analysis of financial services covers Banking and Insurance sectors and the fifth package in financial services under the purview of ASEAN Finance Ministers. There is a brief reference to the scope of the recently concluded sixth package in the financial sector. The quantitative analysis of the transport sector policies compares multilateral and regional commitments and actual policies in 2012 in maritime transport (mode1 and 3), rail (mode 3), and road freight services (mode 3). The discussion of commitments in air transport services under the Purview of the ASEAN Transport Ministers is based on the Multilateral Agreement on Air Services (MAAS) and the Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS), adopted in 2009 and 2010 respectively.

ASEAN continues to improve its commitments under AFAS. The Protocol to Implement the Sixth Package of Financial Services Commitments was signed in March 2015 by the ASEAN Finance Ministers. The Sixth Protocol of Financial Services Commitments contains the enabling provision for the implementation of the ASEAN Banking Integration Framework (ABIF). The Objective of ABIF is to achieve a more integrated banking market, by allowing any two ASEAN economies to enter into reciprocal agreements to provide Qualified ASEAN Banks (QABs) with greater market access, and operational flexibilities consistent with those of domestic banks in the respective host countries.

The signing of the Protocol to Implement the Eight Package of Commitments on Air Transport Services was completed in November 2014. The signing for the Protocol to Implement the Ninth Package of Commitment under AFAS to-date is also close to completion. In addition, further liberalization in each of these AFAS processes continues to be undertaken. The services commitments made in these subsequent packages include new subsectors, higher foreign equity participation, and fewer restrictions to trade in various modes of supply. It is therefore expected that incorporation of these more recent commitments would have yielded a lower (less restrictive) index of AFAS commitments than that presented in this Report.

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Executive Summary

1. **This report, prepared by the World Bank with support from the ASEAN Secretariat, takes stock of ASEAN's achievements in the integration of services markets and identifies the challenges ahead.** A previous joint report, the *ASEAN Integration Monitoring Report* (ASEAN Secretariat and the World Bank, 2013), looked at the overall progress of regional integration in trade in goods, trade facilitation, investment flows, and services. Both the earlier report and other work (ERIA 2012) have identified services integration as one of the most important challenges facing ASEAN. This is true in terms of both the slow progress in achieving the ASEAN Economic Community (AEC) goals regarding services integration, and the broader potential gains that can be obtained from achieving those goals. This report addresses four questions: (a) How have ASEAN countries performed in services and services trade and why are services trade and integration important for ASEAN countries? (b) How open are services markets within ASEAN and to what extent has ASEAN achieved the goal of services integration? (c) What lessons can be derived from past experiences of services sector reforms in ASEAN countries? (d) What constrains services integration and how can the integration process be enhanced?

2. **ASEAN economies are aware of the key role that the services sector and services trade can play in their development, and have made services central in their integration agenda.** Governments in the region have realized the fundamental role of services for economic growth and job creation, and have embarked on an ambitious regional integration program that is intended to culminate in the free flow of services by 2015. The services integration agenda in the region was first launched through the ASEAN Framework Agreement on Services (AFAS), signed in 1995, three years after the signing of its goods counterpart, the ASEAN Free Trade Area (AFTA). The AEC Blueprint adopted in 2007 provided a bold and more ambitious vision of deep integration, where goods, services, investment, and skilled labor would move freely across the borders of ASEAN countries by 2015. Detailed targets were set for achieving the integration of services markets. The AFAS and the AEC Blueprint provide a valuable framework to foster services trade within the region.

Why are services and services trade important for ASEAN countries and how do they perform?

3. **The growing importance of services in the world economy is being driven by strong demand from consumers and producers, and by international trade.** As incomes increase, consumers seek a widening range of personal and recreational services or consume more services-intensive products, while producers search for more specialized and sophisticated inputs and professional advice. Parts of these demands are satisfied through international trade, since services have also become exports and tradables in their own right. Increasing fragmentation of production processes in global value chains, along with advances in information and telecommunication technology, including digitization of content, has made it possible for many services activities that used to be thought of as being nontradable to be supplied internationally. Furthermore, backbone services, such as transportation, logistics, telecommunications, and financial services are integral to the working of global value chains, serving as the glue that makes it possible for production activities to be undertaken across multiple countries. International experience suggests that an expansion of services trade is associated with increased per capita incomes and higher productivity.

4. **ASEAN economies are no exception to these trends.** While their rapid growth over the last four decades was largely fueled by strong manufacturing exports, the services sector and services trade have become increasingly important. On average, services contributed more than 40 percent of total value added

in ASEAN Member States in 2010 and accounted for more than 50 percent of total employment.[1] Trade in services has also risen sharply. When trade is measured in terms of value added, the share of services in total exports increases in all ASEAN countries except Indonesia.

5. **An analysis of forward linkages of the services sector in this report also shows that services have a key role in ASEAN countries.** Services are important inputs to other economic sectors and exports. Indeed, many services, such as finance, transportation, and communication, are "backbone services" that feed into other production processes, so that services trade can help foster competition through access to vital production inputs at lower costs. Forward linkages are the contributions to value added of a particular sector to other sectors in the economy. In ASEAN countries, the four services sectors (electricity, gas, and water; construction; trade and transport services; other private services) contributed between 25 percent (Lao People's Democratic Republic) and 56 percent (Singapore) of total domestic value added and between 17 percent (Indonesia) and 56 percent (Singapore) of total export value added in 2007. For the more developed ASEAN Member States, Indonesia, Malaysia, the Philippines, Singapore, and Thailand, manufacturing uses services relatively intensely, with services providing about one-third of the value-added contributions of manufacturing. The exception is Indonesia, with a contribution closer to 23 percent. For lower-income ASEAN Member States, that is, Cambodia, Lao PDR, and Vietnam, the share in services in the value added of agriculture as well as energy extraction and minerals is above one-third, reaching almost 47 percent in the case of Lao PDR.

6. **The regional economic integration of the AEC, constituting a potential market of more than 620 million people and US$2.5 trillion of gross domestic product, offers opportunities for using services and services trade to generate growth in productivity and income.** Services contribute between 40 and 70 percent of the gross national income of ASEAN economies. In terms of trade in services, ASEAN's trade in services represents 5 percent of world trade in commercial services, or US$343 billion in 2009. In addition, foreign direct investment (FDI) in the services sector has accounted for about 60 percent of total ASEAN FDI) in the past two years. This clearly underscores the importance of services to ASEAN.

7. **Despite these opportunities, ASEAN countries have not yet realized their full potential in services, particularly in view of their levels of income and development.** This assessment is based on a variety of indicators, including straightforward comparisons with similar countries, analysis using cross-country estimates, and other modeling tools. Some ASEAN countries have established themselves as services exporters in particular sectors. Overall, however, sophisticated, skill-based services exports remain largely niche activities in ASEAN economies. While the contribution of services growth has picked up in the last decade, the share of services in GDP remains relatively low for ASEAN economies (accounting, on average, for less than half of the GDP the last five years) compared to countries in other regions (more than 60 percent in Latin America, Eastern Europe, and the Middle East).

8. **Further, ASEAN Member States are mainly exporting "traditional services" such as transportation, and travel and tourism services.** They have been less successful in tapping into the new services opportunities such as information technology (IT) and business-related services. The Philippines and Singapore are the main exceptions in the region. In the case of the Philippines, in recent years its business processing outsourcing and IT-enabled services exports became a success story. Singapore's exports of modern services, such as professional and other business services have developed significantly since the mid-1990s.

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[1] Following ASEAN's official convention, ASEAN countries are referred to as ASEAN Member States in this report.

9. **Regional trade in services for most ASEAN countries has yet to meet its full potential.** This is seen in two ways: first, actual services trade among most ASEAN countries is less than the potential trade volumes predicted by trade determinants. All ASEAN countries are shown to under-export to Malaysia and Singapore (and Malaysia and Singapore to each other). There also appears to be untapped potential for countries such as Brunei Darussalam, Cambodia, Malaysia, and Singapore to increase services exports with select countries in the region. Second, the intensity of regional services trade is low; that is, services trade among ASEAN countries is generally less than services trade between ASEAN countries and non-ASEAN countries.

How open are services markets within ASEAN?

10. **ASEAN countries have, on average, more restrictive services policies than any other region in the world, except the Gulf States, although the restrictiveness of applied policies varies widely across ASEAN countries.** The average Services Trade Restrictions Index (STRI) for the region is 60 percent higher than the global average. But restrictiveness of applied policies varies widely across countries and income levels. Cambodia and Singapore have the most open policies in the sectors covered. Myanmar and Vietnam are also relatively open with a few restrictions, and the rest (Indonesia, Thailand, the Philippines, and Malaysia) have significant restrictions. Note that in some case, the presence of only a few restrictions may be more reflective of the regulatory readiness in these countries than the openness of their services market policies.

11. **The AFAS has contributed to greater regional policy certainty, but has not resulted in significant additional liberalization on the ground.** On the one hand, commitments to liberalize service sectors scheduled under AFAS now surpass those made under the General Agreement on Trade in Services (GATS) during the World Trade Organization (WTO's) Uruguay Round or even offered under the Doha negotiations. While AFAS commitments have unquestionably created greater regional policy certainty, their commitments have not produced significant additional liberalization, because they did not go far enough beyond the current applied regime.

12. **Further, despite having AFAS in place, ASEAN countries have not undertaken significant liberalization in the last four years.** While there are some instances of market opening, there are also instances of reversal of liberalization. For the six ASEAN Member States for which the same surveys were conducted in 2008, there is little change in the overall policy regime from 2008 to 2012 (regional average STRI fell only about 16 percent from its high level). As a consequence, even though actual openness is greater than that promised by current AFAS commitments, it is still not close to the ambitious, broad, goals to achieve free flow of services, especially in the case of Mode 3 trade, that is, in liberalizing foreign investment ("commercial presence") in services. But it is important to recognize the valuable role of AFAS commitments in reducing policy risks, as shown in the limited instances of reversal of liberalization.

13. **ASEAN countries have made modest progress toward creating a more regionally integrated market.** There is little evidence that ASEAN economies are more open vis-à-vis each other in services trade than vis-à-vis non-ASEAN economies. For the seven broad sectors (and relevant modes) for which policy data were collected for this study, this report found little difference between policy treatment of intra-ASEAN and extra-ASEAN trade. ASEAN Member States therefore received virtually the same treatment as nonpreferential or most-favored-nation (MFN) policies.

14. **Market access in many of the ASEAN economies is uncertain and unpredictable due to a discretionary licensing regime.** From banking to transport, entry is restricted by the explicit and implicit limit on new licenses, and the licensing process can be opaque and discretionary. In several ASEAN countries, licenses and foreign equity ownership are decided on a case-by-case basis, subject to requirements or approvals that involve several regulators and ministries. Some countries, particularly newer

Member States, do not have regulations in some sectors pertaining to the supply of services through the cross-border and consumption abroad modes. In such cases, even though the supply of services is usually allowed in practice, the absence of regulation makes it difficult to identify and define the policy regime affecting the supply of services, creating a less predictable policy environment.

15. **There are two areas, however, where progress in services integration is noticeable.** First, in air transport, ASEAN countries have taken some steps toward regional open skies. Second, in certain professional services, mutual recognition agreements have been negotiated and concluded. These initiatives suggest that regionalism could have incremental value when it focuses on areas which are not being addressed multilaterally. This is not surprising, given that regionalism offers a potentially valuable avenue for liberalization in areas where multilateral cooperation is difficult, such as in professional services and transportation. However, even in these areas, regional integration efforts are incomplete. In professional services, domestic regulations have not yet been aligned with the ASEAN Mutual Recognition Agreements or Arrangements (MRAs), while some MRAs need to be complemented with further bilateral negotiations to make them operational. In air transport, further liberalization will be necessary to achieve a truly integrated regional air transport services market.

16. **In the financial sector, also, ASEAN Member States are working to deepen financial services integration in the ASEAN context.** Initiatives by ASEAN Member States have aimed to strengthen and harmonize capital market disclosure standards. To further deepen regional financial integration, the ASEAN Central Bank Governors' Meeting (ACGM) in December 2014 endorsed an ASEAN Banking Integration Framework (ABIF), which will enable "Qualified ASEAN Banks" (QABs), to have a greater role in promoting intraregional trade and investment. The ABIF guidelines were also approved by ACGM in December 2014, and the provision for enabling QABs implementation was signed by ASEAN Finance Ministers in March 2015, as part of the Protocol to implement the 6th Package of Financial Services under the AFAS.

17. **Successful liberalization also requires supporting reforms of domestic regulation.** These range from prudential regulation in financial and professional services to pro-competitive regulation in telecommunication and transport services. In these areas too, there is scope for regional coordination and cooperation, to reap economies of scale in regulation and to prevent the fragmentation of the regional market because of divergent national regulation.

What lessons can be derived from past experiences of services sector reform?

18. **ASEAN economies have accumulated valuable experience in reforming their service sectors, which can be useful for regional integration.** A key lesson is that national governments have an important role to play not only in shaping the regional and international integration agenda, but also in ensuring there is a supporting domestic reform process. Governments have to work closely with the private sector to ensure that the domestic regulatory framework and other complementary policies are in place to support the development of a more competitive services sector. Setting standards, accreditation processes, and quality control measures, which enable the development and trading of services, while protecting domestic consumers, have been key elements in these developments. Five country-sector experiences of services reform offer valuable lessons for future reforms.

19. **Malaysia successfully established itself as one of the pioneers in private higher education by opening up the sector, fostering cross-border trade in education services, and implementing both the requisite regulatory framework and quality assurance infrastructure.** As a result, the number of privately and foreign-controlled educational service providers, and the number of foreign students studying in Malaysia, increased markedly. The government's willingness to liberalize higher education and cede some control over the sector's development to private service providers, establish a regulatory framework

for the new private universities and set up the quality assurance infrastructure that made it possible to avoid a slide toward "degree mills," and support the outward orientation and international benchmarking when setting standards for courses and degrees, all helped anchor the credibility of the new educational offerings. Finally, the active pursuit of partnerships with foreign universities through the establishment of branch campuses or twinning programs brought foreign expertise and competition to the country.

20. **After the Asian Financial Crisis in 1997, Singapore retained and strengthened its position as the region's financial center by combining market opening with active preparation of the domestic financial sector and reformed regulatory framework.** Since the late 1960s to the start of the Asian Financial Crisis, Singapore actively promoted the development of its financial sector with the aim of becoming a financial center in the region. Yet, until the Asian Financial Crisis, local banks and financial institutions continued to be shielded from international competition by separating the activities of the offshore financial center from the domestic banking and insurance sector. The crisis highlighted the deficiencies of this system and subsequently triggered a multitude of gradual reforms that included opening the market to foreign banks and insurance companies, and the active preparation of the domestic financial sector for the coming increased competition. Moreover, the Monetary Authority of Singapore scrutinized the foreign service providers and granted a limited number of operating licenses to select companies that best met its set of criteria and, thus, kept control on the country's financial system.

21. **Thailand has been one of the frontrunners with respect to patient insourcing in Southeast Asia through its ability to respond effectively to the initial challenges posed by market opening and being proactive in targeting the high-value-added markets.** Thailand was able to respond to the challenge of polarization of public-private health care and a brain drain of health professionals from the public sector through complementary policies such as compulsory public service for medical graduates and financial incentives for rural doctors. The country initially focused on tourism-related activities such as spas, traditional massages, and herbal treatments. Yet, in recent years, private hospitals have discovered that they can profitably attract and treat foreign patients not only for essential treatment such as heart bypass procedures, but also for elective medical procedures, such as plastic surgery. The ensuing growth of private hospitals has given rise to a brain drain of health professionals and other resources from the public sector toward the private sector. The Thai government responded to this challenge by devising a set of complementary policies such as the imposition of a three-year compulsory public service for medical graduates, with two-thirds of the latter being sent to work in rural areas, along with other financial incentives for doctors to work in rural areas.

22. **The Philippines has been very successful in capturing a significant share of the international business process outsourcing (BPO) market through a holistic approach to developing the sector.** Competitive salaries and low compensation costs, a large pool of suitably qualified talent, low telecommunication and real estate costs, the opening of the telecommunication sector, the availability of investment incentives for firms in the BPO sector, and the fostering of tertiary education have been the keys to this success. The Philippines has been trying to benefit from the growing trend in high-income countries for firms to outsource back-office and information technology functions in order to take advantage of advanced skills and lower labor costs of specialized service providers. The government has facilitated the success of the BPO industry in the country through investment and export incentives supporting tertiary education. Most important was the liberalization of the telecommunications industry in the mid-1990s. In particular, competition in local long-distance services and the authorization of international simple resale led to a sharp drop in telecommunication rates.

How can the services integration process be enhanced?

23. **ASEAN Member States have made progress in the liberalization of trade and investment in services under AFAS, but there is room for improvement in terms of sectoral coverage and depth of**

commitments. Reinforced by the negotiating goals set out in the AEC Blueprint, AFAS has provided a strong platform for reducing formal restrictions to services trade. Eight rounds of negotiations have committed ASEAN Member States to opening up services trade more so than commitments made or offered under GATS. But ASEAN now faces the challenge of completing the final two rounds in 2015. Further, a comparison with other agreements—including the bilateral agreements made by some ASEAN countries with other countries outside the region—highlights the more modest ambition of the AFAS in terms of sectoral coverage and depth of commitments.

24. **Completing the intraregional liberalization of services trade and investment, as envisaged in the AEC Blueprint, will set the foundation for the establishment of an ASEAN Economic Community.** This will entail the removal of all limitations to market access and the elimination of discriminatory measures, including caps on foreign equity. On occasion, however, public order, safety of services, or prudential reasons may justify some restrictions.

25. **To facilitate this process, the foundation of the ASEAN services integration process, the ASEAN Framework Agreement on Services, and other sector-specific initiatives—or any successor agreement—needs to be strengthened.** AFAS follows GATS's main substantial obligations, including provisions on market access and national treatment, and the typology for scheduling commitments. As such, market access prohibits a number of quantitative restrictions, and the national treatment obligation covers both de jure and de facto discrimination. That is, a measure is deemed discriminatory when it alters the conditions of competition in favor of domestic services and service suppliers, regardless of whether the measure is openly discriminatory in its text. Typical examples of discriminatory measures include sectors reserved to nationals, training requirements imposed only on foreign suppliers, or language requirements that are not directly relevant to the exercise of a profession.

26. **To create greater certainty, more clarity is needed on the extent of applicability of GATS disciplines, including their interpretations and supporting documents, to AFAS.** For example, the GATS provisions on market access and national treatment have been interpreted by WTO panels and the Appellate Body in several dispute settlement cases. These interpretations help clarify the meaning of these provisions in the WTO context. But it is not clear what significance such interpretations have under the AFAS. One way forward could be for the ASEAN bodies such as the ASEAN Secretariat or the ASEAN Member States to clarify the scope of these provisions in the context of AFAS.

27. **Establishing an Implementation Monitoring Mechanism for AFAS will help achieve the full potential of the agreement.** Such a mechanism needs to go beyond the current legal compliance monitoring of the AEC scorecard and improving the existing ASEAN dispute settlement mechanism. A major shortcoming under the current AFAS is the inability to monitor and, where needed, compel the implementation of commitments in services trade. In fact, the lack of information on the level of implementation is such that there is no clear understanding of to what extent and how liberalization commitments are actually reflected in the ASEAN Member States' domestic laws and regulations. An Implementation Monitoring Mechanism that goes beyond legal compliance, once established, would review the level of implementation of AFAS commitments by ASEAN Member States, including through information provided by other Member States and/or other appropriate parties, including private service suppliers. Ongoing efforts to improve the system should be strengthened with a view to coming to a prompt conclusion. A renewed dispute settlement mechanism could include an interpretative procedure, which ASEAN Member States could consult on the terms of the agreements and commitments without the need for a formal dispute with another member. This would be in line with the successful experience with these procedures in other regional integration processes. The ASEAN Secretariat could also consider issuing informal "notes" that reflect some general understanding on the services integration process for greater clarity and transparency, but would not have any legal implication for the ASEAN Member States.

28. **Removal of quantitative and discriminatory limitations or formal restrictions will not be sufficient for regional services integration if regulatory barriers that fall outside current services negotiations are not addressed.** Even when full commitments are undertaken in all services sectors, a number of limitations to trade in services will remain in place. While the elimination of quantitative and discriminatory limitations would help reduce formal barriers to trade within ASEAN, regulatory barriers would fall beyond the main obligations of the agreement and could be maintained. The region has focused so far on the elimination of formal barriers to trade and investment in services, but ASEAN countries have done little to complement the reduction of formal barriers with positive actions such as coordinated regulatory policies in services.

29. **Without a stronger agenda on regulatory cooperation and implementation of liberalization commitments, the ASEAN intraregional services integration agenda will likely be overridden by more ambitious free trade agreements with third parties.** This may undermine the goal of creating a regional services market. To further expand integration in services in the region, ASEAN's clear priority should be on reforming regulatory barriers to trade and investment. The current framework provided by AFAS fails to deliver effective integration in services due to pervasive regulatory barriers, bringing about a shallow level of integration.

30. **Regulatory cooperation may be more important for ASEAN countries because of the diversity in quality of regulations.** Although regulatory matters are still to a large extent outside the work of the AFAS, the services integration process in ASEAN can play a positive role in fostering services regulatory quality and governance. For all ASEAN Member States except Singapore, regulatory weaknesses remain since the entry into force of the AFAS, even though there have been improvements. For the lower-income ASEAN countries, the challenges in terms of improving regulatory quality are high, and strong support from other ASEAN countries and bodies and knowledge partners will be required to improve it.

31. **In the context of ASEAN, a specific and important example of integration in the services market that can be pursued through regulatory cooperation lies in the area of company law.** Following the EU experience, ASEAN Members States may evaluate addressing basic requirements for the establishment of companies, including areas like compulsory disclosure of information, and power of representation of company organs. Requirements on disclosure, in particular, may include the harmonization of information requirements and the establishment of an official company register accessible by all Member States. Another example is the case of harmonizing capital markets disclosure requirements to facilitate capital flows, where work has already started in providing common guidelines and standards.

32. **The scope for regulatory cooperation in ASEAN is broad, and concerted efforts are needed to better coordinate and create synergies among ASEAN institutions working on services.** At present, regulatory cooperation is uneven, and there is potential to reap substantial additional benefits. For example, in the area of professional services, ASEAN Member States have agreed on mutual recognition arrangements for eight professional activities, but their operationalization may be impeded by the lack of follow-up measures, institutional infrastructure for implementation, and other legal considerations. There are also positive stories. While AFAS discussion has been focusing on incorporating commitments on road or maritime transport services, concrete progress has been made in the harmonization of safety standards for road transportation and in investment in port infrastructure that is being undertaken under the umbrella of the Infrastructure Division. Scope for regulatory cooperation also exists in many other sectors. Some regulatory cooperation in financial services and air transport is being advanced outside of the AFAS negotiating framework.

33. **ASEAN countries should pursue regulatory cooperation on two different levels.** First, cooperation at a horizontal level may require establishing common general principles that would guide

domestic regulation on services trade and investment. At a minimum, ASEAN Member States could recognize that domestic laws and regulations should conform to certain principles of good regulation, such as transparency, consultations (both public and interagency), due process, and efficiency. Agreeing on such common regulatory goals is an essential step toward ensuring greater regulatory coherence and eventual mutual recognition of licenses and authorizations. Second, more detailed regulatory principles could be developed on a sectoral basis, in particular for heavily regulated services. This would follow the steps already taken in ASEAN in some services, like air transport and some financial services. Other key services sectors that would greatly benefit from common regional rules include land and water transport, telecommunications, and professional services. The report provides more detailed recommendations on the way forward, drawing on experiences from other countries, including Europe.

34. **To make progress, the ASEAN services integration agenda needs to be more comprehensive, going beyond removal of formal restrictions to also cover regulatory cooperation and implementation of commitments.** Services trade can be both increased as a share of total trade, and diversified into new and more dynamic activities such as business services, professional services, and information and communications technology (ICT) and ICT-enabling services. Despite the progress achieved in incorporating services in the integration agenda and the success in increasing binding commitments in their services schedule, looking forward, there is a need to reduce the level of restrictiveness that still remains for a number of sectors and countries in the region. In addition, there is a need to reduce regulatory heterogeneity and improve the governance of services regulations across the region.

Chapter 1. Why Is the Services Trade Agenda Important for ASEAN, and How Are ASEAN Economies Performing?

This chapter makes the case for boosting the performance of ASEAN services sectors and services trade and integration. It draws on a survey of economic research and provides fresh empirical results to show how the growth of services trade and productivity boosts income and productivity levels. Services, which have become more tradable in the last few decades due to increased fragmentation in production processes and advances in information and communication technology (ICT) and digital technology, serve as a vital intermediate input for manufacturing and other services. This development is particularly relevant for ASEAN countries that are mostly middle income or about to become middle income. Further, a heuristic assessment of global production and trade in value-added terms, such as measuring the forward linkages of services sectors to other sectors, all suggest that the importance of services in ASEAN economies is being underestimated. Services sectors and services trade in ASEAN economies have grown rapidly in recent years, but they still relatively lag behind other countries at similar stages of development, as indicated by a variety of measures: the size of services sectors, the share of services trade and exports, and the "traditional" content of services trade in ASEAN countries.

A. Services and ASEAN Economies

1. **The services sector is a critical part of any modern economy.** It makes a direct and significant contribution to income and job creation, and provides crucial inputs for other parts of the economy. Some backbone services, such as energy, finance, telecommunication, and transport, are of central importance for the international competitiveness of agricultural and industrial producers, while others, such as the health, education, water, and sanitation, are directly relevant to achieving poverty reduction and long-term development objectives.

2. **The ASEAN economies grew rapidly over the last four decades primarily as manufacturing and trading powers.** From 1967—when ASEAN was formed—to 1997, the middle-income ASEAN countries and Singapore grew at a rate of nearly 7 percent per year. While growth has slowed since the Asian Financial crisis of 1997, it has still been a robust 5 percent per year over the last decade. Over the last two decades, the lower-income countries of Cambodia and Vietnam have also joined the growth bandwagon. Supported by robustly performing agricultural sectors, the export-oriented manufacturing sector has led growth in ASEAN economies.

3. **Services sectors have also become significant providers of both output and employment in ASEAN economies in recent years.** On average, services contribute more than 40 percent of total value added and accounted more than 50 percent of total employment. Trade in service has also risen sharply, although there are notable differences across countries due to the differences in the countries' levels of economic development, resource endowments, and trade intensities.

4. **In the future, as ASEAN economies grow to become middle- and upper-middle-income economies, the services sector will become an even more important source of growth and employment.** This will be true in two senses. First, in the accounting sense, the increasing share of services in GDP and employment means strong growth in services, and service productivity will be required for overall growth. Second, it will be important for its spillover effects: productivity growth in services will raise productivity in other sectors, as well.

5. **Moreover, recent economic research has found that while productivity gaps among countries across the globe are being substantially reduced in agriculture and industry over time, they are not being reduced by nearly as much in services** (Duarte and Restuccia 2010). Hence, low productivity in services explains to a large extent the lack of catch-up of developing countries toward high-income countries. The productivity differentials are thereby particularly pronounced for financial, telecommunication, and transport services. Policy action to foster stronger, higher-productivity services sectors are thus a critical component of economic policy making in developing and emerging economies.

6. **The services growth agenda for ASEAN countries is thus closely related to another big challenge facing them: how to overcome the "the middle-income trap."** Worldwide, only 14 countries have managed to grow from middle-income to high-income countries since 1960. This failure to make the transition is because most middle-income countries are unable to boost their productivity adequately to remain competitive as their wages increase. Most middle-income countries are unable to innovate and diversify their economies to more productive manufacturing and services. As a result, on one side, middle-income countries are outcompeted in traditional sectors by other developing countries where wages are low. On the other side, the middle-income countries cannot compete with high-income economies where productivity and technological sophistication are much higher. Increasing the productivity and competitiveness of the services sector will be central, because services—transport, finance, health, education, research, and professional services—are essential inputs for increasing innovation and productivity in all sectors of the economy.

7. **In this context, international trade and integration in services also have a key role.** Trade in services can help create opportunities for countries to expand their outputs of services in sectors where they have a comparative advantage, thus creating jobs, contributing to growth, and generating foreign exchange. Indeed, services exports can be a critical part of a developing country's growth strategy. India, for example, has been capitalizing on a boom in exports of IT-enabled services, as firms in high-income countries have increasingly outsourced certain administrative functions to lower-cost providers overseas. Trade in services can significantly improve economic performance by bringing greater competition, international best practice, advanced technologies, and investment capital. The entry of foreign, including regional, services providers may yield better-quality services for domestic consumers at reduced prices, and hence improve the performance and competitiveness of domestic firms by lowering their input costs. Given that much trade in services is brought about through foreign direct investment, it can also serve to bring much-needed capital and managerial know-how into the country. In some cases, the temporary movement of workers can equally represent a substantial economic boost, either through additional income via remittances, or the elimination of supply bottlenecks for particular skills or professions in the labor market.

8. **ASEAN economies are aware of the key role that the services sector and services trade can play in their development, and have made services integration integral to the ASEAN Economic Community Agenda.** The ASEAN Economic Community Blueprint has provided a bold vision of deep integration where goods, services, investment, and skilled labor would move freely across the borders of ASEAN countries. Detailed targets were set for achieving the integration of services by the end of 2015. Pursuing services market integration at the regional rather than the global level has the advantage of more easily tailoring reform efforts to the adjustment capacities of countries within the region, and of facilitating the convergence and harmonization of regulatory measures among similar, like-minded countries.

9. **This report takes stock of ASEAN's achievements in the area of services market integration, and discusses issues that need to be addressed to accelerate progress toward integration and enhance competitiveness.** A previous report from this work, the *ASEAN Integration Monitoring Report* (ASEAN Secretariat and World Bank 2013), looked at the overall progress of regional integration in trade in goods, trade facilitation, and investment flows and services. Both the earlier report and other work (ERIA 2013) have identified services integration as one of the most important challenges facing ASEAN. This report

takes a detailed look at services sector integration issues. It reviews (a) the importance of services trade and the current state of ASEAN services and trade integration and it potential (Chapter 1); (b) services trade policies, including both commitments to liberalize and actual policies concerning services trade, to measure progress in liberalizing and integrating services trade (Chapter 2); (c) case studies of successful services sector liberalization and developments in ASEAN countries that can provide important lessons for the future (Chapter 3); (d) the current ASEAN Framework Agreement on Services (AFAS), which serves as the institutional basis of services negotiations, and the issues that constrain progress (Chapter 4); and (e) the central issue of services-related regulatory reforms and cooperation, which this report identifies as the main priority for making progress with services sector integration. The approach taken is broad, comprising statistical analysis of services market outcomes, quantitative appraisals of services trade restrictions, regulatory assessments of the services market framework, case study analysis of services reforms, and descriptive evaluation of the status of regulatory cooperation. Particular emphasis is placed throughout on comparisons among countries or groups of countries, both within ASEAN and with suitable comparators outside the region. The findings are intended to inform the policy process and help ASEAN decision makers in devising the next steps for the regional integration agenda.

10. **The remainder of this chapter lays the foundation for the subsequent analysis by examining the economic importance of the services sector and services integration for ASEAN.** The chapter first surveys the economic literature and international evidence on the role of the services sector and services trade in enhancing productivity and economic growth (Section B). The discussion then turns in Section C to the current state of development of the services sector and services trade in ASEAN economies. Section D discusses the role of services for international competitiveness, and how services can be leveraged in the development of global value chains within ASEAN. Section E looks at the potential for regional integration in services, drawing a gravity model of trade among ASEAN countries. A brief summary concludes the chapter.

B. Importance of Services: International Evidence

11. **There are both demand- and supply-side reasons that explain why the services sector will become more important for ASEAN economies.** On the demand side, consumer demand for services has high-income elasticity—as incomes rise, demand by consumers for services rises more than proportionately for health, communication, tourism, and financial services, and for high services-content products. The demand for services in production also grows more rapidly. As countries grow richer, manufacturing and construction firms tend to specialize in more high niches, and want to outsource design, transport, and financing. The need for professional services thus increases across the board. As ASEAN countries climb up the middle-income country ladder or become a middle-income country, as Vietnam has recently become and Cambodia and Lao PDR will become in the next few years, the demand for services—from both consumption and investment—will grow rapidly. The trend toward higher demand for services will be strengthened even more as the population of ASEAN countries becomes older, as demographic projections indicate. Consumers will demand diversified and differentiated products such as hospitality, entertainment, and higher-quality health services and education.

12. **On the supply side, economic thinking about the services sector has changed markedly in the last few decades, in two respects.** First, services were previously thought to be highly embodied in labor and, thus, inherently labor-intensive compared to manufacturing. Also, the scope for raising productivity and technological progress was deemed to be less than in manufacturing. Second, services were thought to require proximity between producers and consumers of services, which reduced the scope for trade and productivity gains that arise from trade. All this led to the formulation of "Baumol's cost disease"—that is, how costs would go up and productivity fall because an increasing demand for services and more resources being allocated to producing less productive services would lead to a decline in overall productivity.

13. **Two developments in the 1990s sharply changed this traditional view of services.** First was the proliferation of global value chains, where international fragmentation of production saw production activities—including those requiring services inputs—to be located in multiple locations or countries, lengthening the distance between producers and the final consumers of services. Second was the revolution in information and communications technology (ICT), which saw rapid growth of transportability, and tradability of services with the advent of the internet age. Both events profoundly raised the scope for both productivity increases and tradability of services (Baumol 1967; Ghani and Kharas 2010; Mishra et al. 2011).

14. **Digitization has led to services becoming more amenable to technological progress that boosts productivity in services.** A rising number of services can now be stored and traded digitally, and are not subject to many of the trade barriers that physical exports have to overcome. However, this does not mean that trade in services is less restricted. On the contrary, trade in services is inherently more complex, since there are often manifold regulations under the purview of different authorities that apply and that can make monitoring difficult. Yet, services have become similar to manufacturing goods in the sense that they benefit from technological advancement, and their costs depend on economies of scale, agglomeration, networks, and division of labor. More important, these sophisticated services mostly require digital labor mobility, which provides an opportunity for relatively innovative, high-tech job creation in low- and middle-income economies. On the supply side, the services sector becomes more important due to differences in sectoral factor proportion, that is, introduction of skill-based technological changes.

15. **As a result of these technological developments, both manufacturing and services have become unbundled, and services have become important intermediate inputs for manufacturing and other sectors.** At the same time, the dichotomy of manufacturing and services becomes increasingly blurred. Services are an important component of global value chains. Production activities or tasks along the global value chains can now be fragmented and done separately at different geographic locations. Fragmentation also occurs in service sectors providing prospects for specialization, which did not exist previously. Factors such as relatively low (sometimes even negligible) transportation and telecommunication costs, lower capital intensity, and a mix of regulations may drive competitiveness among service-exporting countries. A well-integrated and sophisticated logistical supply chain service network and a competitive services market have become critical for unleashing productivity in manufacturing. This in turn may drive specialization, sophistication, and trade in services.

16. **The unbundling and fragmentation of services in global production networks and value chains have led to rapid growth in the trade in services.** The global value of cross-border services exports in 2007 was US$3.3 trillion (20 percent of total world trade). However, the share of services rises to almost 50 percent if transactions are measured in terms of direct and indirect value-added content, which would address the risk of double counting of imported intermediates used in final products for export (Hubert Escaith 2008). Adding the sales of services by foreign affiliates of multinational firms, which are often unrecorded in the balance of payments, makes the value of trade in services rise even further. Data for 15 Organisation for Economic Co-operation and Development (OECD) countries put the value of such sales at some US$1.5 trillion in 2007 (Francois and Hoekman 2010; WTO 2009). This has resulted in rapid growth of what can be called modern services that do not necessarily require face-to-face contact, such as communication, banking, insurance, business-related services, remote access services, transcribing medical records, call centers, and education.

17. **A productive service sector and trade also helps to draw foreign direct investment, including regional investment, and stimulate domestic investment in higher-value-added manufacturing and services and create more competitive markets.** Modern services are thus deemed to be important for overall economic growth both directly and indirectly by improving efficiency in other sectors of the economy. Many service sectors, such as finance, communications, and transport not only provide inputs

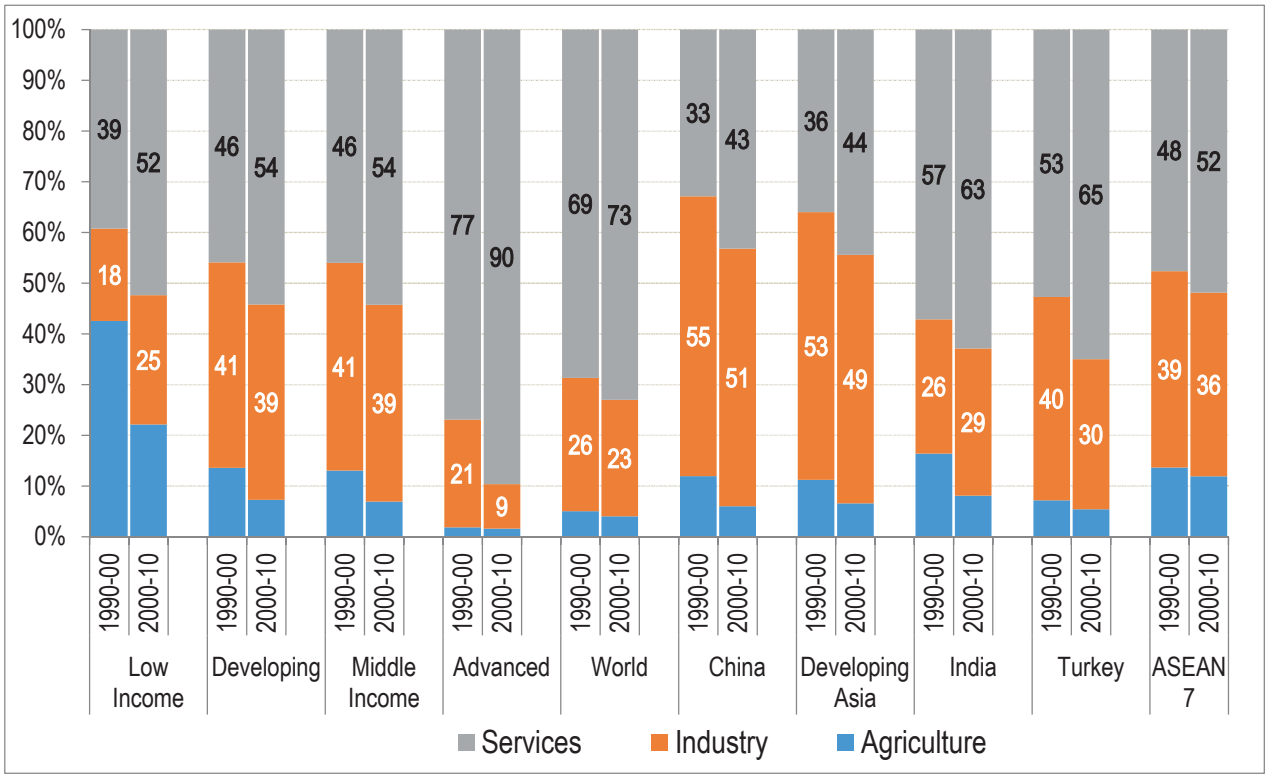
for the manufacturing sector, but also facilitate trade by supporting transactions through space (transport and telecommunications) and time (finance).

Evidence from research

18. **Services account for over 70 percent of global GDP and an even bigger component of productivity and GDP growth in both developing and advanced economies.** Two-thirds of the total output in the services sector of Europe (which is the largest commercial service exporter), and four-fifths of its growth in recent years is due to the service sector (Uppenbarg and Strauss 2010). Similarly, over 70 percent of the surge in labor productivity in the post-2000 U.S. economy is attributed to productivity gains in services (Bosworth and Triplett 2007). Productivity growth driven by services requires both fixed investment in building and ICT technologies, but also intangible capital in terms of new computer software and skills in other disciplines, so as to create new organizational structures and business models, sometimes based entirely on a new services product. There is also evidence that services contribute more to GDP growth than industry, both in developed and developing countries.

19. **Services now account for almost 75 percent of global economic growth (55 percent in developing economies).** Figure 1.1 shows the composition of services and industry-to-GDP growth in the last 30 years for developed and developing countries. In both cases, the contribution of services to total growth is higher than industry's contribution. Also, services have made an increasing contribution to growth.

Figure 1.1 Decomposing GDP Growth in Developed and Developing Countries, 1990–2000 and 2000–10



Source: Derived from WDI data.

20. **A large body of evidence links service sector development and trade with growth and development.** In the case of high-income OECD countries, research on seven countries (Australia, Canada, France, Germany, the Netherlands, the United Kingdom, and the United States) (Inklaar, Timmer, and van Ark 2007, 2008) suggests that differences between aggregate productivity levels and growth rates of these countries were largely explained by differences of the performance in the service sector. As may be expected, manufacturing and industrial productivity across the high-income countries are largely the same due to increasing tradability of technology. Going further, research at industry levels suggests that differences in productivity are largely explained by the difference in productivity in business services. Research on an advanced economy such as the United States suggests that productivity growth of distribution and financial services largely explained the growth of economic productivity after 1995. This research across sectors suggests that technology has led to new business practices, particularly greater use of outsourcing and specialization. For instance, the emergence of "big box" stores (for example, Amazon) has transformed the retail industry. One specific example is that the ability of U.S. firms to offshore many of their services explained 11 percent of the productivity growth in the manufacturing sector between 1992 and 2000 (Amiti and Wei 2006).

21. **Services sector performance has a key role in the development of middle-income countries.** Research work that looks at firm-level data particularly highlights the importance of the services sector in raising productivity growth in manufacturing. Evidence supporting this has been found in countries and regions as diverse as Africa, India and, in the Asia and the Pacific region, Indonesia. Arnold, Mattoo, and Narciso (2008) focused on Africa, using data from 1,000 firms in 10 Sub-Saharan African countries, and found a positive effect of performance of communications, electricity, and financial sectors on manufacturing total factor productivity. Fernandes and Paunov (2008) used firm-level data of Chilean manufacturers combined with FDI stocks in the services sector to examine the impact of the latter on manufacturing firms' productivity, and found a significant positive effect both economically and statistically. Interestingly, they also found that those manufacturing firms furthest from the technology frontier had most to gain in terms of productivity improvements as a result of service sector liberalization. Finally, Arnold, Javorcik, Lipscomb, and Mattoo (2010) used data from Indian manufacturing firms and constructed indicators of service sector reform in the same country, and found that potential productivity gains appear to be greatest from reforming those service sectors most closely related to trade: transport, communications, and finance. They found the effects on foreign firms to be stronger.

22. **Within the region, there is similar supporting evidence in the case of Indonesia.** Here, the reliance of the manufacturing sector on inputs from each services sector was examined by using Indonesian input-output tables. The main finding was that relaxing policies toward FDI in the services sector was associated with improvements in perceived performance of the Indonesian services sector (Duggan, Rahardja, and Varela 2013). The gains accrue largely to the most productive firms and are related to the relaxation of restrictions in both the transport, and the electricity, gas, and water sectors. Total factor productivity gains are associated, in particular, with the relaxation of foreign equity limits and screening and prior approval requirements, but less so with discriminatory regulations against multinationals on hiring key personnel.

23. **Trade in services has significant impact on growth and trade in other sectors of the economy, especially manufacturing.** For instance, a 10 percent increase in services trade is found to lead to a 6 percent increase in the trade of goods (Blyde and Sinyavskaya 2007). Higher efficiency in transport and communications services created by greater liberalization, and competition in services creates the strongest gains in goods trade. In general, quantitative analysis based on general equilibrium modeling suggests that reducing costs, markups, and penalties by 10 percent through service sector reforms leads to a four times higher gain than would be obtained from liberalization of services. Further, trade in services also seems to help technological progress. In particular, a study on OECD countries suggests that greater imports of

producer services have been found to increase the skill and technological sophistication of exports (Francis and Woerz 2008).

24. **Trade in services is very closely linked to FDI.** This is partly unsurprising given that a large part of trade in services takes place through supply of services through Mode 3, that is, by a service supplier through commercial presence, in the territory of the trading partner. In the case of the United States, for instance, sales of services by U.S. foreign affiliates (US$530 billion) were some 50 percent higher than total cross-border services exports as registered in the balance of payments (US$360 billion). More broadly, as much as 60 percent of the global stock of FDI of US$15 trillion in 2007 was in services. The services provided by foreign affiliates of OECD countries were estimated to be around US$3 trillion. But beyond the direct contribution of FDI in services, evidence also suggests that manufacturing FDI from a country closely follows trade in services to that country (Francois and Hoekman 2010).

25. **Emerging evidence also suggests that improvements in service sector efficiency have an impact beyond economic sectors to improving human development outcomes.** To some extent, this impact should be intuitive, since health and education services constitute a significant part of the service sector. As efficiency and productivity in these services increase, they can translate directly into welfare improvements for the population. The supporting evidence suggests that greater restrictiveness and barriers to entry such as education are linked to worsening in human development outcomes such as school enrollment (Shepherd and Pasadilla 2011). It is worth stressing, also, that opening the services market will not, by itself, address human development concerns, such as ensuring universal access to basic services, such as telecommunications, education, health, and financial access.

Cross-country empirical evidence

26. **While the discussion above highlighted the importance of services in general, the expectation would be that services productivity and trade will affect low-, middle-, and high-income countries differently.** Service sector growth will affect growth in all cases simply because of the large size of the services sector. However, productivity of services will differ across income groups. Lower-income countries are more dependent on agriculture and labor-intensive manufacturing. While the services sector may still be large as a source of GDP and employment, in lower-income economies, most of the employment will be of low-productivity levels. Given low levels of human capital, low-income countries are unlikely to have a comparative advantage in the service sector, and hence are less likely to depend on exports of services than on imports. This, however, should not ignore the fact that services have a significant role even in traditional sectors such as agriculture and labor-intensive manufacturing. As countries pass through the middle-income-country stage and infrastructural, technological, and human development take place, it creates comparative advantage in services.

27. **It can be expected that services productivity growth will have more impact on income levels and aggregate productivity growth as countries become middle income and higher income.** Such a view is broadly supported by the analysis of cross-country data carried out for this report. As figure 1.2 shows, services productivity levels (measured in logs) and per capita income levels are most robustly correlated in middle-income countries and higher-income countries.[2] A 1 percent increase in service sector productivity levels increases per capita incomes by 0.6 percent or more in middle- and high-income countries. The impact for ASEAN middle-income countries is even higher. This impact is not found in the case of low-income countries. This suggests that the contribution of services to growth comes not only

[2] These correlations, however, account for country and time effects and hence account for the time or place invariant omitted variable.

through its direct effect but also through its indirect effect of increasing the productivity of manufacturing sectors (figure 1.3).

28. **Services contribute to income growth not just through its direct effect, but also through their impact on industrial productivity.** The role of services as an input into high-value-added manufacturing is quite intuitive. High-quality services provide access to energy (cheap and reliable), finance and trade support, telecommunications (for example, for e-commerce or electronic transfers), transport, and so forth (see Cattaneo et al. 2013). In a recent OECD-WTO survey, access to finance (for 52 percent of the firms surveyed) and transport infrastructure (for 39 percent of the firms surveyed) were the two most serious national supply-side constraints identified by developing-country global value-chain suppliers as affecting their ability to enter, establish, or move up global value-chains (OECD-WTO 2013c). The organization of the domestic segment of the value chain is as important as the international one.

29. **The cross-country evidence for this is highlighted in figure 1.3.** Here is it clear that the impact of services productivity on industrial productivity is significant and high for countries in all three stages of development, which suggests that as labor productivity rises in the service sectors by 1 percent, it raises productivity in the industrial sector by more than 0.8 percent in middle-income countries, including those in ASEAN. The effect is slightly lower in higher-income countries and much lower in lower-income countries.

Figure 1.2 Services Labor Productivity and Per Capita Income Levels (using 3-year averages)

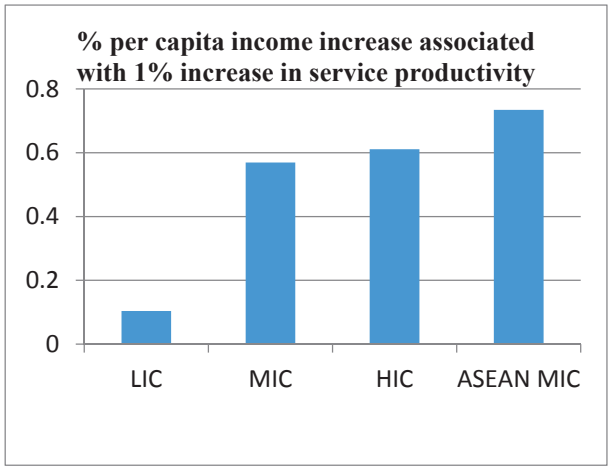
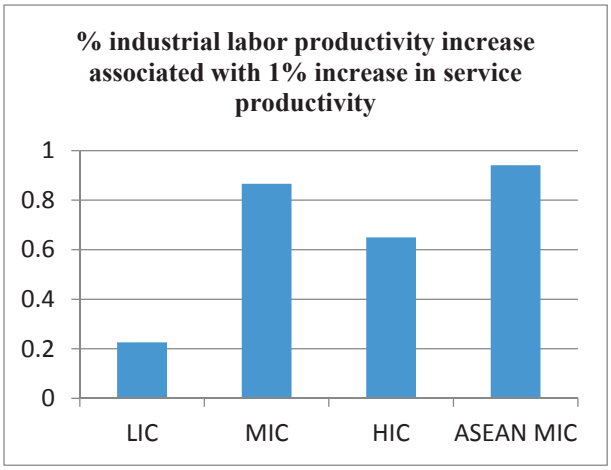


Figure 1.3 Services Labor Productivity and Industrial Labor Productivity (using 3-year averages)



Source: WDI data.
Note: These estimates account for country and time fixed effects and hence can be seen as more than correlations. LIC = lower-income countries; MIC = middle-income countries; HIC = high-income countries.

30. **International trade in services appears to be closely linked to per capita income and productivity in both industry and services.** To some extent this is to be expected, since international trade in services can only take place in high-end services that provide higher-quality and more efficient inputs and services to producers. Figures 1.4 and 1.5 provide evidence of this effect. Increase in trade in services—the sum of both exports and imports—appears to be closely linked to per capita income levels in both lower-income and middle-income countries. But exports of services are most robustly linked to per capita income in middle-income countries. The linkages between services exports and productivity levels are, however, most robustly linked to both productivity levels in all income groups. The relationship between services trade and services productivity (not shown here) is also robustly linked in both lower- and middle-income countries.

Figure 1.4 Services Trade and Per Capita Income

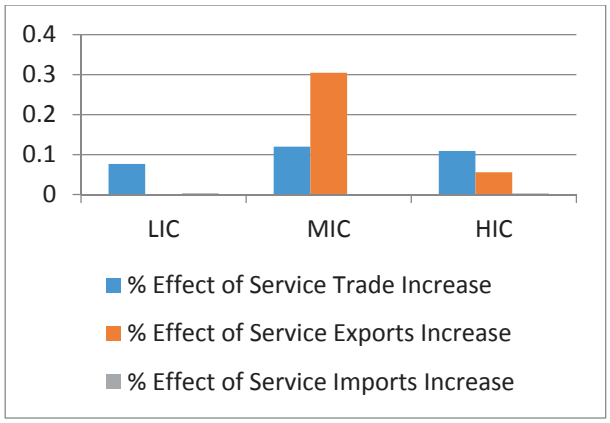
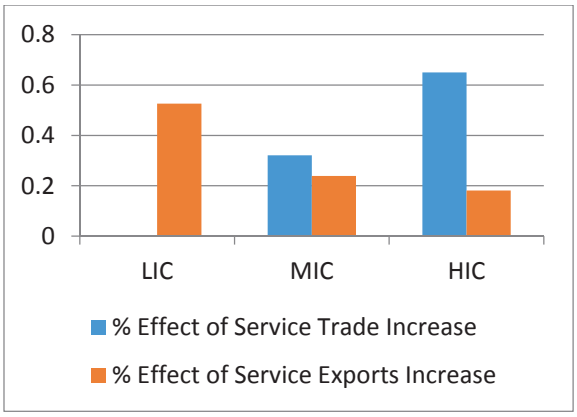


Figure 1.5 Services Trade and Industrial Productivity



Source: Computed from BPM5 Data.
Note: LIC = lower-income countries; MIC = middle-income countries; HIC = high-income countries.

C. How Do ASEAN Countries Perform in Services?

31. **With some exceptions, there is room for ASEAN countries to improve the performance of their service sectors, measured by several indicators.**[3] While the contribution of services to GDP and trade has picked up in the last decade (figures 1.6 and 1.7), the share of services in GDP remains relatively low for ASEAN and East Asian economies (including China and Mongolia) compared to countries in other regions. Given the rapid pace of integration of ASEAN economies into the global trading system and the intensifying pace of free trade agreement negotiations, it would be timely now for ASEAN member countries to deepen and widen services integration. Local services providers will be able to take advantage of new market openings, and to benefit from new ideas and processes arising out of the opening up of the services sector.

32. **Against this backdrop, this section examines services competitiveness performance in ASEAN countries**.[4] The main question is how countries in the ASEAN region perform in the services sector and in services trade. The focus is principally on service exports and service sector performance compared to countries in other regions at similar levels of development.

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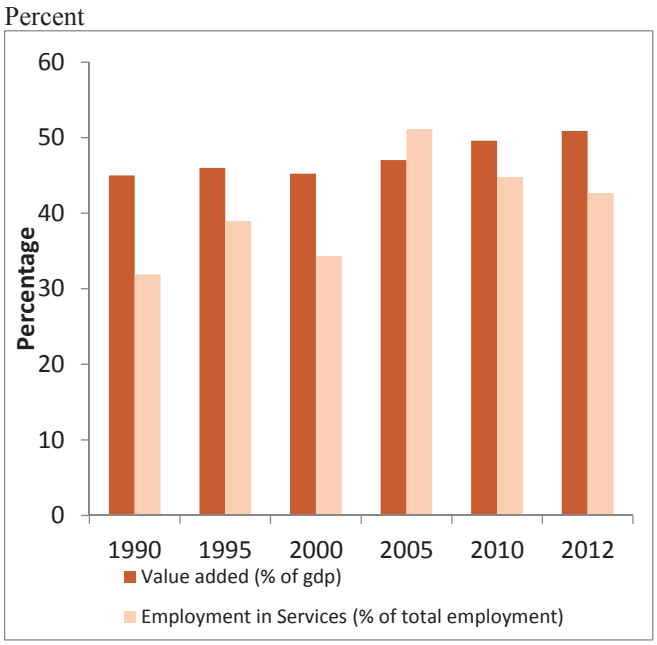
[3] This analysis follows Sáez et al. (2015).

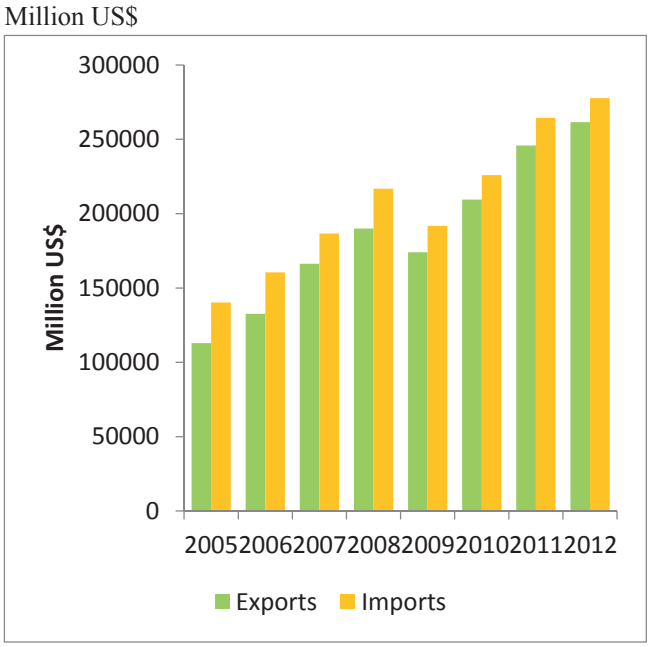
[4] Another analysis is provided in Annex 1.A of this chapter. To provide this comparative perspective, ASEAN countries are classified into two groups: the Middle-Income country (Group1) includes the middle- and high-income countries of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. For group 1, Brazil, China, India, and Korea were chosen as comparator countries, based on their relative development stage in the region. Group 1 (lower-income countries) includes the lower-income countries of the region, Cambodia, Lao PDR, Myanmar, and Vietnam. For group 2, Bangladesh, India, and Pakistan were chosen as comparator countries, but only for select aspects of trade in services. India is chosen as a comparator for both groups because it has both middle- and low-income-country characteristics. For most aspects of trade in services, the period looked at ranges from 1996, that is, from the stage before most integration took place among the ASEAN Member States, and the most current data available (2011 in most cases). Due to data gaps, select countries are not shown in certain graphs. The report uses data from the World Development Indicators, IMF Balance-of-Payments Statistics (BPM5), and a newly constructed services trade database by the World Bank to simulate outcomes for service sectors in ASEAN countries.

Figure 1.6 Services are Important for Value Added and Employment in ASEAN Countries



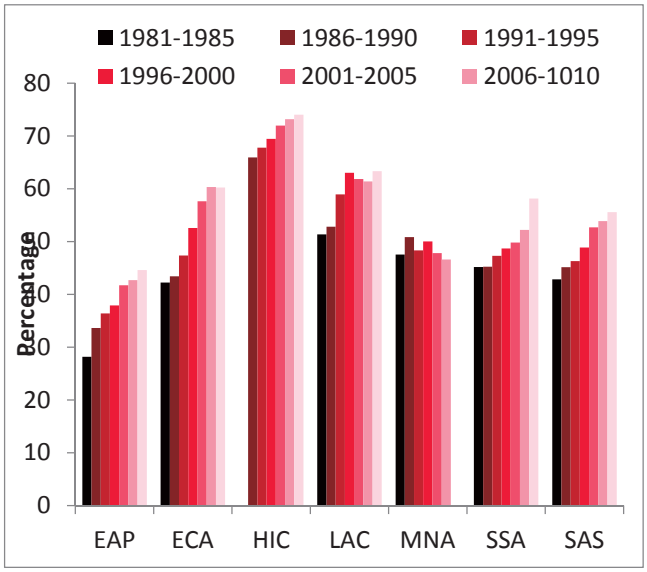
Source: WDI.

Figure 1.7 ASEAN Trade in Services have also Increased Significantly since the 2000s



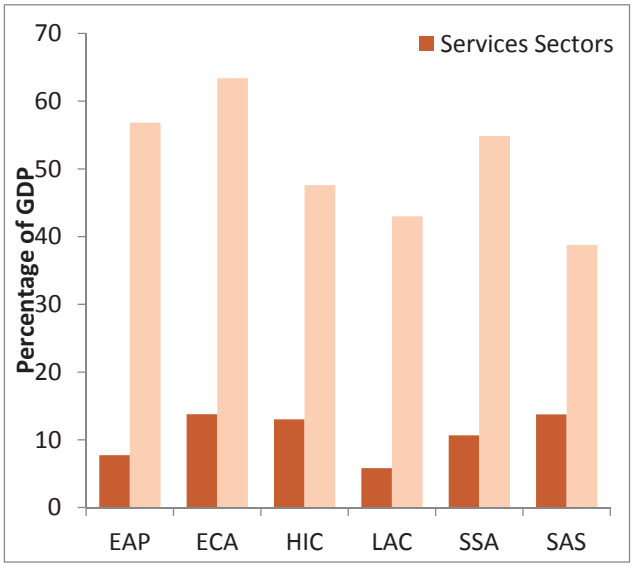
Source: WDI.

Figure 1.8 Services' Share of GDP in East Asia Remains Relatively Low (%)



Source: WDI.
Note: Ratio of nominal GDP.

Figure 1.9 Trade in Services Remains Substantially below Goods Trade



Source: WDI. Data for 2012.

33. **In terms of services trade performance indicators, ASEAN Member States perform below other countries with similar levels of income.** Typically, ASEAN service sectors are smaller compared to those in other countries with the same level of income. ASEAN exports' share in GDP similarly lag behind, and not only do they lag behind other countries, but the share of services in GDP and trade has been slow to increase. In addition, while services trade growth in the region is significant, it still lags other goods

sectors. Further, ASEAN Member States mainly exporting "traditional services" such as transportation and travel and tourism services, are less successful in tapping into new services opportunities such as information technology (IT) and business-related services. The Philippines and Singapore are the main exceptions. In the case of the Philippines, in recent years its business processing outsourcing (BPO) and IT-enabled services exports have become a success story. Singapore services exports of modern services such as professional and other business services have developed significantly since the mid-1990s.

Services in GDP and trade

34. **The share of a country's value added from services activity provides a first indication for the potential of the services sector to make a contribution to export growth.** While the share of services in GDP generally increases with economic development, there are significant variations among countries with similar level of development. For example, the share of services in Brazil is about 70 percent, while in Malaysia it is about 40 percent, despite the two countries having a similar per capita income (see Annex 1.A). Also, the share of services in GDP in ASEAN lower-income countries was well below what could be expected by their per capita income levels in both 1996 and 2011. Hence, the services sector appears to be relatively underdeveloped in many ASEAN countries.

35. **Over the last two decades, trade in services has grown rapidly across the globe.** The geographic and organizational separation of production in different stages and the development of trade in tasks, intermediate products, and services has become a dynamic component of trade and an alternative for export diversification. One of the most significant outcomes of production fragmentation is the growth of exports of so-called "modern services" that allow the cross-border exchange of services, such as business services, that previously required provider and consumer proximity to be delivered. Their share in world services exports has increased to more than 50 percent, while the share of transport and travel and tourism services exports has declined.

36. **ASEAN economies in both the higher- and middle-income country group, and in the lower-income country group (Cambodia, Myanmar, and Vietnam), also show considerable dynamism in services exports.** Trade in services grew between four and eight times for ASEAN economies in the middle-income country group over the last two decades, and even more strongly in the lower-income countries. However, unlike general trends in international markets, the share of commercial services grew less dynamically than exports and imports of transport services.

37. **The share of services exports in GDP in ASEAN countries, however, did not increase noticeably between 1996 and 2010, with the exception of Cambodia and Singapore.** In fact, Cambodia has experienced rapid economic growth over the last two decades, partly as a result of determined regulatory reform and economic modernization. In 2004, it became the first least-developed country to join the World Trade Organization (WTO). It has also become one of East Asia's most open economies, especially in the services sector. Service exports grew more than 20 percent a year for most of the last decade, mainly led by the expansion in tourism (World Bank 2013).

38. **At the subsectoral level, there is considerable heterogeneity across countries.** Indonesia's and Thailand's exports show significant increases of trade in traditional service sectors such as transport and construction, along with some rise in professional services in recent years. Malaysia shows good performance in computers, information services, and financial services. The Philippines shows a good rise in other professional services and insurance. Singapore shows the most diversified growth, with strong financial services.

Exports of services measured in value added

39. **Another evaluation of ASEAN's services performance is obtained by measuring the value added of their trade and exports.** Services are an important component of the economy and can directly enhance regional integration through bilateral services trade. In the following discussion, the contribution of services is measured taking into account its role as inputs into other domestic and export sectors for ASEAN Member States. This measure uses the new *World Bank Export of Value Added Database*, developed by Francois, Manchin, and Tomberger (2013).[5] Direct measures of trade statistics are registered in customs or balance of payments. Trade data are usually registered at transaction value, that is, the price actually paid or payable for the goods and services. Transaction values represent the gross value of goods and services (value added plus intermediate inputs). This measure may underestimate the real contribution of services to trade. To highlight this, new measures of exports are examined here using a new database on Input-Output Tables developed by the World Bank.

40. This measure includes the direct contribution of service sectors to total exports measured in terms of their value-added content, as well as their indirect contribution through sector linkages. Indirect contribution to total exports is measured by sectoral forward linkages, which look at the value added within a sector embodied in forward links, in the final exports of other sectors. Forward linkages show which sectors contribute to the value added to final exports. In other words, forward linkages show how important services are as inputs to other export activities (see box 1.1).[6]

Box 1.1 Value Added in Exports

Value-added indicators in exports include the following measures:

- ***Gross export:*** Total value of exports as shown in the business processing outsourcing (BOP) (for both goods and services). This captures both the value added embodied in the production of exported products and all domestic and imported inputs.
- ***Direct value added of exports:*** Domestic value added embodied in exports, that is, gross exports less domestic and foreign inputs. This measure captures the true sector-specific value added of exports. This is increasingly important in an environment where global production is fragmented across production-sharing networks. For example, a BPO service from India contains telecommunication services, from both local providers and from foreign owners of satellites. The delivery price of the BPO service accounts for the cost of such inputs. This measure nets out domestic and foreign inputs and captures the true value added generated in the BPO sector in India.

[5] The database uses input-output data from the Global Trade Analysis Project (GTAP) to construct country-specific measures of the direct and indirect contribution of services to the value added contained in a given country's domestic production and exports. The dataset contains two matrixes, a domestic value-added table and an export value-added table, which identify the value-added contribution of particular inputs to sectors that either sell the final good to the domestic market or export it. The cross-country dataset covers about 100 countries spanning intermittent years from 1992 to 2007.

[6] This database contains indicators of the services content of downstream sectors (goods and services). It is derived from a global input-output dataset covering about 100 countries using the most recent versions of the Global Trade Analysis Project (GTAP) model. This allows the computation of the value added of exports (goods or services). Because the GTAP database has information on the geographic origin of inputs, it can quantify value added specific to inputs produced domestically.

Box 1.1 Value Added in Exports (continued)

- ***Total value added of exports:*** This measure adds to the direct value added of exports the portion of the value added of the inputs that are produced domestically. For example, in the above example, the measure captures the value added of the BPO service plus the value of the domestic satellites used as input in the underlying telecommunication service, but not the value of the foreign-owned satellite input. This measure captures the full domestic component of an exported service. This in turns can be expressed in terms of forward and backward linkages.

Formally, the value added contained in exports is measured as follows.

First, direct cost shares linked to demand for intermediate inputs are measured by the following:

$$_{z,i} \quad \frac{e_{z,i}}{\quad e_{j,i}} \quad 100$$

$$_{j}$$

Direct value added in exports:

$$_{z} \quad v_z x_z$$

Total (direct and indirect) value added in exports based on forward linkages:

$$F_z \quad _{z} \quad .01 \quad _{z,i} v_z x_i$$

$$_{i \;\; z}$$

Total (direct and indirect) value added in exports based on backward linkages:

$$B_z \quad _{z} \quad .01 \quad _{i,z} v_i x_z$$

$$_{i \;\; z}$$

where: $e_{i,j}$ represents expenditure in sector j on inputs indexed by i, including both value added or primary inputs (capital, labor, land) and intermediate inputs; v_j represents expenditure on primary inputs as a share of total costs of production in sector j; and x_j represents the gross value of exports from sector j.

Source: Francois, Manchin, and Tomberger (2013).

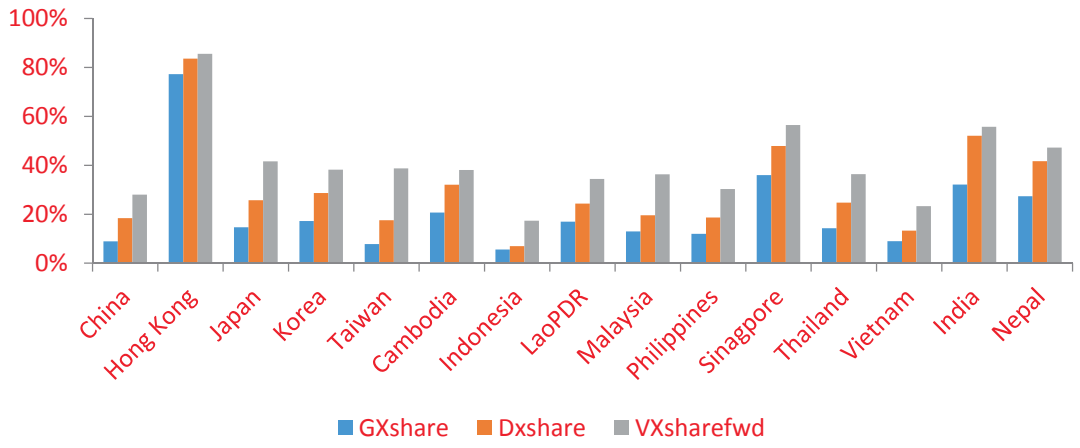
41. The implication of this analysis for the ASEAN region is shown in figure 1.10. The measures correspond to the share of services to total exports (goods and services) in terms of gross value (or as reported in the balance-of-payment statistics), the direct measure of services measured in terms of value added, and the total contribution of services measured in terms of value added and including the forward linkages to other export activities. This is considering services as inputs to other exports of goods and services.

Services trade measured in value added

42. **When trade is measured in terms of value added, the direct contribution of services in total exports increases significantly.** Figure 1.10 depicts the three measures of the share of services to total exports for ASEAN Member States and other countries in Asia. The blue bars indicate that when trade is measured in terms of gross value, the share of services is relatively low for all ASEAN Member States, except Singapore. Figure 1.10 also shows that in general, gross values are well below 15 percent, except (again) Cambodia, Lao PDR, and Singapore. Among the countries in the region, Indonesia has the lowest share. When services trade is measured in terms of value added (red bars), there is a significant increase in

the share of services in total exports, except for the case of Indonesia. In the case of Cambodia, this share increases to more than 30 percent, and in the case of Singapore, it is below 50 percent.

Figure 1.10 Service Exports as Share of Total Exports: Gross, Value Added, and Total



Source: World Bank Export of Value Added Database.
Note: GXshare = Gross Exports Share; DXshre = Direct Exports Share; VXshsrefwd = Total Exports Share.

43. **The strong forward linkages confirm the importance of services as inputs to other economic sectors, and in particular exports.** Accordingly, a key measure here is "forward linkages": the share of services as inputs to other goods and services measured in value added. This is the third measure included in figure 1.10. Again, when the share of services is measured in terms of value added, including value added in other activities, the share of services in total exports increases significantly for all countries, including ASEAN countries. While Indonesia's share is still relatively low, when forward linkages are considered, the share of services to total exports increases from 7 percent to about 17 percent.

44. **The sectoral composition of services exports differs across ASEAN economies, which to an extent can be explained by their level of development and economic structure.** Figure 1.11 shows that transport, distribution, and other services play a significant role in total exports for all ASEAN countries, except for Indonesia and Vietnam. In these two cases, figure 1.12 (other private services) shows that professional, business, and other services have a higher share in total exports than for any other ASEAN member (except Lao PDR). Also, in the cases of Cambodia and the Philippines, professional, business, and other services represent a relatively high share, considering their relative level of development.

45. **There is no uniform trend in services exports structure across ASEAN countries.** Figures 1.13 and 1.14 assess changes in services exports structure. They show the information for 1995 and 2007 for total services exports, and for services exports excluding transport, distribution, and other services, including for both forward linkages, respectively.[7] Figure 1.13 shows that there is no uniform trend among ASEAN countries. For some Member States, the share of total service exports in total exports increased, while for other it decreased. For example, in the case of Malaysia, Singapore, and Thailand, this share increased, while for Indonesia, the Philippines, and Vietnam, it decreased. Figure 1.14 shows that in the case of other private services (which include professional, business, and other services), their share in total exports increased between 1995 and 2007 for all countries except Indonesia and the Philippines.

[7] There are no data for 1995 for Cambodia and Lao PDR.

Figure 1.11 Share of Transport and other Services in Total Exports

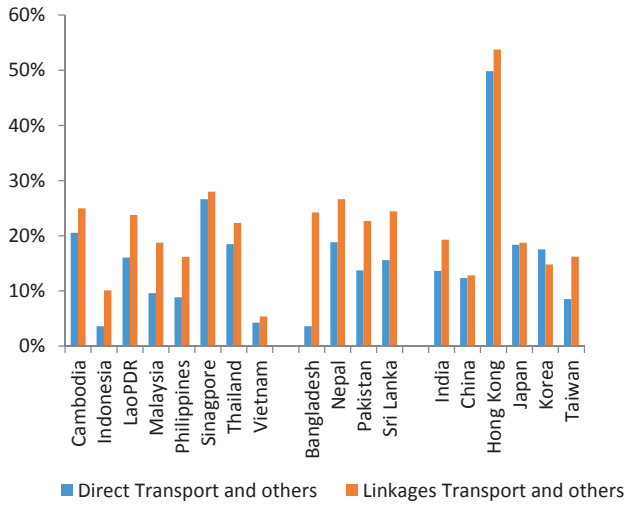
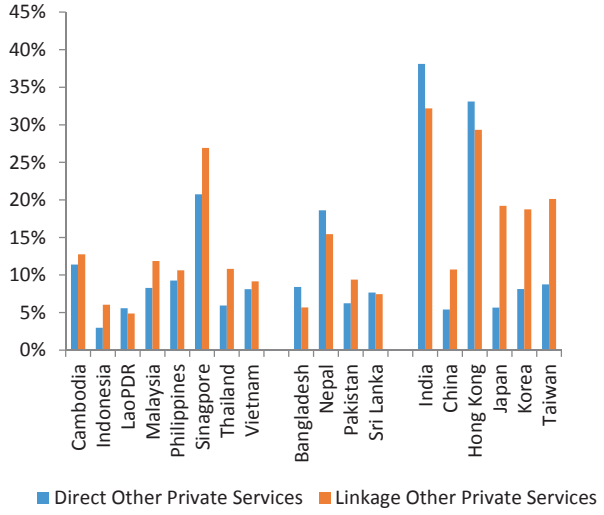


Figure 1.12 Share of other Private Services in Total Exports



Source: World Bank Export of Value Added Database.
Note: Due to data limitations, two broad sectoral categories are used. The first category corresponds to transport, distribution, and tourism activities, broadly speaking. The second category (Other Private Services) corresponds to activities such as professional services, business services, financial, entertainment services, and others.

Figure 1.13 Share of Services in Total Exports

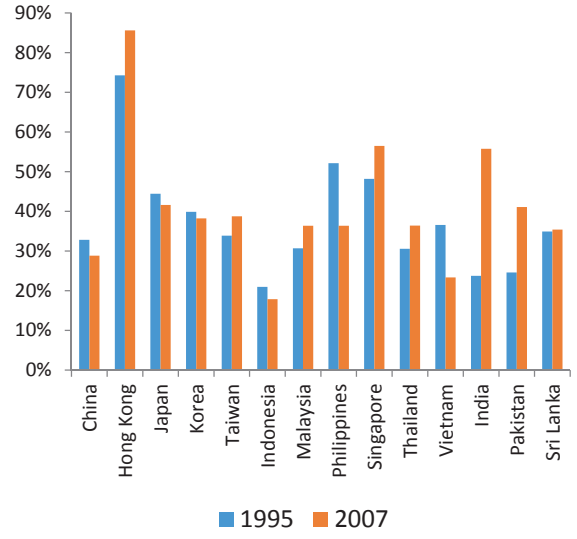
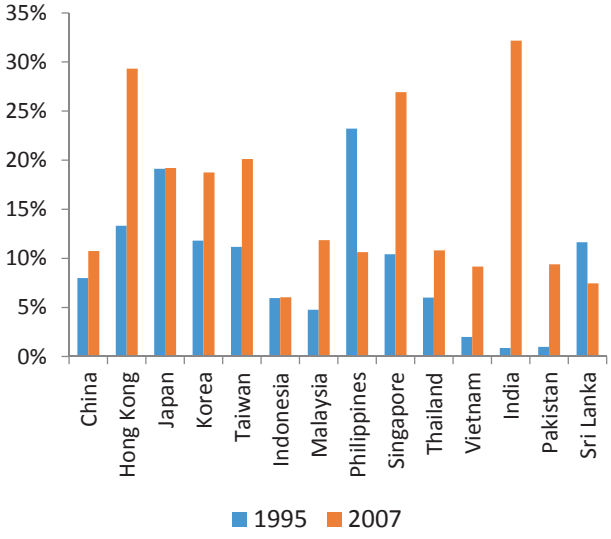


Figure 1.14 Share of other Private Services in Total Exports



Source: World Bank Export of Value Added Database.
Note: Due to data limitations, two broad sectoral categories are used. The first category corresponds to transport, distribution, and tourism activities, broadly speaking. The second category (Other Private Services) corresponds to activities such as professional services, business services, financial, entertainment services, and others.

46. **The analysis of forward linkages of the services sector to other input sectors, including agriculture, energy extraction and minerals, manufacturing, and other (public services and dwellings) highlights the important contributions that services make to other sectors.** Forward linkages are the contributions to value added of a particular sector to other sectors in the economy. The

analysis differentiates between the domestic and export value added contribution. Table 1.1 presents the contribution to the overall economy, while tables 1.2–1.4 are the contributions to other sectors of the economy. These four service sectors (electricity, gas, and water; construction; trade and transport services; other private services) contributed between 25 percent (Lao PDR) and 57 percent (Singapore) of total domestic value added, and between 17 percent (Indonesia) and 56 percent (Singapore) of total export value added in 2007. For most developed ASEAN Member States, Indonesia, Malaysia, the Philippines, Singapore, and Thailand, manufacturing uses services relatively intensely, with services providing about one-third of the value added contributions of manufacturing. The exception is Indonesia, with a contribution closer to 23 percent. For lower-income ASEAN Member States (group 2), Cambodia, Lao PDR, and Vietnam, the share in services in the value added of agriculture, as well as energy extraction and minerals, is above one-third, reaching almost 47 percent in the case of Lao PDR. The largest services contributions are from trade and transport services.

Table 1.1 Forward Linkages of Selected Inputs in All Sectors (%)

	Indonesia		Malaysia		Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
Electricity, gas, & water	0.94	0.81	4.40	3.91	4.45	3.22	1.04	0.92	2.99	3.07	0.16	0.09	2.06	5.65	10.40	8.51
Construc-tion	6.85	0.39	3.65	1.82	3.69	0.23	5.66	0.65	2.40	0.18	4.64	0.24	3.04	0.10	7.80	0.31
Trade & transport services	14.17	10.09	19.02	18.75	17.69	16.20	25.72	27.98	26.67	22.33	19.38	24.97	15.53	23.77	7.61	5.36
Other private services	8.59	6.04	20.58	11.86	14.06	10.63	24.22	26.93	10.29	10.82	13.41	12.76	4.56	4.87	7.87	9.16
Total services	30.56	17.33	47.65	36.34	39.89	30.29	56.64	56.49	42.34	36.39	37.60	38.06	25.19	34.40	33.68	23.34
Agricul-ture, energy extraction, & minerals	27.06	45.02	20.07	23.03	13.63	9.08	0.85	1.16	10.80	11.22	32.03	16.68	46.62	28.97	32.15	46.28
Manufac-turing	22.84	36.52	29.81	40.16	30.54	59.93	30.25	40.41	34.87	51.32	22.31	44.07	22.29	34.88	22.37	28.98
Other (public services & dwellings)	19.54	1.13	2.47	0.47	15.93	0.70	12.26	1.94	11.99	1.07	8.06	1.18	5.90	1.75	11.80	1.40

Source: World Bank *Export of Value Added Database.*

Table 1.2 Forward Linkages of Selected Inputs in the Manufacturing Sector (%)

	Indonesia		Malaysia		The Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
Electricity, gas & water	0.86	1.08	4.30	4.30	3.28	2.99	1.07	1.06	3.19	3.36	0.08	0.08	0.85	2.26	11.83	12.92
Construction	0.19	0.22	1.24	1.29	0.06	0.05	0.26	0.26	0.06	0.06	0.13	0.14	0.04	0.03	0.00	0.00
Trade & transport services	11.60	11.29	16.62	16.84	10.07	12.63	9.02	8.95	13.59	13.78	12.86	14.78	8.74	16.77	3.60	3.79
Other private services	4.60	5.09	6.95	6.92	3.24	3.37	7.59	7.59	6.96	6.79	4.27	5.18	0.75	1.16	3.75	3.93
Total services	17.26	17.68	29.11	29.35	16.65	19.04	17.95	17.86	23.80	23.99	17.33	20.18	10.39	20.21	19.18	20.64
Agriculture, energy extraction & minerals	26.38	24.09	14.43	13.88	15.35	5.36	0.33	0.34	9.95	9.23	35.11	15.08	49.46	23.50	28.78	25.34
Manufacturi ng	55.69	57.52	56.30	56.62	67.87	75.54	80.76	80.83	65.86	66.38	47.51	64.67	40.13	56.26	51.75	53.72
Other (public services & dwellings)	0.67	0.70	0.16	0.15	0.13	0.05	0.96	0.96	0.39	0.39	0.05	0.06	0.02	0.03	0.28	0.29

Source: World Bank *Export of Value Added Database.*

Table 1.3 Forward Linkages of Selected Inputs in Agriculture, Energy Extraction, and Minerals Sector (%)

	Indonesia		Malaysia		The Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
Electricity gas & water	0.14	0.19	0.61	0.64	1.20	1.75	6.45	6.70	0.67	0.65	0.01	0.01	2.52	11.27	2.00	2.00
Construction	0.18	0.25	0.55	0.59	0.21	0.52	0.30	0.31	0.03	0.03	0.03	0.04	0.05	0.11	0.02	0.02
Trade & transport services	2.36	2.18	6.59	6.73	1.21	1.41	10.32	10.22	6.69	5.89	2.48	2.68	4.38	14.52	1.27	1.44
Other private services	2.07	2.11	2.70	2.69	2.61	5.51	11.52	11.63	5.62	6.72	1.08	1.18	0.69	1.72	3.25	3.19
Total services	4.75	4.72	10.45	10.65	5.23	9.20	28.59	28.85	13.00	13.30	3.60	3.91	7.64	27.62	6.54	6.65
Agriculture, energy extraction & minerals	92.84	93.58	87.81	87.75	89.71	85.82	66.52	66.49	81.14	81.67	95.41	95.07	90.05	70.36	90.83	90.92
Manufac-turing	2.21	1.46	1.62	1.48	4.46	4.59	3.90	3.70	5.70	4.84	0.98	1.01	2.28	2.01	2.39	2.14
Other (public services & dwellings)	0.20	0.23	0.12	0.13	0.60	0.39	0.98	0.95	0.16	0.19	0.01	0.01	0.02	0.02	0.23	0.29

Source: World Bank *Export of Value Added Database.*

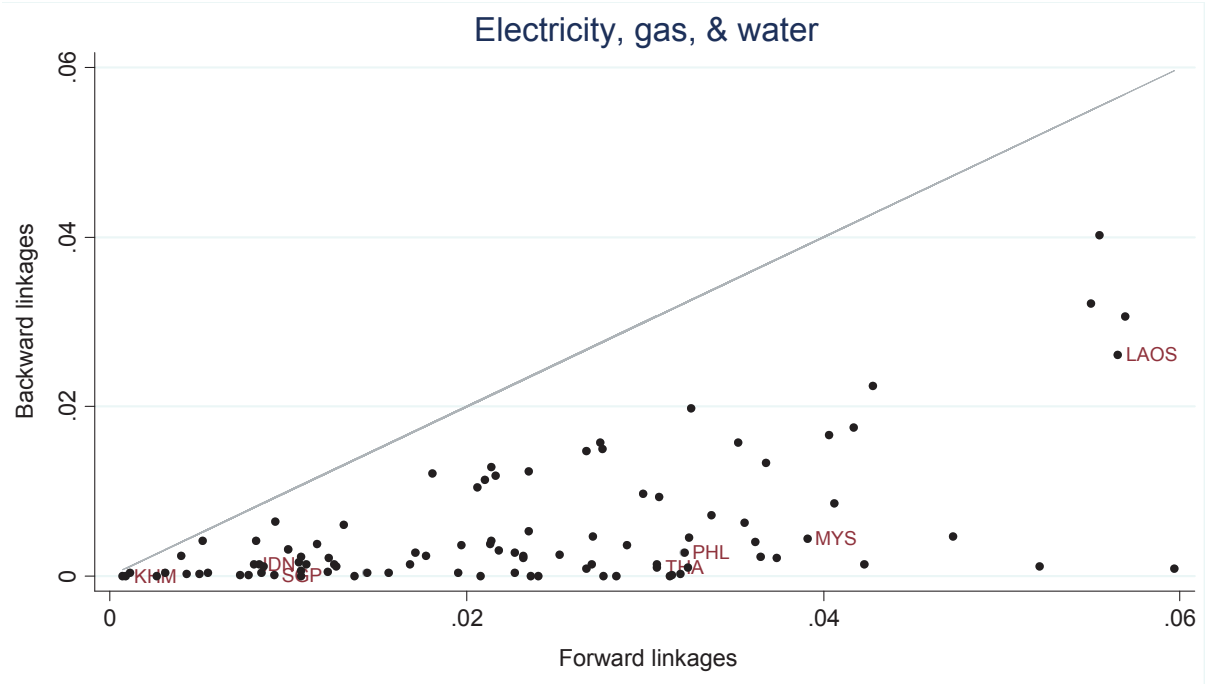
Table 1.4 Forward Linkages of Selected Inputs to Exports in Service Sector (%)

	Indonesia		Malaysia		The Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
Electricity, gas & water	1.85	1.42	5.98	4.95	7.30	4.70	0.86	0.60	3.64	2.51	0.33	0.12	4.88	11.48	18.38	9.56
Construction	20.62	2.68	7.53	5.00	9.89	0.95	10.57	1.04	6.82	0.64	13.78	0.49	15.76	0.29	27.24	2.74
Trade & transport services	28.85	38.71	27.70	36.74	37.77	37.57	43.47	47.54	56.25	58.47	39.22	53.74	51.47	60.61	20.58	25.98
Other private services	19.61	36.18	46.13	39.50	33.08	45.69	39.83	46.52	18.59	27.11	31.26	32.14	18.91	20.84	18.81	53.84
Total services	70.92	79.00	87.33	86.20	88.04	88.91	94.74	95.70	85.30	88.73	84.59	86.50	91.02	93.22	85.02	92.11
Agriculture, energy extraction & minerals	13.09	10.74	6.99	8.32	4.39	4.04	0.12	0.13	6.38	5.09	12.83	11.47	2.90	4.58	4.38	2.85
Manufacturing	14.33	8.01	5.39	5.19	7.46	6.92	4.20	3.16	7.90	5.72	2.50	1.95	6.06	2.18	10.29	4.51
Other (public services & dwellings)	1.67	2.25	0.29	0.29	0.11	0.13	0.94	1.02	0.42	0.46	0.08	0.08	0.02	0.02	0.31	0.53

Source: World Bank *Export Value Added Database*.

47. **Forward linkages of services inputs in exports appear stronger in most countries than backward linkages.** Figures 1.15–1.18 show cross-country comparisons of forward and backward linkages of services inputs in exports for electricity, gas, and water; construction; transport, distribution and other services; and other private services in 2007. While forward linkages represent the total share of a specific input being used across all sectors, analogously, backward linkages represent the total share of different inputs being used in a specific sector. Since most countries appear below the 45-degree line in each of the graphs, this indicates clearly that forward linkages in services are stronger in most countries than backward linkages. That is, these services contribute to export value added more strongly than they make use of export value-added contributions from other sectors. This is particularly true in the electricity, gas, and water sector (figure 1.15).

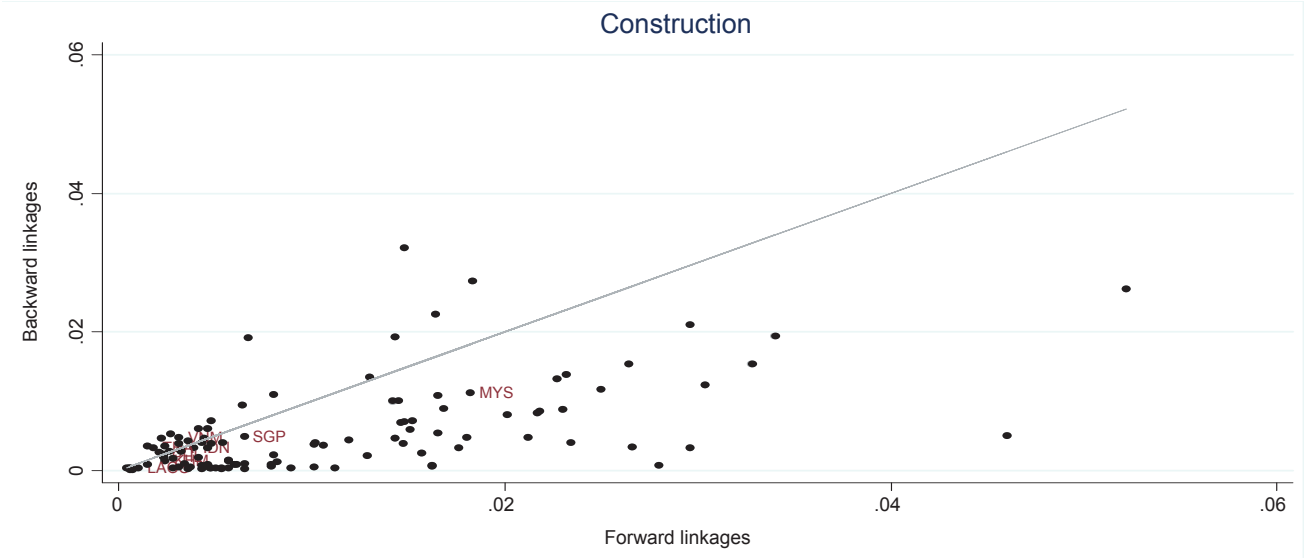
Figure 1.15 Forward and Backward Linkages, 2007



48. **With the exception of Cambodia, Indonesia, and Singapore, other ASEAN countries' forward linkages were very strong in electricity, gas, and water in 2007.** In the case of the Malaysia, the Philippines, and Thailand, the backward linkages are comparatively weak, while Lao PDR is a strong performer in terms of both backward and forward linkages. In the case of construction services, with the exception Malaysia, none of the ASEAN countries show strong forward or backward linkages (figure 1.16).

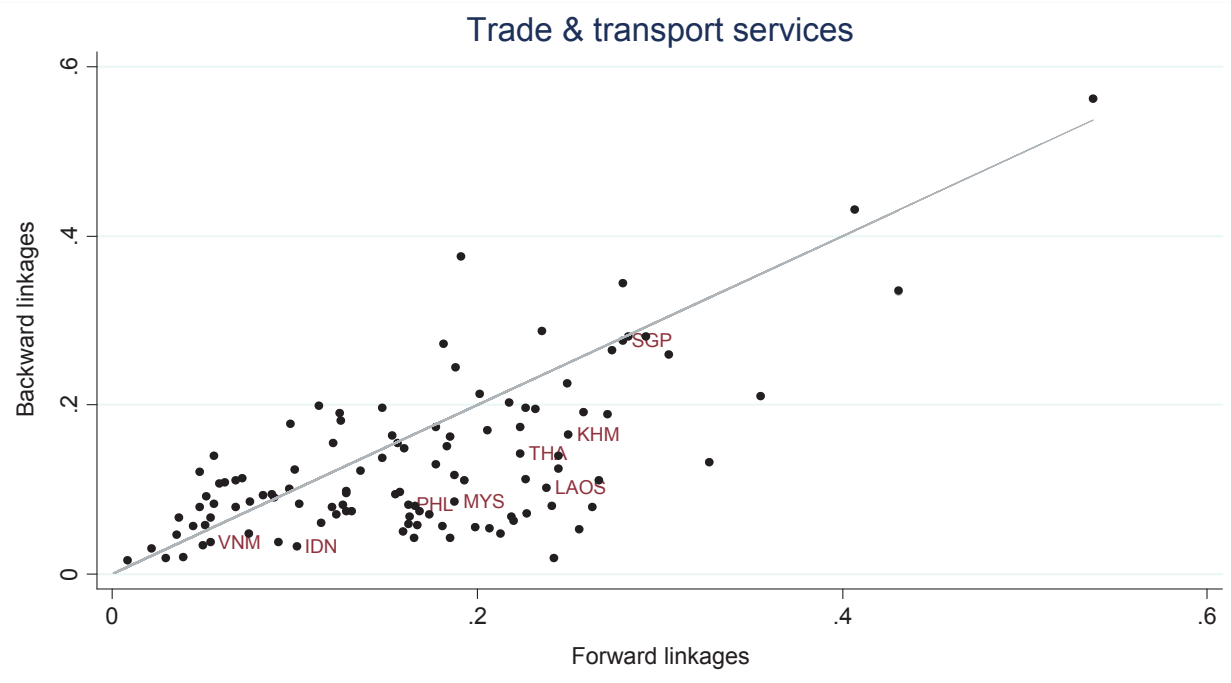
49. **Trade and transport services and other private services tend to have higher backward linkages for ASEAN Member States, although forward linkages are relatively more important.** Indonesia and Vietnam have particularly weak backward and forward linkages. In contrast, Singapore has strong linkages with other export activities, as shown by its position in figure 1.17. In the case of other private services, only Singapore has strong linkages to other export activities, as shown in figure 1.18. Indonesia and Lao PDR have particularly weak backward and forward linkages.

Figure 1.16 Forward and Backward Linkages, 2007: Construction



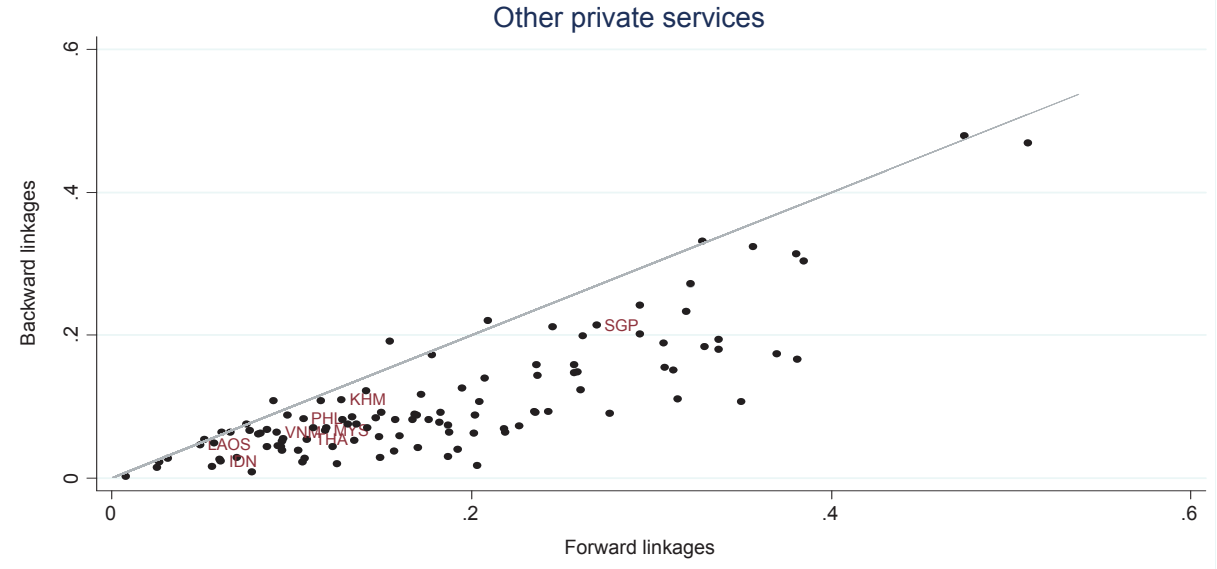
Source: World Bank *Export Value Added Database.*

Figure 1.17 Forward and Backward Linkages, 2007: Trade and Transport Services



Source: World Bank *Export Value Added Database.*

Figure 1.18 Forward and Backward Linkages, 2007



Source: World Bank *Export Value Added Database.*

D. The Effect of Services Integration on Competitiveness

50. **As noted earlier, changes in information and communication technologies are altering trade patterns.** More specifically, technological changes are reducing the need for proximity between producer and consumer of services, and have fragmented production functions into tasks that may be performed in different locations. These trends have increased the interdependence among trade, FDI, and temporary labor mobility of both high-skilled and low-skilled workers (Baldwin 2011; Cattaneo et al. 2013; Feenstra 2010; Grossman and Rossi-Hansberg 2008; Helpman 2011; Jones 2000).

51. **Services play a key coordinating role in international production sharing.** What are some of the implications of the changes in trade patterns? Baldwin (2011, 2012) defines the trade-investment-services nexus as the defining characteristic of 21st century trade, reflecting the intertwining of trade in parts and components; international movement of investment in production facilities; and movement of people, technology, and long-term business relationships. In this context, services coordinate the dispersed production in different geographic locations. A country's trade pattern is inseparable from its position in the supply chain. Consequently, strategic participation in an international supply chain, especially in manufacturing, can be a way for nations to industrialize.

52. **In terms of services export composition, ASEAN countries in general are still concentrated in traditional services, and appear less successful in tapping into higher-value-added services, with some exceptions.** Although services trade growth in the region is significant, ASEAN Member States are mainly exporting "traditional services" such as transportation and travel and tourism services, and are less successful in tapping into the new services opportunities such as IT and business-related services. The Philippines and Singapore are the main exception in the region. In the case of the Philippines, in recent years its BPO and IT-enabled services exports have become a success story. Singapore's exports of modern services, such as professional and other business services, have developed significantly since the mid-1990s.

53. **Regional integration, together with appropriate domestic policies, provides an opportunity to boost services competitiveness in ASEAN.** Regional integration, together with appropriate domestic policies, can increase the contribution of services to trade and economic growth by enhancing competitiveness. Services trade is affected by two broad sets of regulations: trade regulations that aim at

limiting the participation of foreign services and services providers in the domestic markets (trade restrictions), and regulations that aim to address a market failure that may impact services trade, as well (broadly: domestic regulations). Trade agreements aim at eliminating regulations that restrict trade to an unnecessary extent, while recognizing the need for regulations that pursue legitimate nontrade policy objectives such as health, environmental concerns, competition, and information asymmetries. For example, professional services regulations try to ensure the quality and standing of services providers, and provide information to consumers with regard to the professional qualifications of the supplier. However, these regulations might at the same time have a negative impact on services trade. The reduction of these adverse effects, for example, through the modification of residency or nationality requirements, requires cooperation among countries.

54. **The costs and benefits of preferential services integration requires further assessment.** The economic literature on services integration is relatively thin. Assessing costs and benefits of trade agreements have focused mainly on the impact of tariff changes on the flow in trade in goods and on countries' welfare (see Bhagwati, Krishna, and Panagariya 1999). More recently, Mattoo and Fink (2002), Fink and Jansen (2009), and Mattoo and Sauvé (2003, 2004, 2008, 2011) discuss the implications of services integration on countries' welfare and trade in services. Services trade has two important characteristics that need to be factored in when assessing the costs and benefits of preferential integration. First, because services trade requires the movement of factors of production—capital and labor—in addition to cross-border trade, preferential rules on establishment (FDI) and the temporary movement of labor should be considered. Second, unlike trade in goods, trade in services is restricted by domestic regulations, both discriminatory and nondiscriminatory, which may affect services and service providers (companies and people). Examples of the former are taxes that affect only foreign providers or services, and subsidies granted exclusively to firms established in the country or to nationals living in that country. Nondiscriminatory barriers, however, are barriers that affect both national and foreign services providers.

55. **Preferential access to foreign firms can be granted by, for example, reducing existing ownership restrictions to certain countries and not to others.** Alternatively, market access may be allowed in markets where access is limited, by allowing entry to firms established in countries that are part of an agreement. In the case of temporary movement of labor, preferential access may be granted by eliminating the nationality or residency requirements for workers of certain trading partners, or by facilitating visa or work permit requirements.

56. **Preferential access to services and services providers impact a country's competitiveness and welfare in different ways.** The literature has identified at least four transmission mechanisms, depending on the impact of regulations (a) on costs, variable or fixed; (b) on entry or the preferred mode of entry; (c) on sunk costs and sequencing of liberalization; and (d) on static and dynamic economies of scale.

57. **When regulations affect variable costs, preferential or regional access can lead to gains, but less than those provided by nonpreferential access.** Such regulations "impose a cost on foreign providers, without generating any benefit (such as improved quality) or revenue for the government or other domestic entities, welfare would necessarily be enhanced by preferential liberalization" (Fink and Mattoo 2002). However, nonpreferential liberalization would lead to an even greater increase in welfare nationally and globally because the service would then be supplied by the most efficient locations."

58. **When regulations affect fixed costs, a country may benefit even more from preferential liberalization.** Such liberalization would provide gains by eliminating, even on a preferential basis, any excessive fixed costs of entry imposed on foreign providers. Normally, these are regulations that affect entry or establishment, and thereby competition, such as local presence requirements, license fees for entry into the market, or the need to requalify for foreign professionals, for example, if the liberalization results in removing unnecessary qualification, licensing, and local-establishment requirements (Mattoo and Sauvé 2008). Also, the gain from preferential liberalization leading to the elimination of fixed-costs of entry depends on the competitiveness of the partner countries' service providers. Preferential access will

maximize welfare gains if countries have comparable regulations and the agreements are not exclusive—that is, if they do not apply restrictive rules of origin. In this case, there are benefits from both increased competition and greater diversity of services.

59. **For many service sectors, economies of scale matter, hence the potential benefit of regional integration.** This is the case, for example, for transportation, audiovisual, postal, and telecommunication services (Fink and Jensen 2009). By increasing market size, regional integration reduces the trade-off between competition and economies of scale. In a market of a given size, full exploitation of economies of scale may make it possible for only a limited number of providers to operate at an efficient scale. The enlargement of domestic markets beyond national boundaries brought about by regional integration reduces this restraint and allows increasing use of economies of scale, while also inducing more competition from trading partners' service providers and services. If the regional agreement does not have restrictive rules of origin, the agreement can also attract new FDI seeking to take advantage of a larger, more attractive market.

60. **Another way regional agreements in services may help economies is by allowing for the gradual development of domestic industries, starting with achieving regional competitiveness** (Mattoo and Sauvé 2008, 2011). An agreement such as ASEAN—focused mainly on developing and emerging countries—may help services providers compete in the global market later on by first exposing them to competition only within the regional market. For these authors, there is also the possibility that once competitiveness is reached at the regional level, these firms may be less likely to resist broader-based liberalization. There is the risk, however, that regional liberalization that does not generate internationally competitive firms might create vested interests that could resist further market opening later on. Moving up global value chains for services in ASEAN

61. **The recent development of global value chains (GVCs) provides another opportunity for using service sector growth and development in ASEAN economies.** ASEAN economies have already gained significantly from participating in global value chains in manufacturing. Increasing competitiveness in services will provide these economies the scope to climb up the value chains in both upstream and downstream activities where services can predominate. A major component of the trading tasks involved in the GVCs involves services, from the mundane such as cargo handling to the more skill-based ones such as financial advisory. Already, there is talk within regional groupings of conducting targeted capacity building for the development of innovative and open services within the GVCs. Indeed, services fulfil a vital and complex role in the GVCs, and these efforts have intensified recently with the increased presence of GVCs and seeing how they have transformed regional economic groupings such as Asia-Pacific Economic Cooperation (APEC). However, the intangibility of services makes them analytically and statistically elusive. The systematic effort to deepen understanding of the economic role afforded by services, particularly at the international level, has only recently occurred. One cause for this is the challenge of decoupling the dual aspects of services—one as an intermediate for manufacturing (that is, logistics services), and another as final products (for example, education, finance, and health care).

62. **While services have long occupied a dominant place in most economies, the recognition of their role and significance has increased only recently.** Even large manufacturing firms are seeing dramatic shifts in revenue derived from services (Spohrer and Maglio 2008). According to the World Bank's World Development Indicators (2012), the share of services value added in world GDP was 70 percent in 2010, up from 53 percent in 1970. By any account, this suggests that ASEAN is lagging this benchmark. Put simply, the world is clearly, albeit slowly, converging to a large service system, with a large portion of the labor force employed in services compared to agriculture and manufacturing, and ASEAN must follow suit. Besides reflecting the shift toward service economies in the advanced countries, the services share has also risen as a result of the structural changes in the economies. This trend is somewhat reflected in the case of ASEAN (see table 1.5).

Table 1.5 ASEAN Economies at a Glance

					Value Added as % of GDP			Trade as % of GDP	
	GDP (US$ million)	GDP/capita (US$)	Size of Trade (as % share of GDP)	ASEAN Trade (as % share of GDP)	Agriculture	Industry	Services	Merchandise	Services
Brunei Darussalam	16,969.7	42,445.5	99.3	19.6	0.7	71.1	28.2	100.0	
Cambodia	14,400.8	976.9	129.6	35.7	35.6	24.3	40.1	136.8	29.1
Indonesia	878,223.4	3,578.4	43.5	10.9	14.4	47.0	38.6	43.1	6.6
Lao PDR	9,083.1	1,394.3	67.8	25.7	28.0	36.2	35.8	54.2	9.8
Malaysia	305,154.4	10,337.9	138.9	37.9	10.1	40.9	57.1	139.0	26.3
Myanmar	51,597.5	846.2	35.9	14.6					
Philippines	250,542.7	2,567.2	46.8	9.9	11.8	31.1	73.2	46.9	13.3
Singapore	284,389.0	53,533.1	277.1	73.7	0.0	26.7	44.2	286.9	86.6
Thailand	366,126.6	5,391.3	130.4	27.2	12.3	43.6	41.7	130.4	28.1
Vietnam	141,669.1	1,595.9	160.8	27.0	19.7	38.6	49.1	146.6	14.2
ASEAN	2,318,156.4	3,756.1	106.8	26.0	NA	NA	NA	NA	NA
China					10.1	45.3	44.6	47.0	5.8
India					17.5	26.2	56.3	42.1	14.8
East Asia and Pacific Developing					10.9	44.5	44.6	54.2	7.7
OECD					1.5	24.1	74.4	46.2	12.1

Sources: ASEAN Statistics (2012a); WDI (2012) (data for 2012).

63. **ASEAN has traditionally been strong in contract manufacturing, particularly for electronics, serving as vital export nodes for the production network, and the concept of borderless production systems has been well leveraged.** This experience provides a better and more sustainable option to bringing on significant sustained growth and economic development through using the GVC in services. The role of services in GVCs can thus be viewed from the perspective of creating or engaging more deeply into GVCs, both services GVCs and the services components in other GVCs. In short, economies should consider participation in the high-value-added services components of GVCs as a viable means to achieve sustained growth and development. Just what are the high-value-added services and how to measure the value added in trade for such services is still an unanswered question.

64. **As ASEAN looks forward to regional economic integration in the form of the ASEAN Economic Community (AEC) serving a potential market of more than 600 million people, it is timely to use the full potential of another engine of regional growth—that of services.** Services contributed between 38 and 68 percent of the gross national income of ASEAN's economies in 2012 (ASEAN 2013). In terms of trade in services, ASEAN's trade in services represented 5 percent of world trade in commercial services, or US$343 billion, in 2009. In addition, foreign direct investment in the services sector has accounted for more than 50 percent of total ASEAN FDI. This clearly underscores the importance of services to ASEAN and the need to manage the role of services for specific ASEAN member countries in relation to their relative competitive advantages and economic maturity, and for the region in general to ensure the region's competitive advantage in international trade (Brunner 2013).

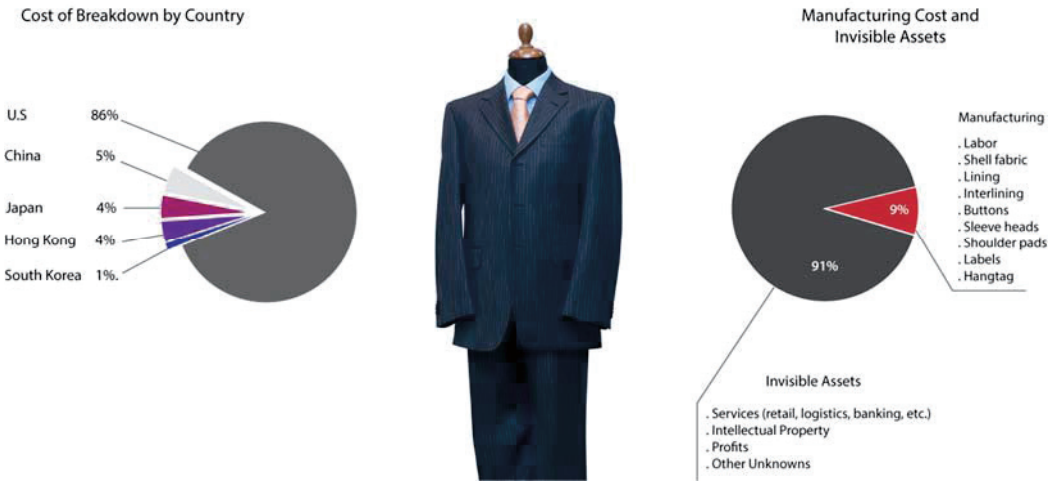
65. **If well implemented, the liberalization measures brought about by the ASEAN Framework Agreement on Services and the General Agreement on Trade in Services can assist in transforming the AEC into a global services hub, although this alone will not be sufficient.** Already, with the engine for the 12 priority sectors for ASEAN set in motion, five of which are services-oriented (see ASEAN [2012b] for the details and updates), there is now a concerted push to realize the goal of regional economic integration through making the service sector within ASEAN more efficient. The five service-oriented priority integration sectors are e-ASEAN, tourism, air travel, health care, and logistics. They are key sectors in themselves or serve as strategic inputs to all other sectors in the regional economy, both goods and services.

66. **Through the examples presented earlier and discussed below in box 1.2, it is clear that services have a role in the GVC either as an intermediate input or otherwise.** Indeed, services cannot and should not be decoupled from manufacturing, since services have the potential to increase the high-value-added content in manufacturing. The liberalization of such services and the harmonization of their standards, particularly in logistics package delivery across all modes of supply, is an imperative. By the same token, a manufacturing GVC can be more effective only when it is properly coalesced with competitive services inputs, such as telecommunication services, logistics delivery, and the associated financial services.

Box 1.2 The Contribution of Services in Global Value Chains

It is not easy to separately identify all the individual service components that constitute the full value of a product, not least because manufacturing and services often tend to be bundled together. The discussion below presents examples that try to disaggregate a range of different services (Low 2013). Figure B 1.2.1 provides a product cost breakdown.

Figure Box 1.2.1 Breakdown of Costs of a Jacket made in China and sold in the United States

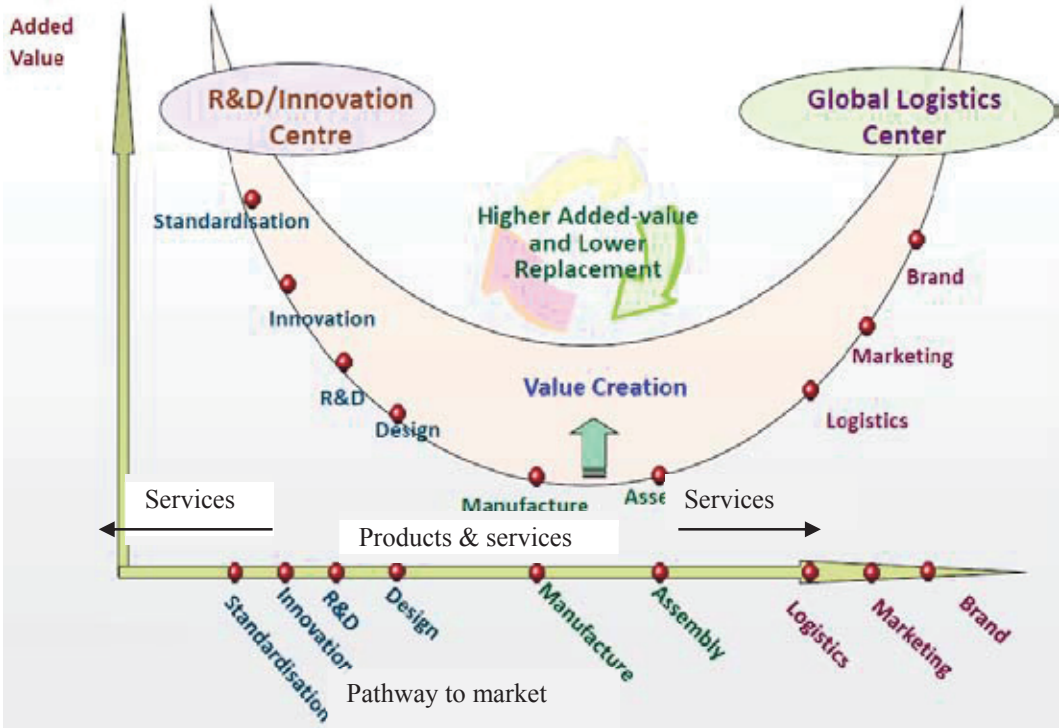


Only 9 percent of the US$425 retail value for the jacket is linked to the cost of tangible inputs for making the jacket. The remainder is attributed to "invisible" assets. Therein lies the identification challenge: what is contained in the invisible assets? There will be elements in both the preproduction (upstream) and postproduction (downstream) part of the process. In this GVC, the upstream sources of value will include creativity, design, intellectual property, and branding. The downstream elements include advertising, marketing, and retailing. Disentangling the sources of value, the individual services involved, and the implications of policy for these segments of the supply chain are formidable tasks, even for the enterprises (multinational and small and medium enterprises) directly involved in the business.

Recently, Ali-Yrkkö et al. (2011) presented a case study of the Nokia N95 phone and produced a detailed breakdown of the value chain for the N95. The parts (including processors, memories, integrated circuits, display, and camera) accounted for 33 percent of the product by revenue. Assembly accounted for only 2 percent. The remaining two-thirds of the product were accounted for by Nokia's internal support services (31 percent), licenses (4 percent), distribution (4 percent), retailing (11 percent), and operating profit (15 percent). This value-add breakdown concurs with the smiling curve presented by Shih (2005) (see figure B 1.2.2). The contribution of services to product revenue is 31 percent more than the parts revenue. Indeed, it is the other services that are provided within the context of the GVC that will add value to the product made, and generate higher profit margins for the firm, indirectly benefiting economies and the livelihood of the workforce. In short, a strong services sector spurs economic growth faster than manufacturing.

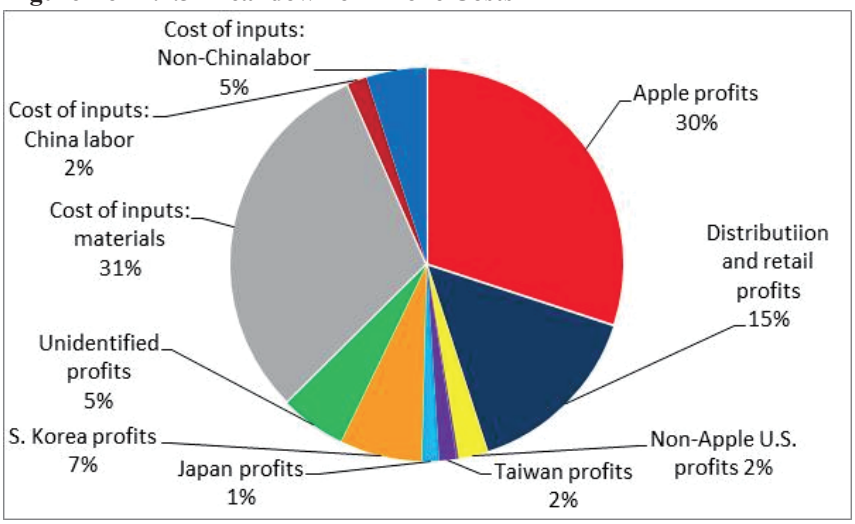
Box 1.2 The Contribution of Services in Global Value Chains (continued)

Figure Box 1.2.2 Shih's Smiling Curve



Source: Shih 2005.

Figure Box 1.2.3 Breakdown of iPhone Costs



Yet another example is that of the iPhone, as shown in figure B 1.2.3, where one Taiwanese company, Foxconn, is into various parts of the global value chain of Apple and is the final assembler (which has the lowest margin for the business and the industry). No doubt, more value can be extracted from services than relying largely on high-volume, precise automated assembling alone. While developing Asia is undertaking a major portion of the assembling of many electronics, apparel, and automotive industries, the developed countries elsewhere are reaping the real benefits in terms of profit and revenue recognition. There is little growth potential or innovation value from the assembling and testing of parts and components. The real value extractor is in the upstream work on research and development, including design and licenses, and downstream activities on outsourced distribution, product repairs, warranty component replacements, and product maintenance. These are the embodied and embedded services that affect supply chain connectivity and positioning in the GVC.

67. **This role for services in GVCs is also seen in the case of knowledge-intensive (value added) tasks such as education, health and Business Process Outsourcing.** This is the situation of Malaysia and Thailand, and to some extent the Philippines. Providing specialized education services is the natural next step in the services GVC in these countries since there is a need to level up the skilled manpower to match the requisite demand from the multinational corporations. This was the path taken by Singapore not too long ago, and more recently Malaysia, when Malaysia opened its doors for foreign universities from Australia, China, and the United Kingdom, such as Nottingham and Hull, to set up regional campuses to educate the local market and serve international students. A good percentage of these international students actually come from the region, notably Indonesia, Myanmar, and Vietnam. These students after receiving their education will return home and help increase the productive capacity of their countries. This creates a virtuous circle and increases Indonesia's and Vietnam's share in the production GVCs, especially for the high-tech and health care GVCs. The natural spinoff from all this is the deepening of regional integration of specific industries in ASEAN.

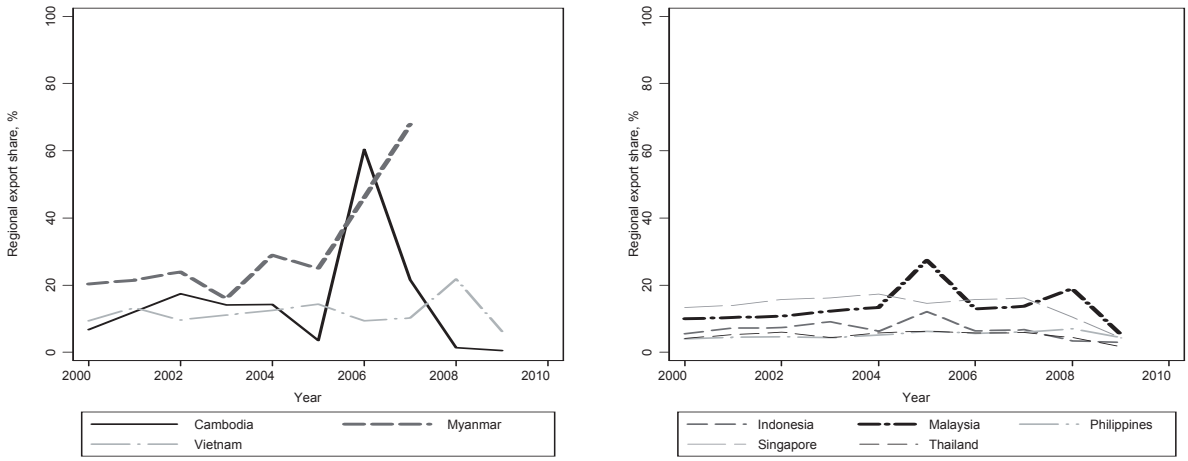
68. **Though small geographically, Singapore has successfully become a value chain location for more knowledge-intensive industries in the GVC, such as in pharmaceutical research and development, highlighting the potential of services to provide an entry point for competitive GVC participation even for smaller economies.** This in turn has led to more international pharmaceutical companies basing themselves in Singapore to undertake more active pharmaceutical ingredient production. By default, this moves Singapore up the GVC and opens new doors for other GVC activities, especially in drug testing and high-end medical tourism. This inevitably increases the variety of trade through horizontal diversification in the product space, increased opportunities for growth in new markets, and reduced vulnerability to economic disruptions (Brunner 2013, 2). Effectively, Singapore now sits on the right ends of the smiling curve. Singapore has research and development/innovation centers for respected multinational corporations such as P&G and GSK, and Singapore is the global logistics center for DHL. This is only made possible as the workforce becomes more educated, with strong institutional support for the investment in human capital, and with the existing government focus on policy reform to support services integration domestically and regionally. In the area of logistics services, virtually all the large shipping lines call at the Port of Singapore to offload cargo for the region and pick up cargo through feeder services for their destination markets in Asia, the Americas, or Europe. This resonates well with the Master Plan on ASEAN Connectivity (ASEAN 2011a), which recognizes the role of the various and specific services in reaching its goal of facilitating the movement of goods, people, and services themselves. However, this choice of a value chain location is not achieved by default, but more by deliberate and careful design, since it needs to be meshed with the associated financial services offered by the financial institutions and insurance houses to support this industry.

69. **Thus, GVCs in services should be exploited as strategically as possible to enhance trade and development, as regional integration through logistics and connectivity improvements.** This increases the potential for trade in services within the region and beyond. However, commitments from the member economies must be improved and implemented, and domestic regulatory reforms and cooperation must be undertaken if the region wants to achieve this reality by 2020.

E. Assessing the Untapped Potential for Regional Integration in ASEAN

70. **With a few exceptions, the trade flows of ASEAN economies in services with ASEAN partners have remained modest.** This can be seen in the trends in the share of exports of ASEAN countries that go to other ASEAN countries (figure 1.19). Among low-income countries, ASEAN has become over the years a very important destination market for Myanmar's services exports, while the region remains relatively unexploited by Vietnam. For Cambodia, the ASEAN market seems to be a rather unstable destination market. For Malaysia, the ASEAN market seems to be relatively important, while for middle-income countries, the ASEAN market seems to be relatively less important.

Figure 1.19 Share of Regional Exports in Total Services Exports



Source: World Bank *Trade in Services Database*.

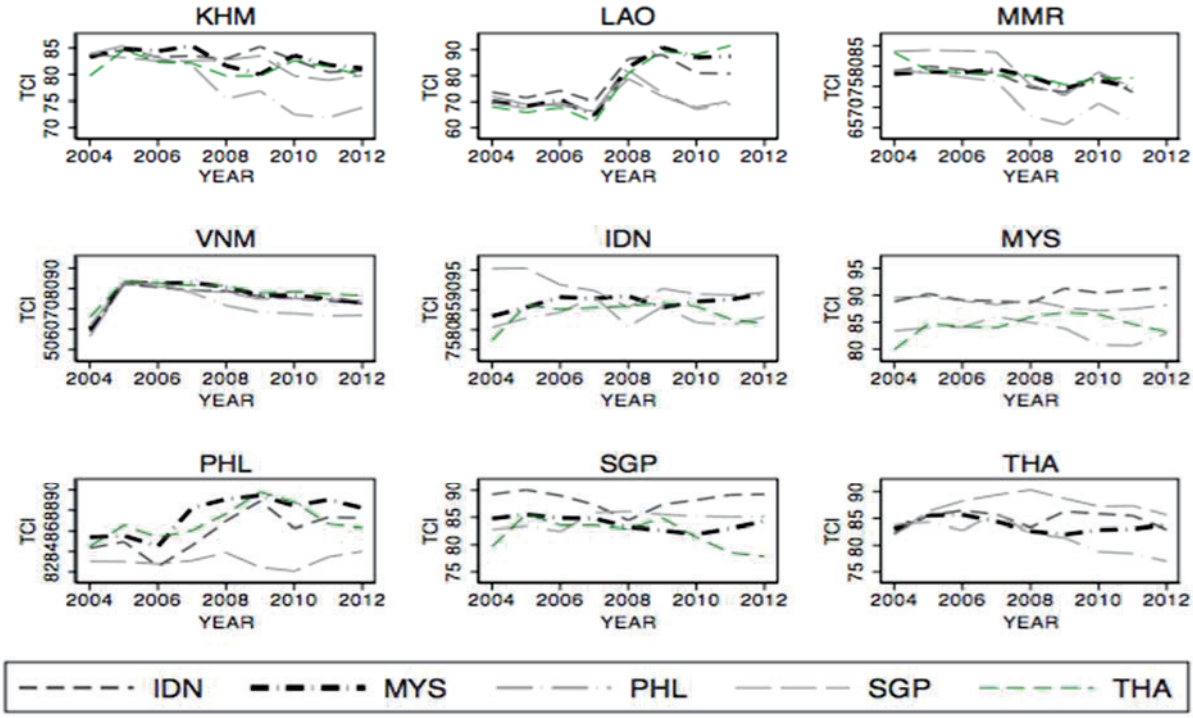
71. **The varying services trade exposure raises two important questions. First, are ASEAN countries trading to their potential, or are there untapped opportunities? And second, what are the impediments for enhancing integration?** These questions are assessed by looking at two indicators, the trade complementarity index and the Trade Intensity Index, and by estimating a gravity model of trade in services. The complementarity index looks at whether a potential importer buys services that a country exports abroad by measuring how well the export structure of one country matches the import structure of another country. The index is based on export and import data at the disaggregated service sectoral level that are then aggregated into a single index for each country pair. The index number varies between 0 and 100. The higher the index number, the higher the potential for that country to export to the other markets. Figure 1.20 depicts the development of the indexes of trade complementarity of each country of interest with all other ASEAN countries for which data are available.[8]

72. **In general, the services complementarity index values for Singapore and middle-income ASEAN Member States (AMS) with all ASEAN states (figure 1.20) are high—above 80 percent, except for trade with Cambodia and Myanmar.** The Philippines has increased its complementarity index with respect to Indonesia, Malaysia, and Thailand, while maintaining a stable index with Singapore. Indonesia's indexes with respect to ASEAN middle-income countries are relatively unstable. Something similar can be found in the case of Malaysia, except in the case of its index with Indonesia. Singapore also has high but unstable index values, while Thailand has decreasing index values compared to other middle-income countries, except Malaysia.

73. **The trade complementary index trends vary across ASEAN's lower-income countries, as presented in figure 1.21.** Lao PDR's complementarity indexes have increased in recent years compared to ASEAN middle-income countries, while in the case of Cambodia, there is comparatively less and decreasing complementarity. In the case of Myanmar, there is a declining trend in recent years. In the case of Vietnam, the indexes are above 80 percent and relatively stable over time.

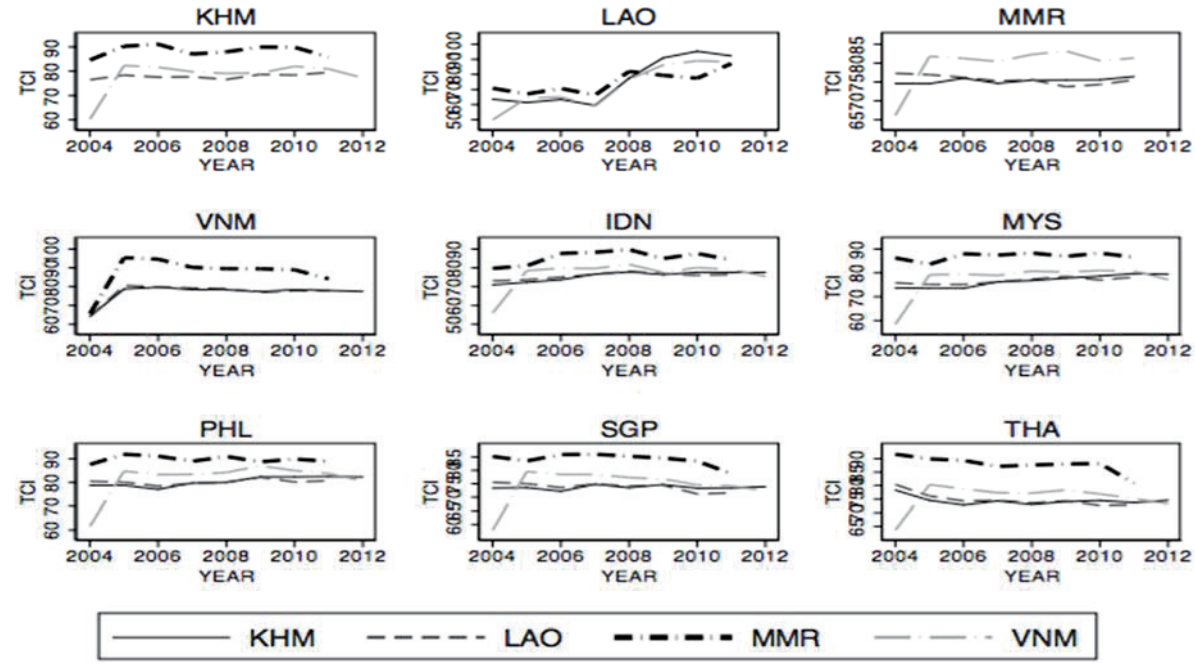
[8] Specifically, the trade complementarity index between exporter i and importer j is calculated as $TCI_{i,j} = \left(1 - \sum_p \frac{\left|{}^{x_{i,p}}/_{X_i} - {}^{m_{j,p}}/_{M_j}\right|}{2}\right) * 100$, where $x_{i,p}$ is exports from i in product p, X_i is total exports of i, $m_{j,p}$ is imports of j in p, and M_j is total imports of j.

Figure 1.20 Trade Complementarity of Singapore and ASEAN Middle-Income Countries



Source: Calculated using data from UNCTADstat.

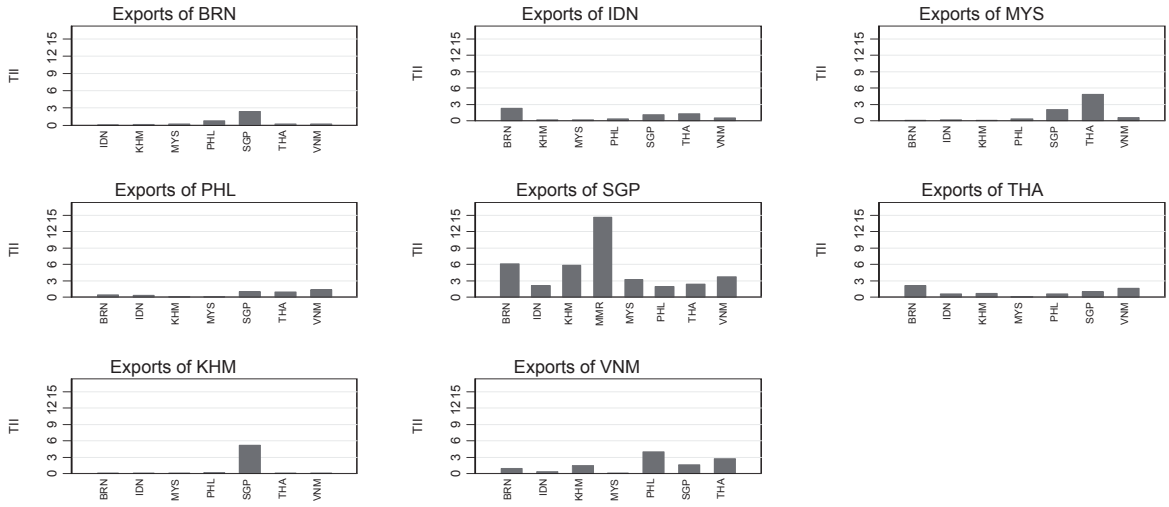
Figure 1.21 Trade Complementarity of Low-Income Countries



Source: Calculated using data from UNCTADstat.

74. **The second measure of services integration potential, the Trade Intensity Index (TII), indicates that there is still great scope for deepening services integration in the region.** The TII indicates a country's relative share of exports to a particular country compared to the rest of the world's share of exports to this country. A large index number suggests the trade between a country and its partner is more intense than trade with the country and the rest of the world. Figure 1.22 depicts the indexes of trade intensity of each bilateral pair observed in the database, averaged over 2005–09 to maximize the number of observations.[9] The TIIs are found to be relatively low for all ASEAN countries, except Singapore. This means that there is untapped potential to increase regional trade. This confirms the findings here that despite the significant progress achieved in the context of ASEAN Framework Agreement on Services, there is still great scope for deepening integration.

Figure 1.22 Trade Intensity Index (TII)



Source: World Bank Trade in Services Database.

75. **The estimated potential trade volumes predicted by structural trade determinants vary in comparison to the actual intraregional trade values between 2008 and 2009 for different countries in the region.** In order to identify if there are still regulatory constraints that may be acting as barriers to trade, a gravity model is estimated. The gravity model relates countries' bilateral trade flows to structural determinants of GDP, geographic distance, and other factors that affect trade barriers. The structural determinants for each pair of countries together with the estimated regression coefficients are used to compute the bilateral trade potentials. The level of bilateral trade between a pair of countries is compared with their trade potential to categorize bilateral exports as overtraded or undertraded, depending on the comparison between realized bilateral export values and the model's predictions. In addition, the regression includes a country's Services Trade Restrictions Index of the World Bank Services Trade Restrictions Database to assess if these are important determinants in explaining the level of bilateral services trade

[9] Specifically, the TII between exporter i and importer j is calculated as $TII_{i,j} = \frac{x_{i,j}/X_i}{x_{w,j}/X_w}$, where $x_{i,j}$ is exports from i to j, X_i is total exports of i, $x_{w,j}$ is exports from the world to j, and X_w is total world exports.

among ASEAN countries. (See Annex 1.B for a detailed discussion of the methodology and a formal presentation of the results.)

76. The results indicate that while some countries appear to be overtrading, others undertrading, and still others trading at their potential, all ASEAN countries are shown to underexport with Malaysia and Singapore (and Malaysia and Singapore with each other). There also appears to be untapped potential for countries such as Brunei Darussalam, Cambodia, Malaysia, and Singapore to increase services exports with select countries in the region. In addition, countries with more restrictive services regulatory environments are significantly less likely to export services. At the same time, the results suggest there may be limited scope for further trade integration in the region unless structural domestic reforms are implemented in the participating countries. Thus, undertrading in services may suggest the existence of untapped potential to increase exports among these countries via the removal of trade-related obstacles.

F. Summing Up

77. **This chapter has made the case for the importance of boosting the performance of ASEAN services sectors and services trade as a way to enhance income and productivity levels to achieve sustained growth and development.** It has drawn on a survey of economics research and provided fresh empirical results to show how the growth of services productivity and trade boosts overall income and productivity levels. Services, which have become considerably more tradable in the last few decades due to developments in ICT and digital technology, serve as a vital intermediate input for manufacturing and other services, especially when countries are in the middle-income stages of development. This is particularly relevant for ASEAN countries, which are mostly middle income, or those about to become middle income. Overall, the integration of the services sector can foster competition and productivity due to large markets, and help ASEAN countries overcome the "middle-income trap."

78. The chapter then showed that while service sectors and services trade in ASEAN economies have grown rapidly in recent years, they still relatively lag behind other countries at similar stages in development, as indicated by a variety of measures: the size of services sectors, the share of services trade and exports, and the "traditional" content of services trade in ASEAN countries. Further, new measures such as exports of services in value-added terms, and measuring the forward linkages of service sectors to other sectors, suggest that the importance of services in ASEAN economies is being underestimated. Hence, addressing the relative underperformance of ASEAN service sectors and services trade becomes important. The next chapter discusses the causes behind the underperformance in services trade through a review of services trade policies and regulations and the ASEAN agreement on services integration.

Annex 1.A The Importance of Services (Illustrations)

1. To provide a comparative perspective, ASEAN countries are classified into two groups. Group 1 includes the middle- and high-income countries of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. For group 1, Brazil, China, India, and the Republic of Korea were chosen as comparator countries, based on their relative development stage in the region. Group 2 includes the lower-income countries of the region, Cambodia, Lao PDR, Myanmar, and Vietnam.

2. For group 2, Bangladesh, India, and Pakistan were chosen as comparator countries, but only for select aspects of trade in services. India is chosen as a comparator for both groups, since it has both middle- and low-income country characteristics. It is relatively poor but has one of the most dynamic services sectors among developing countries. The share of services in GDP is 57 percent. The share of services trade in GDP at 14 percent is one of the largest for a country of its size, and its annual services exports of US$148 billion (in 2013) is second only to China among developing countries.

3. For most aspects of trade in services, the period looked at ranges from 1996, that is, from the stage before most integration took place between the ASEAN Member States, and the most current data available (2011 in most cases). Due to data gaps, selected countries are not shown in certain graphs. The report uses data from the World Development Indicators, IMF Balance of Payments Statistics (BPM5), and a newly constructed World Bank Services Trade Database to simulate outcomes for services sectors in ASEAN countries.

4. Figure 1.A.1 through Figure 1.A.18 provide the comparative data discussed here.

Figure 1.A.1 Services Value Added as Share of GDP, Group 1, 1996

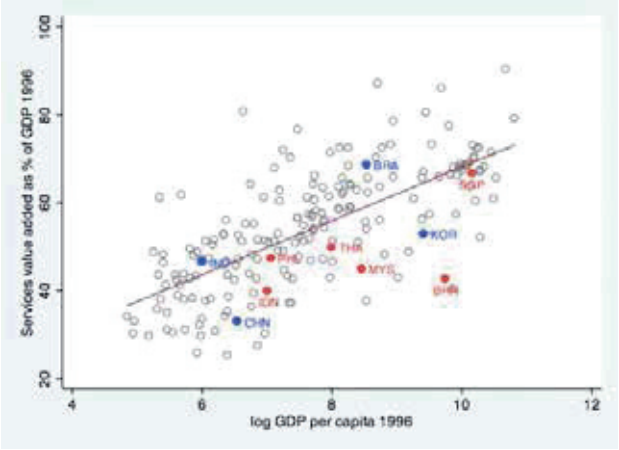
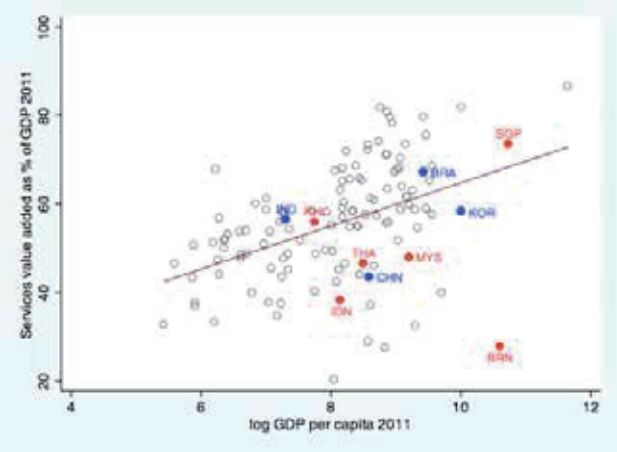


Figure 1.A.2 Services Value Added as Share of GDP, Group 1, 2011



Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.3 Services Value Added as Share of GDP, Group 2, 1996

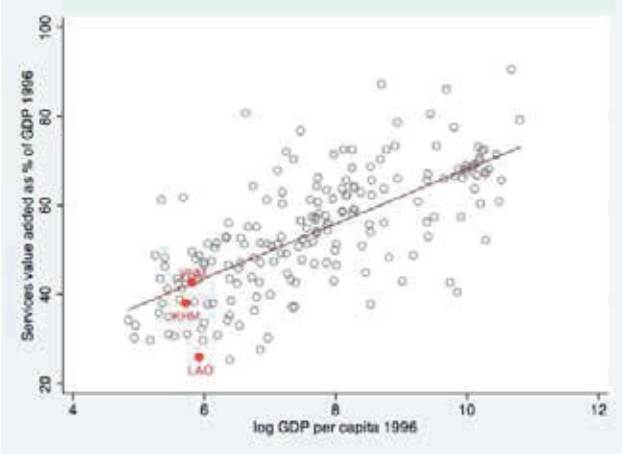
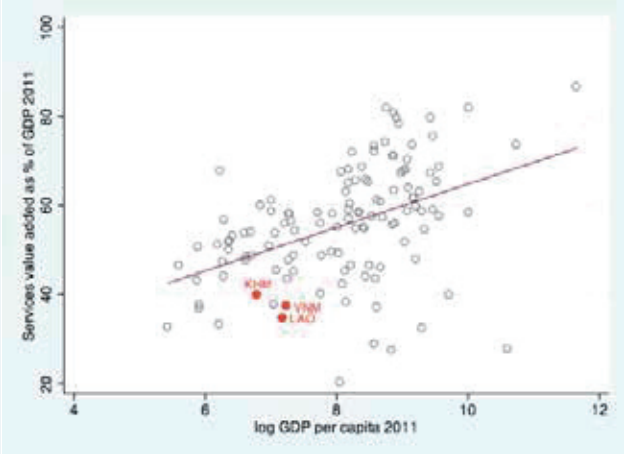
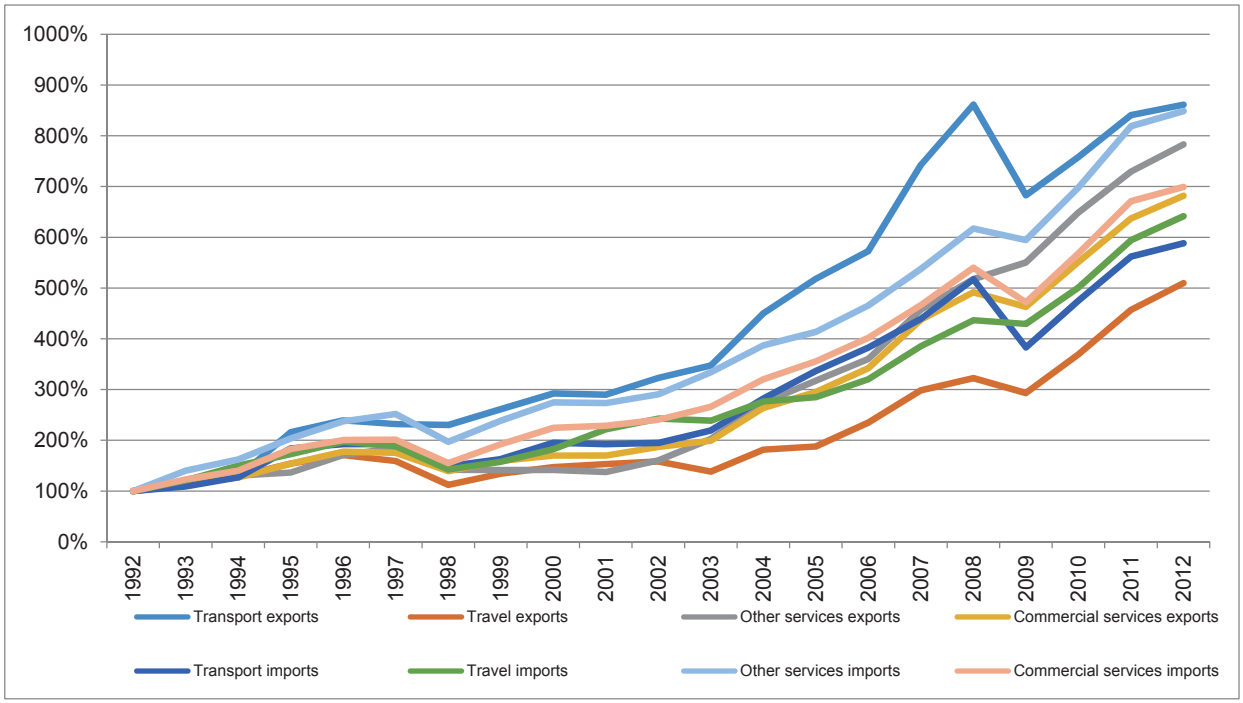


Figure 1.A.4 Services Value Added as Share of GDP, Group 2, 2011



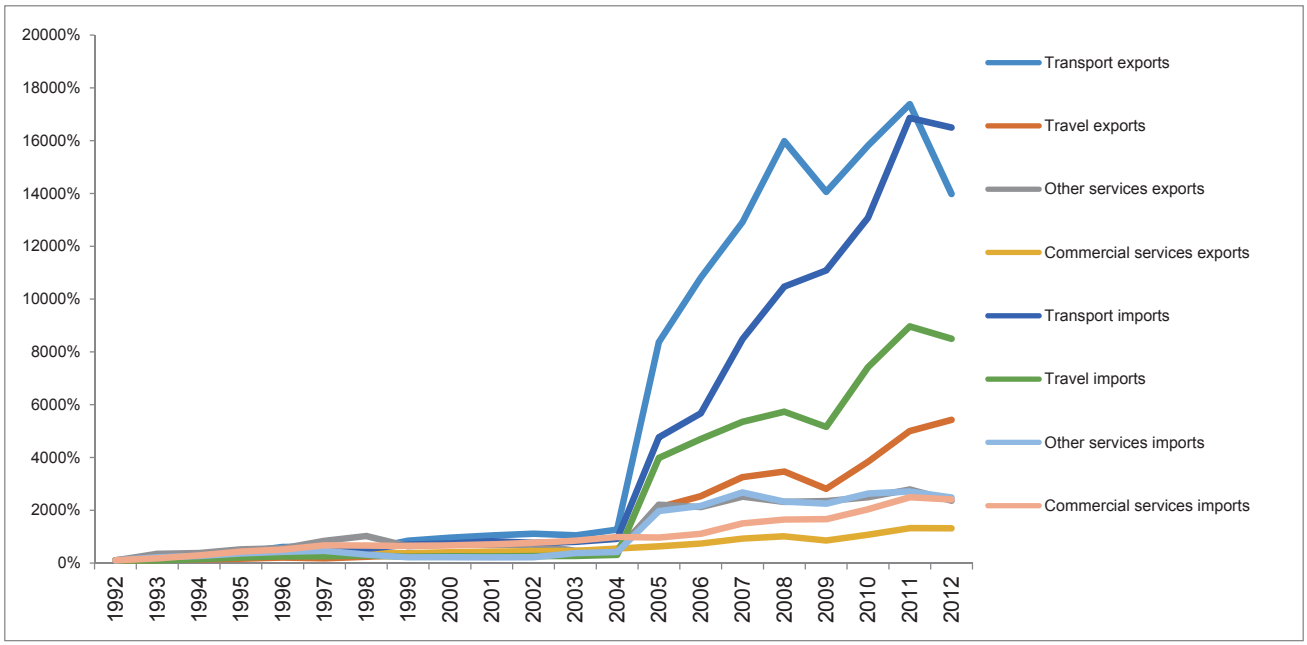
Source: Calculated based on World Bank, World Development Indicators, 2012.

Figure 1.A.5 Growth of Services Exports and Imports, Group 1 (combined), 1992–2012



Source: Calculated based on UNCTADstat, 2013.

Figure 1.A.6 Growth of Service Exports and Imports, Group 2 (combined), 1992–2012



Source: Calculated based on UNCTADstat, 2013.

Figure 1.A.7 Trade in Services as Share of GDP, Group 1, 1996

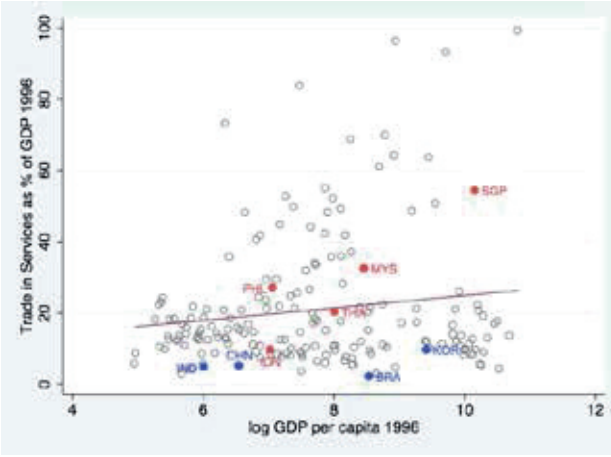
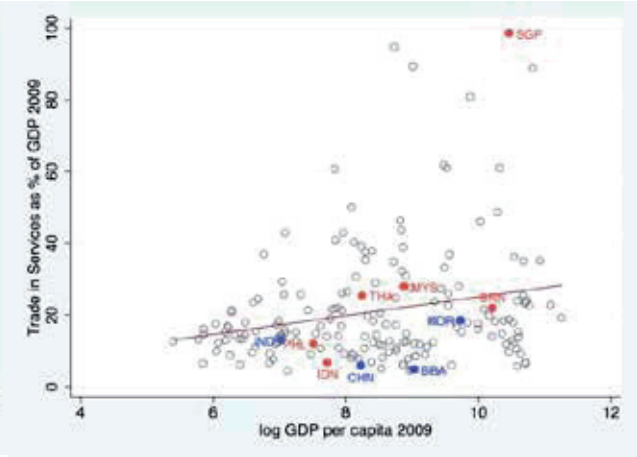


Figure 1.A.8 Trade in Services as Share of GDP, Group 1, 2009



Source: Calculated based on World Bank, World Development Indicators, 2012.

Figure 1.A.9 Trade in Services as Share of GDP, Group 2, 1996

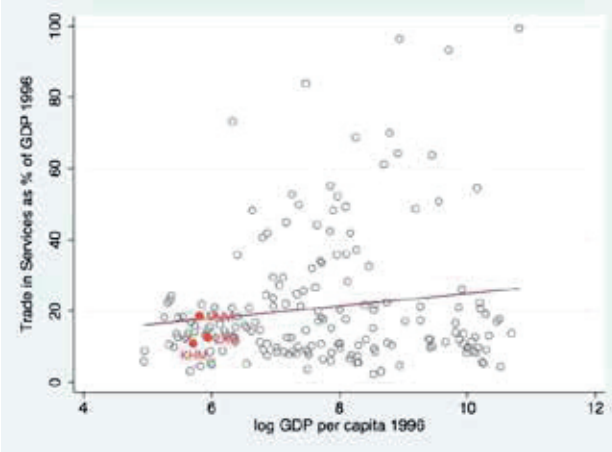
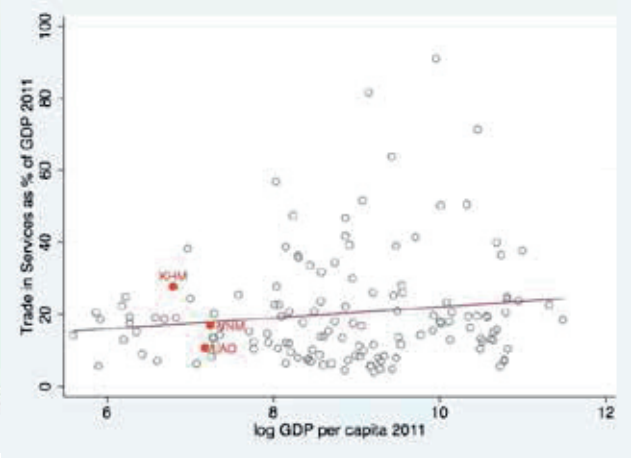


Figure 1.A.10 Trade in Services as Share of GDP, Group 2, 2011



Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.11 Export Share of Services, Group 1, 1996

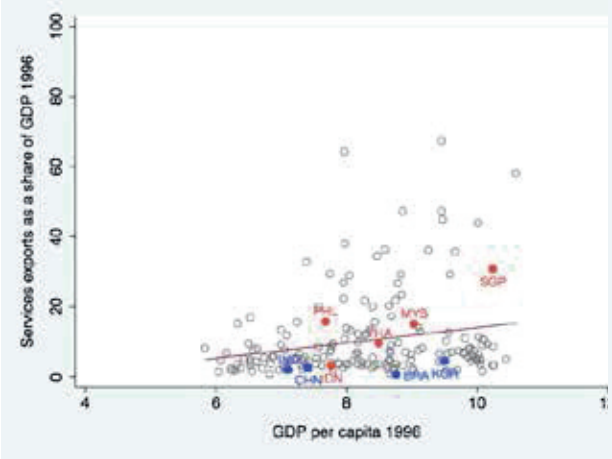
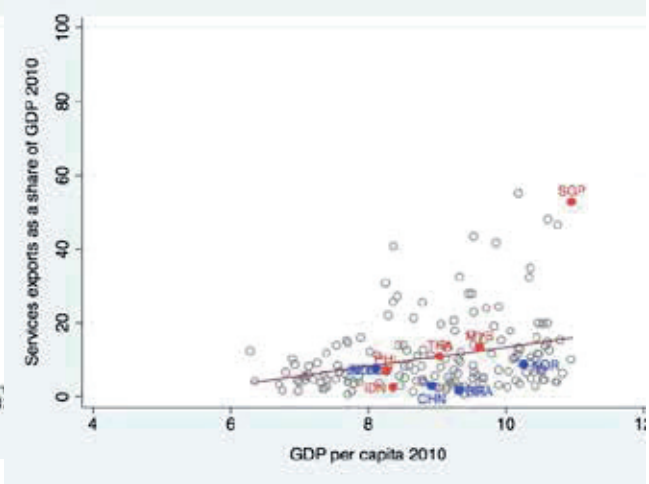


Figure 1.A.12 Export Share of Services, Group 1, 2010



Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.13 Export Share of Services, Group 2, 1996

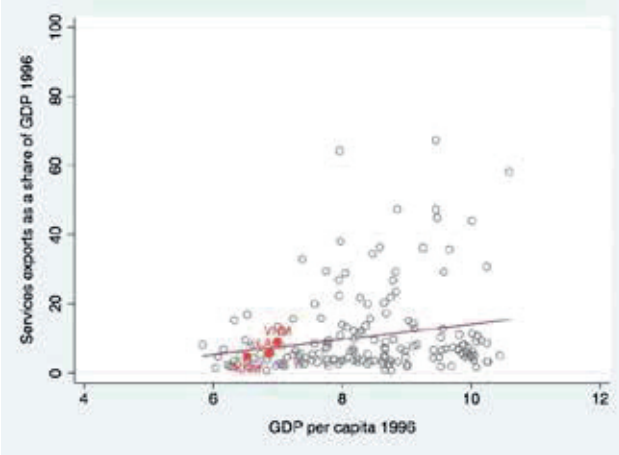
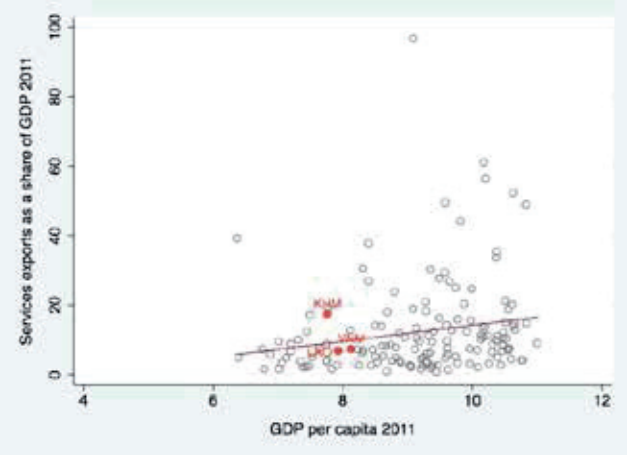


Figure 1.A.14 Export Share of Services, Group 2, 2011



Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.15 Services Imports as Share of GDP, Group 1, 1996

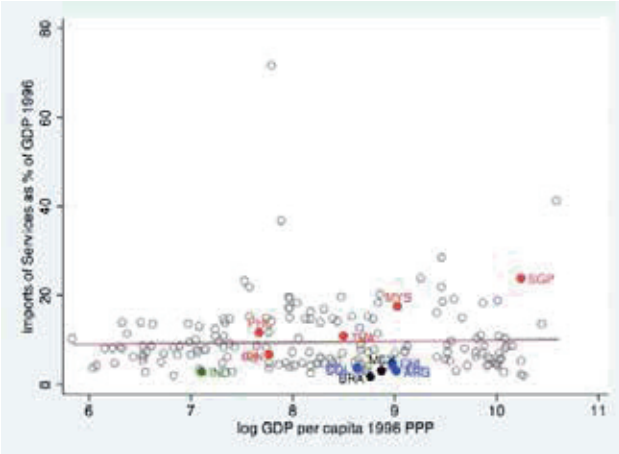
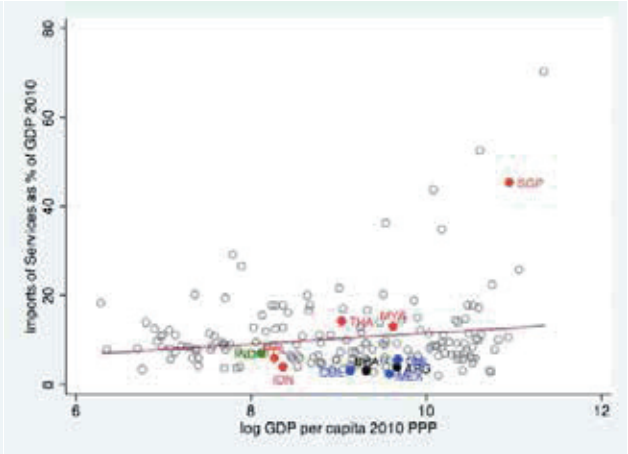


Figure 1.A.16 Services Imports as Share of GDP, Group 1, 2010



Source: Calculated based on World Bank World Development Indicators, 2012.

Figure 1.A.17 Services Imports as Share of GDP, Group 2, 1996

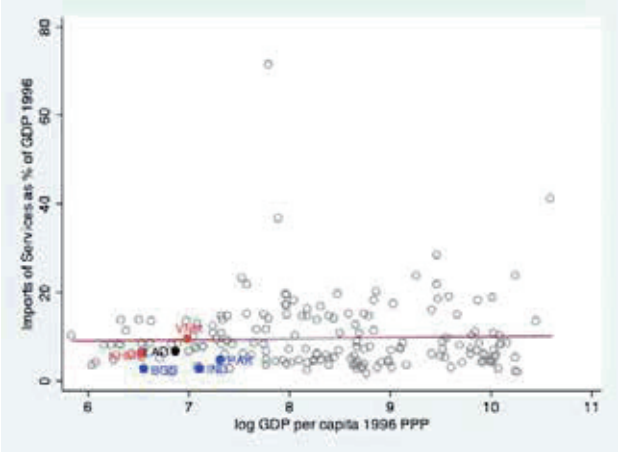
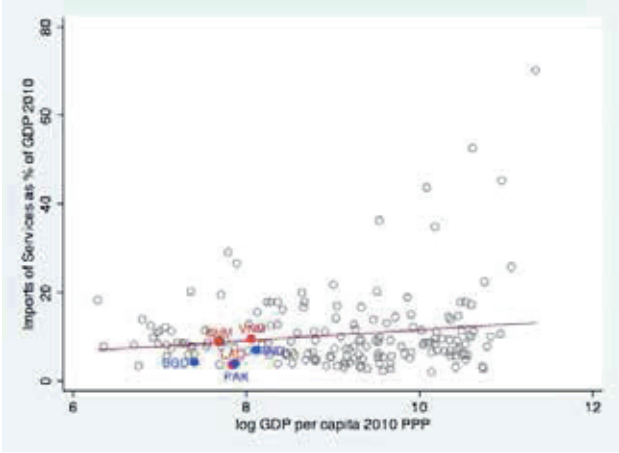


Figure 1.A.18 Services Imports as Share of GDP, Group 2, 2010



Source: Calculated based on World Bank, World Development Indicators, 2012.

Annex 1.B Gravity Model of Trade in Services

1. This annex assesses whether scope exists to increase services trade integration between ASEAN countries at the aggregate level. The main question is whether countries are trading to their potential, or whether potential remains untapped, and where barriers to enhanced integration may lie. The analysis is based on an estimated gravity model of trade in services that is based in economic theory. The gravity model of trade relates countries' bilateral trade flows to structural determinants of GDP, geographic distance, and other factors that affect trade barriers. The gravity model has been extensively used in international trade due to its intuitive empirical and theoretical appeal. Anderson and van Wincoop (2003), Feenstra (2004), and Baldwin and Taglioni (2006), among others, present exhaustive literature reviews on the gravity equation as applied to international trade. The gravity model estimation results can then be used as a framework to evaluate ASEAN countries' pairwise export relationships between 2008 and 2009.

2. The structural determinants for each pair of countries together with the estimated regression coefficients are used to compute the bilateral trade potentials. The level of bilateral trade between a pair of countries is compared relative to their trade potential to categorize bilateral exports as overtraded or undertraded, depending on the comparison between realized bilateral export values and the model's predictions. In addition, a country's Services Trade Restrictions Index (STRI) of the World Bank Services Trade Restrictions Database is included in the regression to assess if these are important determinants in explaining the level of bilateral services trade between ASEAN countries.

3. Bilateral trade flows are from the Trade in Services Database developed by Francois and Pindyuk (2012), which covers bilateral service flows for 248 countries across a multitude of service sectors on a cross-border basis. It uses multiple sources of bilateral trade data based on balance-of-payments statistics, including the OECD, Eurostat, United Nations, and International Monetary Fund. Its advantage over the original source data is that it provides broader coverage, since it is based on mirror flows (deducing a country's export values from its partners' import values). However, only data on cross-border trade (Mode 1) and consumption abroad (Mode 2) can be collected in the dataset, since these are reported in the balance-of-payments statistics of countries' national accounts. FDI (commercial presence or Mode 3) remains an important channel for foreign providers to supply services.

4. It should be noted that the quality of trade data for services is still far from being comparable to trade data for merchandise goods. Due to the long tradition of tariff revenues, trade data for goods have been collected with quite high quality and accuracy. Due to intangibility and nonstorability of services, at-the-border duties cannot be applied to services, which has resulted in much weaker compilation practices, with considerably less accuracy. Thus, the Trade in Services Database should be seen in this light as the best currently available approximation of a comprehensive picture of global trade flows in services.

5. Specifically, the average 2008–09 bilateral exports for 102 countries is regressed on the following country-specific and bilateral characteristics: log of distance, dummy variables for contiguity, common language, common colonial power, STRI of exporter and importer, and log of GDP of exporter and importer to proxy for economic mass. The results of the estimation are presented in the first column of results in table B.1.

6. An alternative specification for the gravity equation is also estimated in which the economic mass variable is picked up not by GDP, but by importer and exporter fixed effects (referred to as a dyadic gravity equation). In this specification, bilateral exports for 198 countries is regressed on log of distance and dummy variables for contiguity, common language, and common colonial power. Only bilateral characteristics can be included in the dyadic model, since the nation dummies prevent the inclusion of country-specific variables such as GDP and the STRI. However, this second specification controls for all country-specific factors that affect bilateral trade flows, and thus also corrects for unobservable omitted variables that could

be present in error terms of the first specification (also potentially biasing the point estimates). The results of the estimation are presented in the second column of results in table 1.B.1 (the coefficients on the fixed effects are repressed to save space).

Table 1.B.1 Gravity Model of Trade in Services

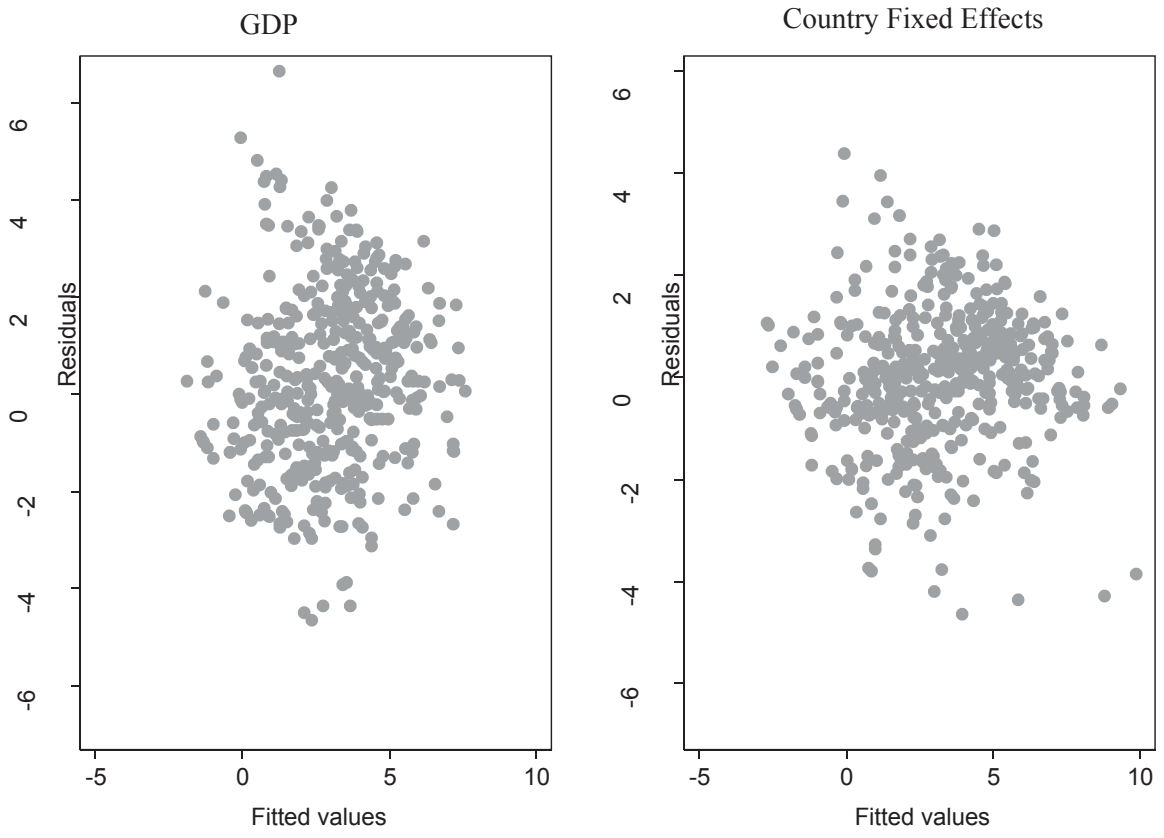
Dependent Variable: log(export value)	Coefficient Estimates	Dyadic Coefficient Estimates
Log(distance)	-0.8526***	-0.9059***
	(0.037)	(0.029)
Contiguity	0.3454**	0.4285***
	(0.168)	(0.110)
Common language	0.9000***	0.4314***
	(0.124)	(0.082)
Common colonial power	0.3089	0.6241***
	(0.217)	(0.109)
Importer STRI	0.0012	
	(0.003)	
Exporter STRI	-0.0141***	
	(0.003)	
Log(importer GDP)	1.0866***	
	(0.021)	
Log(exporter GDP)	1.0808***	
	(0.021)	
Observations	2,533	4,925
Adjusted R-squared	0.700	0.813

Sources: Authors' calculations using data from World Bank *World Development Indicators*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and Centre d'Études Prospectives et d'Informations Internationales (CEPII).
Note: Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

7. The results of the gravity model show that the STRI of the exporting country matters in determining the bilateral exports of that country. Countries with more restrictive services regulatory environments are significantly less likely to export services. The relationship between the level of services restrictions in the importing country and their bilateral services imports is not found to be statistically significant. However, only data on cross-border trade (Mode 1) and consumption abroad (Mode 2) can be collected in the dataset. The importance of FDI (commercial presence or Mode 3) as a channel for foreign providers to supply services could be one potential explanation for the insignificant coefficient on the importer STRI, since these service flows are not captured in the database.

8. Fixed effects (dyadic) estimations control for a wide variety of country-specific factors that affect bilateral trade flows. In other words, they control for the omitted variables that are too difficult to measure directly and that influence the ability of a country to trade, beyond what its economic mass suggests. This includes all country-specific (nonbilateral) trade policy barriers, beyond what can be measured by, for example, the STRI. In contrast, these nonmeasurable country-specific characteristics fall into the residual in the specification where GDP proxies economic mass. Figure 1.B.1 plots the residuals on the y-axis against the model's fitted values on the x-axis for the dyadic specification, and a specification that does not correctly control for such barriers. To properly make the comparison, the STRI has been removed from the specification to see more clearly what happens when these barriers (beyond distance and common language, for example) are not accounted for. Once properly controlling for these other obstacles in the specification with fixed effects, fitted values perform better.

Figure 1.B.1 Residuals Compared to Fitted Values Estimated with GDP and Fixed Effects, 2008–09



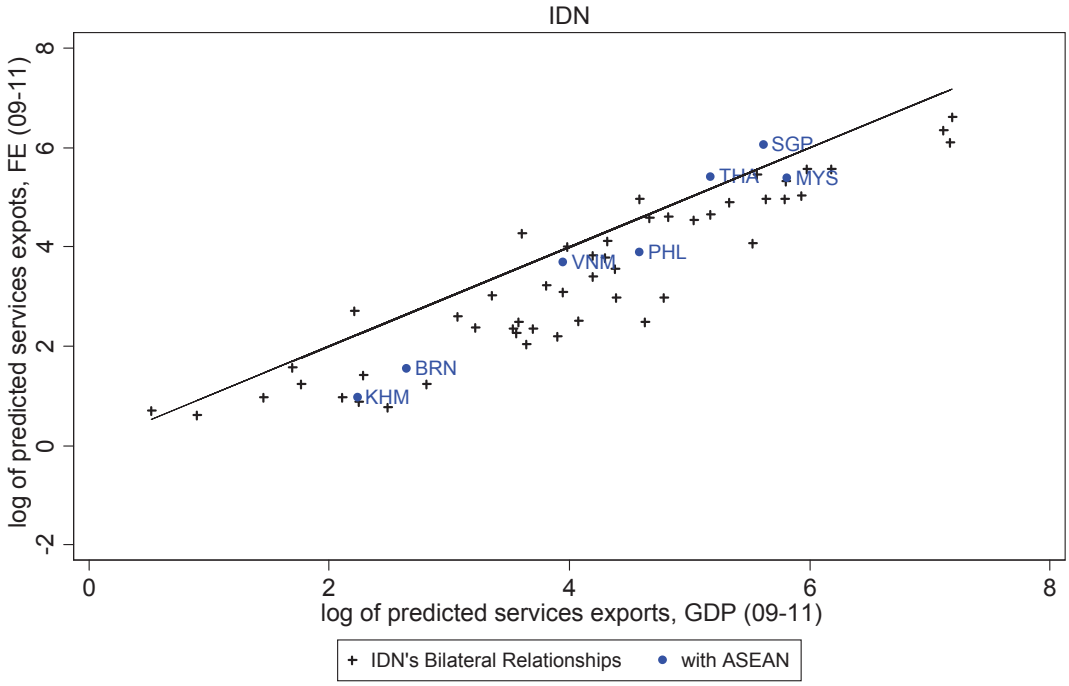
Sources: Authors' calculations using data from World Bank *World Development Indicators*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and CEPII.

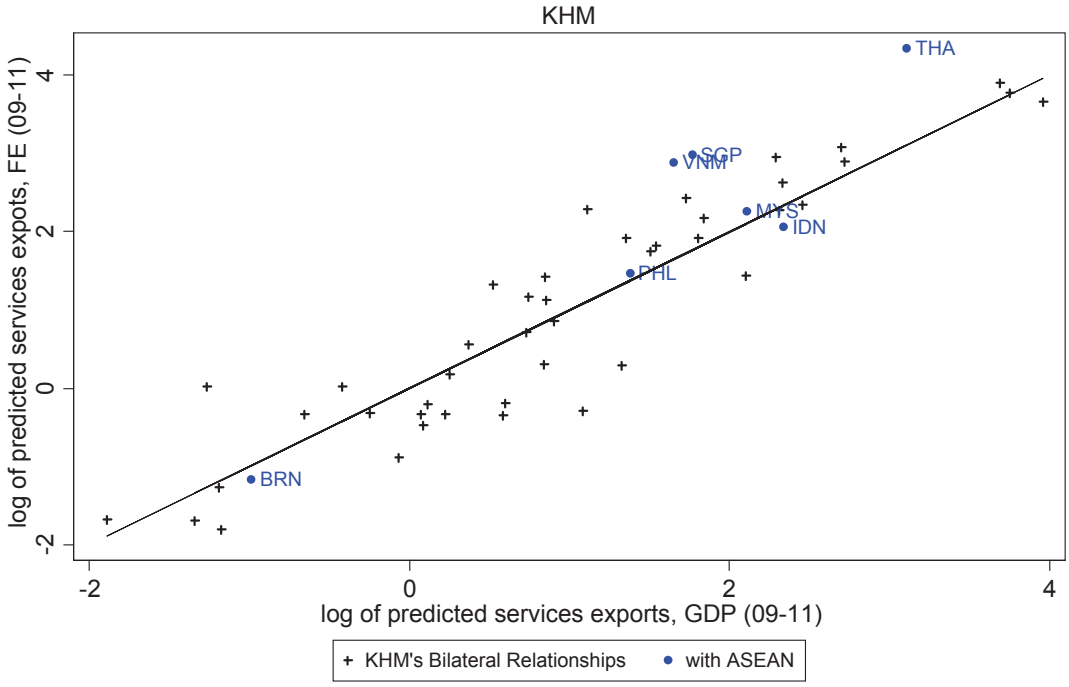
9. This is more clearly illustrated when comparing the differences in trade potential predicted by each of the two models (the dyadic and the specification with economic mass but without the STRI). Figure 1.B.2 plots for each ASEAN country the predicted bilateral trade levels from the specification with GDP

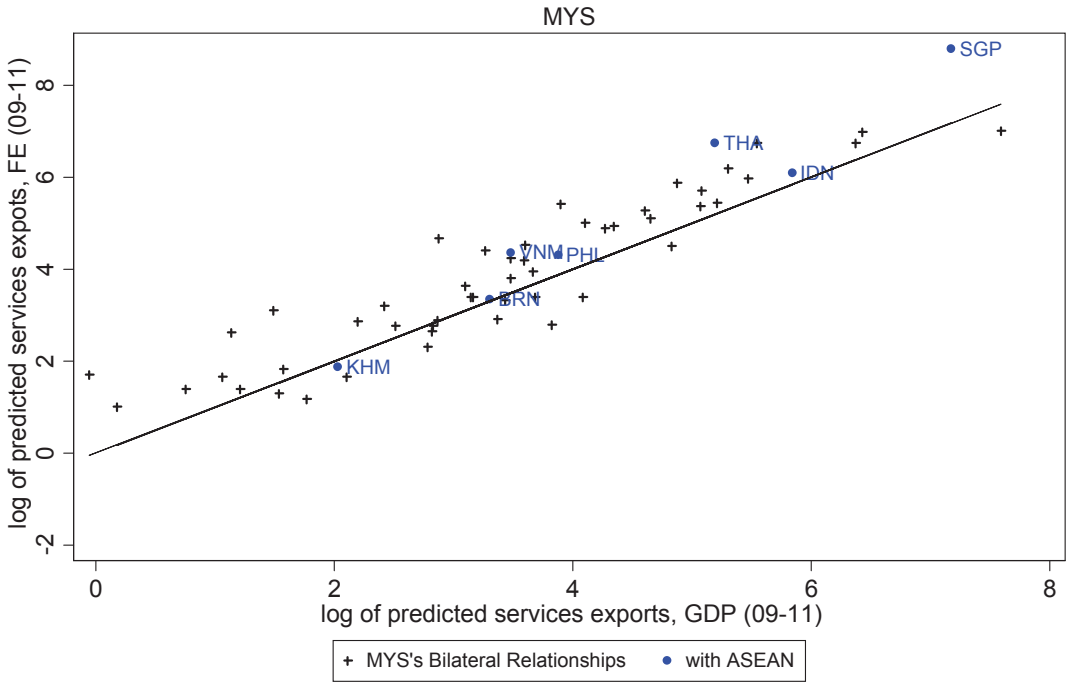
on the x-axis against the predicted levels from the specification with fixed effects (the dyadic gravity model) on the y-axis, in light gray dots. In the figure, each ASEAN country's bilateral exports with other ASEAN countries are in black and are labeled according to their three-digit International Organization for Standardization (ISO) code. Also included in each plot is a 45-degree line. Observations lying below the 45-degree line show that the predicted levels from the specification with fixed effects are lower than the specification with GDP. Because the specification with fixed effects properly controls for country-specific barriers to trade, such a result would suggest that there exist barriers to trade at the national level that are lowering a country's trade potential.

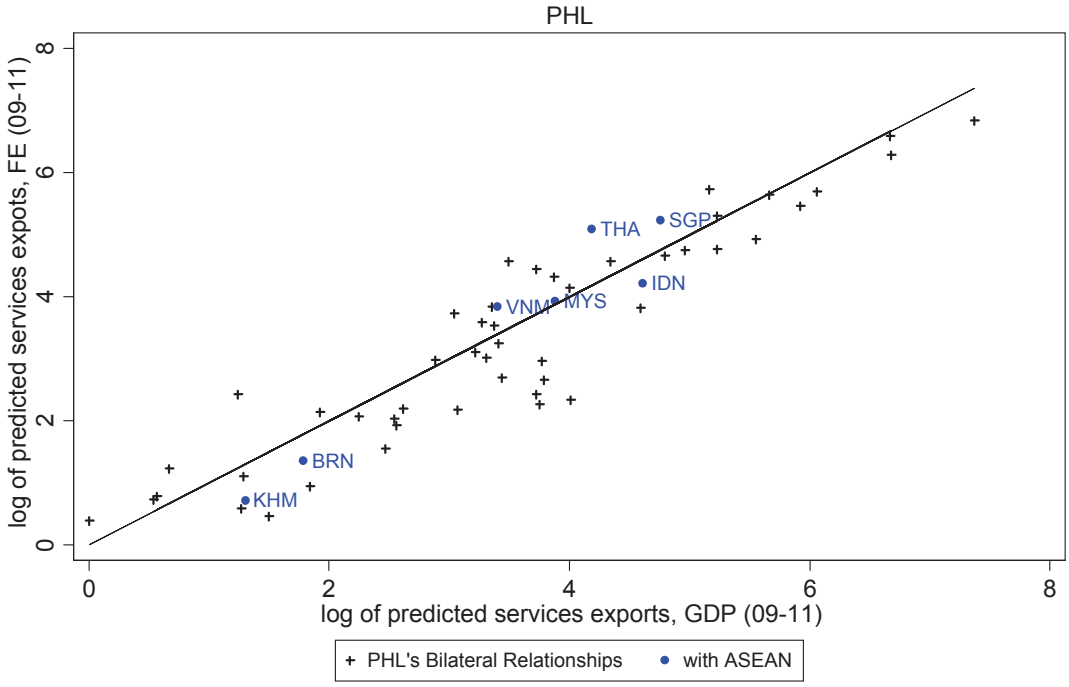
10. Since many observations lie below the 45-degree line, this shows that the predicted levels from the specification with fixed effects are lower than with GDP. Thus, lower potential trade after properly controlling for country-specific obstacles to trade suggests that these barriers are deterring services trade between many ASEAN countries of interest, in particular, but also with other countries in the world. Interestingly, this does not seem to be the case, however, for Malaysia and Thailand. This result is something to be explored further, but in general could suggest that high regulatory restrictions and low regulatory governance (as captured by the STRI, for example) are dampening trade potential.

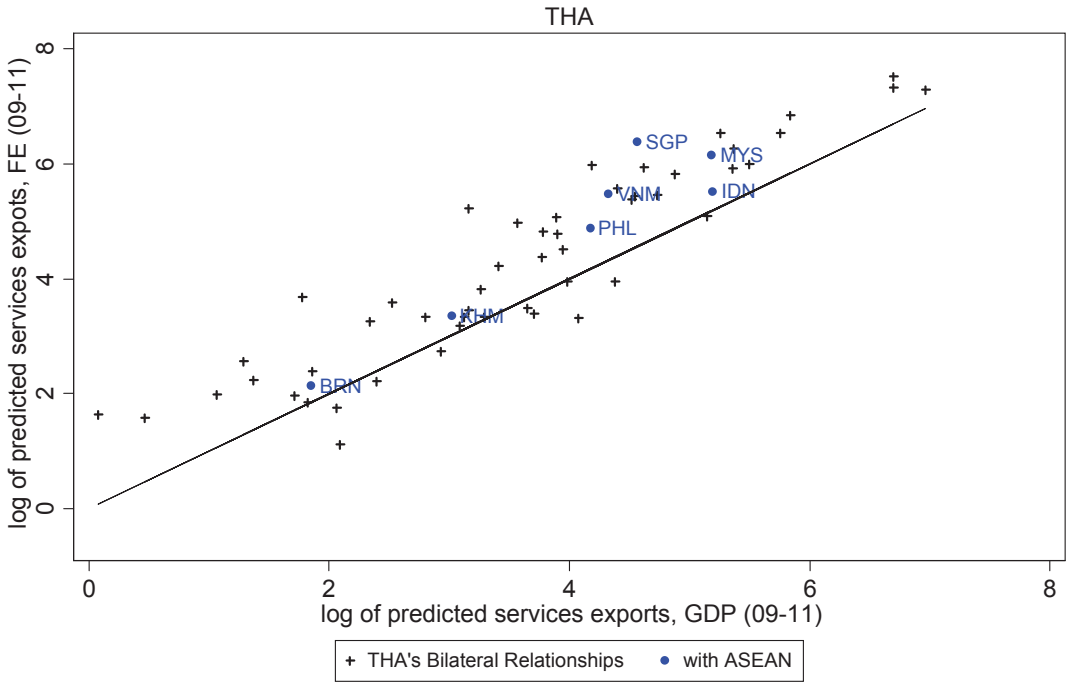
Figure 1.B.2 Predicted Trade Estimated with GDP and Fixed Effects, 2008–09

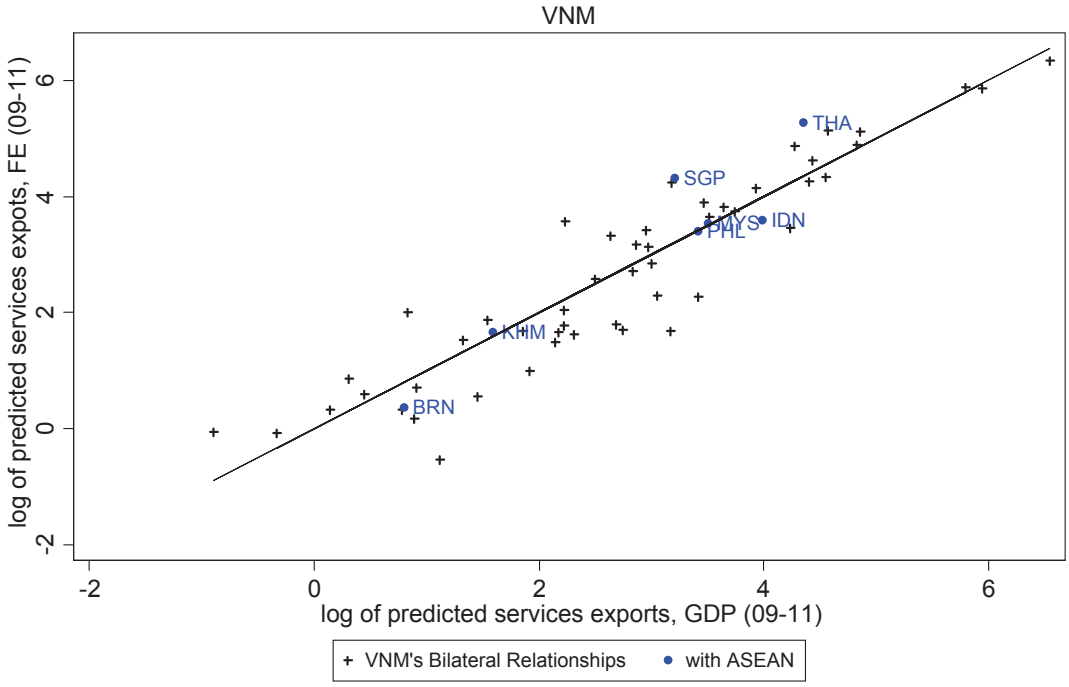



KHM
THA
SGP
VNM
MYS
IDN
PHL
BRN
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
-2
0
2
4
KHM's Bilateral Relationships
with ASEAN


MYS
SGP
THA
IDN
VNM
PHL
BRN
KHM
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
-2
0
2
4
6
8
MYS's Bilateral Relationships
with ASEAN


PHL
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
THA
SGP
IDN
VNM
MYS
BRN
KHM
0
2
4
6
8
PHL's Bilateral Relationships
with ASEAN


THA
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
SGP
MYS
VNM
IDN
PHL
KHM
BRN
0
2
4
6
8
THA's Bilateral Relationships
with ASEAN



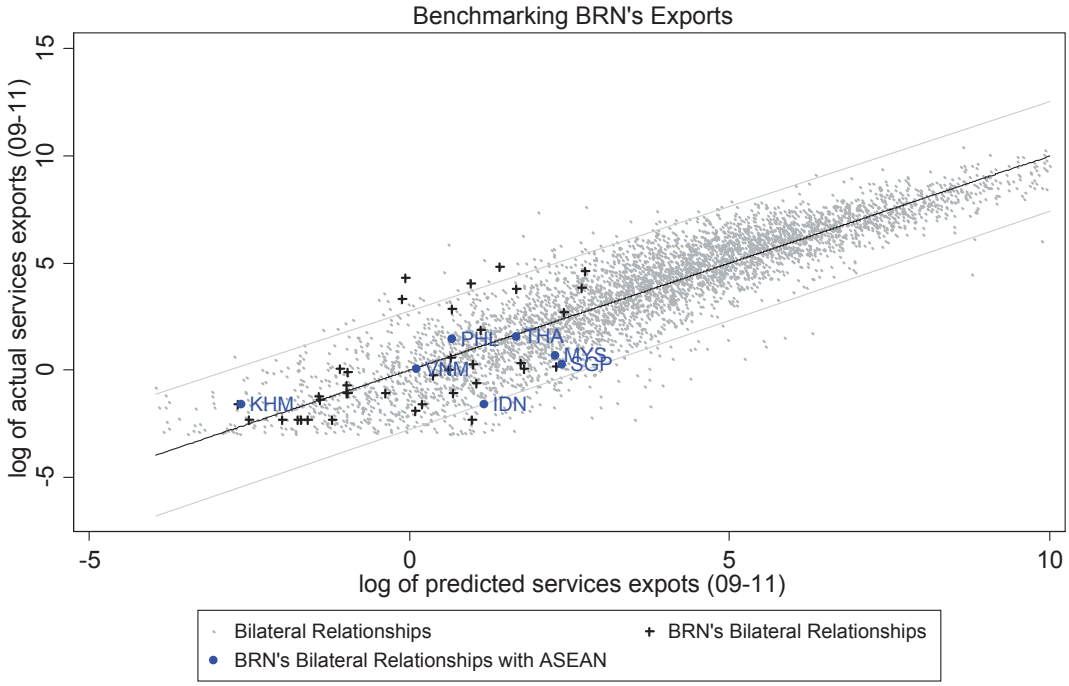
Source: Authors' calculations using data from World Bank *World Development Index*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and CEPII.

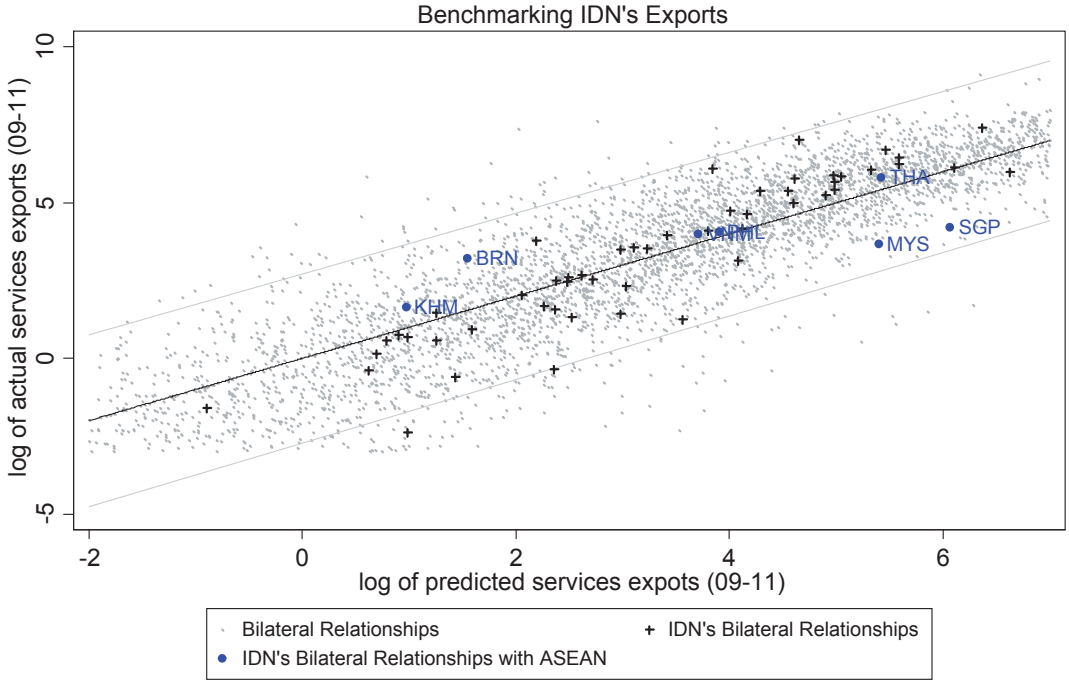
11. Figure 1.B.3 shows each ASEAN country's actual and predicted bilateral export relationships (given by the dyadic gravity equation) in this dataset, in light gray dots. Bilateral trade between ASEAN countries of interest are in black and are labeled according to their three-digit International Organization for Standardization (ISO) code. If an observation is above the 45-degree line, the average observed export relationship during 2008–09 is more than what the gravity model predicts—on the basis of countries' structural determinants—and the exporter is said to be overtrading with its trading partner. If an observation is below the 45-degree line, the average observed export relationship during 2008–09 is less than what the gravity model predicts—on the basis of countries' structural determinants—and the exporter is said to be undertrading with its trading partner.

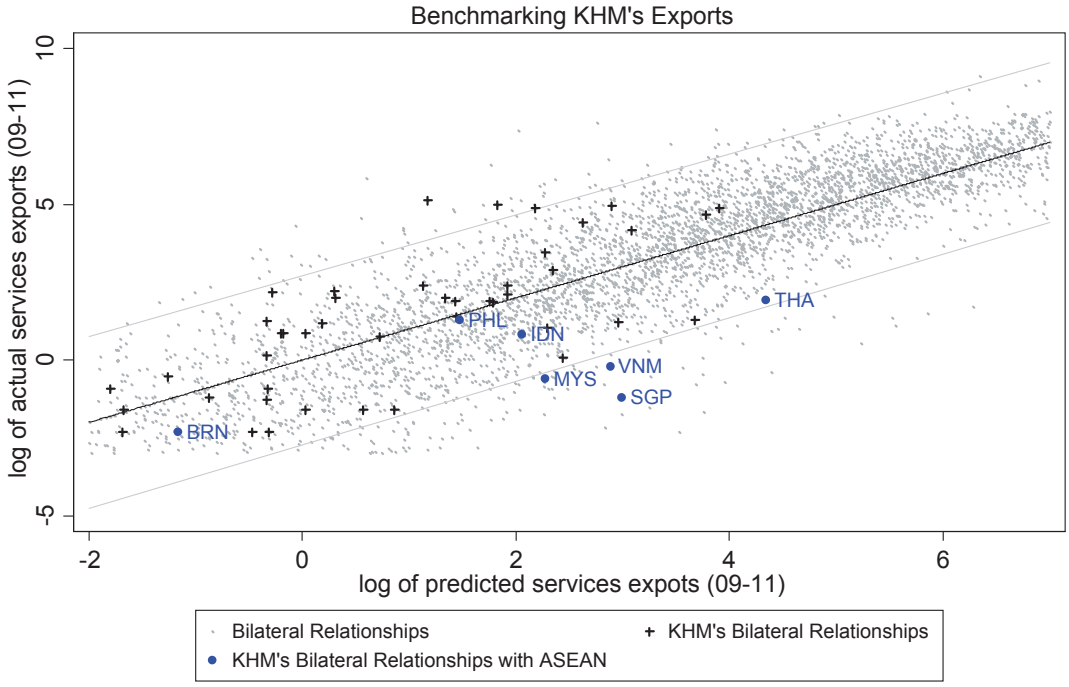
12. Gravity trade model estimates indicate that the estimated potential trade volumes predicted by structural trade determinants vary in comparison to the realized intraregional trade values between 2008 and 2009 for different countries in the region. While some countries appear to be overtrading, others undertrading, and still others trading at their potential, all ASEAN countries are shown to underexport with Malaysia and Singapore (and Malaysia and Singapore with each other). There also appears to be scope for countries such as Brunei Darussalam, Cambodia, Malaysia, and Singapore to increase services exports with select countries in the region.

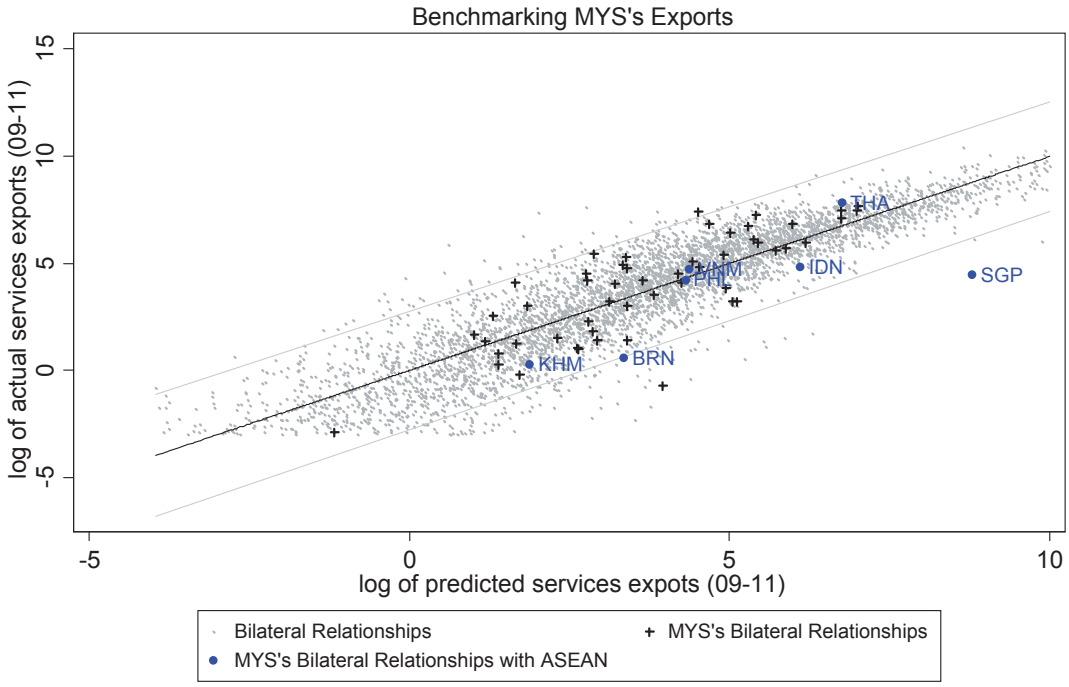
13. At the same time, the results comparing the two separate specifications also show that some countries' trade potential is dampened when the model specification accounted for unobserved country-specific characteristics. This suggests there may be limited scope for further trade integration in the region, unless structural domestic reforms are implemented in the participating countries. Thus, undertrading in services may suggest the existence of untapped potential to increase exports among these countries via the removal of trade-related obstacles. Similarly, removal of such obstacles would increase countries' potential and could explain the result of overtrading.

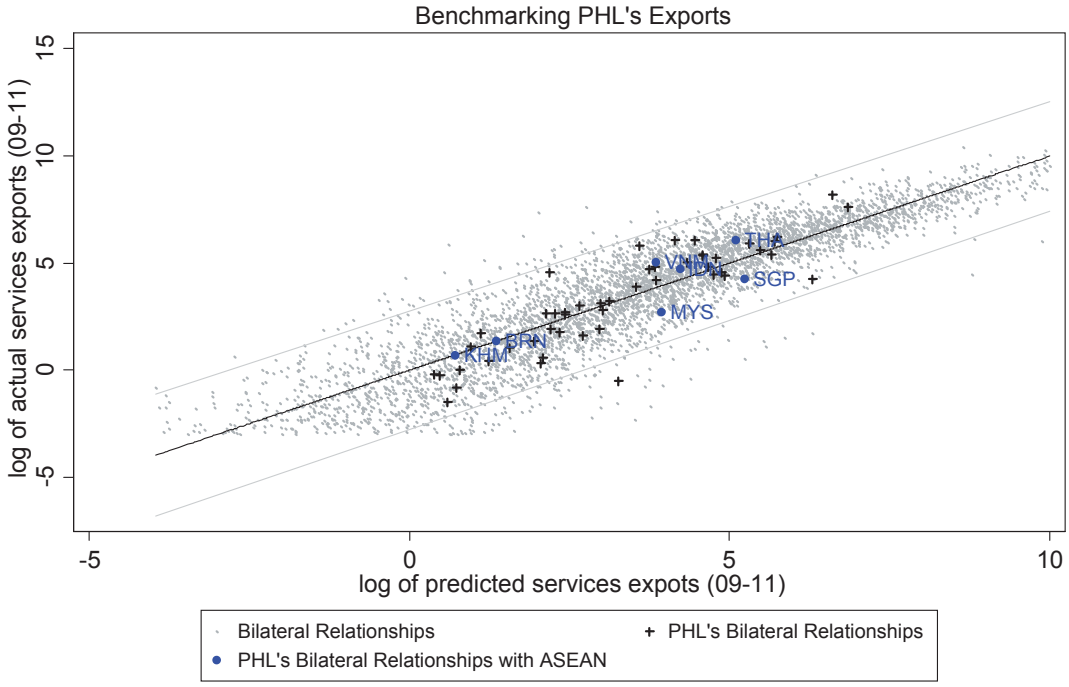
Figure 1.B.3 Gravity Model of Trade in Services, 2008–09






Benchmarking KHM's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
10
5
0
-5
-2
0
2
4
6
THA
PHL
IDN
VNM
MYS
SGP
BRN
Bilateral Relationships
KHM's Bilateral Relationships
KHM's Bilateral Relationships with ASEAN


Benchmarking MYS's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
15
10
5
0
-5
-5
0
5
10
THA
VNM
PHL
IDN
SGP
KHM
BRN
Bilateral Relationships
MYS's Bilateral Relationships
MYS's Bilateral Relationships with ASEAN


Benchmarking PHL's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
15
10
5
0
-5
-5
0
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THA
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IDN
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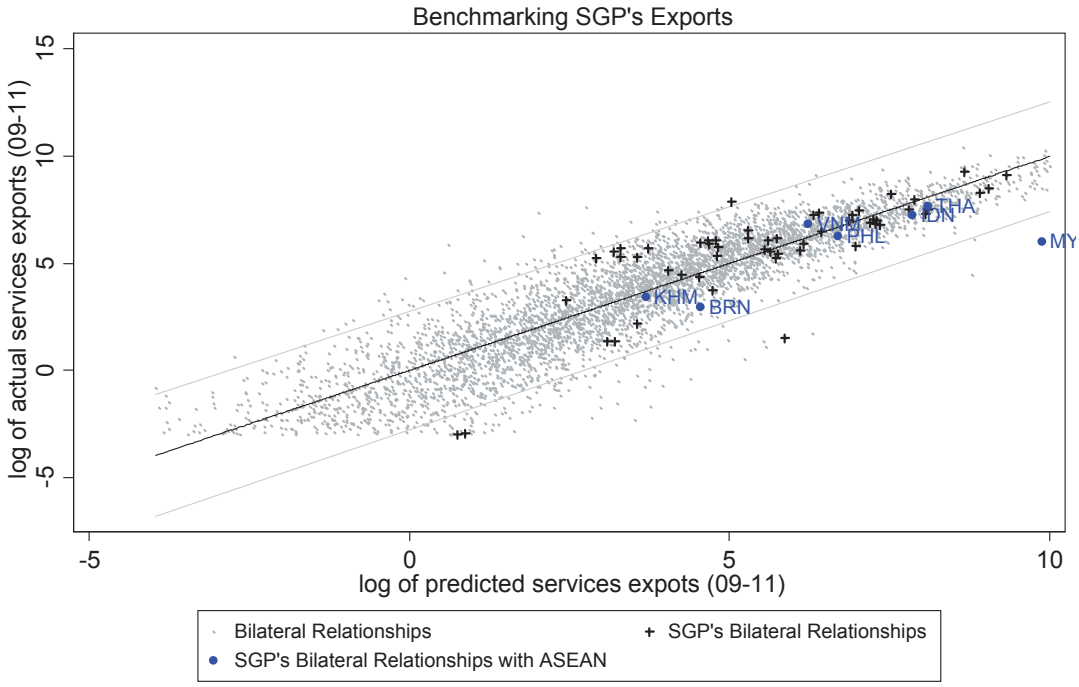
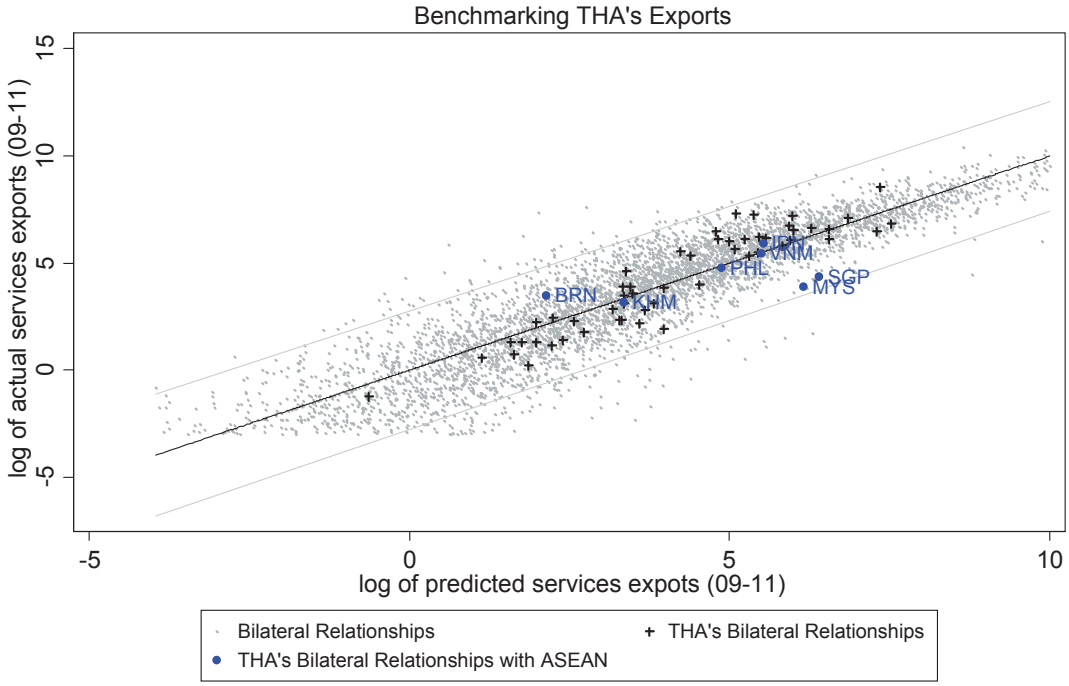
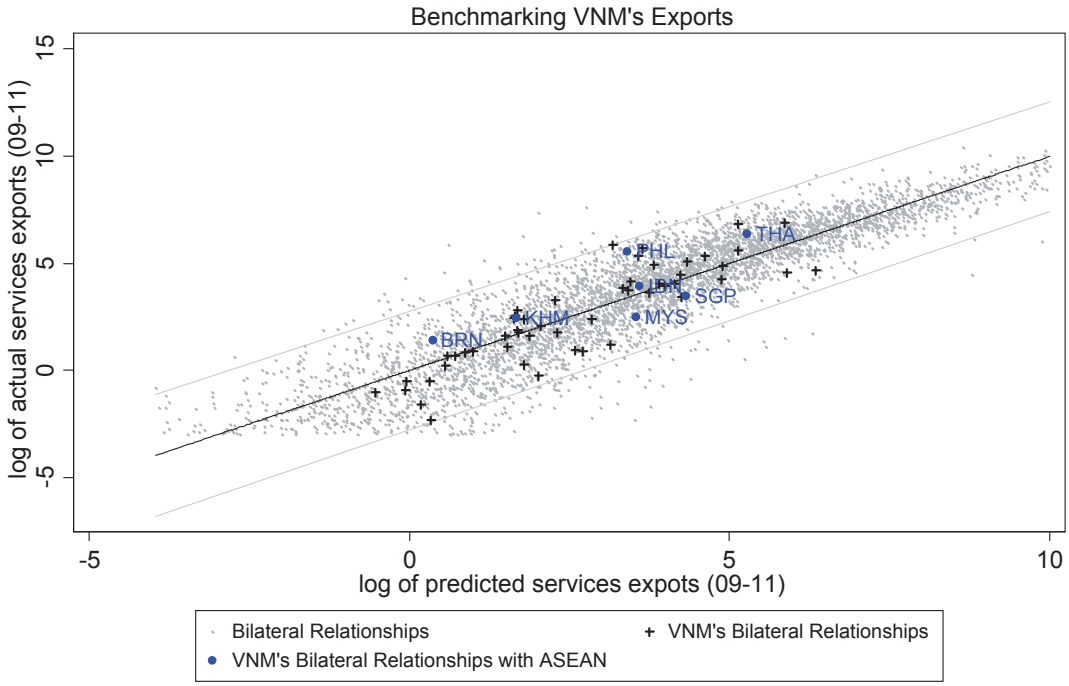
MYS
BRN
KHM
Bilateral Relationships
PHL's Bilateral Relationships
PHL's Bilateral Relationships with ASEAN


Benchmarking SGP's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
15
10
5
0
-5
-5
0
5
10
THA
VNM
IDN
PHL
MY
KHM
BRN
Bilateral Relationships
SGP's Bilateral Relationships
SGP's Bilateral Relationships with ASEAN





Source: Authors' calculations using data from World Bank *World Development Indicators*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and CEPII.

Chapter 2. Policy Barriers to Services Trade in ASEAN

Can regionalism do what multilateralism has so far failed to do—promote greater openness of services markets? While previous research has pointed to the wider and deeper legal commitments under regional agreements as proof that it can, no previous study has assessed the impact of such agreements on applied policies. This chapter focuses on the ASEAN region, where regional integration of services markets has been linked to the thriving regional supply chains. Drawing on surveys in 2008 and 2012 of applied policies in the key service sectors of ASEAN countries, this chapter assesses the impact of the ASEAN Framework Agreement on Services (AFAS) and the ambitious ASEAN Economic Community Blueprint, which envisages integrated services markets by 2015. The finding is that the measures applied to ASEAN countries' trade with each other are for the most part the same as the measures applied to trade with the rest of the world. Recent commitments scheduled under the AFAS are found to have produced moderate liberalization and, in a few instances, services trade policy seems to have taken a more cautious approach. The two exceptions are in areas that are not on the multilateral negotiating agenda: in air transport, steps have been taken toward creating regional open skies; and in professional services, a few mutual recognition arrangements have been negotiated. These findings suggest that regional negotiations add most value when focused on areas that are not being addressed multilaterally.

A. Overview

1. **Since the WTO's Doha Agenda failed to deliver meaningful services liberalization, many countries are turning to regional forums in the hope of greater success.** That raises the question of whether regionalism can do what multilateralism has failed to do, that is, promote greater openness of services markets. While previous research has pointed to the wider and deeper legal commitments under regional agreements as evidence that it can (for example, Marchetti and Roy [2008]; Fink and Molinuevo [2008]; Mattoo and Sauvé [2011]), no previous study has assessed the impact of such agreements on *applied policies*. The ASEAN region merits study because it is widely believed to be at the frontier of what Baldwin (2011) has called "globalization's second unbundling," with regional integration of services markets linked to the thriving regional supply chains. Drawing on surveys in 2008 and 2012 of applied policies in the key service sectors of ASEAN countries, this chapter assesses the impact of the ASEAN Framework Agreement on Services (AFAS) and the ambitious ASEAN Economic Community Blueprint, which envisages integrated services markets by 2015. The analysis on ASEAN's commitments under AFAS contained in this Report is limited to the eighth AFAS package in a wide range of service sectors under the purview of ASEAN Economic Ministers, fifth package in financial services under the purview of ASEAN Finance Ministers, and commitments in air transport services signed under the MAAS and MAFLPAS treaties signed under the Purview of the ASEAN Transport Ministers. ASEAN continues to improve its commitments under AFAS. Recently, the Protocol to Implement the Sixth Package of Financial Services Commitments was signed in March 2015 by the ASEAN Finance Ministers while the signing of the Protocol to Implement the Eight Package of Commitments on Air Transport Services was completed on 19 November 2014.

2. **With these caveats, this chapter addresses four questions.** How open are ASEAN services markets? Have these markets become more open since 2008, when the first policy survey was conducted soon after they agreed on the far-reaching ASEAN Economic Community Blueprint? Is ASEAN integrating faster internally than with rest of the world? How far have the ASEAN countries implemented their commitments under the AFAS, and how far are they from meeting the market integration goal set out in the Blueprint?

3. **The stark conclusion based on the analysis is that the recent commitments scheduled under the AFAS may have created greater regional policy certainty, but have in general produced moderate liberalization within ASEAN.** One consequence of these agreements—which cover primarily intra-ASEAN—could have been that ASEAN countries would today be more open vis-à-vis each other than vis-à-vis non-ASEAN countries. For the most part, they are not. For the seven broad sectors (and relevant modes) covered by the survey for ASEAN, the gap found between policy treatment of intra-ASEAN and extra-ASEAN trade is modest.

4. **The agreements have also promoted, at best, modest openness vis-à-vis countries outside the region.** First, ASEAN countries have higher Services Trade Restrictions Indexes (STRI) than any other region of the world on average, except the Gulf States. The average STRI for the region is 60 percent higher than the global average. But restrictiveness of applied policies varies across countries and income levels. Cambodia and Singapore have the most open policies in the sectors covered (see paragraph 10 below). Myanmar and Vietnam are fairly open, with a few restrictions, which are higher in most of the rest of the countries (Indonesia, Malaysia, the Philippines, and Thailand). The second reason that the agreements seem to have promoted only modest openness generally is because the trade liberalization in ASEAN countries, while encouraging in some respects, has proceeded unevenly during the last four years. While there are some instances of market opening, there are also instances of slight backtracking. For the six ASEAN Member States for which the same surveys were conducted in 2008, there was little change in the overall policy regime as of 2012 (the regional average STRI fell only about 16 percent from its high level). As a consequence, even though actual openness is greater than that promised by current AFAS commitments, there is still room for improvement to achieve the goals specified in the Blueprint. Nevertheless, the AFAS commitments have served the valuable purpose of reducing policy risks.

5. **There are two exceptions to these conclusions: in air transport, where ASEAN countries have taken some steps toward regional open skies; and in certain professional services, where some mutual recognition arrangements (MRAs) have been negotiated.** Even in these areas, the regional integration efforts are still ongoing: in professional services, domestic regulations are still in the process of being aligned with the ASEAN MRAs; and in air transport, further liberalization would help achieve a more integrated regional air market. Nevertheless, these initiatives suggest that regionalism could have incremental value when it focuses on areas that are not being addressed multilaterally (Mattoo and Fink 2004).

6. **There are some broad caveats to the analysis presented here.** Market access in many of the countries, as in other parts of the world, remains difficult to predict. From banking to transport, entry may be restricted by the explicit and implicit limits on new licenses, and the licensing process tends to be opaque and discretionary. In several ASEAN countries, licenses and foreign equity ownership are decided on a case-by-case basis, subject to requirements or approvals that involve several regulators and ministries. Some countries in certain sectors have no regulation at all, especially the lower-income countries in the region and pertaining to the supply of services through the cross-border and consumption abroad modes. In some of these cases, the supply of services is allowed in practice, while in others it is prohibited. In general, the high level of discretion and the absence of regulation creates a less predictable policy environment and makes it difficult to accurately define and assess the policy regime.

7. **Section B of this chapter describes the nature of services trade policy data and how it was collected and verified.** Section C presents the ASEAN policy patterns and places them in a global context. Section D takes a closer look at the policy measures used by ASEAN countries, highlighting certain aspects of the regulatory environment. Section E assesses whether ASEAN countries liberalized their policies between 2008 and 2012. Section F examines instances of where ASEAN countries are becoming more open vis-à-vis each other and provides two examples. Section G compares the regional and multilateral commitments of ASEAN countries with actual policy. Section H concludes.

B. Services Trade Policy Data and Measurement

8. **A detailed description of the original World Bank Services Trade Restrictions Database—including details on the data collection process, the policy measures covered, and the survey questionnaire used in the data collection—is provided in Borchert, Gootiiz, and Mattoo (2012a) and in supplementary material available at http://iresearch.worldbank.org/servicetrade.** The global policy patterns of services trade policy emerging from the database are presented in Borchert, Gootiiz, and Mattoo (2013). Here, the focus is on updating the 2012 information on the six ASEAN countries covered in the original 2008 survey, and on collecting information for the four ASEAN countries not previously covered.[10]

9. **The 2012 ASEAN survey focused, as did the earlier surveys, on policies that affect international trade in services, defined, as is now customary, to include the supply of a service through cross-border delivery, consumption abroad, establishing a commercial presence, or the presence of a natural person.** The perspective is one of a foreign supplier who wishes to provide services to a particular country, and the focus here is mainly on policy measures that discriminate against foreign services or service providers.

10. **The 2012 surveys updated the policy information obtained from the previous surveys of 2008 for Cambodia, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam, and collected information for the first time for Brunei Darussalam, Lao PDR, Myanmar, and Singapore.**[11] The data collection process follows the same method used by the Services Trade Restrictions Database, but with a few changes. First, some new sectors and modes have been added to the questionnaire to reflect the regional liberalization priorities of ASEAN countries.[12] These include education, medical, architecture, engineering, and management consulting, as well as the cross-border mode in road transportation. Second, the questionnaire is designed to identify differences in intra-ASEAN and extra-ASEAN policy regimes in services, and in particular, instances of regional liberalization and preferences. Third, more than in earlier surveys, this survey examines whether there is in fact a regulation or policy in place for each specific subsector mode to take into account the conditions in countries like Lao PDR and Myanmar. The implications of the absence of explicit regulation or policy are also assessed, such as whether there are any implicit limits on the number of licenses allocated.

11. **The seven major service sectors are disaggregated into further subsector modes (as shown in Annex table A.2.2 at the end of this chapter): financial (banking and insurance), education (higher education), medical, telecommunications, retail distribution, transportation, and professional services (accounting, legal, architecture, engineering, and management consulting).** Within each subsector, the database covers the most relevant modes of supplying the respective service: cross-border trade in services (Mode 1) in financial, transportation and some professional services; establishing commercial presence or FDI (Mode 3 in WTO parlance) in every subsector; consumption abroad in education and medical services, and the presence of service-supplying individuals (Mode 4) in professional services.[13] The survey focuses on each country's most-favored nation (MFN)[14] policies affecting trade with

[10] Policy data collected via surveys for ASEAN Member States are not publicly available yet.
[11] The Brunei survey was delayed because there is inadequate information on its policies.
[12] The choice of sectors in the original database was based primarily on the assessment of their economic importance from a development perspective, and on the existence of meaningful restrictions on services trade.
[13] Regarding policies governing cross-border (Mode 1) trade in international air passenger transportation services, the WTO's QUASAR database has been used since it represents the most comprehensive source available on bilateral air services agreements, covering over 2,000 agreements.
[14] "Most-favored-nation," or MFN, means the country that is the recipient of this treatment must receive equal trade advantages as the "most favored nation" by the country granting such treatment.

non-ASEAN member countries, and its intra-ASEAN preferential policies affecting trade with other ASEAN member countries.

12. **The primary focus of the survey was to gather information on policies and regulations that restrict trade in services.** Measures that explicitly discriminate against foreign services or service providers impede trade almost by definition, and thus all these measures belong in the database. But these are not the only measures that obstruct trade. Certain measures that on the face of it do not discriminate against foreign service providers may nevertheless restrict trade. First, quantitative restrictions, such as those that limit the total number of providers, could hurt trade by preventing foreign entry, even though they also limit domestic entry. Second, regulations such as qualification and licensing requirements ostensibly address the asymmetric information problem in certain service sectors, but can impose a disproportionate burden on foreign providers, such as professionals who have already met these requirements in their home countries. Third, in some sectors the *absence* of regulations, such as those that ensure all (domestic and foreign) entrants have access to essential facilities such as ports and telecommunications networks, can be seen as a "sin of omission" because without such access, entry may not be feasible. To cover each possible sin of commission or omission in all sectors is virtually impossible, but the attempt here is to include at least those that are likely to have a significant trade impact.

13. **For each mode, the measures differ depending on the sector.** In general, for Mode 3, a core set of measures across sectors are used, which are supplemented with sector-specific measures, for example, limits on the size of loans in retail banking, and restrictions on the international gateway in telecommunication. The core set of measures that pertain to Mode 3 fall into the following four broad categories: requirements on the legal form of entry and restrictions on foreign equity, limits on licenses and discrimination in the allocation of licenses, restrictions on ongoing operations, and relevant aspects of the regulatory environment.

14. **Measures governing** M**ode 1 are slightly different in that they typically stipulate conditions under which cross-border trade may take place, rather than conditions imposed on the service provider.** Mode 4 measures, covered only in professional services, focus on qualification and (re-) certification requirements, as well as entry and immigration rules, all of which strongly affect the movement of service-supplying individuals. The challenge in evaluating policy measures is to assess whether prudential or regulatory measures affect contestability of the market by restricting entry of foreign suppliers (Findlay and Warren 2000). While an effort is made to capture the important licensing regulations in professional services where they have a significant impact on trade, in future work more could be done to improve the coverage in this database of such measures in areas like financial services. Finally, to understand how the policy was measured and became the Services Trade Restrictiveness Index (STRI), please see the detailed note on the scoring in the Annex 2.1.

15. **First-hand information for ASEAN Member States was collected by administering a questionnaire in 2012 that was completed by local law firms familiar with the policy regime in the respective countries and sectors.** The information on policies received was evaluated, and its restrictiveness assessed, by a team of World Bank economists. To ensure data accuracy, the policy information was reviewed by government officials between March and May of 2013. Upon receiving government comments, the policy information and scores were revised. This chapter is based on the data that have been reviewed and validated by the government officials.

16. **It is notoriously difficult to quantify policies affecting services trade because of their variety and complexity** (see, for example, Hoekman [1996] and the overview by Deardoff and Stern [2008]). Instead, this chapter relies on a measure of the restrictiveness of a country's policy regime for any subsector mode, the STRI, which has the weakness of being subjective but the virtue of being simple, transparent,

and robust (Borchert, Gootiiz, and Mattoo 2012a).[15] This measure is most convenient for depicting overall patterns in policy, across countries, modes, and sectors. Essentially, the approach here is to assess policy regimes in their entirety and assign them into five broad categories: completely open, that is, no restrictions at all; completely closed, that is, no entry allowed at all; virtually open but with minor restrictions; virtually closed but with very limited opportunities to enter and operate; and a final residual "intermediate" category of regimes, which allows entry and operations but imposes restrictions that are neither trivial nor stringent. It is convenient to assign a value to each of these five categories of regimes on an openness scale from 0 to 1, with intervals of 0.25. The resulting score is called the Services Trade Restrictions Index (STRI). Once a score has been attached to each regime, STRI values can be aggregated across sectors and modes of supply, taking weighted averages that reflect the importance of the different modes in each sector and the individual sectors in a standardized country. A detailed description of the quantification method is provided in Annex 2.1.

C. How Open are the Services Markets of ASEAN Countries?

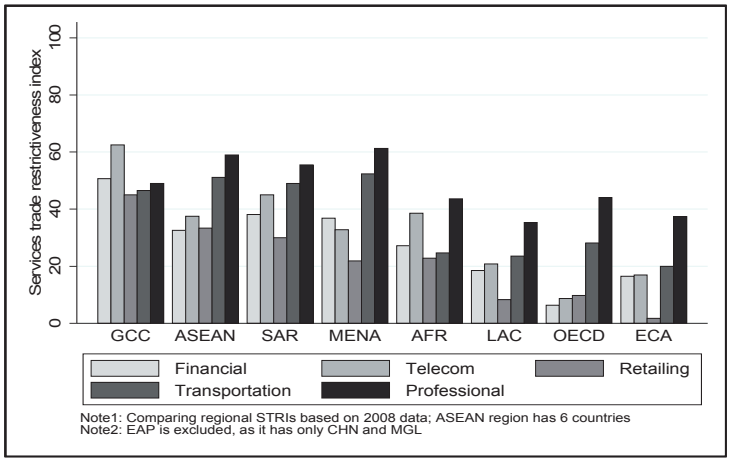
17. **The comparison of STRIs shows that ASEAN had on average higher STRIs than other regions in the world, except for the Gulf States.** The average STRI for the region was 60 percent higher than the global average. Figure 2.1 compares the sectoral policies of the ASEAN region with other regions of the world. It reveals that the policies of ASEAN countries were less restrictive on average than those of the countries of the Gulf Cooperation Council, were comparable to those of countries in South Asia, the Middle East, and North Africa, but were more restrictive than those of countries in Africa, Latin America and the Caribbean, high-income OECD countries, and Eastern and Central European countries. The country-level STRI shows that most of the individual ASEAN countries had higher STRIs than the global average at the corresponding levels of income, except for Singapore, Cambodia, and Myanmar. Figure 2.2 provides a comparison of the policies of individual ASEAN countries in five key sectors.[16] It is useful to look more closely at the nature of these policies.

18. **Financial services. As of 2012, when the survey was conducted**, banking sector policies in Malaysia, Thailand, and Vietnam were more restrictive than in the other countries, because they restricted greenfield entry (that is, the establishment of new financial entities rather than the acquisition of existing ones) and operations. In Thailand, the limit on foreign ownership in a "local bank" was 49 percent. However, such shareholding requirements could be relaxed with prior approval from the Ministry of Finance in cases where it is needed to strengthen operations and enhance financial stability. A foreign-owned subsidiary faced no limit on foreign equity participation, but there was a limit on operations: the number of branches allowed per subsidiary is 20, with an additional 20 off-premise ATMs, resulting in a total of 40 points of access. Foreign bank branches could operate up to three branches or off-premise ATMs without a location limit. In the Philippines, greenfield entry was no longer possible since the license limit of 10 has been reached, and for acquisition, the foreign ownership limit is 60 percent. (However, under the Republic Act (R.A.) No. 10641 enacted in 2014, after the policy survey was conducted, foreign banks can now apply to operate in the Philippines either as a branch or as a wholly owned subsidiary; in addition, the new law allows foreign banks to acquire up to 100 percent of the voting stock of an existing domestic bank). In Malaysia, primary entry as a branch was not allowed, and entry through a subsidiary was temporarily not allowed, since no new licenses were being issued, although there was no limit on foreign ownership in a subsidiary. For acquisition, the limit was 30 percent, and there was a restriction on expanding through additional branches; 10 microfinance branches were allowed per bank, and further branches were allowed based on the effectiveness of these branches in serving microenterprises. There has been a comprehensive modernization and streamlining of Malaysia's regime on licensing and foreign equity limits in the banking and insurance sector (conventional and Islamic) with the enactment of the Financial Services Act 2013 and

[15] The OECD has also developed a measure of services trade restrictiveness, drawing upon the more detailed data available for industrial and more advanced developing countries (OECD 2009a, 2009b, 2011).
[16] The focus here is on the five main sectors. Annex table A.2.2 also includes education and medical services.

the Islamic Financial Services Act 2013 in June 2013. In both conventional and Islamic finance, Application for a license is now based on the prudential and "best interest of Malaysia" criteria. Similarly, the acquisition of a significant foreign equity interest in Malaysian banks and insurance companies could be up to 100 percent, subject to meeting the aforementioned criteria. Vietnam allowed wholly foreign-owned subsidiaries but imposed a limit on the acquisition of banks. To acquire existing banks, the foreign ownership limit was 30 percent for aggregate foreign investment and 20 percent for a single foreign credit institution.

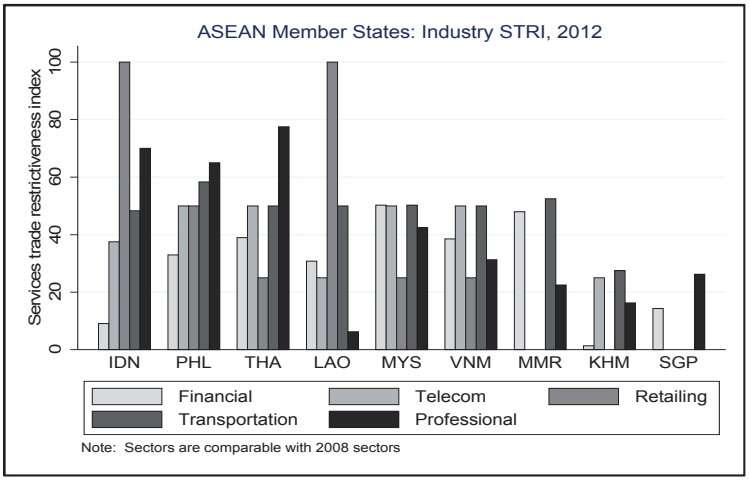
Figure 2.1: STRI by Industry, ASEAN Region Compared with other Regions, 2008



Source: All data in Chapter 2 Diagrams and Tables are derived from the World Bank's ASEAN Trade Restriction Database.

Note: The STRI at the regional level is calculated as a simple average of individual country's STRIs. The STRI in the cross-border air passenger transport subsector is excluded. The financial STRI includes scores for retail banking Mode 1 and Mode 3, automobile, life, and reinsurance Mode 1 and Mode 3, respectively. Telecom STRI includes scores for fixed line and mobile. Retailing STRI includes scores for retailing Mode 3. The transport STRI includes STRIs for air passenger international Mode 3, maritime international Mode 1 and Mode 3, road freight Mode 3, and rail freight Mode 3. Professional services STRI includes scores for accounting, auditing, legal advisory on domestic law and foreign law in Mode 1, Mode 3, and Mode 4. For comparability, the STRI scores for education, medical services, and some other professional services subsectors are excluded.

Figure 2.2 STRIs by Industry for ASEAN Member Countries, 2012



Note: When STRI score is zero, there is no bar. The Member States are ordered based on a descending level of average restrictiveness.

19. **Recently, in March 2015, ASEAN Finance Ministers signed the Sixth Protocol of Financial Services Commitments**, which also contains the enabling provision for the implementation of the ASEAN Banking Integration Framework (ABIF). The Objective of ABIF is to achieve a more integrated banking market, by allowing any two ASEAN countries to enter into reciprocal agreements to provide Qualified ASEAN Banks (QABs) with greater market access, and operational flexibilities consistent with those of domestic banks in the respective host countries.

20. **In automobile and life insurance, Lao PDR, Malaysia, Myanmar, and Thailand have restrictive policies.** Myanmar is still drafting its regulations on the insurance and reinsurance sector, and it is not possible to enter at this stage. In Thailand, the licensing regime is discretionary; if more than 49 percent of foreign equity is desired, the approval of the Minister is required upon the recommendation of the Commission; the Minister of Finance has the power to grant a license with the approval of the Cabinet. In Lao PDR, there is a 49 percent limit on foreign ownership, and the licensing regime seems burdensome, since approval from the Ministry of Planning and Investment, Ministry of Finance, and Ministry of Industry and Commerce is required. Malaysia does not allow entry via a branch. Prior to the liberalization in 2013 (see paragraph 18 above), foreign ownership in a subsidiary can be 100 percent; however, no new licenses were being issued, but were announced from time to time on an ad-hoc basis. The foreign ownership limit on acquiring a share of an existing insurance company was 70 percent. In cross-border reinsurance and retakaful (Islamic reinsurance) relating to non-life insurance and non-family retakaful respectively, Malaysian companies in Malaysia need to demonstrate domestic unavailability in the respective sectors in Malaysia before obtaining services abroad. However, Malaysia does not impose similar policies for reinsurance and retakaful relating to life insurance and family retakaful. The Philippines requires 10 percent of reinsurance to be ceded to the National Reinsurance Corporation of the Philippines.

21. **Telecommunications.** Most ASEAN countries limit foreign investment in fixed and mobile telecommunications services. The limit on foreign ownership is 49 percent in Indonesia and Malaysia, and 40 percent in the Philippines. The limit is a more relaxed 70 percent in Vietnam, but foreign majority control requires government approval, and in Thailand foreign-majority-owned or -controlled providers may offer services only on a resale basis. A number of ASEAN countries allow full foreign ownership in private companies, but restrict foreign ownership in state-owned telecom operators. Thus, the Philippines does not allow acquisition of a state-owned entity, whereas Cambodia and Lao PDR allow only a minority foreign share in state entities. In Vietnam, the state holds a dominant share in telecommunications service providers with network infrastructure. In terms of the legal form of entry, all countries allow entry through greenfield and acquisition, except in Malaysia, where entry at this stage is possible only through acquisition, because no new greenfield licenses are being issued. Singapore and Myanmar are the two relatively open countries in the region in that they do not limit entry and foreign equity participation. However, Cambodia (like Vietnam) does not allow foreign operators to establish their own international gateway, and Singapore requires that at least one director be ordinarily resident in Singapore.

22. **Policy in mobile telecommunications is similar to that in fixed telecommunications.** For most ASEAN Member States, the foreign equity limits in both areas are the same. The exception is Indonesia, where the foreign equity limit for mobile telecommunications operators is a more relaxed 65 percent compared to the 49 percent limit in fixed telecom.

23. **Retail.** Most countries in the region allow FDI in retail, except Indonesia and Lao PDR. Indonesia's FDI policies have become more restrictive since 2008, when foreign investment in retail was still allowed. Other countries surveyed allow investment as long as the foreign retailers meet the minimum capital requirements. In Thailand, the minimum capital requirement for opening the first five shops is B 100 million (about US$3.2 million). For each additional shop, capitalization of no less than B 20 million (US$640,000) is required. In the Philippines, a foreign retailer needs to bring in paid-up capital of US$2.5 million or more, provided that investments for each store must be not less than US$830,000. In Vietnam, establishing an

outlet beyond the first one is considered on a case-by-case basis, and approval depends on the number of outlets, market stability, population density, and consistency of the investment project with the master plan of the city where the shop is planned to be set up. Malaysia also has a minimum capital requirement that foreign retailers need to meet. In these cases, domestic retailers do not have the same requirement.

24. **Transportation.** Transportation services are relatively restricted in ASEAN countries, as they are in other parts of the world. In cross-border (Mode 1) maritime shipping, the chapter examines restrictions on both private and government cargo. Malaysia, the Philippines, Thailand, and Vietnam have restrictions on foreign ships carrying government cargo, but no limitations on private cargo. On commercial presence (Mode 3), for the types of transport covered by the survey (maritime, air, road, and rail), the majority of Member States mention that the control (for example, in terms of the power to name a majority of its directors or otherwise to legally direct its actions) must be held by local companies. In air transport, the Member States signed the ASEAN air transport liberalization agreements covering freight and passenger services. It is difficult to assess how much more openness the regional air services agreements offer beyond the existing Bilateral Air Services Agreements, which are discussed in more detail below.

25. **Education and medical services.** These services are covered most comprehensively, since all modes of supply were included in the survey: cross-border (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3), and presence of natural persons (Mode 4). Not surprisingly, most countries are fairly open in Mode 1 and Mode 2 types of trade in education and medical services. In Mode 3, Indonesia, Myanmar, the Philippines, and Thailand have restrictive policies. In these countries, the control of such institutions must be held by nationals, and in the case of Myanmar, the medical and higher education services are run by state-owned institutions. In the Philippines, medical services are run by the state, and the educational institutions must be owned and operated by Philippine nationals only. In Mode 4, Lao PDR and the Philippine require medical and educational services to be provided by the nationals. Other countries are open in the supply of services through Mode 4.

26. **Professional Services.** The supply of accounting, auditing, legal advisory services on foreign and domestic laws, architectural, engineering, and management consulting services are covered through Mode 1, Mode 3, and Mode 4. Although countries differ in their policies, it appears that most countries have fewer restrictions on management consulting, accounting, legal advice on foreign law, architecture, and engineering services than on auditing and legal advice on domestic law. In many of the countries, the cross-border supply of services (Mode 1) is unregulated and open. In Mode 3, the countries have restrictions on ownership, organization, and practices. Indonesia does not allow investment in most of its professional service sectors. In Mode 4, Thailand and the Philippines are quite restrictive; Thailand does not allow entry via Mode 4 in any of the professional service sectors covered, and the Philippines allows entry subject to restrictive conditions, including reciprocity and labor market tests.

D. Policy Measures Used by ASEAN Countries

27. **Besides the overall policy pattern by sector, a few of the key policy measures that the survey covers are looked at in each sector: legal form of entry and ownership, licensing regime, and regulatory environment.** The central features that emerge are the restrictiveness of policy and the degree of discretion in the policy environment relating to the entry and operation of foreign firms.

Legal form of entry and foreign ownership

28. **As was seen in the previous section, the restrictiveness of the legal form of entry and ownership varies by sector and country, but certain broad trends emerge.** In general, higher foreign ownership is allowed in a greenfield subsidiary than in entry through acquisition (tables 2.1, 2.2, and 2.3). Many countries allow full foreign ownership in a subsidiary, but full foreign ownership does not actually

mean liberal conditions of entry, since licensing can still be a limiting factor. For example, even though Malaysia allows 100 percent foreign ownership in banking and life insurance, new licenses are not being issued. In Thailand, insurance sector licenses are subject to review by several authorities, including the Office of Insurance Commission, on a case-by-case basis. If more than 49 percent of foreign equity is desired, the approval of the Minister of Finance is required upon the recommendation of the commission; the minister has the power to grant a license, with the approval of the Cabinet.

Table 2.1 Foreign Ownership Allowed in a Subsidiary (in percentage)

Selected Sectors	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Banking	99	100	100	100	100	60[a]	100	100	100
Insurance auto.	80	100	49	0	100	100	100	NL	100
Insurance life	80	100	49	0	100	100	100	NL	100
Fixed telecom	49	100	100	100	49	40	100	100	70
Mobile telecom	65	100	100	100	49	40	100	100	70
Retailing	0	100	0	100	100	100	100	100	100
Air transport	49	49	49	0	49	40	100	49	49
Maritime ship.	49	49	n.a.	100	100	40	100	49	49
Maritime aux.	49	100	n.a.	100	—	40	100	49	51
Road freight	49	100	49	100	49	40	100	49	51
Rail freight	0	100	n.a.	0	0	0	n.a.	49	49

Note: a. During the period in review, under Republic Act (R.A.) No. 7721, investment by foreign banks of up to 60 percent of the voting stock of a new banking subsidiary was allowed. However, a moratorium on the establishment of new commercial banks was imposed, except for microfinance-oriented thrift banks and rural banks, which were the means for a foreign bank to enter the Philippines. After the policy survey was conducted, foreign banks can apply to operate in the Philippines either as a branch or as a wholly owned subsidiary under the Republic Act (R.A.) No. 10641 enacted in 2014. In addition, the new law allows foreign banks to acquire up to 100 percent of the voting stock of an existing domestic bank. Zero means foreign ownership is not allowed; n.a. means not applicable for various reasons, such as the country is landlocked or has no railway system. — = not available. NL means no licenses are issued for subsidiaries in Thailand.

Table 2.2 Foreign Ownership Allowed in Acquisition of a Local Company

Selected Sectors	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Banking	99	100	100	100	30[b]	60[a]	100	49	30
Insurance auto.	80	100	49	0	70[b]	100	100	49	100
Insurance life	80	100	49	0	70b	100	100	49	100
Fixed telecom	49	100	100	100	49	40	100	100	70
Mobile telecom	65	100	100	100	49	40	100	100	70
Retailing	0	100	0	100	100	100	100	100	100
Air transport	49	49	49	49	49	40	100	49	49
Maritime ship.	49	49	NA	0	100	40	100	49	49
Maritime aux.	49	100	NA	0		40	100	49	51
Road freight	49	100	49	0	49	40	100	49	51
Rail freight	0	100	NA	0	0	0	NA	49	49

Note: a. In the Philippines, under the Republic Act (R.A.) No. 10641, enacted in 2014, after the policy survey was conducted, foreign banks can now apply to operate in the Philippines either as a branch or as a wholly owned subsidiary. In addition, the new law allows foreign banks to acquire up to 100 percent of the voting stock of an existing domestic bank.
b. Following the enactment of the Financial Services Act 2013 and Islamic Financial Services Act 2013 in June 2013, the acquisition of a significant foreign equity interest in Malaysian banks and insurance companies in both the conventional and Islamic finance sectors could be up to 100 percent, subject to meeting the prudential and "best interest of Malaysia" criteria.

Table 2.3 Foreign Ownership Allowed in Acquisition of a Local State-Owned Company

Selected sectors	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Banking	99	NA	100	0	30[b]	0*	100	9	30
Insurance auto.	80	49	49	0	70[b]	0	100	NL	
Insurance life	80	49	49	0	70[b]	0	100	NL	
Fixed telecom	49	49	100	100	49	0	100	100	70
Mobile telecom	65	49	100	100	49	0	100	100	70
Retailing	0	49	0	0	100	0	100	0	0
Air transport	49	49	49	0	49	0	100	49	49
Maritime ship.	49	49	NA	0	100	0	100	49	49
Maritime aux.	49	49	NA	0		0	100	49	51
Road freight	49	49	49	0	49	0	100	49	51
Rail freight	0	49	NA	0	0	0	NA	49	49

Note: A "Local State-Owned Company" is a company in which the government has majority ownership. NL means no licenses are issued for the acquisition of local state-owned insurance companies in Thailand.
b. Following the enactment of the Financial Services Act 2013 and Islamic Financial Services Act 2013 in June 2013, the acquisition of a significant foreign equity interest in Malaysian banks and insurance companies in both the conventional and Islamic finance sectors could be up to 100 percent, subject to meeting the prudential and "best interest of Malaysia" criteria.

29. **Compared to greenfield entry, there are stricter limits on foreign ownership via acquisition of an existing entity, especially if the entity is state owned.** Myanmar and the Philippines do not allow foreign acquisition of state-owned entities in most of the sectors covered. However, because acquisition is not subject to new licensing requirements, conditions of entry through this legal form may in fact be more liberal than greenfield entry. Across countries, the foreign equity limit is lower in transportation sectors. The only country that allows full foreign ownership of a state-owned entity is Singapore.

Licensing regime

30. **The licensing regime is vital, but it is difficult to assess whether licensing measures are applied for prudential or protectionist reasons.** In most countries, licensing and market entry criteria are publicly available, but fulfilling publicly available criteria does not ensure that a license is granted. All countries except Vietnam indicate licensing is not automatic in at least several sectors (table 2.4), and licenses tend to be issued on a case-by-case basis.

31. **In only a few countries can an explicit licensing limit or a hard-quota-type of restriction be observed, although the discretion of the licensing authority may be used to implement implicit limits.** Many countries also maintain different licensing criteria for foreign and domestic firms, but most such differences are relatively minor, such as an additional document or minimum capital requirement.

Table 2.4 Licensing Limits and Discrimination

	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Sectors for which Entry is Allowed	**14**	**15**	**11**	**10**	**14**	**13**	**14**	**15**	**15**
Licensing: explicit limit	0	1	0	0	8	2	0	0	0
Licensing criteria **not** publicly available	0	2	0	1	5	0	0	0	0
License **not** automatic if publicly available criteria are fulfilled	15	4	12	6	14	5	11	11	1
Different licensing criteria for foreign and domestic firms	4	3	1	4	1	10	3	12	12

Note: Discrimination refers to a difference in licensing requirements for foreign firms and domestic firms.

Regulatory environment

32. **The survey also covered several aspects of the regulatory environment, of which three are described here: whether the regulator is required to provide reasons for license rejection; whether there is a right to appeal the decisions of the regulatory authority; and whether regulators provide prior notice of regulatory and policy changes.** Countries in which the regulators are required to provide reasons for rejecting licenses would presumably have less room for discretion. Having a right to appeal is also connected to the licensing regime and indicates whether the private sector has recourse to a remedial process. The survey results show Malaysia, Myanmar, the Philippines, Singapore, and Thailand do not require regulators to provide reasons for license rejection. Appeals are not allowed in Cambodia, Malaysia, and Myanmar. Prior notice helps the private sector prepare for policy changes, and may even allow for

private sector input into policy. Inserdonesia, Lao PDR, Myanmar, the Philippines (except in banking services), and Thailand do not have processes for prior notice to the private sector (table 2.5).

Table 2.5 Regulatory Measures

	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Sectors for which entry is allowed	**14**	**15**	**11**	**10**	**14**	**13**	**14**	**15**	**15**
Regulator is not required to inform reasons for license rejection	3	0	0	8	12	6	11	7	0
Appeals not allowed	0	14	2	14	8	2	0	0	2
Prior notice of regulatory changes not allowed	15	0	12	15	10	11	0	13	2

33. **In low-income countries, where institutional capacity is limited, the absence of a formal policy or regulation is not uncommon.** The most number of subsector modes that are not covered by any specific regulation or policy appear in Lao PDR, followed by Cambodia, Myanmar, and the Philippines, and it is a phenomenon mostly observed in Modes 1 and 2 (table 2.6). The absence could have a restrictive impact, since it reduces transparency and predictability of the policy regime and increases the potential for discretion. But in many of these cases, in practice the supply of a service is allowed, with Vietnam a notable exception in this respect. Some other dimensions of the regulatory environment that the survey covered are described below.

Table 2.6 Is there a Regulation or Policy that Governs the Subsector Mode?

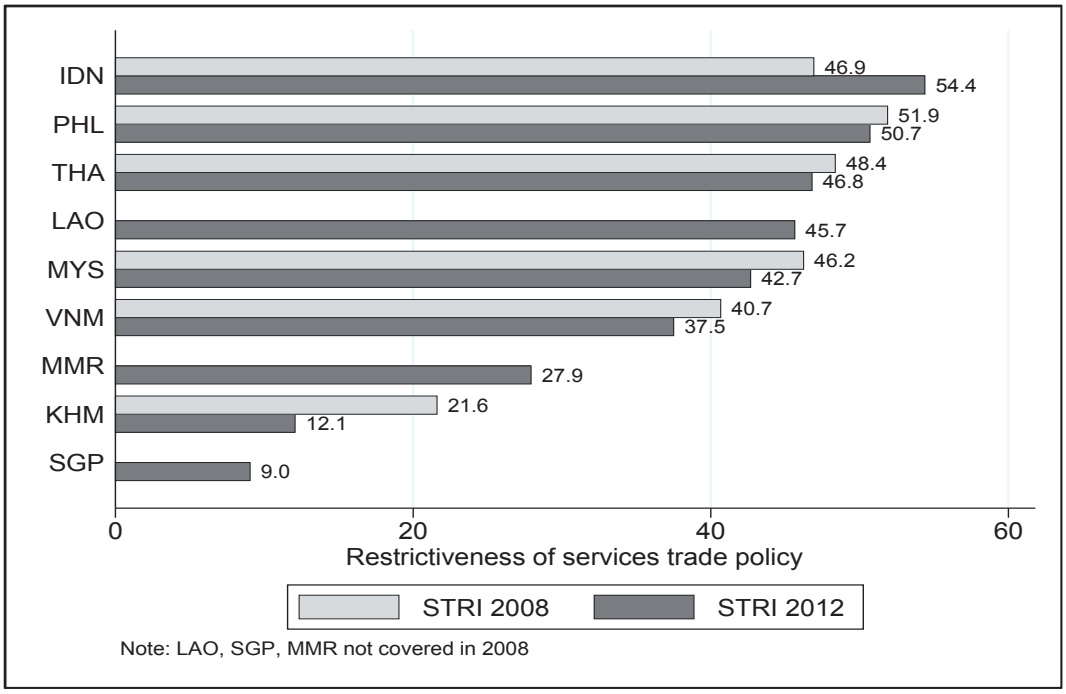
Measures	**VNM**	**SGP**	**IDN**	**KHM**	**MYS**	**PHL**	**THA**	**MMR**	**LAO**
No regulation	11	10	12	16	5	16	6	19	26
In practice, not prohibited	3	10	7	16	5	16	6	17	26
In practice, prohibited	8	0	5	0	0	0	0	2	0
No regulation cases by mode									
Mode 1	10	4	1	2	1	14	4	8	9
Mode 2	0	2	2	2	2	2	2	2	2
Mode 3	1	2	6	5	1	0	0	2	8
Mode 4	0	2	3	7	1	0	0	7	7

Note: Total subsector mode for the table is 46.

E. Have ASEAN Member States become More Open since 2008?

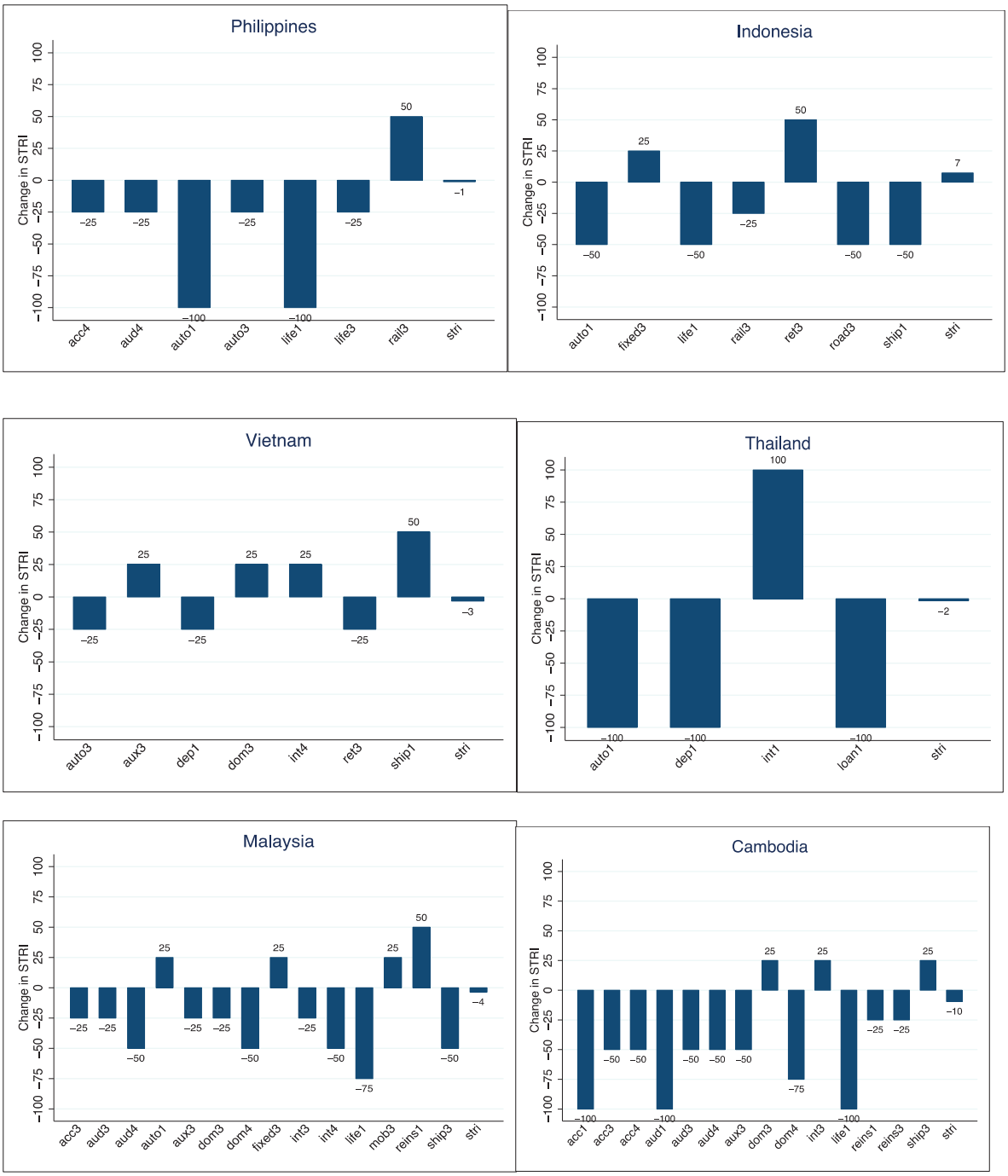
34. **As noted above, the surveys were conducted in both 2008 and 2012 for six ASEAN countries: Cambodia, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.** The data show that over this period, the policies of the six countries on average became more liberal, but the change is modest (figure 2.3). To identify the policy change, there is a need to look at the subsector mode level, because the country-level score is a weighted aggregation of subsector mode scores. For example, Indonesia's overall STRI increased by 7 points between 2008 and 2012. Even though the STRI went down in five subsector modes, it went up in three subsector modes, including in the retail sector.

Figure 2.3 ASEAN Member States Country Level STRI, 2008 and 2012



35. **The depth of liberalization of policies differs significantly across ASEAN countries.** In the Philippines, automobile and life insurance via Mode 1 were not allowed in 2008, but these services are now allowed (figure 2.4). In Thailand, cross-border bank loans, deposits, and automobile insurance were not allowed in 2008, but are now allowed without restrictions. In Cambodia, cross-border accounting and auditing services have been opened up since 2008. In Indonesia, FDI in road freight services was closed in 2008, but is now allowed subject to limitations; in contrast, FDI in retailing was open in 2008, but is now not allowed. In Vietnam, there was no restriction on cross-border maritime international shipping in 2008, but now there is a quota on bulk and liner cargo.

Figure 2.4 Changes in STRI, by Country and Subsector Mode, 2008–12



Note: "Acc1, acc3, and acc4" = accounting services via Modes 1, 3, and 4; "aud3" = auditing services via Mode 3; "auto1 and auto 3" = automobile insurance Mode 1 and 3; "aux3" = maritime auxiliary services Mode 3; "dep1" = bank deposit services Mode 1; "dom3 and dom4" = domestic legal advice via Modes 3 and 4; "fixed3" = fixed telecom via Mode 3; "int1 and int4" = international legal advice Modes 1 and 4; "life1" = life insurance via Mode 1; "loan1 and loan3" = bank loan services via Modes 1 and 3; "mob3" = mobile telecom via Mode 3; reins1 and reins3" = reinsurance services via Modes 1 and 3; "ret3" = retailing via Mode 3; "ship1 and ship3" = maritime shipping via Modes 1 and 3.

F. Is ASEAN Integrating Faster Internally?

36. **One of the goals of the survey, as described in section 2, was to identify instances where ASEAN countries treat services and services providers from their regional partners differently from those whose provenance is outside the region.** In fact, neither the law firms that collected the policy data nor the governments that verified the data could identify any meaningful instances of differential treatment. For the seven broad sectors (and relevant modes) covered by the questionnaire, for the most part the preferential policies vis-à-vis other ASEAN countries are virtually the same as nonpreferential (or most-favored-nation) policies vis-à-vis non-ASEAN countries.

37. **In professional and transport services, liberalization initiatives naturally tend to be among two or a few countries, because the regulatory framework favors reciprocal arrangements, such as recognition of qualifications and negotiation of traffic rights.** ASEAN countries have taken initiatives in both these areas, and to illustrate their impact, the intra-ASEAN openness in architectural and engineering services via Mode 4 and air transport services via Mode 1 is assessed below.

Architectural and Engineering Services via Mode 4

38. **ASEAN Mutual Recognition Arrangements (MRAs) have been developed to facilitate the movement of services professionals within the region.** Currently, there are seven MRAs in professional services: in engineering services (2005), nursing (2006), architectural (2007) surveying qualifications (2007), medical practitioners (2009), dental practitioners (2009), and a framework agreement on accountancy (2009). The Framework Agreement on Accountancy has been succeeded by the MRA on Accountancy, which was signed by the ASEAN Economic Ministers in 2014. The provisions of ASEAN MRAs for Architecture and Engineering services are compared with the MFN provisions in these sectors (table 2.7). Even though these professional services exemplify progress in regional integration, there is room to deepen integration. There are two problems: in some states, the restrictive domestic regime is still in the process of reform to align it with the relatively liberal MRAs; in other states, the liberal domestic regime is already more liberal than the MRAs.

39. **The first challenge is domestic regulatory reform to support the specific MRAs.** Passing new laws or reforming the existing domestic laws (labor law, immigration law, and professional regulation) is difficult due to the Constitutional and other legislative restrictions. For example, the Philippine Constitution (Article 17, Sec. 14) states that the practice of all professional services in the Philippines shall be limited to Filipino citizens, although there is another regulation (Philippines' Republic Act 8981) that provides exceptions when reciprocity requirements are met. Similarly, in Thailand, professional services are reserved for nationals. While Singapore has an approved list of recognized universities, it does accept architectural graduates who are not from these recognized universities, provided such graduates satisfy the relevant board that they are otherwise qualified and pass the examinations prescribed by the Board.

40. **The survey reveals that in some other respects, Member States already have quite liberal regimes for foreign licensed architects and engineers** (table 2.8). In these respects, it appears that being an ASEAN licensed professional confers no additional advantage, since the policy regime vis-à-vis all countries is already liberal. To illustrate this aspect, comparison is made of one condition of the MFN regime with the comparable condition in the MRA: work experience (table 2.9). The ASEAN MRA on architectural services requires at least 10 years of experience; but the MFN regime shows that four countries (Indonesia, Lao PDR, Myanmar, and Vietnam) do not require any work experience, and two countries (the Philippines and Malaysia) require two and five years of experience, respectively, and one country (Singapore) requires two to 10 years of experience. In engineering services, the same pattern can be observed, where the MFN regime is more relaxed than the ASEAN regime. Hence, although the MRAs are potentially an important step in the regional integration in professional services, there still appear to be

limited benefits of being registered as an ASEAN professional—a conclusion that accords with the findings of Aldaba (2013) and Hirawan and Triwidodo (2012).

Table 2.7 ASEAN Mutual Recognition Arrangement (MRA) on Architectural and Engineering Services

MRA on Architecture	MRA on Engineering
The ASEAN professional architects are eligible to apply to the ASEAN Architect Council to be registered as an ASEAN Architect when they meet the following conditions:	The ASEAN engineering professionals are eligible to apply to the ASEAN Chartered Professional Engineers Register as an ASEAN Chartered Professional Engineer when they meet the following conditions:
• **Education:** Completed an accredited architectural degree recognized by the professional architectural accreditation body whether in the Country of Origin or Host Country or assessed and recognized as having the equivalent of such a degree. The education for architects should be no less than five (5) years' duration delivered on a full-time basis in an accredited program in an accredited/validated university in the Country of Origin while allowing flexibility for equivalency.	• **Education:** Completed an accredited engineering degree/program recognized by the professional engineering accreditation body whether in the Country of Origin or Host Country or assessed and recognized as having the equivalent of such a degree.
• **Registration/License:** Obtained a current and valid professional registration or licensing certificate to practice architecture in the Country of Origin issued either by the Professional Regulatory Authority of the ASEAN Member Countries and in accordance with its policy on registration/licensing/certification of the practice of architecture or the Monitoring Committee.	• **Registration/License:** Professionals should have been assessed within their own jurisdiction as eligible for independent practice. The assessment may be undertaken by the Monitoring Committee or by the Professional Regulatory Authority within the country of origin.
• **Work Experience:** Acquired practical and diversified experience of not less than ten (10) years of continuous practice of architecture after graduation, of which at least five (5) years shall be after licensure/registration and at least two (2) years of which shall be in responsible charge of significant architectural works.	• **Work Experience:** Gained a minimum of 7 years of experience (since graduation), of which at least two (2) years shall be in responsible charge of significant engineering works.
• **Training:** Complied with the Continuing Professional Development policy of the country of Origin at a satisfactory level.	• **Training:** Complied with the Continuing Professional Development policy of the Country of Origin at a satisfactory level.
• **Ethical standard:** Obtained certification from the Professional Regulatory Authority of the Country of Origin with no record of serious violation on technical, professional, or ethical standards, local and international, for the practice of architecture.	• **Code of conduct and accountability:** Must agree to be bound by local and international codes of professional conduct.
• **Other requirements:** Complied with any other requirements agreed upon by the ASEAN Architect Council.	• **Other requirements:** Complied with any other requirements agreed upon by the ASEAN Chartered Professional Engineers.

Sources: MRA on Architecture services (2007); MRA on Engineering services (2005).

Table 2.8 Policy Summaries for Architectural Services and Engineering via Mode 4 – MFN Regime

Countries	Architectural Services via Mode 4	Engineering Services via Mode 4
Cambodia	Entry is allowed subject to meeting certain conditions: Educational and work experience requirements must be met. Foreign degrees and work experience recognized; the number of years of work experience is not available. There is a restriction on the employment of foreign employees, which is applicable to all firms. The maximum percentage of foreign employees in any firm is 10%. Exceptions may be granted. Initial stay allowed is 1 month; can be extended to 12 months.	No restrictions except 90 percent of firm employees need to be nationals.
Thailand	Not allowed.	Not allowed.
Vietnam	Must meet educational requirement; degrees from foreign countries recognized. Work experience or training not required. Professional exam in local language is required. Labor market test is required.	No restrictions except for labor market test required.
Indonesia	No sector-specific regulation governing this subsector mode. There is no additional qualification requirement. Work experience or training not required.	No sector-specific regulations governing this subsector mode. There is no additional qualification requirement. Work experience or training not required.
Philippines	Foreign citizens may be allowed to take licensure exam if he or she can meet reciprocity requirement and obtained education from universities recognized by the Government of the Philippines. Foreign nationals need a special/temporary permit from the Board of Architecture and the Professional Regulatory Committee. Must be qualified to practice architecture in his or her own country. Foreign nationals required to work with a Filipino counterpart. Work experience of 2 years is required. Labor market test (LMT) is required.	Foreign licensed professionals may be allowed to take the engineering license exams, practice, or be given a certificate of registration or be entitled to any privileges under the pertinent professional regulatory laws, provided that the country of which he or she is a citizen permits citizens of the Philippines to practice within its territorial limits under the same rules and regulations governing citizens thereof. This provision pertains to agriculture, geodetic, mechanical, metallurgical, chemical, civil, electrical, mining, naval architecture and marine, sanitary and electronic and communication engineering. LMT is required.

Table 2.8 Policy Summaries for Architectural Services and Engineering via Mode 4 – MFN Regime (continued)

Countries	Architectural Services via Mode 4	Engineering Services via Mode 4
Myanmar	No regulation or policy exists, but in practice entry is allowed. Domestic regulations are being drafted. Foreign licensed professionals can provide services automatically without additional requirement for qualification.	No regulation or policy exists, but in practice entry is allowed. Domestic regulations are being drafted. Foreign licensed professionals can provide services automatically without additional requirement for qualification.
Lao PDR	Foreign licensed professionals are qualified automatically without additional requirement. No educational, work experience and training requirement. Entry as a service supplying employees (SSE) is not allowed. The limit on the length of stay initially allowed is 4 years. Extension of stay is allowed.	Foreign licensed professionals are qualified automatically without additional requirement. No educational, work experience, or training requirement. Entry as an SSE is not allowed. The limit on the length of stay initially allowed is 4 years. Extension of stay is allowed.
Malaysia	Must reside in Malaysia not less than 180 days in a calendar year. Must be qualified in the country where he or she normally practices. Need to meet labor market test. The length of stay initially allowed is 5 years. Extensions of stay are allowed. Work experience of 5 years is required, foreign experience is recognized. Entry through (intracorporate transferees) ICT is not allowed.	Must reside in Malaysia not less than 180 days in a calendar year. Must be qualified in the country where he or she normally practices. Need to meet labor market test. The length of stay initially allowed is 5 years. Extensions of stay are allowed. Work experience of 5 years is required, foreign experience is recognized. Entry through ICT is not allowed.
Singapore	Foreign licensed professionals can provide services subject to certain conditions, (regulated by the Architects Act). Must meet educational requirement, degrees from certain countries are recognized: universities from Australia; Canada; China; England; Scotland; Wales; Ireland; Northern Ireland; France; Germany; Hong Kong SAR, China; Japan; New Zealand; the United States. Must be qualified to practice in any foreign country. Work experience (can be in any country) requirement varies from 2 to 10 years. The length of stay initially allowed is 2 years. Extension of stay is allowed.	For professional engineering services in civil, mechanical, and electrical engineering, all persons (including foreign licensed professionals) can provide services subject to certain conditions: Must be qualified and licensed to practice in Singapore as professional engineers in the above branches. Foreign degrees from certain countries are recognized (Australia; Belgium; Canada; China; France; Germany; Hong Kong SAR, China; India; Ireland; Japan; Republic of Korea; Malaysia; the Netherlands; New Zealand; South Africa; Sweden; Switzerland; Taiwan, China; the United Kingdom; the United States). Work experience of not less than 4 years (in any country) required. The length of stay initially allowed is 2 years. Extension of stay is allowed.

Source: World Bank surveys on Services Trade Integration for ASEAN countries, December 2012. Information was confirmed/reviewed by the respective government officials in May 2013.

Table 2.9 Work Experience Requirement for Architectural and Engineering via Mode 4

Member States	Architecture – MFN Regime	Engineering – MFN Regime	ASEAN – MRA
If work experience is required, how many years?			
Cambodia	—	—	**Architecture** **10 years** of experience required, of which 5 years shall be after licensure and 2 years of which shall be in responsible charge of significant architectural work (Prov. 3.1.3, page 6, ASEAN MRA on Architectural Services). **Engineering** **7 years** of practical and diversified work experience (after graduation) required, of which at least 2 years is spent in responsible charge of significant engineering work (Provision 3.1.3 page 5, ASEAN MRA on Engineering Services).
Thailand	Not applicable (entry via Mode 4 is not allowed for foreign nationals)	Not applicable (entry via Mode 4 is not allowed for foreign nationals)	
Vietnam	Not required	Not required	
Indonesia	Not required	Not required	
Philippines	2 years (upon having met reciprocity and labor market test (LMT) requirement)	4 years (upon having met the reciprocity and LMT requirement)	
Myanmar	Not required	Not required	
Lao PDR	Not required	Not required	
Malaysia	5 years	5 years (experience obtained in any country is recognized)	
Singapore	2–10 years	4 years is required (experience obtained in any country is recognized)	

Sources: WB surveys on ASEAN integration (2012); ASEAN the Mutual Recognition Agreement on Architectural and Engineering Services.
Note: — = not available.

Cross-border air transport

41. **Compared to other sectors, ASEAN Member States appear to have made progress in the regional integration of their air transport markets.**[17] They have signed "multilateral" air transport agreements that are more liberal than their previous bilateral air service agreements. However, regional integration is still ongoing, since there are a number of areas that need to be further liberalized to achieve a more integrated regional air market. In fact, some Member States have moved ahead and individually concluded bilateral agreements with certain OECD countries.

42. **Most bilateral routes within ASEAN have now been liberalized by the ASEAN multilateral agreements.** The only exceptions are routes into and out of those Member States that have not fully accepted the air transport agreements, and these remain governed by Bilateral Air Services Agreements. The formal ASEAN agreements on air transport liberalization are the Multilateral Agreement on Air Services, the Multilateral Agreement for Full Liberalization of Passenger Air Services, and the Multilateral Agreement for Full Liberalization of Air Freight Services and their respective Implementing Protocols. These multilateral agreements go beyond the Bilateral Air Services Agreements in two important aspects: the agreements allow third, fourth, and fifth freedom rights for air carriers between designated secondary

[17] This Section and Annex Section 2 are based on the insightful study by Tan (2013).

cities and all capital cities of ASEAN Member States;[18] instead of substantial ownership and control by the nationals, the "community carrier" concept is in principle allowed. This means an airline can be substantially owned and effectively controlled by ASEAN interests taken cumulatively or in the aggregate (Tan 2009). This provision allows airlines to attract capital infusions and management expertise from multiple sources within ASEAN.

43. **However, there is still room for deepening regional integration in certain key respects.** To achieve a more integrated aviation market, ASEAN Member States need to consider further liberalization, such as the seventh freedom (the right to fly between two ASEAN countries while not offering flights to one's own country), the eighth freedom (the right to fly between two or more airports within an ASEAN country while continuing service to one's own country), and the ninth freedom (the right to fly inside an ASEAN country without continuing service to one's own country) for the ASEAN Member States to consider. A single aviation market such as that which exists in the European Union liberalizes such operations fully and allows market competition throughout the region. It seems, however, that domestic carriage remains sensitive for large ASEAN countries with a large domestic population where, as elsewhere, such operations are reserved exclusively for local players.

44. **As far as ownership and control is concerned, although in theory a "community carrier" is allowed to operate, in practice, there is still room for progress.** It is not obvious whether the "community carrier" can fly into all Member States in the region, since the Member States still need to provide approval before the carrier can operate. However, if a specific number of Member States declare their unequivocal approval for such a model, it can encourage investors to establish such an airline. For now, investors comply with the traditional "substantial ownership and effective control of nationals" rule.

45. **Finally, even though the agreements are in force among most ASEAN Member States, there are states where there remains room to improve the scope of the agreements.** Indonesia's position on the ASEAN agreements can be traced to its leading carriers' lobbying of their government to continue protecting their international operations against those of rival airlines from neighbouring ASEAN states. Through their industry group, the Indonesian National Air Carriers Association, the major carriers have traditionally opposed efforts to open up the ASEAN air travel market. The Philippines' reluctance is related to the limited airport slots and infrastructural constraints.

46. **However, there are several factors that may provide the momentum to achieve more beyond 2015.** First is the growing confidence of Indonesian carriers such as Garuda and Lion Air. As these airlines expand their services and increase their competitiveness and appeal to passengers, there may come a time when they feel more secure and see less of a need to resist greater liberalization. Second, there is the pressure created by the provincial governments, tourism authorities, and business community to allow greater direct access into secondary cities. Third, there are the obligations created by the agreements with larger countries such as China. The Member States recognize that the consolidation as a single market agreement internally could help in negotiations with large countries like China. Fourth, innovative airlines have sought to get around the restrictions, including those that are cast in the bilateral and multilateral agreements. One example is how AirAsia pioneered the cross-border joint venture model—while still imperfect, it allows

[18] The freedoms of the air are described in ICAO (2004) as the following: *first* is the right to fly over a foreign country, without landing there; *second* is the right to refuel or carry out maintenance in a foreign country on the way to another country; *third* is the right to fly from one's own country to another; *fourth* is the right to fly from another country to one's own; *fifth* is the right to fly between two foreign countries during flights while the flight originates or ends in one's own country; *sixth* is the right to fly from a foreign country to another one while stopping in one's own country for nontechnical reasons; *seventh* is the right to fly between two foreign countries while not offering flights to one's own country; *eighth* is the right to fly between two or more airports in a foreign country while continuing service to one's own country; ninth is the right to fly inside a foreign country without continuing service to one's own country.

AirAsia to get around the "seventh freedom" prohibition and to operate region-wide from multiple hubs using a common, well-recognized brand.

47. **Recent research by Tan (2013) suggests that some ASEAN Member States have more liberal air services agreements with third parties than among themselves.** With the United States, Brunei Darussalam, Indonesia, Lao PDR, Malaysia, Singapore, and Thailand have "open skies" agreements that allow, at a minimum, unlimited third and fourth freedom capacity. Moreover, Singapore and Brunei Darussalam have gone further with the United States in that they are state parties to the APEC-sponsored Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT) and the Protocol of the agreement.[19] The MALIAT Agreement provides for unlimited third, fourth, *and* fifth freedom rights among the state parties and replaces the traditional "substantial ownership and effective control" requirement with a more progressive "principal place of business and incorporation and effective control" clause. Brunei Darussalam and Singapore are also parties of the MALIAT Protocol, which goes further in providing for the exchange of seventh freedom and cabotage rights.

48. **In addition, several ASEAN Member States have entered into "horizontal" agreements with the European Community that recognize the right of all EU carriers to operate between any EU point and the state concerned.**[20] As of October 2013, four ASEAN Member States—Indonesia Malaysia, Singapore, and Vietnam—have entered into horizontal agreements with the European Community, and their individual bilateral agreements with the EU members do go much further. For instance, Singapore has had an agreement with the United Kingdom since 2007 that provides for unlimited third, fourth, and fifth freedom capacity *and* even seventh freedom and domestic carriage rights for both carriers on both sides. In June 2013, Malaysia adopted a new agreement with the United Kingdom containing similar rights. Annex 2.2 discusses in greater detail the ASEAN multilateral air transport agreements and reasons why some Member States have remained reluctant to liberalize the domestic air market.

G. Regional and Multilateral Commitments and Goals

49. **Having examined applied policies, three sets of comparisons can now be made—**between regional commitments and goals, and actual policy; between multilateral commitments and offers, and actual policy; and between the regional and multilateral dimensions.

The regional dimension

50. **The ASEAN Framework Agreement on Services (AFAS), signed in 1995, is one of the first regional trade agreements in services.** AFAS is closely related to the General Agreement on Trade in Services (GATS) and follows its main principles, disciplines, and approach to liberalization. It contains liberalization commitments that aim to reduce restrictions to services trade between ASEAN Member States, and calls for liberalization of services trade through successive rounds of negotiations of sector-specific commitments. Since 1995, numerous packages of AFAS commitments have been concluded and signed by ASEAN Member States. Most recently the Protocol to Implement the Sixth Package of Financial Services Commitments was signed in March 2015 by the ASEAN Finance Ministers while the signing of the Protocol to Implement the Eight Package of Commitments on Air Transport Services was completed in November 2014. These negotiations have thus resulted in eight packages of commitments in a wide range of service sectors under the purview of ASEAN Economic Ministers, six packages of commitments in financial services, and eight packages of commitments in air transport.

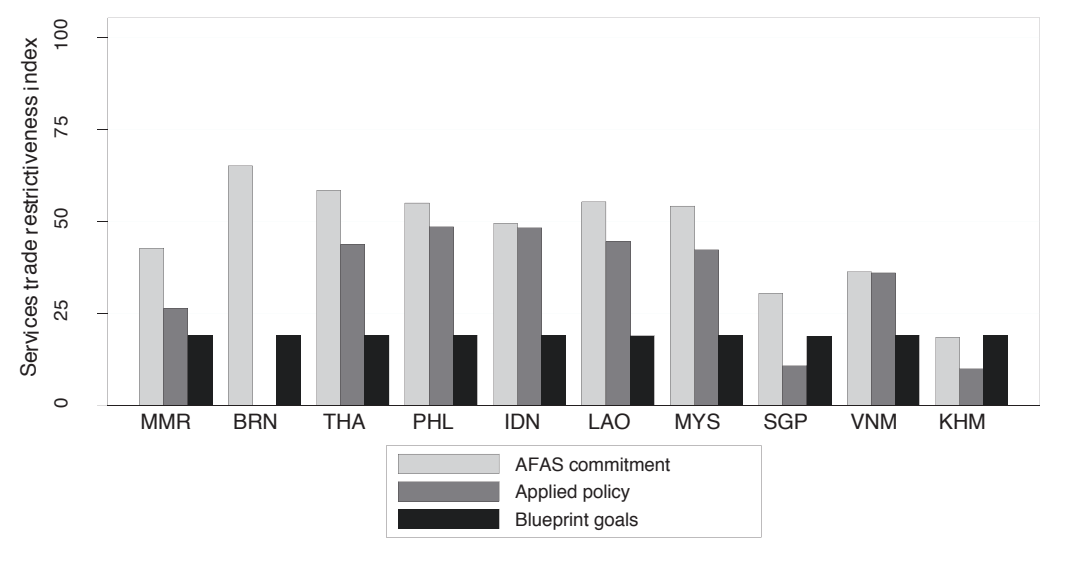
[19] The other parties to MALIAT are Chile, the Cook Islands, New Zealand, Samoa, and Tonga.
[20] These horizontal agreements do not alter the capacity provided for in the existing bilateral agreements.

51. **The ASEAN Economic Community (AEC) Blueprint was adopted in 2007 to further liberalize services trade among ASEAN Member States and create a free trade area in services trade by 2015.** The Blueprint aims to remove substantially all restrictions on trade in services for the four priority service sectors—air transport, e-ASEAN, health care, and tourism—by 2010, and the fifth priority service sector, logistics services, by 2013; remove substantially all restrictions on trade in services for all other service sectors by 2015; and undertake liberalization through consecutive rounds every two years until 2015, that is, 2008, 2010, 2012, 2014, and 2015.

52. **In addition, the Blueprint goals establish specific liberalization parameters for the sectors.** In all sectors, there would be no restrictions for Modes 1 and 2, with exceptions for bona fide regulatory reasons (such as public safety), which are subject to agreement by all Member States on a case-by-case basis. For the four priority service sectors, foreign (ASEAN) equity participation would be allowed of not less than 51 percent by 2008 and 70 percent by 2010, and for logistics services not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2013. For the other service sectors, the equity participation thresholds were not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2015. ASEAN also agreed to progressively remove other Mode 3 market access limitations by 2015.

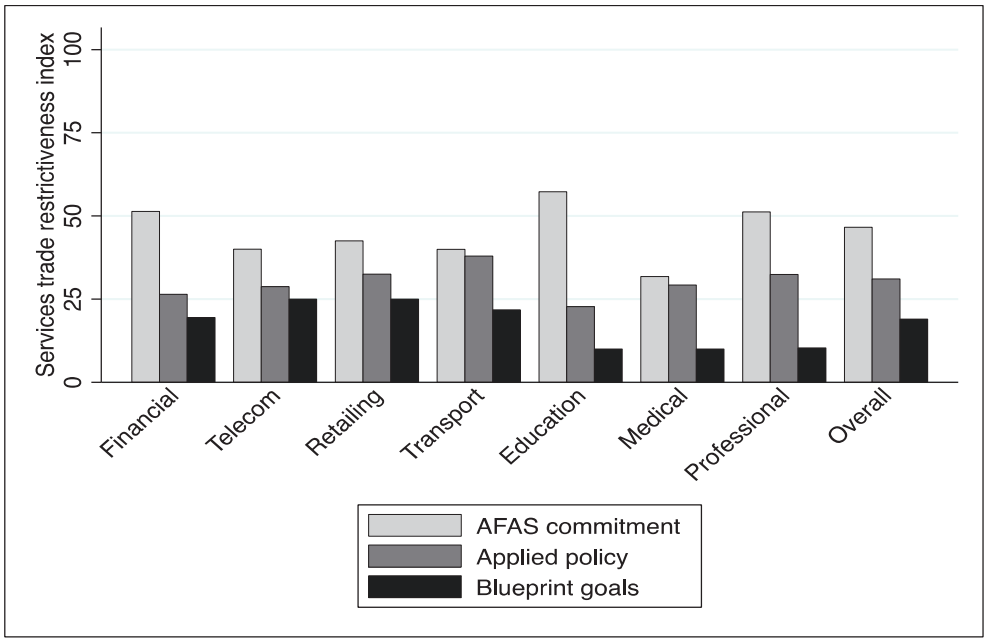
53. **It is evident from table 2.10 (and figure 2.5) that all ASEAN member countries' applied policies are more liberal than their AFAS commitments (through the Eighth Package), though the size of the gap varies across countries and sectors.** Indonesia and Vietnam are examples of countries where the gap is modest, whereas Cambodia, Myanmar, and Singapore have policies that are more open than their commitments. In terms of sectors, table 2.11 (and figure 2.6) shows that gaps in financial (especially banking) and education services with the STRI of commitments are more than twice the level of applied policy, and negligible in transport and medical services.

Figure 2.5 AFAS Commitments through the Eighth Package, Applied Policy, and Blueprint Goals, by Country



Note: Applied policy information for Brunei is missing.

Figure 2.6 AFAS Commitments, Applied Policy, and Blueprint Goals by Industry



Note: More disaggregated scores are provided in Annex figure 2.A.1

54. **Table 2.12 provides a more textured comparison, drawing upon the restrictions on entry and ownership in fixed-line telecommunications services.** Myanmar and Singapore already apply no restrictions on entry and ownership, and are ahead of the Blueprint goals for 2015 (which allows foreign equity limits greater than 70 percent). In contrast, Indonesia, Malaysia, and the Philippines are examples of countries in which the foreign equity limit is below that of the Blueprint goals.

55. **On the whole, evidence shows that in most ASEAN countries there is still room to narrow the gap between applied policy and Blueprint 2015 (the average gap is about 20 STRI points).** The two notable exceptions are Singapore and Cambodia; STRIs of their applied policies are on average lower than those of the Blueprint goals. In terms of sectors, applied policies are close to goals in financial, telecommunication, and retail services, but there is still room to achieve the goals in other sectors.

The multilateral dimension

56. **Two things are immediately evident from tables 2.10 and 2.11 (and figure 2.7 and 2.8).** First, the differences in the offers submitted during the course of the WTO's unfinished Doha negotiations by most ASEAN countries and the Uruguay Round commitments remain modest (the offers improve on commitments on only two STRI points). To be fair, more far-reaching offers would probably have been put forward if services negotiations had reached a more conclusive stage. Second, in most cases, both WTO commitments and offers bear no relationship to applied policies, which are significantly more liberal, with the starkest gaps in the case of Myanmar and Singapore. In fixed-line telecommunications, for example, table 2.3 shows that Singapore, which has an open market, limits direct and indirect foreign investment to 73.99 percent in both its GATS commitments and Doha offer, whereas Myanmar, with a similarly open market, has made neither commitments nor an offer. There are, however, two exceptions: Cambodia and Vietnam, both of which made far-reaching commitments during their WTO accession negotiations. Lao PDR's accession negotiations do not seem to have led to bindings that are as close to applied policies.

Figure 2.7 GATS Commitments Up To the Eighth Package, Doha Offers, and Applied Policy, by Country

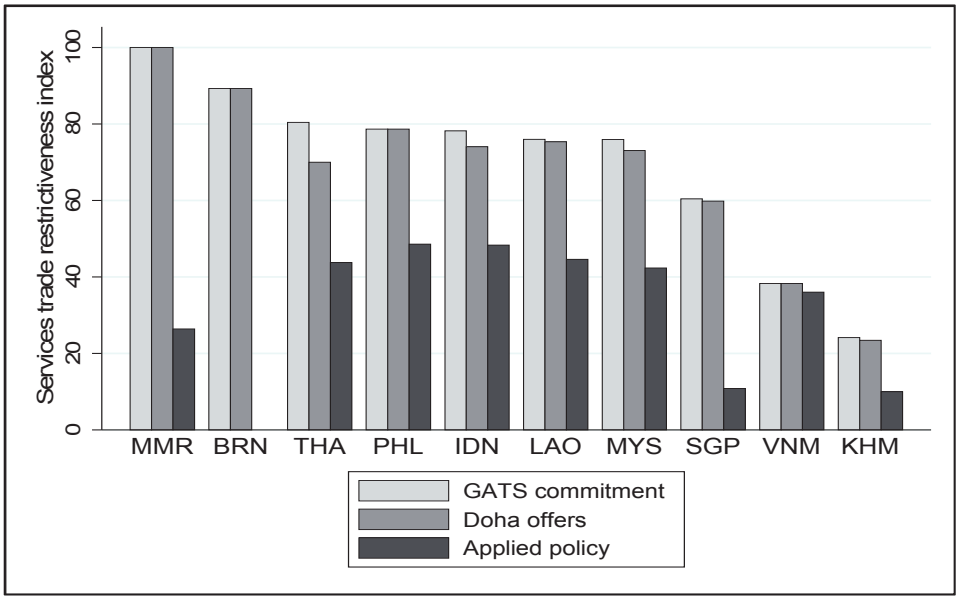
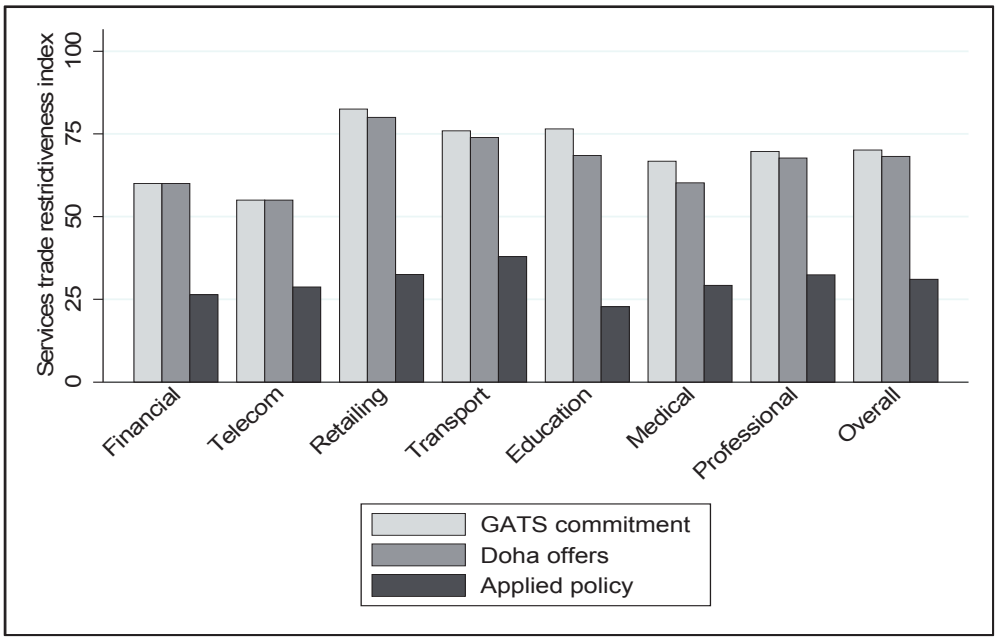


Figure 2.8 GATS Commitments, Doha Offers, and Applied Policy, by Industry



Note: More disaggregated scores are provided in Annex figure A.2.3.

Comparing regional and multilateral dimensions

57. **To summarize, the GATS commitments and Doha offers of ASEAN countries are far more restrictive than their AFAS commitments (with a gap of about 23 STRI points).** Thus, there is no doubt that the countries—especially Myanmar—have displayed a far greater willingness to widen and deepen their legal bindings in the regional than in the multilateral context. The two exceptions are again the recently acceding countries, Cambodia and Vietnam, whose WTO and AFAS commitments share some similarities. But the STRI of the ASEAN countries' AFAS commitments remains higher than that of applied policies, as seen above. And the gap between applied policy and Blueprint 2015 is about 20 STRI points.

Table 2.10 Restrictiveness of GATS Commitments, Doha Offers, AFAS Commitments, Applied Policy, and Blueprint Goals, by Country

Country	Restrictiveness of GATS Commitments	Restrictiveness of Doha Offers	Restrictiveness of AFAS Commitments	Restrictiveness of Applied Policy	Restrictiveness of Blueprint Goals
Brunei Darussalam	89.3	89.3	65.2	No data	19.1
Indonesia	78.2	74.0	49.5	48.3	19.1
Cambodia	24.1	23.4	18.5	10.0	19.1
Lao PDR	76.0	75.3	55.3	44.6	19.1
Myanmar	100.0	100.0	42.8	26.4	19.1
Malaysia	76.0	73.1	54.2	42.3	19.1
Philippines	78.7	78.7	55.0	48.6	19.1
Singapore	60.4	59.8	30.5	10.8	19.1
Thailand	80.4	70.0	58.5	43.8	19.1
Vietnam	38.3	38.3	36.4	36.0	19.1

Table 2.11 Restrictiveness of GATS Commitments, Doha Offers, AFAS Commitments Up To the Eighth Package, Applied Policies, and Blueprint Goals, by Sector

STRI, by Sector	Restrictiveness of GATS Commitments	Restrictiveness of Doha Offers	Restrictiveness of AFAS Commitments	Restrictiveness of Applied Policy	Restrictiveness of Blueprint 2015 Goals
Overall	**70.1**	**68.2**	**46.6**	**31.1**	**19.0**
Financial	**60.0**	**60.0**	**51.3**	**26.4**	**19.5**
Banking	64.6	64.6	59.0	24.6	21.3
Insurance	52.8	52.8	39.3	29.3	16.7
Telecom	**55.0**	**55.0**	**40.0**	**28.8**	**25.0**
Retailing	**82.5**	**80.0**	**42.5**	**32.5**	**25.0**
Transport	**75.9**	**73.9**	**40.0**	**37.9**	**21.8**
Maritime shipping	59.7	55.8	18.3	25.6	7.5
Maritime auxiliary	72.2	66.7	35.0	33.3	25.0
Road	77.5	77.5	45.0	37.5	25.0
Rail	92.5	92.5	70.0	59.4	25.0
Education	**76.5**	**68.5**	**57.3**	**22.8**	**10.0**
Medical	**66.8**	**60.3**	**31.8**	**29.3**	**10.0**
Professional	**69.7**	**67.7**	**51.2**	**32.4**	**10.4**
Accounting	73.0	73.0	49.0	27.0	10.0
Auditing	68.0	68.0	44.0	37.0	10.0
Legal advice domestic	91.3	91.3	90.0	53.8	12.5
Legal advice foreign	73.0	69.0	76.0	33.0	10.0
Engineering	60.0	57.0	32.5	28.0	10.0
Architecture	61.5	58.5	40.0	30.0	10.0
Management consulting	61.0	57.0	27.0	18.0	10.0

Table 2.12 Comparing Multilateral and Regional Commitments with Applied Policies: Restrictions on Entry and Ownership (Mode 3) in the Fixed Telecommunications Sectors

Country	GATS Commitments	Doha Offers	ASEAN Framework Agreement on Services (AFAS Eighth Package)	Blueprint 2015	Applied Policy (as of 2012), Reviewed by Government
Brunei	Subject to licensing by the appropriate regulatory authority and Companies Act. Local public switched voice telephone services are provided exclusively by Jabatan Telekom Brunei (JTB), a government department. International services: Exclusive monopoly until 2010, then, the government will review policy and decide whether to permit additional suppliers.	Offer is similar to GATS commitment.	Subject to licensing by the appropriate regulatory authority and Companies Act.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%. Progressively remove other Mode 3 market access limitations by 2015.	Data not available.
Cambodia	Provided exclusively by Telecom Cambodia until January 2009. Thereafter, no restrictions except a requirement that local shareholding of up to 49% is applicable.	Did not submit an offer.	No restrictions, except subject to requirement for local shareholding of up to 49%.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	No restrictions, except when acquiring a state-owned entity, the foreign equity limit is 49%.
Indonesia	Local services: Provided exclusively by PT Telecom until 2011. International: Provided exclusively by duopoly, expires 2005. Foreign equity limit is 35% and must be in form of a joint venture. At the end of each period, government decides whether to permit additional suppliers.	Offer is similar to GATS commitment.	Only through joint venture with local private sector. Foreign equity limit is 49%.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	There are no restrictions except foreign ownership limit is 49%.
Lao PDR	Only through acquisition of existing operators, and foreign equity participation limit is 49% for 5 years after the date of accession. Thereafter, commercial presence is allowed, with foreign equity limit of 60%.	Did not submit an offer.	Local and national long-distance services can be supplied only on a facilities basis for public use. 100% foreign owned or joint venture enterprise is allowed.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Foreign ownership limit in a state-owned entity is 49.9%.

Table 2.12 Comparing Multilateral and Regional Commitments with Applied Policies: Restrictions on Entry and Ownership (Mode 3) in the Fixed Telecommunications Sectors (continued)

Country	GATS Commitments	Doha Offers	ASEAN Framework Agreement on Services (AFAS Eighth Package)	Blueprint 2015	Applied Policy (as of 2012), Reviewed by Government
Malaysia	Entry allowed only through acquisition. Foreign equity limit is 30%.	With respect to network facilities and services provider: only through acquisition and foreign equity limit is 30%. The management must be controlled by Malaysians. For Telekom Malaysia, the foreign equity limit is 30% in aggregate with no single country holding more than 5% of the equity at any one time.	Only through acquisition of shares of existing licensed public telecommunications operators, foreign equity participation limited to 51% in such providers.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Entry is possible only through acquisition (no new license is allowed). The foreign equity limit is 49%.
Myanmar	No commitment.	Did not submit an offer.	No commitment.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%. Progressively remove other Mode 3 market access limitations by 2015.	Foreign Investment Law (2012) allows commercial presence of foreign service suppliers. No restrictions on the foreign equity participation.
Philippines	Franchise from the Congress and Certificate of Public Convenience and Necessity from the National Telecommunications Commission required. Foreign equity limit is 40%. All executives and managers must be citizens and limit on the share of foreigners in BOD is 40%.	Offer is similar to GATS commitment.	Entry is subject to the following requirements and conditions: 1. Franchise from Congress of the Philippines, 2. Certificate of Public Convenience and Necessity from National Telecommunications Commission, and 3. Foreign equity permitted up to 40%. 4. Resale of private leased line is not allowed.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Entry as a branch or acquisition of state-owned entity is not allowed. Foreign ownership limit is 40%. Nationality requirement for board of directors is 60%.

Table 2.12 Comparing Multilateral and Regional Commitments with Applied Policies: Restrictions on Entry and Ownership (Mode 3) in the Fixed Telecommunications Sectors (continued)

Country	GATS Commitments	Doha Offers	ASEAN Framework Agreement on Services (AFAS Eighth Package)	Blueprint 2015	Applied Policy (as of 2012), Reviewed by Government
Singapore	Up to two additional operators will be licensed in 1998 for the provision of these services commencing April 1, 2000. Thereafter, additional licenses will be granted. A cumulative total 73.99% foreign shareholding, based on 49% direct investment and 24.99% indirect investment in these operators is allowed.	A cumulative total 73.99% foreign shareholding, based on 49% direct investment and 24.99% indirect investment is allowed.	A cumulative total of 73.99% foreign shareholding, based on 49% direct investment and 24.99% indirect investment is allowed.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	No restriction on foreign ownership, there shall be at least except that at least one member of the Board of Director shall be Resident in Singapore.
Thailand	Must be locally incorporated. Foreign equity limit is 20% of the registered capital. Due to scarce resources, the number of licenses may be limited. Since 2006, new commitments will be introduced, conditional on new communications acts.	Offers reflect commitment, except: Starting in 2006, new commitments will be made, as the Thai Communications Acts are being revised.	Facilities-based: Foreign equity limit is 25%. Number of licenses may be limited. Head office and management must be in Thai territory.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Foreign-majority-owned or controlled providers may only offer services on a resale basis, and such offerings are limited to certain defined services. No other restrictions.
Vietnam	Facilities-based: Upon accession, joint ventures with telecom service suppliers duly licensed in Vietnam will be allowed. Foreign equity limit is 49%. Non-facilities based: Upon accession, joint venture with telecom service suppliers duly licensed in Vietnam with foreign equity limit of 51% is allowed.	Did not submit an offer.	None; services must be offered through commercial arrangements with an entity established in Vietnam and licensed to provide international telecommunication services.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Foreign equity limit is 70% (including facilities-based services). Approval required for majority control. The State of Vietnam holds dominant shares in telecommunications service providers with network infrastructure.

Sources: Uruguay round commitments, accession schedules, and Doha round offers are from the WTO website. ASEAN Framework Agreement on Services (AFAS): Eighth Package of Schedules; Financial Services, 5th Package of Schedules; and ASEAN Economic Community Blueprint, January 2008.

H. Conclusion

58. **This chapter presented and analyzed a rich body of applied policy information on ASEAN Member States.** Four gaps in data limit the scope of the present analysis and should be the focus of future data collection and research. First, there are inadequate data on the existing market structure—for example, the number of firms, their market share, and ownership—across sectors and countries, which means that policy measures analyzed capture the restrictions on entry into markets but do not capture the prevailing extent of competition between domestic and/or foreign firms. Second, good data are unavailable on outcome variables such as prices, quality, or diversity of services, which makes it hard to infer the restrictiveness of policies by econometrically analyzing their impact on outcome variables of interest. Third, thus only limited information can be captured on the state of prudential and procompetitive regulation, which makes it difficult to assess how nondiscriminatory measures offer de facto protection to domestic service providers. More important, this gap makes it difficult to assess how the gains from market opening depend on the state of complementary regulation, and it is worth emphasizing in this context that a mechanical elimination of trade barriers with inadequate complementary reform of regulation is not necessarily desirable. Finally, limited information on the implementation of policies can be captured. For instance, while an effort is made to identify certain aspects of the processes involved in licensing services providers, such as transparency and accountability, the process remains opaque, and it is difficult to determine the extent to which the processes in themselves offer protection to domestic providers. In some cases, the absence of laws and regulations makes it a challenge to assess actual practice, and thus to determine whether a de jure vacuum signifies de facto openness or prohibition.

59. **Despite these limitations, some clear conclusions can be reached.** First, the ASEAN Member States have an average STRI higher than that of the most other regions, and the pace of recent reform has been gradual. Furthermore, with regard to the explicit restrictions, there is little sign of preferential treatment of any ASEAN Member State of other Member States. While the absence of preferences is not a problem, the absence of reform is. Member States will need to reduce the remaining explicit barriers to foreign entry and ownership—ideally on an MFN basis—to achieve the Blueprint Goals by 2015.

60. **Second, regionalism offers a potentially valuable avenue for liberalization in areas where multilateral cooperation is difficult, such as in professional services and transportation.** ASEAN Member States made some progress in deepening regional integration in these areas, and the efforts continue. There remains room for ASEAN Member States to reform domestic regulations in professional services to better align them with the MRA provisions. In air transport, there is opportunity to further liberalize the freedom of rights by allowing seventh freedom and eventually even cabotage, and making the community ownership of designated airlines automatic.

61. **Third, successful liberalization requires supporting reform of domestic regulation, ranging from prudential regulation in financial and professional services to procompetitive regulation in telecommunication and transport services.** In these areas, too, there is scope for regional coordination and cooperation, to reap economies of scale in regulation and to prevent the fragmentation of the regional market because of divergent national regulation (Mattoo and Sauvé 2011).

62. **Finally, the reform process needs to be monitored, transparent, and informed by sound analysis.** For all these reasons, ASEAN Member States may consider how to remedy the shortcomings in the current state of data identified above. In particular, it will require effort to collect better data on the implementation of reform in all dimensions—ranging from liberalization to improvement in regulation—as well as the consequences of reform for market structures and market outcomes—relating to the prices, quality, diversity, and access to services. Such data would facilitate analysis of both the gains from reform and design of reform, which could make future reform socially desirable and politically feasible.

Annex 2.A Measuring Services Trade Policy, STRI

1. **The policy information in this study was obtained through two surveys in 2008 and 2012.** The 2008 survey covered six ASEAN countries and the 2012 survey covered 9 ASEAN countries. The three new ones were Myanmar, Singapore and Lao PDR. Table 2.A.1 describes the sectors and modes covered by the two surveys.[21]

Table 2.A.1 Sector and Modal Weighting Schemes Used for Constructing STRIs

Aggregate Sectors	Subsectors, by Mode of Supply	Modal Weights $w_m^{(j)}$	Sector Weights w_j
Banking	Mode 1:		0.149
	(1) Deposit acceptance	0.15	
	(2) Bank lending	0.15	
	Mode 3:		
	(3) Deposit acceptance	0.85	
	(4) Bank lending	0.85	
Insurance	Mode 1:		0.095
	(5) Life	0.10	
	(6) Automobile	0.10	
	(7) Reinsurance	0.80	
	Mode 3:		
	(8) Life	0.90	
	(9) Automobile	0.90	
	(10) Reinsurance	0.20	
Telecommunications	Mode 3:		0.095
	(11) Fixed-line	1.00	
	(12) Mobile	1.00	
Retailing	Mode 3:		0.239
	(13) Retail distribution	1.00	
Transportation	Mode 1:		0.223
	(14) Air passenger international	0.70	(0.037)
	(15) International shipping	0.70	(0.037)

[21] The Brunei survey was delayed because there is inadequate information on its policies.

Table 2.A.1 Sector and Modal Weighting Schemes Used for Constructing STRIs (continued)

	Mode 3: (16) Air passenger international (17) Air passenger domestic (18) International shipping	 0.30 0.30 0.30	
	(19) Maritime auxiliary (20) Road freight (21) Rail freight	1.00 1.00 1.00	(0.050) (0.062) (0.037)
Professional Services	Mode 1: (22) Accounting (23) Auditing (24) International law (25) Architecture (26) Engineering (27) Management consulting	 0.20 0.20 0.20 0.20 0.20 0.20	0.199
	Mode 3: (28) Accounting (29) Auditing (30) Domestic law (31) International law (32) Architecture (33) Engineering	 0.40 0.40 0.50 0.40 0.40 0.40	
	(34) Management consulting Mode 4: (35) Accounting (36) Auditing (37) Domestic law (38) International law (39) Architecture (40) Engineering (cc) Management consulting	0.40 0.40 0.40 0.50 0.40 0.40 0.40 0.40	
Education	Mode 1: Higher education Mode 2: Higher education Mode 3: Higher education Mode 4: Higher education	 0.15 0.15 0.40 0.30	

Table 2.A.1 Sector and Modal Weighting Schemes Used for Constructing STRIs (continued)

Health	Mode 1:		
	Medical and dental services	0.15	
	Mode 2:		
	Medical and dental services	0.15	
	Mode 3:		
	Medical and dental services	0.40	
	Mode 4:		
	Medical and dental services	0.30	

Note: The sector weights are used for constructing country STRIs. There are no sector weights reported for education and health services, because these sectors were not covered in 2008 surveys, and for comparison with 2008 country-level STRIs, the 2012 country-level STRIs do not aggregate STRIs for education and health. The STRIs for midwife and physical therapist services via Mode 4 were aggregated with medical dental services via Mode 4, with equal weights.

2. **It is notoriously difficult to measure policies affecting services trade because of their variety and complexity** (see, for example, the overview by Deardoff and Stern [2008]). Here, a measure of the restrictiveness of a country's policy regime, the Services Trade Restrictions Index (STRI) is developed, which has the weakness of being subjective but the virtue of being simple, transparent, and robust. This measure is most convenient to depict overall patterns in policy, across countries, modes, and sectors. It builds on a relatively long tradition of restrictiveness indexes, ranging from simple counts of policy barriers (Hoekman 1996) to more complex weighted averages, where weights reflect prior (usually subjective) assessments of the relative restrictiveness of specific policy barriers; work currently being undertaken at the OECD[22] uses an elaborate version of this method, which is described in OECD (2009a).

3. **A single measure of overall openness for any subsector mode combination is constructed; for example, one for the cross-border supply of bank loans and another for accepting bank deposits by establishing a commercial presence abroad.** This measure avoids the pitfalls of the approaches that assign fixed weights to all types of restrictions (entry, operational, regulatory) and that treat the restrictions as additive. For instance, if foreign suppliers are not allowed to enter in the first place, then that restriction is binding and other restrictions on operations and regulatory environment simply do not matter. Similarly, a foreign equity limit of 49 percent already precludes foreign corporate control, and so adding to it a further (frequently encountered) requirement that the majority of boards of directors be nationals would amount to double counting.

4. **Essentially, policy regimes are assessed in their entirety and assigned into five broad categories:** completely open, that is, no restrictions at all[23]; completely closed, that is, no entry allowed at all; virtually open but with minor restrictions; virtually closed but with very limited opportunities to enter and operate; and a final residual "intermediate" category of regimes that allow entry and operations but impose restrictions that are neither trivial nor stringent. Table 2.A.2 presents the five principal categories and illustrates what portfolio of policies might underpin the restrictiveness scores.

[22] Further information about the OECD's work in this area, which focuses on member economies, can be found at http://www.oecd.org/trade/stri, and is described in OECD (2011). The ability of their index to capture trade costs in services is explored in OECD (2009b).

[23] "No restrictions at all" applies only to the measures covered for a subsector mode; it does not mean there are no other restrictions that are not covered.

Table 2.A.2 How STRI Scores Are Assigned

Overall Policy Description	5-Point Scale	Policy Summary Examples for ASEAN Member States
Open without restrictions	0	**Cambodia: Retail bank loan – Mode 1** "No restrictions."
Virtually open	0.25	**Vietnam: Life insurance – Mode 3** "Entry as a branch is not allowed. No restrictions on foreign ownership in greenfield subsidiary or acquisition of existing entity."
Existence of major/nontrivial restrictions	0.50	**Thailand: Air passenger domestic – Mode 3** "The limit on foreign ownership is 49 percent, with effective control by Thai nationals. At least 40% of Board of Directors must be national."
Virtually closed	0.75	**Malaysia: Reinsurance – Mode 1** "Reinsurance companies must demonstrate domestic unavailability in both Malaysia and Labuan before obtaining services abroad."
Completely closed	1	**Philippines: Architecture services – Mode 3** "Commercial presence is not allowed."

Note: As is apparent from the examples shown, most subsector mode combinations are characterized by multiple provisions, in which case the regime assignment reflects the overall restrictiveness of all applicable measures.

5. **Since the principal criterion for covering certain policy measures in the database is their potential to significantly affect services trade, most measures in the database are taken into account in determining the STRI.** There are, however, some exceptions. First, there is a de minimis threshold in the sense that while some variables clearly add to the rich texture of the database, their restrictive impact is either not clear or small relative to the impact of other variables already considered. For instance, the failure to give advance notice prior to introducing regulatory changes is not penalized; or, when there are already restrictions on greenfield investment and acquisitions, additional restrictions on forming joint ventures are also not penalized. A variable may be more important in one sector, but its impact may fall below the de minimis threshold in others. For instance, restrictions on entry as a branch matter in financial services, but do not in other sectors where local incorporation is the preferred mode of establishing commercial presence; similarly restrictions on acquiring state-owned firms matter in the transportation and telecommunications sectors, where there are likely to be state-owned incumbents, but not in professional and retail services. Finally, a few variables for which the response rate was low or inconsistent, for example, license length or license allocation mode, were not considered for scoring, as cross-country differences would reflect response rates or interpretation differences rather than differences in restrictiveness.

6. **It is convenient to assign a value to each of these five categories of regimes on an openness scale from 0 to 1 with intervals of 0.25.**[24] The resulting score is called a Services Trade Restrictions Index (STRI). As the examples in table 2.A.2 show, most policy regimes have more than one provision in place per subsector and mode of supply, in which case the assigned score (shown in the right-most column) reflects the overall restrictiveness of all measures evaluated simultaneously.[25] Since the STRI focuses

[24] At this level, basic STRI scores are no more than "labels" attached to the five ordered categories of restrictiveness. However, as soon as these scores are further processed, either by aggregation or by use in a quantitative model, the specific values assume a cardinal meaning that implies the five categories are "equidistant" in terms of restrictiveness. The working paper version of this article (Borchert, Gootiiz, and Mattoo 2012b) discusses an alternative approach of ranking policy bundles purely ordinally.

[25] The Database Guide (Borchert, Gootiiz and Mattoo, 2012a) contains in its Section 4 three examples—from Burundi, Thailand, and India—that illustrate how a portfolio of several measures is being assigned to one of the five basic

mainly on the set of measures which discriminate against foreign services and providers, the greatest level of openness is associated with a value of zero. However, since the STRI does not adequately cover complementary areas of nondiscriminatory prudential and procompetitive regulation, and since it is likely that the results of liberalization depend on the state of these types of complementary regulation, it cannot be said that a zero level of STRI is necessarily immediately desirable from a broader welfare or development perspective.

7. **Once a score has been attached to each regime, STRI values can be aggregated across sectors and modes of supply.** Let s_{jmc} denote the basic scores on a five-point scale per subsector and mode of supply, as described in table 2.A.1 In order to arrive at an aggregate STRI of country *c*, $STRI_c$, weighted averages across modes of supply $m \in M$ are taken, whereby the set of modal weights $w_m^{(j)}$ is specific to sector *j*. The sectors differ in the relative importance of alternative modes for delivering a specific service. For instance, in a "consumer service" such as life insurance, a higher modal weight is attached to commercial presence than in the reinsurance sector, in which cross-border provision among firms is the dominant mode of supply. Formally, the sectoral scores are given by

$$STRI_{cj} = \sum_m w_m^{(j)} s_{jmc} \ .$$

8. **Sectoral scores are then aggregated across all sectors $j \in J$ using weights w_j that reflect the relative importance of constituent service sectors in domestic value added.** Sector weights w_j are based on service sectors' standardized share in total services output for an "average" industrialized country.[26] Overall country-level scores are obtained as

$$STRI_c = \sum_j w_j STRI_{cj} \ .$$

9. **The complete weighting schemes used to aggregate modes, subsectors, and sectors, respectively, can be found in table 2.A.2, including further details regarding the sectoral weights.** All scores at any level of aggregation are available from the STRI section of the database; in particular, the full set of baseline values s_{jmc} is accessible so that users are free to devise alternative aggregation schemes if they wish.

10. **The subjectivity of this approach is clear, but given data constraints and the wide range of sectors covered, there is no obviously superior method of quantification.** A demonstration that the STRI assessments are broadly corroborated by alternative methods of quantification can be found in Borchert, Gootiiz, and Mattoo (2012b). The subjectivity of the STRI is somewhat mitigated by the extensive consultations that have been done with the private sector and regulators in making the assignments of

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scores. In principle, policy measures can be divided into two tiers. The first-tier measures include those that affect market entry decisions most significantly, such as a limit on foreign ownership and the number of licenses. The second-tier measures are those that affect operations of service providers, such as restrictions on the repatriation of earnings. The second-tier measures do not contribute to overall restrictiveness when first-tier measures are prohibitive. In contrast, if the first-tier measures are not prohibitive, then second-tier measures are also considered in determining the overall restrictiveness score.

[26] A sense of how sectors are overweighted or underweighted in low-income countries can be gleaned from the fact that the share of financial and business/professional services tends to rise with income, whereas the share of retail distribution and, to some extent, telecommunications services, tends to decline with income. However, for the STRI to be comparable across countries, it is necessary to use one uniform set of weights for all countries.

weights to specific categories, and developing a scoring rule sheet, which sets out how a specific restriction is scored. The adopted approach is at this stage perhaps more suitable than any fixed algorithm to turn the rich and difficult-to-quantify aspects of policy information into broadly plausible if somewhat imprecise restrictiveness scores. In Paul Krugman's words, it has the virtue of being "roughly right rather than precisely wrong."

Weighting schemes for the STRI

11. **Table 2.A.3 documents the sets of weights used to derive aggregate, country-level STRI scores, $STRI_c$, from basic scores per subsector and mode, s_{jmc}.** Modal weights sum up to unity within any given subsector, for example, "accounting" (all subsectors are listed in table 2.A.1). Subsectors are aggregated to the sectoral level, for example, "telecommunications," using simple averages. Sector scores are aggregated to the country level using standardized weights based on the constituent service sectors' share in total services output for an "average" industrialized country. The service sector output shares are taken from Hoekman (1996, 37, Appendix 1) and scaled so as to make the weights of all sectors covered in the Services Trade Restrictions Database add up to unity. It is recognized that service sectors command a different share in total services output in different countries, especially across developing and developed countries, and are at least in part influenced by policy restrictions. As an empirical regularity, the share of financial and business/professional services tends to rise with income, whereas retail distribution and, to a lesser extent, telecommunications services, occupy a larger share in poorer countries. However, comparability requires the use of one uniform set of weights for all countries. The shares for an "average" industrialized country have been chosen as this benchmark because industrial countries tend to be more open, so shares are less likely to be distorted by restrictions.

Table 2.A.3 Sectors and Modes Covered by the Surveys in 2008 and 2012

Aggregate Sectors	Subsectors	Modes	Year
Financial	**Retail Banking** (1) Acceptance of deposits (2) Lending	Modes 1 and 3	2008, 2012
	Insurance		
	(3) Life (4) Automobile (5) Reinsurance	Modes 1 and 3	2008, 2012
Telecommunications	(6) Fixed line (7) Mobile	Mode 3	2008, 2012
Retailing	(8) Retailing	Mode 3	2008, 2012
Transportation	(9) Air passenger international (10) Air passenger domestic (11) Air cargo international	Modes 1 and 3	2008, 2012
	(12) Air cargo domestic (13) International shipping		
	(14) Maritime shipping auxiliary (15) Road freight[a] (16) Rail freight		

Table 2.A.3 Sectors and Modes Covered by the Surveys in 2008 and 2012 (continued)

Aggregate Sectors	Subsectors	Modes	Year
Professional Services	(17) Accounting (18) Auditing Advice on domestic law Advice on foreign law	Modes 1, 3, and 4	2008, 2012
	Architecture		only 2012
	(22) Engineering (23) Management Consulting		
Education	Higher education	Modes 1, 2 3, and 4	only 2012
Health	Medical and dental services	Modes 1, 2 3, and 4	only 2012
	(26) Nurses and Paramedics	Modes 4	only 2012

Note: As an exception to the modal aggregation rule outlined above, air passenger transport subsectors are first aggregated within Mode 3, that is, air passenger domestic and air passenger international, then the resulting modal score is aggregated with Mode 1 using the modal weights as shown.
a. In road transport, only Mode 3 in 2008 and both Mode 1 and Mode 3 in 2012 were covered.

12. For most sectors, the deviations between the set of weights used and weights representative of low-income countries are not large; if anything, scores in the retailing sector are underweighted, whereas professional services scores are somewhat overweighted.

13. Figures 2.A.1 and 2.A.2 present Services liberalization commitments measured by the STRI methodology in different sectors by ASEAN countries under AFAS and WTO respectively. Figure 2.A.3 gives the score of applied policies by ASEAN countries in different sectors.

Figure 2.A.1 AFAS Commitments, Applied Policy, and Blueprint Goals by Sector

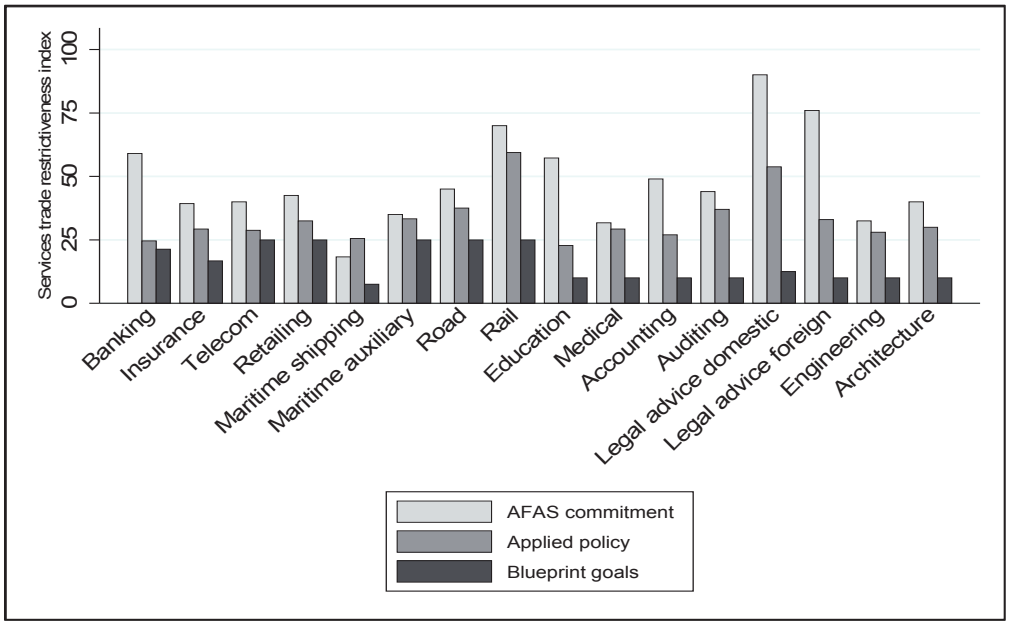


Figure 2.A.2 GATS Commitments, Doha Offers, and Applied Policy, by Sector

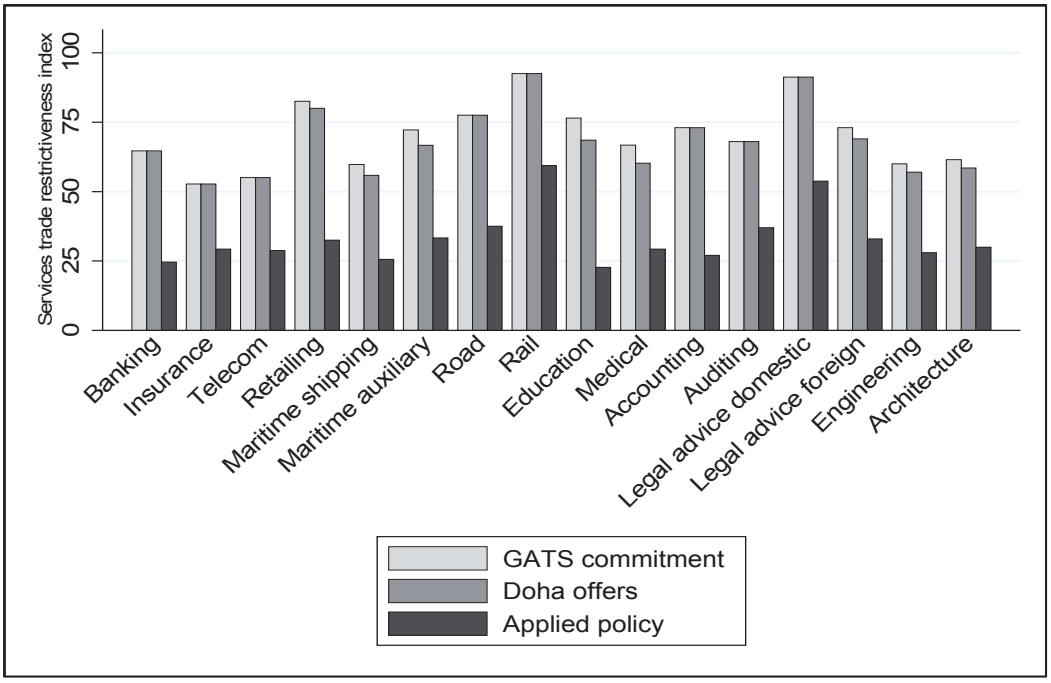
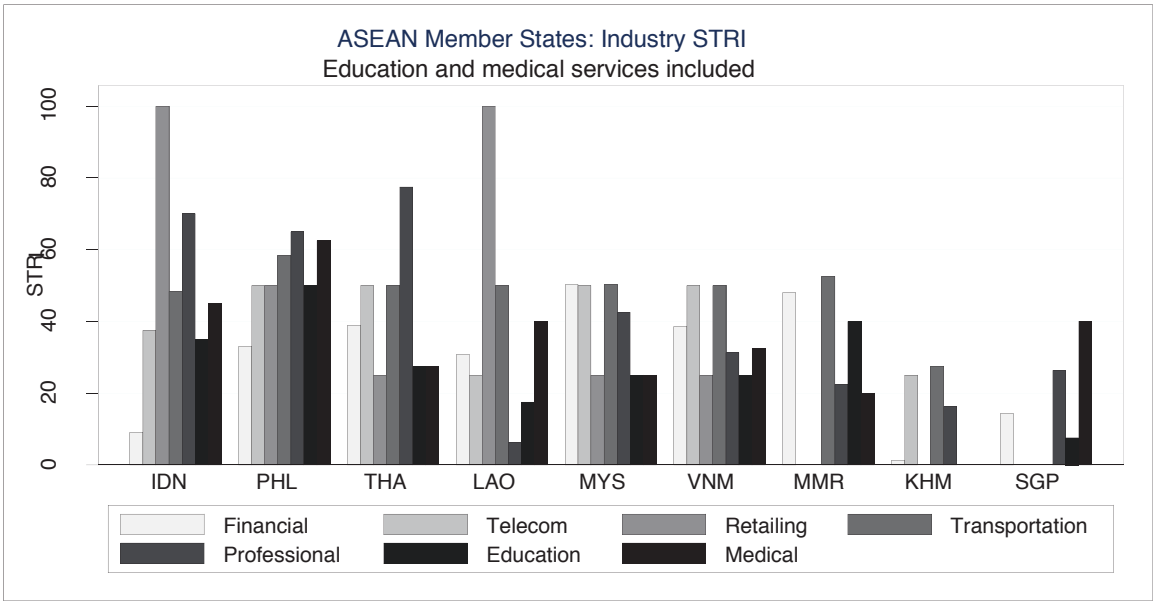


Figure 2.A.3 Applied Policies for ASEAN Member States, by Industry



Annex 2.B ASEAN Multilateral Agreements in Air Transport[27]

1. **The discussions on regional air services agreements started in November 2004, during the 10th ASEAN Transport Ministers' Meeting held in Cambodia, with adoption of a document called the Action Plan for ASEAN Air Transport Integration and Liberalization 2005–2015.** The Action Plan, together with an accompanying document known as the Roadmap for Integration of Air Travel Sector (RIATS), established the objective of achieving an effective "open skies" regime for the region by the target date of 2015. The RIATS aimed to fully liberalize air cargo services by 2008 and allow third, fourth, and fifth freedom flights to the regional air passenger service providers between designated points within ASEAN subregions by 2006, and between ASEAN capital cities by 2010.

2. **Subsequently, the RIATS commitments for passenger services were formalized as two legal agreements for ASEAN Member States' acceptance.** These are the Multilateral Agreement on Air Services (MAAS) and the Multilateral Agreement on the Full Liberalization of Passenger Air Services (MAFLPAS), adopted in 2009 and 2010, respectively. Concurrently, an agreement for cargo transport was also adopted—the 2009 Multilateral Agreement on the Full Liberalization of Air Freight Services (MAFLAS). Most recently the Protocol to Implement the Eight Package of Commitments on Air Transport Services has also been signed.

What is allowed under the agreement?

3. **Overall, the objectives of the agreements are found to be modest—market access relaxations are limited to the third, fourth, and fifth freedoms, and have not extended to the seventh, eighth, and ninth freedoms.**[28] More specifically, the MAAS Implementing Protocols specify the following "third," "fourth," and "fifth" freedom market access rights:

- Protocol 1 Unlimited Third and Fourth Freedom Traffic Rights Within ASEAN Sub-Region
- Protocol 2 Unlimited Fifth Freedom Traffic Rights Within ASEAN Sub-Region
- Protocol 3 Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Sub-Regions
- Protocol 4 Unlimited Fifth Freedom Traffic Rights Between ASEAN Sub-Regions
- Protocol 5 Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Capital Cities
- Protocol 6 Unlimited Fifth Freedom Traffic Rights Between ASEAN Capital Cities

4. **The first four Implementing Protocols of MAAS—Protocols 1 to 4—are limited in impact and relatively straightforward.** By virtue of their geographic scope, they only deal with market access relaxations designed to spur growth within subregions straddling the Member States' boundary regions, and the designated points are mainly secondary cities (Forsyth et al. 2006). Four such subregions have been identified (new subregions may be declared or existing ones expanded): the Brunei Darussalam, Indonesia,

[27] This section is based on the insightful study by Tan (2013).

[28] *Third and fourth freedom:* If the Singapore carrier has rights to carry passengers from Singapore to Bangkok, it is utilizing the "third freedom" granted by Thailand to Singapore. The reverse journey back to Singapore with the same rights would constitute the "fourth freedom." *Fifth freedom:* In both directions, if the carrier has the right to stop over in Malaysia to drop off some passengers and fill up the vacated seats with new passengers picked up from there, this is the "fifth freedom" granted to Singapore by both Thailand and Malaysia that permits Singapore carriers to carry traffic between their respective points. *Seventh freedom:* The right of a carrier to connect two international points *outside of its home country*. *Eighth freedom:* If the flight originates in the carrier's home country (Malaysia), and operates between domestic points within the contracting party (Jakarta and Bali). *Ninth freedom:* The same carrier operates between domestic points (Jakarta and Bali) of contracting party without starting or ending in the home country.

Malaysia, and the Philippines East ASEAN Growth Area (BIMP-EAGA); the Sub-regional Cooperation in Air Transport among Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV) (this corresponds with the CLMV Agreement); the Indonesia, Malaysia, Singapore Growth Triangle (IMS-GT); and the Indonesia, Malaysia, Thailand Growth Triangle (IMT-GT).

5. **In terms of air traffic volume and market potential, Protocols 5 and 6 have much greater economic significance, since these cover the 10 capital cities and are not limited by subregional proximity.** Specifically, Protocol 5 provides contracting states' designated carriers with unlimited third and fourth freedom opportunities between their own capital city and all the other ASEAN capital cities. Protocol 5 further provides that such rights shall be allowed by December 31, 2008 (although, as noted above, Protocol 5 was actually adopted only in May 2009). Protocol 6 lays down a deadline of December 31, 2010, for a contracting state's designated carriers to operate full third, fourth, and fifth freedom rights from their capital city to other contracting states' capital cities (for example, a Malaysian carrier from Kuala Lumpur to Hanoi with fifth freedom pickup rights in Phnom Penh).

6. The MAFLPAS Implementing Protocols address the following market access rights:

- Protocol 1 Unlimited Third and Fourth Freedom Traffic Rights Between Any ASEAN Cities
- Protocol 2 Unlimited Fifth Freedom Traffic Rights Between Any ASEAN Cities.

7. **The MAFLPAS agreement was designed to supplement MAAS and to cover the rest of the ASEAN cities.** Hence, MAFLPAS Protocol 1 allows for unlimited third and fourth freedom operations for state parties' carriers between two noncapital cities, or between a noncapital and a capital city (capital-to-capital operations remain governed by MAAS Protocol 5). MAFLPAS Protocol 2 provides for unlimited fifth freedom operations involving the noncapital cities. Under its terms, Protocol 2 can also cover flights involving capital cities, except when *all three points* are capitals, in which case MAAS Protocol 6 governs.

Ownership and control

8. **How have the ASEAN multilateral agreements sought to deal with these ownership and control restrictions?** In essence, when both market access and ownership and control are freed up, the Member States can achieve a single air market. On top of prohibiting seventh freedom and domestic operations by foreign carriers, the current ASEAN regime allows limits to be placed on carriers like AirAsia from going into, say, Indonesia, either to establish a wholly owned subsidiary or to buy an existing local airline fully. In comparison, the EU permits any EU national to move into another EU country and establish a fully owned airline there, *and* fly it between any two points within the EU (including domestic points).

9. **Interestingly, both MAAS and MAFLPAS provide *alternatives* to the traditional "substantial ownership and effective control" rule.** They allow an "ASEAN community carrier," which means an airline can be substantially owned and effectively controlled by ASEAN interests *taken cumulatively or in the aggregate* (Tan 2009). This means that airlines can now attract capital infusions and management expertise from more sources across ASEAN. However, it is not clear that the "community carrier" can fly into all Member States in the region, because the Member States receiving an application from such a carrier must provide an approval before the carrier can operate. To encourage investors to establish airlines in the region, it would help if a specific number of Member States declared their unequivocal approval for such a model. For now, investors comply with the traditional "substantial ownership and effective control of nationals" rule. No community carrier has thus far been set up in ASEAN, and new airlines like Malindo and Thai Vietjet Air continue to employ the traditional joint venture model that requires majority ownership and effective national control. A regime that allows carriers bearing a community ownership structure to be recognized automatically in ASEAN will be a way forward. One solution is to allow Member States to

retain the traditional *national* ownership and control restrictions for *their own* designated carriers if they wish to, without affecting other carriers' ability to be set up as community carriers.

How far have the Member States implemented these agreements and the relevant commitments?

10. **The agreements are in force among most ASEAN Member States. However, some states need to be brought more fully within the scope of the agreements.** Both MAAS and MAFLPAS are in force after having received the acceptance of the minimum number of three ASEAN Member States for each agreement. At the same time, the respective Protocols' separate requirements for entry into force have been satisfied. All the Protocols are thus in force for those Member States that have ratified them. As shown in table 2.B.1, all Member States have accepted MAAS Protocols 1 to 4, but Protocols 5 and 6 have not yet been ratified by the Philippines. In the case of MAFLPAS and its Protocols 1 and 2, Indonesia and Lao PDR are not yet state parties (table 2.B.2).

11. **The following tables summarize the Member States' ratification status as of October 2013.**

Table 2.B.1 Ratification Status of 2009 Multilateral Agreement on Air Services (MAAS)

	MAAS (Parent Agree-ment)	Protocol 1: Third and Fourth Freedom within Subregion	Protocol 2: Fifth Freedom within Subregion	Protocol 3: Third and Fourth Freedom between Subregions	Protocol 4: Fifth Freedom between Subregions	Protocol 5: Third and Fourth Freedom between Capitals	Protocol 6: Fifth Freedom between Capitals
Brunei Darussalam	✓	✓	✓	✓	✓	✓	✓
Cambodia	✓	✓	✓	✓	✓	✓	✓
Indonesia	✓	✓	✓	✓	✓	✓	✓
Lao PDR	✓	✓	✓	✓	✓	✓	✓
Malaysia	✓	✓	✓	✓	✓	✓	✓
Myanmar	✓	✓	✓	✓	✓	✓	✓
Philippines	✓	✓	✓	✓	✓	[X]	[X]
Singapore	✓	✓	✓	✓	✓	✓	✓
Thailand	✓	✓	✓	✓	✓	✓	✓
Vietnam	✓	✓	✓	✓	✓	✓	✓

Source: ASEAN Secretariat.
Note: ✓ denotes state party; [X] denotes nonstate party.

Table 2.B.2 Ratification Status of 2010 Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS)

	MAFLPAS (Parent Agreement)	Protocol 1: Third and Fourth Freedom between all Cities	Protocol 2: Fifth Freedom between all Cities
Brunei Darussalam	✓	✓	✓
Cambodia	✓	✓	✓
Indonesia	[X]	[X]	[X]
Lao PDR	[X]	[X]	[X]
Malaysia	✓	✓	✓
Myanmar	✓	✓	✓
Philippines	✓	✓	✓
Singapore	✓	✓	✓
Thailand	✓	✓	✓
Vietnam	✓	✓	✓

Source: ASEAN Secretariat.
Note: ✓ denotes state party; [X] denotes nonstate part

12. **Indonesia is, of course, the one Member State whose acceptance of the ASEAN agreements is critical for the entire ASEAN Single Aviation Market (ASAM) project.** Spanning 17,000 islands and home to 270 million people (effectively half the entire ASEAN population), Indonesia has the region's largest land area, economy, population, and air travel market. Its capital, Jakarta, is ASEAN's biggest city by population.

13. **Indonesia's position on the ASEAN agreements can be traced to its leading carriers' lobbying of their government to continue protecting their international operations against those of rival airlines from neighboring ASEAN states.** Through their industry group, the Indonesian National Air Carriers Association (INACA), the major carriers are traditionally not in favor of efforts to open up the ASEAN air travel market (although see below for recent changes in attitude). Their concern lies with the stronger airlines from the other ASEAN states, principally Malaysia, Singapore, and Thailand, which may dominate the international market between Indonesia and these countries. INACA's position is that as a huge archipelago, Indonesia has hundreds of points to offer international aviation, whereas the other states have far fewer points to offer (indeed, Singapore has all of one!). For some Indonesian carriers, this represents a systemic imbalance for exchanging air traffic rights.

14. **Overall, despite Indonesia's traditional stance toward liberalization, the recent capacity revision with Singapore is a positive development.** It shows that the Indonesian carriers are likely to support (or at least not object to) capacity increases for foreign carriers when they themselves come close to exhausting their own limits to fly to other states.

15. **Indeed, the Indonesian carriers are expanding rapidly across the region, showing a capability and willingness to compete with their regional rivals.** Lion Air has even established a subsidiary, Malindo, in Malaysia, taking the challenge right into the turf of its Low Cost Carrier (LCC) rival, AirAsia. In essence, Lion Air is seeking to penetrate AirAsia's home market in the same manner that the latter has entered Indonesia. Another subsidiary, Thai Lion Air, is scheduled to commence operations in Thailand in

late 2013. Yet another subsidiary in Myanmar is reportedly being launched. In short, Lion Air is seeking to replicate AirAsia's experience with its joint venture subsidiaries across the region.

16. **In this backdrop, there have been encouraging changes in Indonesia's policy on the ASEAN agreements.** The Indonesian Government has ratified MAAS Protocols 5 and 6. This will be a huge boost for the ASEAN Single Aviation Market integration project and the entire region.

17. **In comparison, the Philippine government's position is slightly different.** The Philippines has actually embraced MAFLPAS Protocols 1 and 2 to open up access to its secondary cities in a bid to spur regional development. Yet, it has kept its capital, Manila, restricted and has not ratified MAAS Protocols 5 and 6. The government justifies its decision based on the shortage of landing and takeoff slots and overall runway congestion at central Manila's Ninoy Aquino International Airport.

18. **While the concern over congestion at Ninoy Aquino International is understandable, the attempt to link traffic rights and airport slots is problematic.** Indeed, these are separate matters that should be kept distinct. In particular, the lack of airport slots should not prevent Member States from ratifying the ASEAN agreements to liberalize market access rights and to signal their support for the ASEAN's market integration efforts. Linking slots to access rights may encourage air rights negotiators to use congestion and lack of slots (which may be within the competence of other government agencies) as pretexts to delay their acceptance of regional agreements.

19. **For its part, it is unclear why Lao PDR has not ratified MAFLPAS Protocols 1 and 2.** It is likely that internal consultations are ongoing within Lao government agencies and that ratification will happen soon. It should also be noted that Cambodia, in 2013, submitted instruments of ratification for MAFLPAS and Protocols 1 and 2, becoming the latest Member State to ratify these agreements.

Chapter 3. Services Liberalization in ASEAN Countries: Impacts, Experiences, and Lessons

Findings from case study analyses highlight the complementarity of private sector initiative and government support for success in services exports. For example, the strong trade performance of higher education services in Malaysia, medical tourism in Thailand, and back-office processing in the Philippines have been based on private investments that were accompanied by an enabling business and regulatory environment and an active role of the government in establishing and monitoring quality standards. Also, public authorities often have a crucial role in mitigating adverse distributional effects and social hardship that might result from trade-induced structural adjustment in social sectors.

A. Introduction

1. **This chapter summarizes sectoral reform experiences undertaken in a unilateral, plurilateral, and multilateral context and their implications in ASEAN Member States.** Five examples are analyzed: higher education services in Malaysia, financial services in Singapore, health services in Thailand, telecommunication-based services in the Philippines, and transport services in the Greater Mekong region. These case studies highlight important elements of the process to reform domestic service sectors and attract investment, and could contains lessons for other ASEAN Member States that are envisaging similar services trade policy reforms.

2. **One recurrent theme that emerges across the case studies is cooperation between the government and the private sector in conceiving and implementing service sector reforms.** Private firms are often the driving force and key client of change and trade success; therefore, government support to facilitate and encourage investment is critical. At the same time, governments have an important role to play in accommodating private initiatives and developing a regulatory and operational framework, such as through standards, accreditation, and quality control measures, which enable the development and internationalization of services, while protecting domestic consumers. Hence, the process of fostering services trade is not only a question of liberalization and the opening of markets, but also a process of careful regulatory reform that encourages competition, efficiency, and service quality.

B. Malaysia: Higher Education Services

3. **Education plays a crucial role in fostering personal and social development, and is a driver for economic growth and development.** Because of its central importance for society, government involvement in the sector has traditionally been very prominent. Most schools, technical colleges, universities, and adult education centers have typically been owned, financed, and operated as public facilities. Yet demographic changes, technological developments, and the evolution of national development goals have over time prompted governments toward reforms that have opened the sector to new operating models and the involvement of private service providers. In parallel, international trade in education services, particularly at the tertiary level, has been growing in importance (WTO 2010).

4. **Malaysia has been one of the pioneers in Southeast Asia in developing a private higher education sector and fostering cross-border trade in education services.** In particular, the Government of Malaysia has introduced major educational reforms since the mid-1990s in order to turn the country into a regional education hub. Private institutions were allowed to offer tertiary degrees, and foreign universities received permission to establish branch campuses. As a result, the number of privately and foreign-

controlled educational service providers, and the number of foreign students studying in Malaysia, have increased markedly.

Higher education policy reforms

5. **Two of the priorities during the two decades following Malaysia's independence in 1957 was fostering national unity and pursuing policies that would equalize opportunities among people of different ethnic backgrounds.** Broadening access to publicly funded higher education was a means to advance this social equity objective, and the government expanded the supply of educational services accordingly. The University of Malaysia, the first in the country, was founded in 1961, and by the 1980s, strong demand for college and university education had led to the establishment of several other institutions of higher education. Yet, the resulting investment and operating costs started to put growing strains on the government's budget. Government expenditure on tertiary education increased from 9 percent in 1970 to 13 percent of GDP in 1990 (Ziguras 2001).

6. **Despite the government's investments in higher education, the available university places remained insufficient to meet the demands for tertiary education, and those who were unable to secure admission to the local universities had to turn to overseas institutions.** In 1995, about 20 percent of Malaysian students were pursuing degrees abroad (Ziguras 2001). In order to stem the outflow of currency for overseas education and to satisfy the growing demand for university education, the government decided to liberalize its educational system, allowing the private sector to engage in higher education (Abidin et al. 2012). These reforms paved the way for the subsequent growth and export success of Malaysian educational service providers.

7. **Several laws and regulations have been instrumental in fostering the development of an internationalized system of higher education in Malaysia since the mid-1990s** (table 3.1). This body of legislation notably established a framework for the operation of private colleges and universities, as well as foreign branch campuses. In parallel, it created the necessary institutional infrastructure of accreditation and quality assurance in order to ensure that the newly emerging educational offerings were satisfying the government's minimum standards and were in line with international standards. Also, in 2004, the government shifted responsibilities for tertiary education from the Ministry of Education to a new, dedicated Ministry of Higher Education, which oversees the sector and guides its development.

Table 3.1: Main Legislation Concerning the Internationalization of Higher Education in Malaysia

Law/Regulation	Description
Private Higher Educational Institutions Act, 1996	The act opened the doors for Malaysian private higher education institutions to award certificates either at the subdegree level or through degree programs offered as a result of collaborative or twinning arrangements with local or foreign universities.
National Accreditation Board Act, 1996	The law led to the creation of the National Accreditation Board (renamed the Malaysian Qualifications Agency), with responsibilities for accreditation and quality control with respect to private higher educational institutions.
Private Higher Educational Institutions Act, amended 2003	The amendment paved the way for the establishment and upgrading of private universities, university colleges, and branch campuses of foreign universities in Malaysia.
Malaysian Qualifications Act, 2007	The law created a single quality assurance body through the merger of two respective government bodies.

Source: Nga 2009.

8. **In order for private sector service suppliers to conduct courses and degree programs in Malaysia, four administrative stages are required.** First, prospective tertiary education providers must secure approval from the Ministry of Higher Education to establish a private higher educational institution. This process is based on an invitation the ministry extends to private universities and branch campuses of foreign universities, or on an application put forward by a particular educational institution. All applicants must be incorporated as local companies. Second, the institution has to secure registration from the Private Higher Education Management Sector within the ministry. Third, the private higher educational institution needs to apply to the Ministry of Higher Education to get permission to conduct its particular course or training program. And fourth, the Malaysian Qualification Agency must give its green light concerning the extent to which the courses meet Malaysia's minimum standards. This assessment then forms the basis for the recommendation to the Minister of High Education on whether to grant overall approval for the launch of the private higher educational institution's course and degree programs (Yean and Yi 2007). Only accredited programs are allowed to recruit international students.

9. **In 2007, the Government of Malaysia launched the National Higher Education Strategic Plan to further advance the privatization of higher education, while emphasizing standardization and quality assurance.** It thereby aims to establish world class higher education institutions by 2020 that can produce highly qualified graduates for modern jobs in industry and services. The Strategic Plan also established ambitious targets of more than doubling the number of foreign students pursuing degrees in Malaysia to 200,000 by 2020 and increasing export earnings from higher education correspondingly.

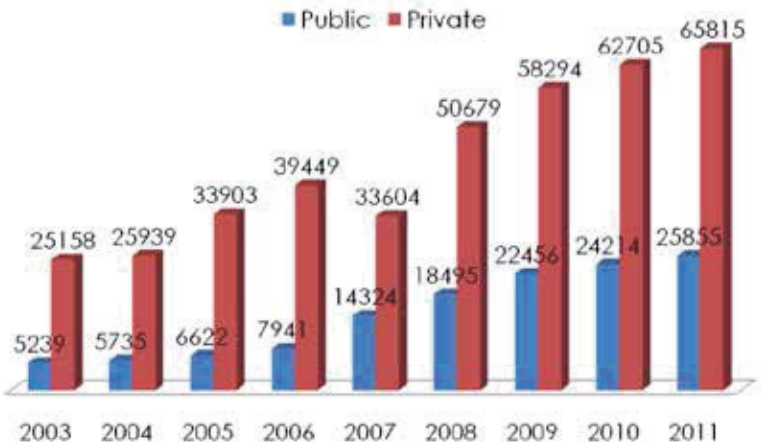
10. **As part of the drive toward the internationalization of higher education, the government has been promoting the development of EduCity Iskandar in Southern Malaysia.** This integrated education hub is to bring eight foreign universities together on a single campus by 2015, so that they can share common facilities, such as student accommodations and sports and recreation centers. EduCity is located within a 15-minute driving distance from Singapore, and is part of a larger cluster of tourism, wellness, and creative services activities.

Trade in higher education services

11. **While the liberalization of the higher education sector in Malaysia was initially driven by the objective of providing opportunities for university study for Malaysians, that is, to meet domestic demand, it quickly became evident that the sector also offered substantial potential for international services trade.** Indeed, Malaysia turned out to have several significant strengths as an exporter of higher education services: English is widely spoken and used as the language of instruction; the country represents a welcoming melting pot of cultures, traditions and ethnicities; and living costs and course fees are relatively low. Completing a degree in an Australian branch campus in Malaysia has been estimated to cost about US$32,000 compared with US$87,000 on the Australian mother campus (Yean and Yi 2007). Meanwhile, the government's efforts with respect to accreditation of educational establishments and recognition of programs nationally and internationally have helped to make the study options attractive for foreigners.

12. **Indeed, the number of international students hosted in Malaysia expanded quickly over the last decade and more than tripled between 2003 and 2011 to more than 91,000** (figure 3.1). Most students hail from Southeast Asia or the Middle East, with Indonesia, China, and Iran being the most prominent countries of origin. Each foreign student is estimated to contribute on average about 30,000 ringgit (US$9,600) to Malaysia's gross national income per year (Abd Aziz 2012).

Figure 3.1 Foreign Students Hosted in Malaysia



Source: Ministry of Higher Education.

13. **In addition to foreigners consuming education services in Malaysia—that is, services trade under Mode 2—there is also trade under the other three modes: cross-border trade, commercial presence, and temporary movement of persons.** Malaysia has several universities that provide for distance or online learning services, two of which also serve foreign students through cross-border trade. In particular, the Asia e-University had 1,033 local and 217 foreign students in 2012, and the Open University Malaysia had 64,253 local and 128 foreign students (Abd Aziz 2012).

14. **Concerning commercial presence, Malaysia had attracted seven branch campuses of Australian, British, Dutch, and Indian universities by 2011.** These branch campuses offer the same courses and degrees as the home universities to students based in Malaysia, thus making it possible for students to realize substantial savings in living expenses while pursuing an internationally renowned degree. In 2011, three-quarters of the 15,300 students at Malaysia's foreign branch campuses were from the host country, while the remaining quarter was foreigners.

15. **Partly related to the need to staff foreign branch campuses, Malaysia is also a significant importer of higher education services through the temporary movement of natural persons.** According to the Ministry of Higher Education, there were 6,684 international academic staff working at higher education institutions in Malaysia in 2010.

16. **Moreover, a number of private higher education institutions have made transnational arrangements with foreign partners to facilitate the movement of Malaysian students, and, hence, services trade.** Under these twinning or advanced credit transfer arrangements, students who have successfully completed certain parts of their studies at Malaysian private higher educational institutions are enabled to enter the degree programs at the partner university abroad at an advanced stage and receive their degree from the foreign university in an accelerated manner.

17. **Despite notable success in the internationalization of higher education, Malaysia is encountering a number of challenges in the sector.** In particular, international rankings of universities do not place Malaysian institutions very highly. Decades of affirmative action in the public sector have eroded the quality of the faculty pool, as measured, for example, by the percentage of faculty with PhDs, coupled with an overly centralized administration and lack of research funding. There is evidence that graduate unemployment has been rising, while midlevel skills are in short supply and technical education and vocational training need to be better

coordinated (Boston Consulting Group 2011). In short, while Malaysia has succeeded in promoting private and international provision in higher education, there is a need to accelerate reforms of the overall domestic higher education framework.

Lessons for Higher Education Reform in ASEAN

18. **The impetus of the reform process of higher education in Malaysia was to improve the availability of high-quality tertiary education opportunities for domestic students.** The government realized that increasing demand for university study could be better served by harnessing private sector capital and initiative, while making sure that new, private service providers adhere to a set of minimum quality standards. Yet fairly soon, the new universities realized that they could not only offer an attractive education program to local students so that more of them did not need to study abroad, but that the private higher educational institutions themselves could profitably attract foreign students to pursue degrees in Malaysia.

19. **Several factors seem to have been instrumental for the export success of Malaysia in the higher education sector.** The government's willingness to liberalize higher education and cede some control over the sector's development to private service providers laid the foundation for the subsequent dynamism in the sector. At the same time, the government established a regulatory framework for new private universities and set up the quality assurance infrastructure that made it possible to avoid a slide toward educational establishments that merely serve as "degree mills." Further, the outward orientation and international benchmarking when setting standards for courses and degrees anchored the credibility of the new educational offerings, and facilitated the recognition of graduate qualifications from these private higher educational institutions, which would in turn attract more demand. Finally, the active pursuit of partnerships with foreign universities through branch campus establishment or twinning programs brought foreign expertise and competition to the country that have helped lift the prestige of receiving a university education in Malaysia. This favorable reputation in combination with the cost advantages of study and student life triggered the education services export boom that Malaysia experienced over the last decade.

20. **All of these aspects of higher education reform could also be gainfully pursued in other ASEAN countries.** They represent good policy practice that will help establish a well-performing domestic education sector. Whether such a tertiary education system then goes on to yield export success will also depend on other factors, such as language considerations, cost competitiveness, the sociopolitical environment, and immigration policies. Within Southeast Asia, Singapore and Thailand already have ambitious targets to increase their intake of foreign students over the coming years, as have Australia, China, and Japan in the wider Asia-Pacific sphere (Abd Aziz 2012). Nevertheless, the global market for tertiary education is expanding, so that other countries in the region might well want to pursue strategies for developing education hubs that serve the worldwide increasing number of international students or the region's own students who are currently looking at overseas education. As ASEAN economies become more dynamic and appealing to international businesses and organizations, there is additional value in pursing higher education in the region, since it gives students an edge in understanding the local context and dynamics that would facilitate their professional aspirations.

C. Singapore: Financial Services

21. **Financial institutions play a critical role in managing risks and closing information gaps within society.** They diversify the risks faced by depositors by pooling their savings and distributing them among many creditors. They also collect and evaluate the information necessary to make prudent and productive investment decisions. Moreover, they contribute to better corporate governance by evaluating the performance of borrowers and, when necessary, compelling them to act in the best interests of the firm—and therefore of its providers of funds (Dobson 2008). Yet, to perform this critical role properly, financial

institutions need a regulatory framework that ensures the stability of the overall system in the interest of all participants.

22. **Given the crucial role of financial services in modern economies, having a well-performing financial system is a central element of any growth and development strategy.** In this context, fostering competition in the sector to entice financial institutions to provide high-quality services at reasonable prices is key. Opening financial markets to foreign service providers is one important means of generating such a procompetitive business environment. In particular, financial services liberalization calls for the removal of discriminatory quantitative or qualitative regulation that used to keep foreign financial service providers out of the domestic market. These regulatory measures can notably concern cross-border trade and the commercial presence of banking and insurance companies.

23. **Since the late 1960s, Singapore has actively promoted the development of its financial sector, with the aim of becoming a financial center in the region.** At that time, Singapore was dominated by foreign banks. From the early 1970s, the Monetary Authority of Singapore (MAS) adopted policies to protect the local banks, especially in retail banking, so that they could grow and assume a larger share of the domestic market. MAS decided in the late 1990s that there was a need to proactively manage the inevitable increase in competition to further strengthen the local banks. MAS undertook a comprehensive review of Singapore's financial system against the backdrop of the Asian Financial Crisis. This eventually led to significant liberalization of the financial sector, and a more risk-based supervisory approach. Further liberalization measures were extended in bilateral and plurilateral Free Trade Agreements that Singapore signed with a number of international partners, including ASEAN, Australia, Japan, New Zealand, and the United States. This liberalization effort was accompanied by strengthening the regulatory framework through more demanding disclosure standards, liquidity support, deposit guarantees, and foreign exchange arrangements.

Policy reforms concerning financial services

24. **The liberalization in Singapore's retail banking sector was undertaken in a gradual manner and involved several phases (AIMO 2014), which were managed and supervised by the MAS.** The first reforms were launched in March 1999 and involved new banking privileges and licenses for foreign banks. A new category of banking license, the "Qualifying Full Bank" (QFB), was created, which grants holders enhanced privileges in establishing additional branches, offsite Automated Teller Machines (ATMs), and sharing of ATMs. The 40 percent limit on foreign shareholding of local banks was also removed. Over the following six years, QFBs were given additional privileges to reduce the differentiation between foreign and local banks. These included operating up to 25 locations participating in government schemes,[29] and providing Electronic Funds Transfer at Point of Sale services (Yue 2003). The first four QFB licenses were issued to ABN Amro Bank, Banque Nationale de Paris, Citibank, and Standard Chartered Bank by the end of 2000, and further two QFB licenses were allocated to Malaysia's Maybank and HSBC in December 2001. Subsequent QFBs were awarded under Free Trade Agreements.

25. **By 2005, the only substantive restriction on foreign banks, compared to local banks, was the number of service locations they could operate. Singapore took further steps to reduce this gap.** In June 2012, MAS announced its intention to grant significantly rooted QFBs an additional 25 places of business, of which up to 10 may be branches (MAS 2013). In determining whether a QFB is significantly rooted, MAS would consider a range of quantitative and qualitative attributes, such as whether the bank is locally incorporated with majority Singaporean representation, what types of businesses are conducted by

[29] Specifically, the provision of Supplementary Retirement Scheme and CPF Investment Scheme accounts, and the acceptance of CPF fixed deposits. These are schemes under the Central Provident Fund, Singapore's social security system.

the locally incorporated entity, and whether Singapore is one of the bank's major markets in terms of group profits and assets. This would allow Singapore to achieve greater foreign bank participation in its domestic financial system in a way that strengthens financial stability, while encouraging foreign banks to deepen their roots in Singapore.

26. **Singapore also restructured the nonretail banking sector, with the aim of encouraging greater participation by foreign banks in its domestic wholesale market.** Prior to 2001, there were two categories of nonretail banks—Restricted Banks and Offshore Banks. In 2001, a new license category of Wholesale Banks was created, and all Restricted Banks were converted to Wholesale Banks. Many Offshore Banks also applied and were upgraded to Wholesale Banks. Wholesale Banks can engage in the whole range of banking operations, except that they can have only one operating office in Singapore, are only allowed to accept fixed deposits of at least S$250,000 per deposit, and are not allowed to operate savings accounts in Singapore dollars. The same framework applies to both local and foreign Wholesale Banks. In 2002, the first Wholesale Bank licenses were granted to 20 foreign banks, including financial service providers from Australia, France, Japan, and Switzerland. Today, any bank may apply for a Wholesale Bank license in Singapore, subject to its meeting MAS's prudential requirements.

27. **To strengthen the domestic banking industry in the context of increased foreign competition, the Singaporean authorities encouraged consolidation among the local banks.** The first merger occurred in 1998 between Development Bank of Singapore (DBS) and Post Office Saving Bank (POSB). Other mergers soon followed, including United Overseas Bank's (UOB's) US$10 billion acquisition of Overseas Union Bank (OUB), and Overseas-Chinese Banking Corporation's (OCBC)'s US$5 billion acquisition of Keppel-Tat Lee Bank. These mergers entailed the rationalization of operations and the upgrading of risk management systems. With greater economies of scale, the banks were able to lower costs, which in turn facilitated the introduction of new products and services.

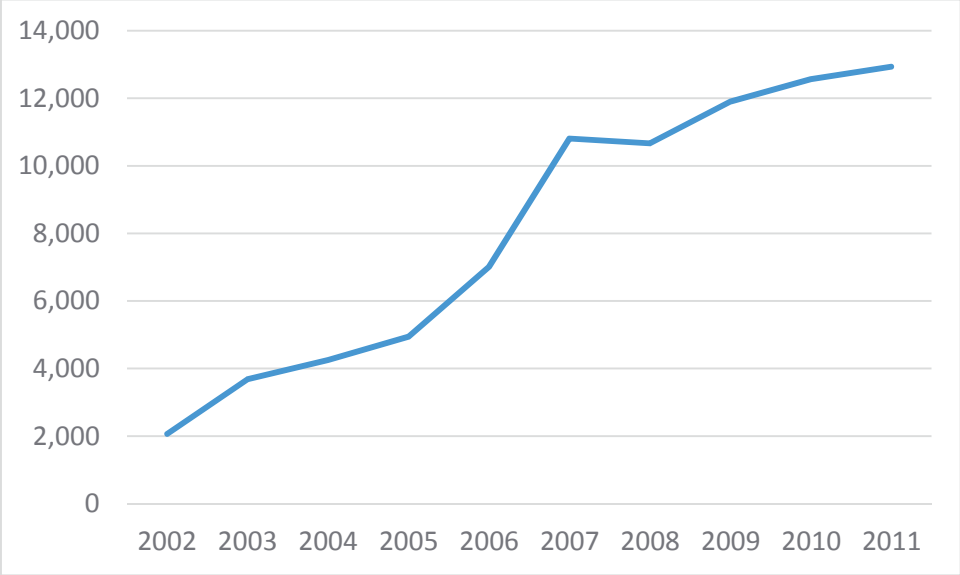
28. **Capital markets also underwent reform.** In December 1999, the Stock Exchange of Singapore (SES) merged with the Singapore International Monetary Exchange (SIMEX) to form the Singapore Exchange (SGX). In 2000, the stockbroking industry was liberalized to free the level of fees charged and to open up market entry. As a result, brokerages consolidated, upgraded their capabilities, and widened the services and products they provide. New foreign brokerages were permitted to reach out to foreign investors. Since SGX was listed in November 2000, MAS issued statutory laws regulating the capital market, and is overseeing SGX's regulatory role with respect to market participants.

29. **Singapore also opened up completely the direct life and general insurance market.** In March 2000, the closed door policy on direct insurers and the 49 percent foreign shareholding limit in locally owned direct insurers were lifted to foster an open and competitive environment for the industry. In 2003, the Insurance Act was amended to allow for the establishment of a risk-based capital framework, which was subsequently introduced in 2004. Since risk-based supervision reduced the need to rely on high minimum paid-up capital, MAS lowered the minimum paid-up capital requirements from S$25 million, to S$10 million for direct insurers, and S$5 million for monoline insurers under the framework. This would also help develop the market and attract niche insurance players to Singapore.

Trade in financial services

30. **The liberalization in Singapore's financial sector has made it possible for the country to substantially increase its exports of insurance and financial services.** Between 2002 and 2011, exports almost quadrupled from S$5.9 billion to S$22.4 billion. Imports also increased, but net exports show a strong upward trend (see figure 3.2) and, indeed, are the main contributor to Singapore's now positive services trade balance.

Figure 3.2 Net Exports of Insurance and Financial Services in Singapore (S$ million)



Source: Singstat.

31. **Indeed, Singapore has a trade surplus in financial services with all of its major trading partners** (see table 3.2). Trade with partners in Asia is particularly strong, underlining the role of Singapore as a regional financial center, but commercial transactions with partners in America and Europe are also substantial. Trade in financial services with other ASEAN countries accounts for 13 percent of total financial services exports and 9 percent of imports.

Table 3.2 Singapore's Trade in Insurance and Financial Services with Major Partners, 2011 (S$ million)

	Exports	Imports	Net Exports
Asia	**6,085**	**3,744**	**2,341**
China	582	434	149
Hong Kong SAR, China	1,213	765	448
India	509	347	162
Japan	880	794	86
Korea, Republic of	403	160	243
America	**3,234**	**1,413**	**1,821**
United States	1,461	801	660
Europe	**3,367**	**1,669**	**1,698**
Oceania	**1,344**	**592**	**752**
Australia	1,197	520	677
ASEAN	1,807	676	1,131
European Union	2,855	1,162	1,693

Source: Singstat.

Lessons for financial services reform in ASEAN

32. **Singapore's liberalization of the financial sector was characterized by gradual reforms that affected all major elements of the financial system.** Also, the process did not just involve opening the market to foreign banks and insurance companies, but extended to the active preparation of the domestic financial sector for the coming increased competition. Moreover, MAS imposed strict licensing conditions so that only foreign service providers that met its high prudential standards could set up in Singapore. This ensured continued stability of the financial system.

33. **Singapore's remarkable success in growing its financial sector could usefully inspire other ASEAN Member States to pursue similar reform policies.** Not every country in the region might be in a position to become a financial center, but opening the domestic market to foreign financial services providers can have a number of benefits that go beyond trade enhancement and positively affect the entire domestic economy. Foreign banks can often provide high-quality banking services at lower cost; spur quality improvements; trigger cost-cutting in the domestic banking industry; promote better accounting, auditing, and rating institutions; and increase the pressure on governments for greater transparency in prudential regulation (Levine 2004). Enhanced market access for foreign insurers will also allow local markets to diversify risk more effectively and benefit from the foreign companies' know-how and resources (Dobson 2008). Such changes will increase the efficiency with which capital is allocated, and spur economic growth over what would otherwise have been the case. But as the Singaporean reforms have shown, the market opening should go hand-in-hand with a review of the regulatory regime and the possible adoption of new measures to guard against systemic risk.

D. Thailand Health Services Exports

34. **The well-being of a country's citizens depends critically on the performance of its health sector. Quality health services are a key ingredient to human development and a prerequisite for sustained economic growth.** In particular, effective preventive and restorative care preserves a country's stock of human capital and keeps the working population in a physical condition that makes it possible for it to be highly productive.

35. **While the health sector in most countries remains predominantly oriented toward the domestic market, international trade has been gaining in importance in recent years.** This trend is driven by rising health care costs in high-income countries and rising health care demand as a result of modern life styles, combined with limited insurance coverage and long waiting lines. Emerging and developing countries that have well-qualified medical and nursing staffs can often provide health services of similar quality at lower prices, and have been attracting foreign patients for treatment abroad.

36. **Thailand has been one of the frontrunners with respect to patient insourcing in Southeast Asia.** The country initially focused on tourism-related activities such as spas, traditional massages, and herbal treatments. In recent years, however, private hospitals have discovered that they can profitably attract and treat foreign patients for elective medical procedures, such as plastic surgery.

Policy reforms concerning health services

37. **While Thailand has been a well-known tourist destination for many decades, it was not until the 2000s that medical tourism started to surge** (Supakankunti and Herberholz 2012). In the wake of the 1997 Asian economic crisis, bed occupancy in many private hospitals declined significantly, prompting high-end private medical institutions, which had invested substantially during the economic boom, to seek out medical tourists from abroad.

38. **Subsequently, the Thai government adopted a series of measures to promote medical tourism, which culminated into the development of a vision for Thailand to become a world-class medical hub.** This vision has been explicitly spelled out and pursued by the Ministry of Public Health (MoPH 2009). Yet, since the policy equally affects the wellness sector and herbal treatments, several other ministries (Commerce, Labor, Education, and Foreign Affairs) and the Tourism Authority of Thailand have also been directly implicated. A major step toward becoming a prime destination for medical tourists has been the adoption of standards for hospital accreditation in Thailand that were in line with international standards (Supakankunti and Herberholz 2012).

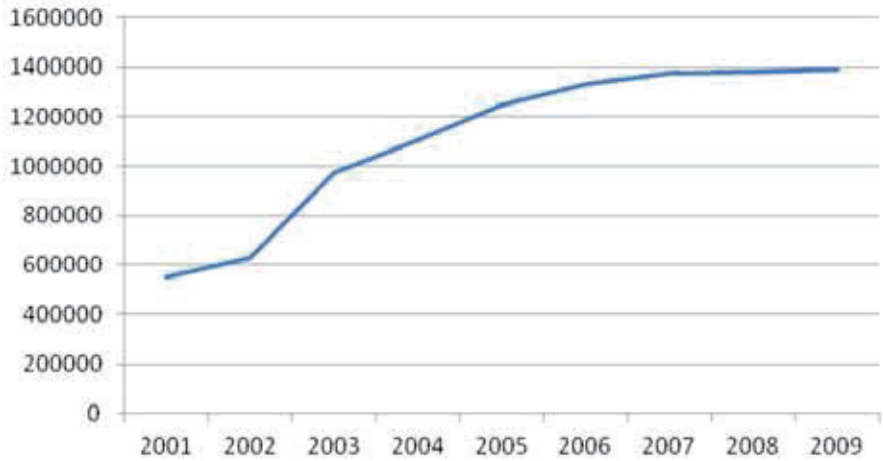
39. **One major challenge for the development of a health services export sector in Thailand has been the emergence of a dual market structure and internal brain drain.** Doctors and nurses in the private, export-oriented sector can earn three to five times as much as their colleagues in the public sector. This income gap has enticed the best medical professionals to seek employment in private hospitals in urban areas, while shortages of trained medical staff occur in rural areas. The problem is due to the fact that private hospitals that treat foreign patients do not participate in Thailand's social health insurance schemes. Foreigners and upper-income Thai citizens pay out of pocket or are covered by private health insurance. This practice diverts resources, including medical personnel, away from public hospitals, which participate in the social health insurance schemes and serve only Thai patients (Cattaneo 2012). A related concern is that tertiary medical education is provided almost exclusively by the public sector. Hence, all the talent that private, export-oriented hospitals hire has been formed with taxpayers' money.

40. **As a result, the Thai government had to devise a set of complementary policies in order to contain political and social discontent about the uneven distribution and quality of medical services.** One principal element of this flanking policy has been the imposition of three years' compulsory public service for medical graduates, with two-thirds of whom are sent to work in rural areas (Cattaneo 2012). Moreover, financial incentives were introduced for doctors in rural areas, such as allowances for hardship, not engaging in private practice, overtime work, and special service. Additional financial incentives were announced in 2004–05, as a result of which a new medical graduate in the most remote rural district can earn a salary equal to that of a senior medical practitioner in the central department with 25 years of experience. In 2004, the government approved the "One District, One Doctor Project," under which new medical students are recruited from high schools in rural districts, educated at a local university and local hospital, and retained to work in their own districts. In mid-2004, the government also approved a project to rapidly increase the acceptance of medical graduates as a proactive approach to human resources planning in the health sector, where the duration of education is long.

Trade in health services

41. **The number of international patients in Thailand increased markedly during the 2000s to 1.4 million in 2009** (see figure 3.3). This total includes general tourists and foreigners who work or live in Thailand and receive medical treatment during their stay. Pure medical tourists accounted for an estimated 30 percent of all international patients, or 420,000 individuals (NaRanong and NaRanong 2011). This number exceeds the corresponding figure for Singapore, which used to be considered the leading medical tourist destination in the region and the "medical hub of Asia." Recently, the growth rate of international patients in Thailand has slowed, however, as a result of political instability and the global financial crisis.

Figure 3.3 Number of Foreign Patients Treated in Thailand



Source: Supakankunti and Herberholz 2012.

42. **Thailand's main strengths as a medical tourism destination are its high-quality medical professionals and a hospitable and service-minded culture.** In addition, the cost of medical treatments is competitive relative to other providers in the region (see table 3.3). Moreover, since Thailand has traditionally been a major tourism destination, the country is particularly well placed to supply tourism-related medical treatment and wellness packages. In this context, the general tourism infrastructure like hotels, shopping malls, and restaurants is also an important component of the medical tourism experience of international patients, and is supporting Thailand's quest to become a leading medical services supplier (Supakankunti and Herberholz 2012).

Table 3.3 Competitive Position of International Health Service Locations in Asia

Competitive Advantage	Thai	Singapore	India	Malaysia
Service & Hospitality	*****	**	*	*
Hi-technological Hardware	**	****	**	*
HR Quality	****	****	**	**
International Accredited Hospital	**	**		*
Pre-emptive Move	**	***		* *
Synergy/Strategic Partner	*	**		* *
Accessibility/Market Channel	**	***	*	**
Reasonable Cost	****	*	****	***

Source: Thailand MoPH 2009.
Note: A higher number of stars suggests a stronger competitive position of a country in that sector.

Lessons for health services reform in ASEAN

43. **Many developing-country governments see medical tourism as an opportunity to generate additional export revenues and jobs.** Yet, the public health system will rarely be in a position to attract and accommodate international patients, so that the extent to which the private sector does, or is able to, participate in the provision of health services is a crucial factor for the development of medical tourism.

44. **In Thailand, the growth of private hospitals has given rise to a brain drain of health professionals from the public sector toward the private sector.** Increasing numbers of foreign patients and related export revenues have channeled more health care resources in the private sector toward servicing foreign and high-income local patients, to the detriment of low- and middle-income patients. This type of issue should ideally be addressed before actively promoting medical tourism in order to reduce supply bottlenecks and minimize social and political discontent. There are basically three means by which supply shortages in the public sector could be alleviated (Arunanondchai and Fink 2007): (a) investment in the education of more health care professionals by both the public and private health sectors, (b) incentives to stem the brain drain from the public sector and from rural areas, and (c) imports of foreign health care professionals. All of these choices involve important commitments of public resources or politically sensitive trade-offs, but pursuing such policies early on is bound to make the process of liberalizing the domestic health sector and enhancing health services exports smoother and more broadly beneficial for the entire population.

E. The Philippines: Telecommunications-Based Services

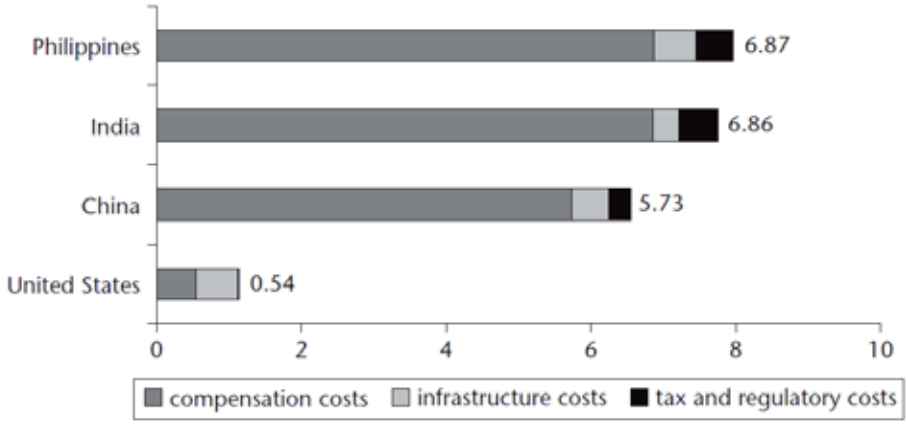
45. **Following the path of India, many developing economies have recently emerged as outsourcing destinations, and their exports of information-technology-based services have grown rapidly.** This expansion of services trade has been driven by considerable reductions in communications, transport, and transactions costs. Rapid advances in information and communication technologies and the ongoing liberalization of trade and investment in services have increased the tradability of many service activities and created new kinds of tradable services. Many service sector activities are thus becoming increasingly internationalized, especially since advanced information and communications technology enables the production of services to be location-independent. This development has led to the globalization of services activities, with associated changes in trade, cross-border investment, and employment patterns.

46. **The Philippines has been very successful in trying to benefit from the growing trend in high-income countries for firms to outsource back-office and information technology functions in order to take advantage of advanced skills and lower labor costs of specialized service providers.** This success has been possible thanks to several favorable structural factors, notably modest labor compensation costs, a large pool of suitably qualified talent, and low telecommunications and real estate costs.

47. **Business process outsourcing (BPO) is labor-intensive, and wage expenses account for about half of total costs.** The Philippines has been very competitive with respect to labor costs due to monthly wage rates of about US$400 that place the labor compensation costs in the country at the same level as those of India (A.T. Kearney 2011). This is reflected in the high financial attractiveness score of the Philippines compared to some of its competitors (figure 3.4).

48. **The Philippines has a well-performing tertiary education system that makes it possible for the country to graduate about 500,000 college graduates every year, many of whom have a science, engineering, or business specialization.** Moreover, young Filipinos are familiar with the cultural, legal, and accounting systems in the United States; speak idiomatic American English better than many other Asians and with more neutral accents; and are known for their warm, customer-oriented attitude that is important for BPO and call center activity. Overall, the share of college graduates deemed fit to work in international operations is estimated to be at least twice as high as, for example, in China (Yi 2012).

Figure 3.4 Financial Attractiveness Score, Selected Countries, 2011



Source: A.T. Kearney 2011.

49. **While there are notable weaknesses in the telecommunications and general infrastructure in the Philippines, the broadband telecommunications system in urban centers and industrial parks, which are of critical importance for BPO, performs well.** Communications costs are low and the quality and reliability of services are good. Moreover, the development of BPO activities has benefited from the ready availability of reasonably priced office space in Makati City, Manila's main business district, after the Asian financial crisis.

Policy reforms concerning ICT services

50. **The government has facilitated the success of the BPO industry in the country by trying to provide an enabling, supportive business environment.** One key policy reform was the liberalization of the telecommunications industry in the mid-1990s. In particular, competition in local long-distance services and the authorization of international simple resale led to a sharp drop in telecommunication rates. Indeed, the price reduction for phone calls in the Philippines was more pronounced than in most other countries in the region (Fink, Mattoo, and Rathindran 2001). Moreover, a large number of Voice over Internet Protocol (VoIP) providers was subsequently allowed to emerge in the Philippines, which further contributed to lowering communications costs.

51. **Several public institutions and government programs have been instrumental in establishing the skill and knowledge foundations for the BPO boom.** In particular, the Commission on Higher Education, which is attached to the Office of the President, has been in charge of establishing standards for all degree-granting programs at postsecondary educational institutions. Moreover, the Technical Education and Skills Development Authority, which is responsible for managing and supervising technical education and skills development, provided voucher-based funding for private sector training initiatives.

52. **The rapid expansion of the BPO sector in the Philippines has also benefited from governmental investment support and financial incentives.** Foreigners were allowed to own up to 100 percent of BPO firms. This full foreign ownership possibility has been helpful in assuaging investor concerns about employee integrity, leakage of technological know-how, and data protection.

53. **The Philippine government has encouraged FDI through several forms of investment incentives.** If firms engage in one of the activities contained in the government's Investment Priorities Plan, which includes BPO activities, they are eligible for fiscal incentives from the Board of Investments. Such incentives include income tax holidays of up to eight years, tax deductions equivalent to 50 percent of

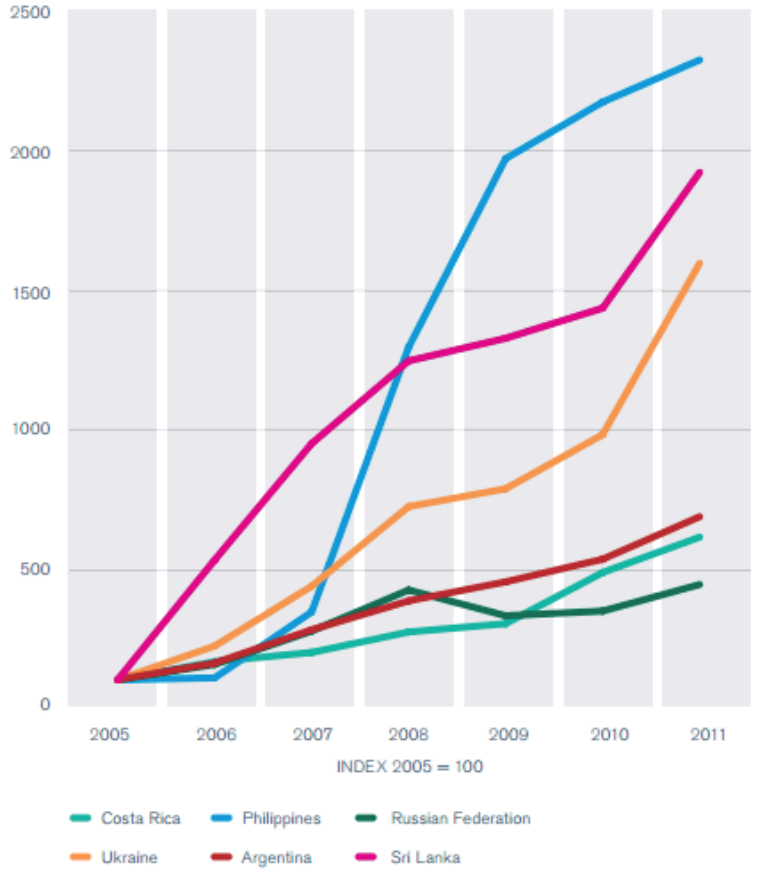
wages of direct-hire workers, and duty exemptions for imports of raw materials. Moreover, firms that export at least 70 percent of their output and have established themselves with the Philippines Export Zone Authority (PEZA) enjoy additional incentives, such as a low 5 percent gross income tax rate, exemption from all local government fees or taxes, and exemption from expanded withholding tax (Yi 2012).

54. **Further, for companies registering under PEZA, the authority offers one-stop-shop services for business registration, and extends an exemption from local government business permits, licenses, and fees.** PEZA issues permits related to building and occupancy, import and export, and environment compliance (Yi 2012). Such services have helped reduce business start-up time and costs.

Trade in ICT services

55. **Between 2005 and 2011, Philippine exports of computer services rose by an annual average of 69 percent, outgrowing many other emerging services providers (see figure 3.5), and since 2010 the Philippines has become the world's biggest voice-BPO provider.** In 2011, BPO exports accounted for 16 percent of total Philippine exports (Mitra 2013). BPO is estimated to have generated more than US$15 billion in revenues in 2013, with BPO firms employing more than 900,000 staff. The IT-BPO Road Map 2011–2016 of the Business Processing Association of the Philippines foresees further growth in the industry, and estimates that by 2016, BPO-firms could earn up to US$25 billion in revenues and provide employment for 1.3 million office workers. The sector would then contribute 9 percent to the country's GDP.

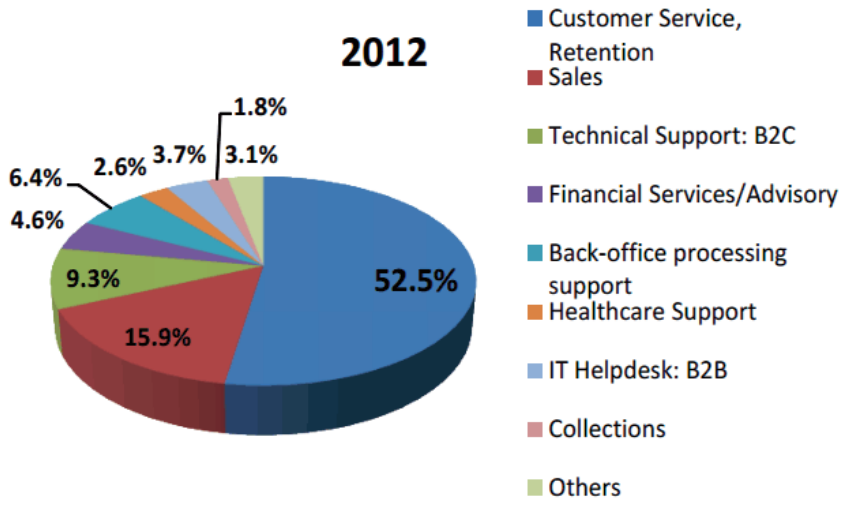
Figure 3.5 Exports of Computer Services in Selected Developing Economies



Source: WTO 2012.

56. **About 80 percent of the total BPO industry has been centered on call center activities, of which about three-quarters are provided for the U.S. market.** Within call center operations, two-thirds of all activities concern customer service and sales (see figure 3.6). There have been efforts, however, to diversify revenue and employment into a broader range of nonvoice, complex services, including legal, financial, and other analytical work.

Figure 3.6 Distribution of Call Center Activities



Source: Call Center Association of the Philippines.

Lessons for ICT-related reforms in ASEAN

57. **Over just one decade, BPO activities have grown from virtual nonexistence to a significant part of the Philippine economy.** This export success has been made possible through private sector initiative that took advantage of some key strengths of the Philippines, notably low labor costs; an abundant supply of well-qualified, Anglophone graduates; and a good telecommunications infrastructure. In addition, the government supported the development of the sector by making BPO firms eligible for investment support and export zone benefits, and fostering tertiary education.

58. **Despite the continuing growth in BPO activities in the Philippines, a number of challenges are emerging that also warrant the attention of policy makers in other emerging services exporters.** One fragile point in the Philippine success is the strong concentration of BPO activity in call centers and the heavy reliance on one client market, the United States. This strong exposure to a narrow market segment and one geographic client location makes the sector's revenues and employment vulnerable to cost pressures. Indeed, the appreciation of the Philippine peso vis-à-vis the U.S. dollar up to mid-2013 significantly reduced the attractiveness of the country for voice service offshoring. Hence, efforts to diversify the activity spectrum of BPO services and to broaden the geographic client base are important medium- to long-term objectives for public and private decision makers. One critical element in this context concerns further improvements in the quality of tertiary education and on-the-job training in order to develop the skills base for the shift toward higher-value knowledge process outsourcing.

59. **Moreover, policy makers should be mindful of the income distribution effects of BPO development.** Most jobs in call centers and other outsourcing activities have been created in or near major urban centers, notably Manila, and provided income for young, college-trained graduates, while rural, less educated workers have not benefited from the BPO boom. More generally, recent research on services liberalization in the Philippines points to increasing wage disparities, to the detriment of more vulnerable

populations (Amoranto, Brooks, and Chun 2010), so that complementary, broad-based policies to support training and education that makes it possible for broad segments of the population to upgrade their earning potential are called for.

F. The Greater Mekong Subregion: Transportation Services

60. **The Greater Mekong Subregion (GMS), which comprises the six countries of Cambodia, China (Guangxi Zhuang Autonomous Region and Yunnan Province), Lao PDR, Myanmar, Thailand, and Vietnam, has experienced strong economic growth over the last decade, largely driven by expanding trade and investment links.** The physical connectivity in the region has improved, and policy barriers to intraregional trade and investment have come down. Yet, there is untapped potential to make additional improvements in trade and transport facilitation, and the poorest GMS countries—Cambodia, Lao PDR, and Myanmar—are seen as the biggest beneficiaries of further reductions in trade transactions costs (Stone and Strutt 2009).

61. **At the national level, internal and external connectivity has been expanded substantially over the last 15 years.** National road networks have been developed and up-scaled, and modern communication technology has spread rapidly throughout GMS countries (CIE 2010). Also, tariff and nontariff barriers have come down. Yet, there remains considerable scope to realize further gains from regional integration by reducing avoidable transaction costs and delays in cross-border trade.

Policy reforms concerning logistics services

62. **Policy makers in GMS countries are aware of the benefits of trade and transport facilitation and have pursued two initiatives within the broader GMS Economic Cooperation Program aimed at reducing trade transactions costs: the Strategic Framework for Action on Trade Facilitation (SFA-TFI) and the Cross-Border Transport Agreement (CBTA).** These programs complement other national and regional efforts to remove impediments to regional integration, and present a collaborative way to realize substantial gains that benefit the entire region.

63. **The SFA-TFI is focused on institution building, training, and research activities at the regional level.** It addresses policy and institutional issues related to the treatment of border and behind-border issues, and the development of policy positions and negotiation capacities in relation to bilateral, plurilateral, and multilateral trade agreements (ADB 2008).

64. **The CBTA promotes transport and trade facilitation in the GMS region** (Nyunt 2013). It was initially signed in November 1999 by Lao PDR, Thailand, and Vietnam. Cambodia, China, and Myanmar acceded to the Agreement in November 2001, November 2002, and September 2003, respectively. The central features of the CBTA focus on (a) enabling vehicles, drivers, and goods to cross national borders through the GMS road transport permit system; (b) avoiding costly transshipment through a customs transit and temporary importation system and a guarantee system for goods, vehicles, and containers; (c) reducing processing time at borders, through single-window inspection, single-stop inspection, information and communication equipment and systems for information exchange, risk management, and advance information for clearance; and (c) encouraging network effects and economies of scale by promoting the number of border checkpoints implementing CBTA.

65. **The GMS countries have been successful in mobilizing funds and loans for developing national and regional road and rail infrastructure, but progress within CBTA and the implementation of related soft infrastructure reforms (for example, regulations, procedures, and expertise) have been lagging.** Trade facilitation issues go well beyond customs administration, and notably involve improved coordination with and among other border agencies. The prevalence of informal

payments and lack of transparency with respect to the applicable procedures and regulations continue to be a problem in the GMS region. Also, differences in logistics regulations across countries, for example, concerning axel load limits in main transport corridors, and a lack of common standards, for example, with respect to the use of containers or trucks in transborder shipments, continue to complicate the movement of goods within GMS (World Bank 2012b).

66. **Almost every country in the region is working on building its National Single Window as an anchor for trade facilitation reform.** The National Single Window forces agencies to work together toward a shared vision. The major challenges reformers face in this context are not typically ICT related, but relate to the very high degree of active collaboration required from both public and private stakeholders (World Bank 2012b).

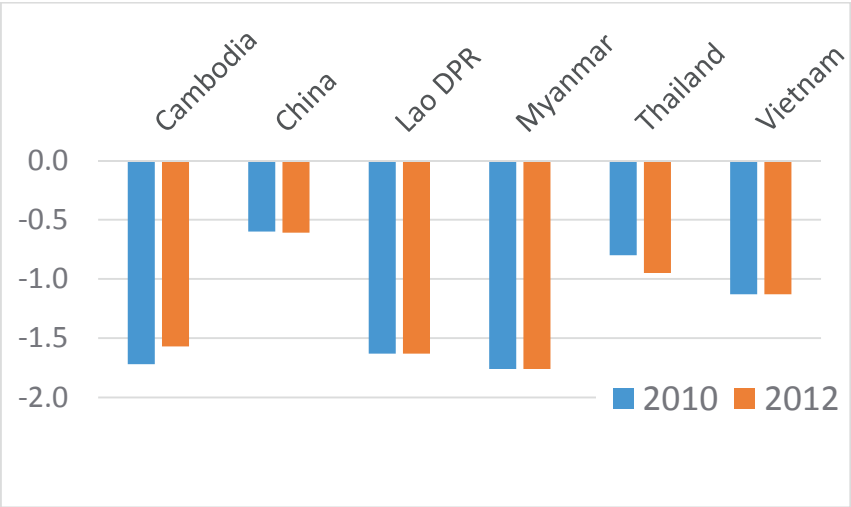
67. **Moreover, national logistics plans are under development by many GMS governments to identify key short- and long-term priorities for action.** Such blueprints have proven to be most useful and effective if they benefit from high-level political commitment to lead and monitor implementation, and if they are developed as multimodal, integrated plans, rather than on a sectoral (air, land, water) basis. Also, a clear definition and delimitation of responsibilities of different stakeholders is instrumental for implementation success.

Logistics performance

68. **The performance of the logistics sector plays a critical role in shaping countries' international competitiveness.** With trade policy barriers falling, the integration of logistics systems across countries is becoming a crucial factor for enabling the participation of countries and regions in international production sharing networks that have been driving global trade growth.

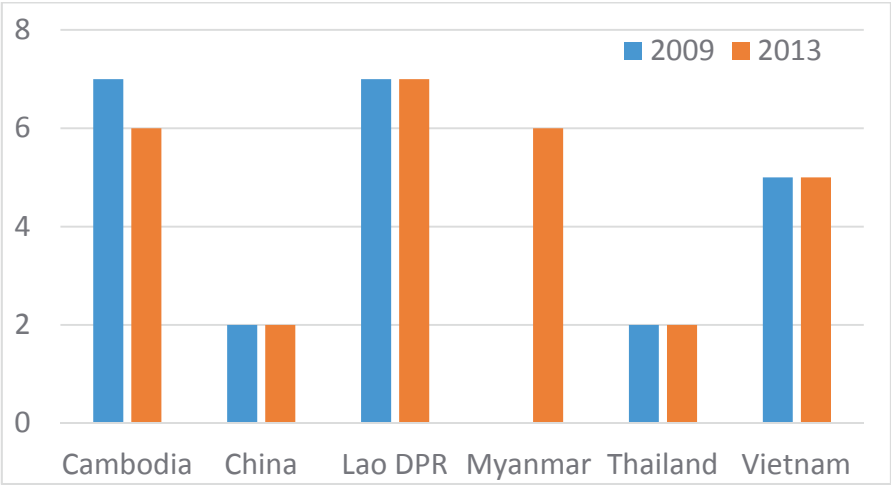
69. **The trade and transport facilitation efforts in GMS countries have been bearing fruit in the sense that their logistics performance is improving.** For all countries in the region, except Thailand, the World Bank's Logistics Performance Index showed a higher value in 2012 than in 2010. However, the progress of logistics in the GMS region seems modest. The gap between the GMS countries and the best performer in ASEAN, that is Singapore, remains largely unchanged, except for Cambodia, whose gap has narrowed (figure 3.7). A similar picture emerges when assessing the complexity of documentary requirements over time, as measured by the number of documents required for imports (figure 3.8).

Figure 3.7 Logistics Performance Index (gap to Singapore)



Source: World Bank 2012a.

Figure 3.8 Number of Documents to Import (difference to Singapore)



Source: World Bank Doing Business Database.

Lessons for logistics reforms in ASEAN

70. **Trade and transport facilitation promise substantial gains for the GMS region.** The CBTA contains a number of pertinent provisions to facilitate cross-border movement and customs transit. These measures aim to reduce the time and administrative procedures when moving goods across the region. In particular, customs and border clearance formalities are to be harmonized or facilitated, and greater use of risk management techniques and information and communications technology are envisaged. However, putting the agreed measures into practice has proven time-consuming, and the resulting delay in implementation might have limited trade and transport operators from reaping the full benefits of regional integration. Hence, considerations for policy makers include identifying potential implementation bottlenecks on the ground, more resources to support their administrations, and adequate timelines and political guidance to reduce trade transaction costs.

71. **Some elements of the CBTA have, over time, been overtaken by broader regional initiatives, as is the case with the ASEAN Single Window.** To achieve the objectives more effectively, ASEAN needs to continue to ensure minimal overlap among initiatives at the unilateral, plurilateral, and multilateral level, and to coordinate the interventions of different development partners. In this context, institutional capacity building is called for in order to equip national administration with the skills and tools to deal with the multitude of customs and border clearance reforms and projects.

Chapter 4. Strengthening the ASEAN Framework Agreement on Services and the Services Integration Process

This chapter reviews the ASEAN Framework Agreement on Services (AFAS) and assesses how it contributes to promoting integration of services trade within the region. In particular, the chapter assesses (a) the disciplines and architecture of AFAS, including its key rules and obligations, sectoral provisions, and institutional framework; and (b) the progress under AFAS, drawing on a database that captures the commitments made under it, and compares it with commitments under the General Agreement on Trade in Services (GATS) and other trade agreements. It also takes a look at mutual recognition arrangements as an important initiative to facilitate the flow of professional services. Based on this analysis, it finds that ASEAN Member States have taken important steps in the liberalization of trade and investment in services, but the "single market" still remains a distant goal. The ASEAN Economic Community (AEC)-AFAS framework has provided few opportunities to tackle regulatory barriers on services trade, which is ultimately leading to a shallow integration process that will not create a true single market. In addition, a number of issues regarding AFAS's obligations and scope remain, and need to be clarified to ensure its effectiveness in removing barriers to trade and investment in services.

A. Introduction and Background

1. **Economic integration in Southeast Asia is at a crossroad, especially on services integration.** ASEAN Member States have set ambitious goals, seeking to establish a single market for goods and services, to integrate the economies of the 10 countries. Further, in keeping with ASEAN's overarching goals of integrating with the world economy, ASEAN Member States, individually or as a group, are deepening their ties with the world through the negotiation of broad free trade agreements (FTAs) with all the major economies, including China, India, Japan, the Republic of Korea, the European Union, and the United States.

2. **This situation offers important challenges and opportunities on both the internal and external fronts for ASEAN, especially on trade and investment in services.** Advances in communication technology have supported services trade as the fastest-growing segment of international trade for the last three decades (Cattaneo et al. 2010), and great potential remains within ASEAN Member States to increase intraregional trade in services, particularly of high-value-added, modern services (see Chapter 6), offering valuable opportunities for the region. However, because services trade is governed mostly through domestic laws and regulations, service integration entails policy coordination challenges much deeper than trade in goods.

3. **This chapter assesses the ASEAN Framework Agreement on Services (AFAS) and its contribution to promoting integration on services within the region.** To provide a basis for further reform and liberalization of the service sector in ASEAN Member States, this chapter reviews the principles of the AFAS and its achievements to date. In particular, it assesses (a) the disciplines and architecture of the AFAS, including its key rules and obligations, sectoral provisions, and institutional framework; and (b) progress achieved by the AFAS, drawing on comparative institutional data (separate from that discussed in Chapter 2), which captures the commitments made under it and compares it with commitments under GATS and other trade agreements. The chapter also takes a look at mutual recognition arrangements as an important initiative to facilitate the flow of professional services, and services liberalization elements contained in ASEAN Member States' FTA with trading partners. Based on this analysis, the chapter offers

recommendations to strengthen the ASEAN services trade framework, including in the new services integration agreement that the ASEAN Member States are considering now.

4. **The findings of this analysis are twofold.** First, ASEAN Member States have made important progress in the liberalization of trade and investment in services, and the AFAS, reinforced by the negotiating goals set out in the ASEAN Economic Community Blueprint, has provided a solid platform for reducing market access and national treatment limitations to services trade. Second, despite this progress, the AEC-AFAS framework has provided few opportunities to tackle regulatory barriers on trade and investment in services, which is ultimately leading to a shallow integration process that is not leading to a true single market. In fact, if ASEAN fails to advance toward the elimination of regulatory restrictions to trade in services, the conclusion of FTAs with third parties may do away with the ASEAN services integration agenda altogether. A central message of this chapter, and running through this report, is that, to maintain the progress made in obtaining reciprocal preference on services under the AFAS and to advance toward an effective single market, ASEAN Member States need to strengthen the agenda for cooperation on the regulation of services.

5. **This chapter draws on the literature on ASEAN services trade treaties and regulations.** Trewin et al. (2008) offer a comprehensive review of East Asian FTAs and how they affect ASEAN services trade; they provide an analysis of commitments based on a literature review, explain the differences in the various agreements in political and economic terms, and offer recommendations for ASEAN agreements with third parties. Dee (2009, 2010) assesses in detail the AFAS commitments on services trade and the gaps between the commitments and actual policies in ASEAN Member States. Sectors reviewed included medical, health, and financial services (Dee 2009), and air transport, maritime, and telecommunications services (Dee 2010). Dee (2013) updates the findings on financial services and air transport and compares them with actual regulatory practices, which allows her to provide specific recommendations. ERIA (2012) offers a broad review of the implementation of AEC goals across all areas, including services trade, and provides an estimate of the impact of such measures on the ASEAN economies. The analysis here attempts to expand on these studies by focusing on the operation of, and dynamics generated by, the rules and institutional settings on services trade in ASEAN, and avoiding unnecessary repetition of the formal aspects of the system. In terms of progress, this chapter goes beyond the existing literature by reviewing the types of commitments in place and evaluating them in light of other services agreements in the region and abroad.

6. **The chapter is organized as follows.** The remainder of section A provides background on the ASEAN process and the restrictions that affect services trade. Section B offers a detailed analysis of the disciplines that apply to services trade in the region and how they affect the services integration process. Section C provides a comprehensive review of the ASEAN institutions and bodies involved in promoting services integration. It also analyzes the decision-making process that ASEAN Member States follow to that end, and evaluates the implications of these institutions and procedures for the advancement of services trade. Section D assesses ASEAN progress in services integration by comparing the existing AFAS liberalization commitments with those offered by ASEAN Member States under the multilateral and bilateral agreements, and to those hypothetically required by the ASEAN Economic Community Blueprint. Section E summarizes the main findings and makes specific recommendations to further promote services integration within ASEAN and realize a single services market.

Regional integration under the ASEAN Economic Community

7. **The ASEAN Economic Community encompasses four pillars:** (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy. In 2007, ASEAN leaders adopted the ASEAN Economic Community (AEC) Blueprint with the commitment to accelerate their efforts toward regional

economic integration. The AEC Blueprint sets out a set of ambitious goals for 2015 and a strategic schedule for implementing a number of measures that lead toward closer regional integration.

8. **The liberalization of trade in services is one of the central elements in realizing the first pillar of the AEC, which includes the free flow of services.** The Blueprint aims to establish the "free flow of trade in services, where there will be substantially no restrictions to ASEAN services suppliers in providing services and in establishing companies across national borders within the region, subject to domestic regulations." The institutionalization of ASEAN services integration predated the AEC Blueprint with the signing of the ASEAN Framework Agreement on Services (AFAS) in 1995. AFAS has three main objectives: to enhance services cooperation among Member States to substantially eliminate restrictions to trade in services among Member States; to liberalize trade in services beyond those undertaken by Member States under the GATS, with the aim to realizing a free trade area in services; and to arrive at what are referred to as packages of commitments, to be accomplished through successive rounds of negotiations of sector-specific commitments. Specific targets for service sector liberalization and integration have been set under the AEC (box 4.1)

Box 4. 1 AEC Blueprint for Economic Integration in Services Trade

The AEC Blueprint contains the following action plan for the liberalization of trade in services:

1. Remove substantially all restrictions on trade in services for four priority service sectors—air transport, e-ASEAN, health care, and tourism—by 2010, and the fifth priority service sector, logistics services, by 2013.
2. Remove substantially all restrictions on trade in services for all other service sectors by 2015.
3. Undertake liberalization through consecutive rounds every two years until 2015, that is, 2008, 2010, 2012, 2014, and 2015.
4. Target to schedule minimum numbers of new subsectors for each round: 10 subsectors in 2008, 15 in 2010, 20 in 2012, 20 in 2014, and 7 in 2015, based on GATS W/120 Services Classification List.
5. Schedule packages of commitments for every round according to the following parameters:
   - No restrictions for Modes 1 and 2, with exceptions due to bona fide regulatory reasons (such as public safety), which are subject to agreement by all Member States on a case-by-case basis
   - Allow for foreign (ASEAN) equity participation of not less than 51 percent by 2008, and 70 percent by 2010 for the four priority service sectors; not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2013 for logistics services; and not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2015 for other service sectors
   - Progressively remove other Mode 3 market access limitations by 2015.
6. Set the parameters of liberalization for national treatment limitations, Mode 4, and limitations in the horizontal commitments for each round by 2009.
7. Schedule commitments according to agreed parameters for national treatment limitations, Mode 4, and limitations in the horizontal commitments set in 2009.
8. Complete the compilation of an inventory of barriers to services by August 2008.
9. Allow for overall flexibilities, which cover the subsectors totally excluded from liberalization and the subsectors in which not all the agreed parameters of liberalization of the modes of supply are met, in scheduling liberalization commitments. The scheduling of liberalization commitments in each round shall be accorded with the following flexibilities:
   - Possibility of catching up in the next round if a Member State is not able to meet the parameters of commitments set for the previous round

Box 4. 1 AEC Blueprint for Economic Integration in Services Trade (continued)

- Allowing for substitution of subsectors that have been agreed to be liberalized in a round but for which a Member State is not able to make commitments, with subsectors outside of the agreed subsectors
- Liberalization through the ASEAN minus X formula (See Note below). Complete mutual recognition arrangements (MRAs) currently under negotiation, that is, architectural services, accountancy services, surveying qualifications, medical practitioners by 2008, and dental practitioners by 2009.

10. Implement the MRAs expeditiously according to the provisions of each respective MRA.
11. Identify and develop MRAs for other professional services by 2012, to be completed by 2015.
12. Strengthen human resource development and capacity building in the area of services.

Source: ASEAN AEC Blueprint.

Note: ASEAN – X formula allows a sub-group of ASEAN Member States to make faster progress in regional integration without requiring the involvement of the other members.

9. Since 1995, numerous *packages* of AFAS commitments have been concluded and signed by ASEAN Member States. These negotiations have resulted in (a) eight packages of commitments in a wide range of service sectors under the purview of ASEAN Economic Ministers, (b) six packages of commitments in financial services, and (c) eight packages of commitments in air transport. The packages contain liberalization commitments that aim at reducing restrictions to services trade among the ASEAN Member States. Liberalization measures in the financial services sector have a more gradual timetable that aims to allow members to ensure orderly financial sector development and maintenance of financial and socioeconomic stability. Member countries are encouraged to follow prudent principles such as using ASEAN-X processes, and to take into account national policy objectives and the level of economic development when liberalizing financial services.

Restrictions on services trade

10. **Trade and investment in services can be limited through formal restrictions or through a wide range of domestic regulations.** Formal restrictions to services are those aimed at limiting access into the domestic services market by local and/or foreign firms, or at affording domestic services suppliers a competitive advantage through measures that discriminate against foreign service suppliers, referred to as market access restrictions and discriminatory measures, respectively. Measures that limit market access are typically quantitative in nature, but may also entail total prohibitions or limitations to the form of entry. Table 4.1 offers examples of formal restrictions to trade and investment in services that are at the core of services trade negotiations, including under the AFAS. In trade agreements, especially those inspired by the GATS, these types of restrictions to trade and investment fall under the scope of the provisions on "market access" and "national treatment," which are the main obligations toward services liberalization.

11. **Regulatory measures normally aim to correct market failures or pursue other noneconomic policy goals, which may not be directly related to trade.** Services are prone to market failures, in particular due to information asymmetries that affect sectors like professional services and financial services, and the existence of monopolies in networked services, including telecommunications and energy distribution. Also, a number of services play an important role in noneconomic policy goals; universal access to health and education services, for example, is a key element of distributional policies (Krajewski 2003; Stiglitz 2010). The objective of dealing with regulatory measures is not their removal, but to ensure that they are not more trade restrictive than necessary for their legitimate purposes.

Table 4.1 Formal Restrictions on Trade and Investment in Services

Market Access Restrictions	Discriminatory Measures

• Monopoly / exclusive service suppliers
• Quantitative limitations on
  o number of services providers
  o services transactions
  o operations / output
  o number of employees
• Geographic restrictions
• Limitations to foreign equity participation
• Economic needs tests
• Limitations on form of establishment
• Joint-venture requirements
• Prohibitions on participation
	• Discriminatory licensing requirements on
	  o Qualifications / education
	  o Technical capacity
	  o experience
	• Nationality / residency of service providers and managers, boards of directors
	• Discriminatory taxation
	• Sectors reserved to domestic investors
	• Landownership restrictions
	• Type of shares owned by foreigners
	• Other forms of discriminatory measures

12. **Regulatory measures govern the way service suppliers do business, but do not usually take the form of discriminatory measures or entail quantitative ceilings.** Regulatory measures, however, do entail conditions that affect services provision. For instance, the substantial conditions for the issuance of licenses or permits can determine whether a service sector is de facto open or closed to foreign participants. This is particularly the case in professional services, which require a demonstration of studies in accredited institutions. Other regulatory measures relevant to services trade include:

- zoning / geographic restrictions
- qualifications requirements
- knowledge transfer
- rules on anticompetitive behavior
- limitations on distribution channels
- limitations on pricing
- limitations on transfer of funds
- advertising limitations
- rules on competition policy
- requirement to subscribe to association
- approval of mergers and acquisitions
- performance requirements
- import permits
- duration of license / divestment
- hours of business operations.

13. **Some regulatory measures can impair services trade and investment and limit market integration, even when they are nondiscriminatory or feature no obvious quantitative restrictions** (WTO 2012). For example, a number of requirements for the issuance of licenses and permits are usually nondiscriminatory and justifiable on public policy grounds, and in fact they exist in all jurisdictions. To the extent that these requirements are different from country to country in terms of substance and procedures, however, even when they pursue similar policy objectives, they can increase costs and lead to market segmentation, limiting integration of the services markets. In this case, efforts to reduce such costs without sacrificing legitimate public policy objectives should be pursued, domestically and externally. Under the GATS and other trade agreements, these types of measures are commonly covered by the disciplines on "domestic regulation" (for example, GATS Article VI), which seek to provide a framework that ensures that these regulatory measures do not entail greater restrictions to trade than what is necessary to achieve their policy goals. If those requirements were discriminatory instead, they would fall under the regular liberalization obligations in trade agreements, including most-favored nation, market access, and/or national treatment.

14. **Consequently, integration of services markets requires two types of efforts: (a) liberalization in the form of removal of market entry and discriminatory restrictions, and (b) regulatory cooperation aimed at reducing barriers from divergent regulation.**[30] In addition, a third level of broader cooperation initiatives, including capacity building, regional coordination of infrastructure development, and promotion of private sector development, can complement liberalization and regulatory cooperation measures. The experience of the most advanced modern integration process, the European Union, demonstrates that services liberalization is usually the first step in economic integration, and focuses on the dismantling of domestic formal restrictions to foreign services. Trade liberalization is generally governed by a set of mandatory disciplines agreed between the partners, focused on removing formal barriers to access and discriminatory treatment. This is the focus, for example, of the GATS, and bilateral free trade agreements. The greater the desired economic integration, instead, the stronger the need to address regulatory barriers through cooperation mechanisms. Greater cooperation tends to require an active and continuous engagement, which is typically reflected in standing institutions and/or procedures that facilitate dialogue among the partners.

B. Disciplines and Negotiating Modalities on Services Trade

15. **The ASEAN Framework Agreement on Services is closely related to the GATS and follows its main principles, disciplines, and approach to liberalization.** The AFAS, signed in 1995, was the first regional agreement to be concluded after the entry into force of the WTO agreement on services, and was influenced by it. The AFAS was meant to:

- enhance cooperation in services among Member States in order to improve efficiency and competitiveness, diversify production capacity, and improve supply and distribution of services within and outside ASEAN
- substantially eliminate restrictions to trade in services among Member States
- liberalize trade in services by expanding the depth and scope of liberalization beyond those undertaken by Member States under the GATS, with the aim to realizing a free trade area in services.

16. **The goals of the AFAS were further strengthened with the signing of the Bali Concord II, which set out to establish the ASEAN Economic Community as a "single market and production base," with "free flow" of goods, services, and investment.** The completion of the AEC, originally scheduled for 2020, was ambitiously advanced to 2015 by the ASEAN Heads of State during the 12th ASEAN Summit in the Philippines in January 2007. The AEC goals and the AEC Blueprint adopted in 2007 thus further elaborated and gave meaning to the AFAS objective of eliminating restrictions to trade in services and realizing a free trade area in services. Ultimately, the AEC–AFAS seeks to go far beyond the progressive services liberalization envisaged in the GATS in order to establish a single market in services trade and investment.

[30] In fact, the removal of regulatory barriers, even those that are nondiscriminatory, can be considered a form of "liberalization" (see, for example, Krajewski 2003). For greater clarity, however, "liberalization" is associated with the removal of formal restrictions to services trade, in the format of market access or discriminatory measures. "Regulatory cooperation" is referred to as the process of reducing regulatory restrictions, through mutual recognition, harmonization of principles, regulatory unification, or otherwise.

Architecture

17. **While the AEC revamped the goals of services integration, the architecture, disciplines, and procedures in place remained those of the AFAS, which, in turn, is linked directly to the GATS in all its elements.** Created only a year after the GATS, the AFAS relies significantly on the GATS to complement its architecture and disciplines. The agreement features 14 provisions (box 2), none of which contains any major liberalization or regulatory obligation. The substantial element of AFAS, instead, is featured in Article XIV(1), entitled "Final Provisions," which provides that:

> *"1. The terms and definitions and other provisions of the GATS shall be referred to and applied to matters arising under this Framework Agreement for which no specific provision has been made under it."*

Box 4.2 AFAS Articles

I.	Objectives
II.	Areas of Cooperation
III.	Liberalization
IV.	Negotiation of Specific Commitments
V.	Mutual Recognition
VI.	Denial of Benefits
VII.	Settlement of Disputes
VIII.	Supplementary Agreements or Arrangements
IX.	Other Agreements
X.	Modification of Schedules of Specific Commitments
XI.	Institutional Arrangements
XII.	Amendments
XIII.	Accession of New Members
XIV.	Final Provisions

In this way, the AFAS effectively incorporates the main substantial disciplines of the GATS, including on the key liberalization obligations of market access and national treatment. The AFAS also adopts GATS's structure in the way it tackles the different modes of services trade, and the GATS architecture for negotiating and making commitments.

Modes of supply

18. **Following the GATS model, the AFAS covers fours modes of services supply, which reflect the various means through which services are traded internationally.** The four modes can be summarized as follows:

- Cross-border supply (Mode 1): similar to trade in goods, it occurs when a service is delivered from a supplier in one country to a consumer in another country.
- Consumption abroad (Mode 2): services supplied in the territory of one country to the consumers of another. The consumer moves to acquire services in the country of the services suppliers. This entails that the services are supplied outside the territory of the country making the commitment.
- Commercial presence (Mode 3): services are supplied through any type of business or professional establishment of one country in the territory of another. This mode captures foreign investments in the service sector.
- Movement of natural persons (Mode 4): services supplied by nationals of one country in the territory of another.

19. **The alternative to this modal structure is the model pioneered by the North American Free Trade Agreement (NAFTA), which provides for different disciplines for *trade* and *investment* in services.** These agreements feature a chapter on cross-border trade in services and a separate one on foreign investment, which covers investment in both goods and services. In the ASEAN region, only Singapore has so far adopted this model in its bilateral trade agreements. Other ASEAN Member States, namely Malaysia and Vietnam, are becoming familiar with this model in the ongoing negotiations on the Trans-Pacific Partnership agreement, which will likely adopt a NAFTA-like format.

20. **The ASEAN Agreement on the Movement of Natural Persons (AMNP), concluded in 2012, altered the AFAS modal structure.** Negotiations pertaining to Mode 4 will now be conducted under the AMNP, thus limiting the liberalization discussions under the AFAS to Modes 1, 2, and 3. The AMNP is a stand-alone agreement that contains its own provisions, including on transparency, recognition, and dispute settlement.

Liberalization Disciplines, Obligations, and Modalities

21. **Unlike the GATS, the AFAS is a framework agreement that features no substantial obligations of its own, but imports GATS's main disciplines through Article XIV of the AFAS.**[31] However, the exact disciplines, including their interpretation, that are in fact incorporated in the AFAS, how, and to what extent, could be further clarified. Although Article XIV of AFAS provides that "The terms and definitions and other provisions of the GATS shall be referred to and applied to matters arising under this Framework Agreement for which no specific provision has been made under it," the agreement is silent regarding what formalities, if any, such as a decision by the ASEAN Member States, are required to incorporate any new developments under the WTO.

22. **The main liberalization disciplines under AFAS pertain to market access and national treatment.** While the AFAS does not expressly refer to these provisions, the wording of the agreement, which refers to "eliminating substantially all existing discriminatory measures and market access limitations," and the use of GATS-like schedules that expressly refer to "market access" and "national treatment," confirms the adoption of these provisions into the AFAS.[32] Together these two provisions aim to reduce quantitative restrictions on services trade and provide a level playing field between domestic and foreign service suppliers. As described in the GATS, AFAS disciplines on "market access" cover the following six categories of restrictions:

- number of service suppliers
- value of service transactions or assets
- number of operations or quantity of output
- number of natural persons supplying a service
- type of legal entity or joint venture
- participation of foreign capital.

Of these, the first four categories are quantitative, since they deal with quota-type limits. These limits may be expressed either as an absolute number or in the form of an economic needs test, and cover both discriminatory and nondiscriminatory measures.

23. **Discriminatory measures are addressed by the national treatment obligation.** The provisions do not provide an exhaustive list of discriminatory measures, but simply require a member to accord to ASEAN services and service suppliers treatment "no less favorable than that it accords to its own like services and service suppliers" with respect to measures affecting trade in services.

24. **Following GATS wording, the national treatment obligation covers both de jure and de facto discrimination.** That is, a measure is discriminatory when it alters the conditions of competition in favor of domestic services and service suppliers, regardless of whether the measure is openly discriminatory in

[31] For a general review of GATS disciplines, see WTO Secretariat (2005, 2006). For a more comprehensive analysis of the agreements, see Wolfrum, Stoll, and Feinäugle (2008).
[32] Moreover, according to information provided during the drafting of the report, WTO Scheduling Guidelines are adhered to in full by ASEAN Member States.

its text. Typical examples of discriminatory measures include restrictions on tax benefits only for nationals, training requirements imposed only on foreign suppliers, or language requirements that are not directly relevant to the exercise of a profession.

25. **The full extent of the incorporation of GATS disciplines also remains generally untested.** For example, the terms of GATS provisions on market access and national treatment have been interpreted by the WTO panels and Appellate Body in a handful of dispute settlement cases.[33] These interpretations help clarify the meaning of these provisions in the WTO context. It is not clear what significance such interpretations have under the AFAS. One example of this is whether the WTO supporting documents, such as the "Scheduling Guidelines," can be used to clarify the scope of these provisions in the context of ASEAN.

26. **Currently, in line with GATS practices, the market access and national treatment obligations are not immediately mandatory across the board.** The reach of these obligations is limited to those services sectors and modes of supply on which the ASEAN Member States have undertaken specific commitments through the AFAS rounds of negotiation. Further, even if full commitments were undertaken in all services sectors, a number of limitations to trade in services could remain in place. While the elimination of quantitative and discriminatory limitations would go a long way in reducing formal barriers to trade within ASEAN, regulatory restrictions, which may constitute unnecessary barriers to trade, would fall beyond the main obligations of the agreement and could be maintained. The central importance of market access and national treatment obligations under the AFAS, especially compared to the status of rules on domestic regulation, which have not yet been developed at the GATS level and therefore are not subject to specific disciplines under the AFAS, confirms that the region has focused so far on the elimination of formal restrictions to trade and investment in services. ASEAN Member States, however, have done little to complement the reduction of formal barriers with positive actions, such as coordinated regulatory policies in services.

Scheduling modalities

27. **Scheduling" is the mechanism for linking specific service sectors and/or a certain type of measure to the disciplines of international trade agreements.** Different models of trade agreements refer to this technique in different ways. GATS-style agreements refer to it as "scheduling of specific commitments." NAFTA-style, negative-list agreements follow the more classical terms of international law, calling this process "listing" (for "list of reservations"), or "taking reservations." Regardless of the name, the purpose of the schedules of commitments / lists of reservations is to determine how the obligations of the agreement apply to each specific services sector and type of measure. Schedules tend to be country specific, and are typically the result of a mercantilist negotiating process. The choice of the scheduling modalities of liberalization obligations is generally regarded as a decision central to the negotiating process, since to some extent it defines the dynamics of the negotiations and is generally linked to the disciplines that the agreement is expected to include.

28. **There are two elements that determine the liberalization approach.** The first is the sectoral coverage of the commitments. Disciplines can apply to services sectors through either a positive list of sectors submitted by each of the parties, or by applying to all sectors except those included in each country-specific list (negative list). The second concerns how the liberalization obligations—that is, the national treatment and market access—apply to those sectors. There can be two approaches. Using a negative list approach, parties can assume that services are generally open and nondiscriminatory, and only exceptional

[33] See, for instance, the panel and Appellate Body reports on EU – Bananas III (WTO documents WT/DS27/R/ECU and WT/DS27/AB/R), United States – Gambling (WTO documents WT/DS285/R and WT/DS285/AB/R), and China – Publications and Audiovisual Products (WTO documents WT/DS363/R and WT/DS363/AB/R).

restrictions need to be listed. Or, on the contrary, each individual liberalization measure can be listed as being committed.

29. **Three types of agreements in services can be identified depending on the liberalization approach.** The "pure positive list" agreements are those that require both sector and specific measures to be explicitly listed in order to be committed. This approach is rare in international services negotiations, and so far has only been adopted by China in it agreements with the special administrative regions of Hong Kong and Macao. A second, much more popular approach is the positive or "hybrid" lists originally introduced by the GATS, whereby nonlisted sectors are excluded from the main liberalization disciplines—on a positive basis—but specific limitations must be recorded in listed sectors if they are to be maintained—on a negative list style. This is the liberalization modality of choice of most developing countries, and of some of the biggest trade hubs like the EU and Japan. Finally, agreements that require the negative listing of both sectors and measures are "negative lists" agreements. The NAFTA pioneered this approach on services trade, and many FTAs have followed its model, in particular those promoted by the United States and Canada, as well as some high-income countries such as Chile, Korea, and Singapore.

30. **Not surprisingly, the AFAS's schedules of commitments follow the hybrid list format featured by the GATS.** This modality has also been used in all services agreements concluded by ASEAN with external partners, namely Australia, China, India, Korea, and New Zealand. This scheduling modality features some advantages for the negotiating parties, not least of which is the familiarity of an approach used at the multilateral level. Furthermore, positive listing provides the additional reassurance for developing countries that only sectors expressly listed are subject to liberalization commitments, which offers greater control over the negotiated sectors.

31. **Even in a hybrid list format, positive listing, however, may not be the best modality for agreements seeking extensive services liberalization and the creation of a single market.** While in principle full liberalization can be reached through either negative or positive lists, negative lists tend to create incentives toward greater liberalization. In particular, empirical evidence suggests that negative lists are associated to greater sectoral coverage in services agreements, although they do not necessarily offer better results in regard to the depth of the commitments (Fink and Molinuevo 2008).

32. **Despite the consistent use of GATS-like schedules in services negotiations, ASEAN countries have experience with negative lists.** ASEAN Member States have experimented successfully with this modality under the framework of the third economic pillar of ASEAN, foreign investment. The ASEAN Comprehensive Investment Agreement (ACIA), which draws on the models of investment protection and liberalization treaties, provides for reservations lists, which list sectors subject to exceptions rather than committed sectors. The ACIA, which is meant to complement the liberalization of trade in goods, applies for the purpose of investment protection with respect to a commercial presence, to all measures affecting services sectors, whether included or not in AMS schedules of commitments, and also reaches some services sectors that are ancillary to the goods production. Some ASEAN Member States also have additional experience with negotiations under negative lists. Singapore regularly makes use of negatives lists in both the services and investment chapters of its trade agreements, following closely the structure and disciplines of agreements from Canada and the United States. Japan promotes the use of negative lists for the investment disciplines, including in its various agreements with ASEAN Member States Brunei Darussalam, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

33. **This experience suggests ASEAN Member States, including the smaller economies, could meet the challenges of negative list negotiations**. While disciplines on services trade and investment may pose some additional challenges with regard to administrative and coordination efforts, and the impact on some sensitive sectors, the use of negative lists under the AFAS would increase transparency and reflect more clearly the liberalization achievements of the ASEAN Economic Community. This would also relate

to the ASEAN Economic Community principles of establishing a single market and production base, although some particular limitations between ASEAN Member States will remain.

Other general disciplines

34. **It is not evident whether the AFAS provides any disciplines beyond market access and national treatment.** In its Article XIV, the AFAS incorporates the GATS's "definitions and other provisions" "for which no specific provision has been made" under the agreement. This seems to suggest that all disciplines found in the GATS are incorporated into ASEAN when such issues are not explicitly covered in the AFAS. Following these terms, GATS disciplines on transparency, domestic regulation, subsidies, fair competition, and transfer of funds, and the exceptions to those obligations, would be included in the AFAS just like market access and national treatment. A strict interpretation of Article XIV also seems to imply that, unlike other regional trade agreements, the AFAS would be amended by any decision of WTO members regarding the GATS, unless ASEAN Member States explicitly provide otherwise on a case-by-case basis. That includes, for example, the Guidelines for Mutual Recognition Agreements or Arrangements in the Accountancy Sector adopted by the WTO Members following the GATS Article VI:4 mandate, and the Least Developed Country Services Waiver, which is a result of GATS Article IV:3 disciplines on special and differential treatment.

35. **Most-favored-nation (MFN) treatment.** The MFN provision is one of the cornerstones of the multilateral system, and requires that, with respect to any measure affecting trade in services, any treatment given by a member to any other country in the world, including non-WTO members, be extended immediately to all fellow WTO members. However, GATS Article V on Economic Integration allows members to deviate from the MFN principle and advance toward free trade and investment in services by concluding economic integration agreements (EIAs). In order to be a lawful exception to the MFN principles, such agreements must:[34]

- have substantial sectoral coverage, in terms of number of sectors, volume of trade affected, and modes of supply (understood as not providing for the a priori exclusion of any mode of supply)
- provide for the absence or elimination of substantially all discrimination that affects service suppliers from a party to an EIA
- not raise the overall level of barriers to trade in services for WTO members that are not party to an EIA.

36. **The AFAS disciplines on MFN treatment provide instead greater "flexibilities" in implementation of the MFN in services.** Originally, AFAS disciplines on MFN, through the AFAS's ubiquitous Article XIV, arguably incorporated those of Article V of the GATS on Economic Integration. An amendment signed in 2003 allowed two or more ASEAN Member States to conclude agreements, *among* themselves, to further liberalize trade in services for specific sectors, without extending such preferences to the rest of ASEAN—the so-called "ASEAN Minus X formula" (ASEAN Secretariat 2009).[35] Broad agreements concluded by ASEAN Member States as a bloc with *third* countries remain subject to the conditions for EIA, as provided by GATS Article V.

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[34] Article V:7(a) of the GATS requires any parties to an Economic Integration agreement to "promptly notify any such agreement and any enlargement or any significant modification of that agreement to the Council for Trade in Services." The Council has not yet been notified about the AFAS.

[35] Arguably, this provision is contrary to Article V of the GATS, which explicitly requires that, for any deviations from the MFN obligation, an economic integration agreement has substantial sectoral coverage in terms of number of sectors, volume of trade affected, and modes of supply (understood as not providing for the a priori exclusion of any mode of supply).

37. **These flexibilities thus create lenient disciplines (or trade benefits) on MFN for Member States, both for agreements within ASEAN and with third countries, without extending them to other ASEAN Member States.** This has its advantages, since it allows those ASEAN Member States with more open regimes to advance reciprocal liberalization either in specific sectors (within ASEAN) or through broad free trade agreements in services (globally). However, these disciplines also suggest that greater liberalization and reciprocal preferences can be achieved with selected partners, even nonmembers of ASEAN, which may not fit squarely with the goal of establishing a "single market" in the region. The conclusion of an ASEAN single market in services should grant ASEAN Member States privileged access to each other's markets, thus beyond any preferences that they may grant to other countries through free trade agreements. A way forward on this issue is to look at the possibility of including a stronger MFN provision in the enhancement of the AFAS, particularly one that covers agreements concluded by individual ASEAN Member States with third countries (which in turn should remain subject to the conditions for EIA).

38. **Transparency and domestic regulation.** Beyond the liberalization provisions, the GATS features general obligations that aim to support and complement the liberalization achieved through the reduction of market access and national treatment restrictions. Key among these is to provide sufficient information about potentially relevant rules and regulations, an obligation critical to the effective implementation of an agreement. The GATS requires WTO members to promptly publish all measures pertaining to or affecting the operation of the GATS. Moreover, there is an obligation to notify the Council for Trade in Services at least annually of all legal or regulatory changes that significantly affect trade in sectors where specific commitments have been made. Members are also required to establish enquiry points that provide specific information to other members upon request.

39. **The GATS also seeks to ensure that domestic regulatory measures do not act as barriers to trade and investment in services.** Disciplines on "domestic regulation" cover those measures that neither set quantitative restrictions nor are discriminatory in nature, such as licensing and registration requirements, screening procedures, and so forth. WTO members are required to ensure, in sectors where commitments exist, that measures of general application are administered impartially and in a reasonable and objective manner. In addition, service suppliers in all sectors must be able to use national tribunals or procedures in order to challenge administrative decisions affecting services trade. The provision also includes a negotiating mandate to develop any necessary disciplines to prevent domestic regulations (qualification requirements and procedures, technical standards, and licensing requirements) from constituting unnecessary barriers to trade. The goals of the provision are to develop sectoral disciplines intended to ensure that domestic regulations are, are among other things:

- based on objective and transparent criteria, such as competence and the ability to supply the service
- not more burdensome than necessary to ensure the quality of the service
- in the case of licensing procedures, not in themselves a restriction on the supply of the service.

40. **Other GATS disciplines provide for additional rules on competition policies, subsidies, and transfer of funds.** On competition policy, the GATS requires WTO members to ensure that monopolies and other business do not act inconsistently with the countries' services commitments. Unlike for many regional agreements, subsidies on services trade are covered by the GATS, while calling for negotiations on the issue. Also, GATS rules require WTO members to allow international transfers and payments for current transactions relating to specific commitments, to the extent this does not impinge on the countries' rights under the WTO Charter.

41. **As noted earlier, these GATS disciplines also apply to the AFAS, under the Final Provision contained in Article XIV (1), but their precise scope needs to be clarified.** Some GATS obligations, including Article V:3 on notification of changes in laws and regulations, and Article VI:1 on reasonable

administrative of domestic regulations, only apply to services sectors where specific commitments have been undertaken under the GATS. It would help to clarify that these provisions would also apply to sectors where specific commitments have been undertaken under AFAS, but not in the GATS.

42. **The AFAS's focus on progressive liberalization through negotiating rounds has left regulatory measures out of the services integration agenda.** Focusing only on market access and national treatment fails to address the restrictive impact that regulatory barriers, including administrative practices, have on services trade and investment. Furthermore, the AFAS's lack of clarity on the disciplines on domestic regulation, and the fact that they do not come across as a priority in the agreement, provides an incentive to maintain the status quo, potentially keeping regulatory barriers as protectionist measures for domestic services providers.

Mutual Recognition Arrangements

43. **As set out in the AEC Blueprint, the conclusion and implementation of Mutual Recognition Arrangements (MRAs) by 2015 is one of the key priorities of economic integration in services.** The MRAs aim to facilitate trade in services by mutual recognition of authorization, licensing, or certification of professional services suppliers. The goal of the MRAs is to facilitate the flow of foreign professionals, taking into account relevant domestic regulations and market demand conditions (ASEAN Secretariat 2009). MRAs in seven occupations under the purview of the ASEAN Economic Ministers have been concluded to date (see table 4.2).

Table 4.2 MRAs Concluded under the Purview of ASEAN Economic Ministers

Mutual Recognition Arrangement	Signing Date	Implemented Through
Engineering services	December 9, 2005	ASEAN registration (ASEAN Chartered Professional Engineer Coordinating Committee)
Nursing services	December 8, 2006	Bilateral registration
Architectural services	November 19, 2007	ASEAN registration (ASEAN Architecture Council)
Framework Arrangement on Surveying Qualifications		MRA
MRA Framework on Accountancy Services	February 26, 2009	MRA
Medical practitioners		Bilateral registration
Dental practitioners		Bilateral registration
Accountancy	November 13, 2014	MRA

44. **The MRAs are currently in various stages of implementation, with bodies being established to administer them.** The different MRAs have different implementing mechanisms. At the outset, the arrangements on accountancy and surveying qualifications are "framework" agreements that provide no substantial obligations. These agreements provide the broad principles and framework for the further negotiations of bilateral or multilateral MRAs on those professions between interested ASEAN Member States.

45. **Progress has occurred in the MRA implementation mechanisms at the regional level.** This is especially the case for architectural and engineering services, which are to be implemented by the

registration of ASEAN chartered professionals with the relevant bodies—the ASEAN Architecture Council and the ASEAN Chartered Professional Engineer Coordinating Committee, respectively. National regulatory bodies in these professions have been established in order to address the domestic procedures, and to monitor the certification and accreditations offered within the country. A number of ASEAN Member States, especially the smaller economies, have yet to establish such domestic professional bodies.

46. **In general, the reporting of actual implementation of the MRAs can still be improved.** The dissemination of information, including through the internet, on the various aspects of the implementation of the MRAs could still be improved. Individual professionals would benefit from the availability of more precise and detailed information on what agreements countries are implementing, and how.

47. **The scope of the MRAs varies across sectors.** The MRA on engineering, for instance, is limited in scope because it provides for foreign professionals to practice only in collaboration with one or more engineers of a host country. While this type of restriction on professional services is applied by many countries, it seems to narrow the scope of the MRA in promoting mobility of engineers within the region.

48. **One issue regarding implementation of the MRAs is the extent to which ASEAN members' policies and regulations on the relevant procedures need to be, and have been brought, in accordance with the MRAs** (ERIA 2012). This issue arises because some of the arrangements do not immediately require ASEAN Member States to allow foreign professionals to access their markets, but rather provide that the recognition of the professional accreditations is to be done on the basis of the current laws and regulations of the recognizing country. For example, the MRA on medical professionals establishes that:

> "A Foreign Medical Practitioner may apply for registration in the Host Country to be recognised as qualified to practise medicine in the Host Country in accordance with its Domestic Regulations and subject to
>
> […]
>
> *any other assessment or requirement* as may be imposed on any such applicant for registration as deemed fit by the [relevant authorities] of the Host Country.]"[36]

Although less explicitly, the MRAs on engineering and architecture also include references to compliance with domestic laws and regulations that could be interpreted as providing the host countries' authorities a similar degree of discretion in the process of recognition.

49. **Partly because of the need to further clarify agreements and its operating procedures, there has been little practical impact of the MRAs to date.** Authorities from different ASEAN Member States maintain different interpretations and practices on various provisions of the arrangements, and many operational details of the MRAs need to be further discussed during the implementation stage. For instance, it is unclear whether retraining can be required by the host country's authorities, or whether certain accreditations by certain educational institutions of professional bodies from at least some of the ASEAN Member States obtain automatic recognition in other jurisdictions. As in other areas of services disciplines in ASEAN, more effort is needed to provide the information to make faster progress on the integration process.

[36] ASEAN Mutual Recognition Arrangements on Medical Practitioners, Article 3.1 (excerpt).

Dispute settlement

50. **Assessing the precise level of compliance with AFAS rules remains a challenge, not just in the case of MRAs, but across all service sectors and for all ASEAN Member States.** This is partly due to the lack of common understanding among ASEAN Member States of the exact scope and meaning of the terms of the relevant agreements. It may also stem from the lack of capacity or willingness of some Member States to amend the current rules and regulations where they contradict regional obligations and commitments. Both of these issues relate to the absence of an operational dispute settlement mechanism for disciplines on economic integration in ASEAN.

51. **An effective dispute settlement mechanism is an essential component of an integration process.** It fosters predictability and confidence in the system by promoting compliance with the agreed rules and commitments and increasing transparency and understanding of the common disciplines through binding interpretations. In 2004, the ASEAN Enhanced Dispute Settlement Mechanism (EDSM) was established, which applies to all economic integration matters, including the ASEAN Economic Community, the AFAS, and sectoral cooperation arrangements.[37,38] The EDSM superseded the 1996 Protocol on Dispute Settlement Mechanism, which had provided for a more politically oriented process.

52. **The EDSM procedures closely follow the WTO dispute settlement mechanism.** Several aspects of the WTO mechanism are replicated in ASEAN, including three procedural stages: consultations, decision, and the possibility of retaliation if the decision is not implemented. Also in line with the multilateral rules, individual countries cannot block the progress of the jurisdictional procedures. The EDSM provides for some specific improvements over the multilateral rules regarding the duration of the dispute, as well as small differences needed to adapt the WTO mechanism to the regional setting.

53. **Following the WTO model, the ASEAN procedures establish two jurisdictional bodies: an ad-hoc panel to issue a first decision, and a standing Appellate Body to review the case on appeal.** The decision taken by the panels or the appellate body is ratified by the Senior Economic Officials' Meetings, unless all 10 countries, including the parties to the dispute, vote against it. This mechanism, referred to as the "negative consensus" rule, ensures the automaticity of the dispute has been appraised as a key component the WTO dispute settlement system.[39]

54. **While the ASEAN dispute settlement mechanism was inspired by WTO procedures and institutions, actual practice has lagged.** The EDSM has never been put in motion, having addressed no dispute between ASEAN Member States. Similarly, the standing Appellate Body was never established. A few differences between ASEAN Member States regarding compliance with their economic agreements, such as on trade in goods issues, have been addressed bilaterally and eventually solved through mutual understanding. Practical difficulties such as funding or political will aside, the mutual understanding approach may be argued to be a reflection of ASEAN Member States' preferred approach to dispute settlement.

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[37] While it is understood that the EDSM applies to all ASEAN economic matters, which presumably encompasses any issue falling under the AEC agenda, there is no specific definition of the competence of the dispute settlement mechanism. Article 1.1 of the EDSM provides that it applies to the "covered agreements," which are the 46 agreements listed in Appendix I. That list, however, was produced in 2004, and has not updated, casting some uncertainty over any agreements concluded after that date.

[38] ASEAN recently incorporated another dispute settlement mechanism into its integration system that covers all other, noneconomic matters within the region, such as political collaboration or border disputes. The agreement providing for such procedures is the ASEAN Charter on Dispute Settlement Mechanisms, signed in Hanoi on April 8, 2010. See Woon (2011) for a description of the system.

[39] See, for instance, Jackson (1998), and Hoekman and Mavroidis (2000).

55. **While this diplomatic system for dispute resolution is effective in redressing conflicts among the ASEAN Member States, it also reduces the transparency and predictability of the system.** In addition, it casts doubt about its role in inducing effective compliance, since the bigger economies may exert greater influence in these information discussions, eventually buying their way out of compliance. Transparency is also reduced due to the absence of an independent third party that might provide an authoritative interpretation of the terms of the agreement. Finally, the lack of implementation of an ASEAN agreement itself, especially one with such a central institutional relevance, weakens the value of the system. In light of these factors, several ASEAN Member States have proposed amending the dispute settlement mechanism, by looking into options to make the system more functional.

56. **The reform of the dispute settlement mechanism should also address some unanswered questions regarding the system.** That should include the details of what agreements, protocols, and other ASEAN disciplines and procedures fall under the review of the EDSM, and how the EDSM is to relate to the ASEAN Charter. In addition, the revision of the system may address the relationship with the WTO framework and whether the interpretations made in the multilateral forum provide guidance on the ASEAN agreements, especially when the regional disciplines are an incorporation of the multilateral rules, as is the case with the AFAS.

57. **An important function of a dispute settlement mechanism is enhancing transparency.** This is done by ascertaining the meaning of common rules that may be unclear to the parties to the agreement. This interpretative function may take place during the process of dispute resolution, when deciding whether a measure by a party conforms to the agreements. The WTO dispute settlement mechanism, as well as the EDSM, grants its jurisdictional bodies this essential, and only, role. The EDSM, like the WTO, only considers disputes stemming from lack of compliance with the relevant agreements. Yet, the experience in other regional integration forums suggests that regional courts can play a more important role as interpreters of common rules than as third parties in a dispute.

58. **The court's consultative role can foster regional integration by clarifying the scope of regional rules.** This would promote common understanding of regional disciplines and help prevent disputes. The Tribunal of Justice of the Andean Community, for example, has the ability to issue "prejudicial interpretations" that clarify the meaning of specific provisions of the Andean Community treaties and decisions (Vigil Toledo 2004). The consultative role of the Andean Tribunal, inspired by the European Court of Justice, has in practice become its main function, accounting for more than 90 percent of its decisions (Porges 2011). These interpretative rulings have been praised for ensuring greater regional integration by permitting the participation of national tribunals in the uniform application of Andean disciplines (Grigera Naón 1996).

C. ASEAN Institutional Framework on Services

59. **ASEAN Member States have developed a sizable and evolving institutional framework to promote integration in services.** Four Ministerial Bodies have been established to oversee different services sectors. While this has allowed ASEAN Member States to make progress in multiple areas simultaneously, insufficient coordination mechanisms among these bodies hampers the region's ability to conduct a comprehensive and coherent approach to the integration of services markets.

General services trade negotiations

60. **The Coordinating Committee on Services (CCS) is the main body involved in services trade negotiations.** The CCS reports to the ASEAN Economic Ministers through the Senior Economic Officials Meetings (SEOMs), which provide political guidance. The CCS is the default body responsible for services negotiations for most of the services sectors and subsectors, unless specific areas have been attributed to

other ASEAN bodies. Exceptions are for financial services, air transport, and services incidental to manufacturing, agriculture, fishery, forestry, and mining and quarrying, which are not part of the CCS portfolio. Other than those areas, service negotiations have been effectively carried out by the CCS and several working groups that operate under the guidance of the CCS.[40] The working groups under CCS supervision had been divided into the following thematic areas:

- business services
- construction
- health care
- logistics and transport services
- telecommunication and IT services
- tourism
- education.

Some of the working groups have been disbanded and their liberalization effort transferred to the CCS over the last few years.

61. **The work carried out by the CCS and the seven working parties focuses on the negotiations of services liberalization measures.** The CCS puts in practice Article IV of the AFAS, which calls for negotiations on measures affecting trade in services, in light of the AEC goals on services set out in the AEC Blueprint. Since the AFAS and, especially, the AEC Blueprint, has oriented the services negotiations to the elimination of formal restrictions on trade in services, the CCS has not to date advanced into other issues relating to services integration. In that sense, the work of the CCS, like the AFAS in general, has been focused on expanding commitments on services liberalization. While there have been informal discussions toward advancing on issues like domestic regulation on services, the focus has been on restrictions on market access and national treatment, in terms of the AFAS and according to the schedule set out in the AEC Blueprint.

62. **In terms of modes of supply, service negotiations focus on cross-border trade, consumption abroad, and the establishment of a commercial presence (that is, Modes 1, 2, and 3 of services supply).** Commitments on the presence of natural persons to provide services (Mode 4), initially covered under the AFAS, have recently been moved to the framework of the Agreement on Movement of Natural Persons, as described in Section A, above.

63. **Since the CCS has no direct authority on the liberalization of various service sectors, its officials need to consult and get their mandates from relevant domestic agencies.** The negotiations are conducted by officials from the trade ministries or planning agencies, with support from other ministries or agencies in the various sectoral working groups. Some ASEAN Member States involve representatives from other ministries and regulatory agencies in their trade negotiating team. However, there are no requirements to do so, and it remains up to each ASEAN member to conduct such coordination internally.

Specific sectoral bodies

64. **In addition to the CCS, there are other ASEAN bodies with a mandate for particular service sectors.** These sectors include financial services; air transport; and services incidental to manufacturing, agriculture, fishery, forestry, and mining and quarrying (or in short, services "incidental to goods"). In the

[40] The Informal ASEAN Economic Ministers (AEM) meeting held in June 1999, in Auckland, New Zealand, agreed that work in service sectors that falls under the purview of other Ministerial Bodies shall be led by these respective Ministerial Bodies, and areas not covered by any existing ASEAN bodies would continue to be under the purview of the CCS/SEOM/AEM. However, overall coordination of liberalization in services would still be under the purview of the AEM/SEOM. At the 33rd AEM meeting held in September 2001, in Hanoi, Vietnam, it was noted that the Tourism Sectoral Working Group, Maritime Transport Sectoral Working Group, and the Telecommunication Negotiation Group indicated readiness to return to the CCS for subsequent rounds of negotiations (ASEAN Secretariat 2009).

case of services "incidental to goods," the rules and liberalization modalities are in conformity with the ACIA agreement, since AFAS rules are not applicable here. Officials from some of the bodies, for example, in air transport and financial services, are also responsible for negotiations and regulatory cooperation in their capacity as members of other ASEAN bodies.

65. **Financial services.** Negotiations on financial services fall under the purview of the ASEAN Finance Ministers Meeting and, specifically, the Working Committee on ASEAN Financial Services Liberalisation (WC-FSL). The WC-FSL in effect acts as the CCS's counterpart in the context of financial services, but does not supervise other negotiating bodies. Representatives to the WC-FSL are generally officials from the finance ministries, central banks, monetary authorities, and securities and insurance regulators. Much like the CCS, the WC-FSL focuses on the elimination of restrictions to financial services following the negotiating mandate of AFAS and the AEC Blueprint. The attention lies on measures that may conflict with the "market access" and national treatment disciplines of the agreement.

66. **However, some specific regulatory matters have been considered by the WC-FSL.** In the context of the negotiations of commitments, ASEAN Member States are working on further improving the WTO Annex on Financial services in the ASEAN context. The WTO Annex does not go into promoting regulatory coordination among the members, but rather clarifies that prudential regulations on financial services are not inconsistent with the disciplines and commitments of the agreement. To further deepen regional financial integration, the ASEAN Central Bank Governors' Meeting (ACGM) in December 2014, endorsed an ASEAN Banking Integration Framework (ABIF), which will enable "Qualified ASEAN Banks" (QABs) to have a greater role in promoting intraregional trade and investment. The ABIF guidelines were also approved by ACGM in December 2014, and the provision for enabling QAB implementation was signed by ASEAN Finance Ministers in March, 2015 as part of the Protocol to implement the 6th Package of Financial Services under the AFAS.

67. **Capital Markets:** Initiatives to promote freer flow of capital and greater connectivity of ASEAN capital markets are being undertaken by the ASEAN Capital Markets Forum (ACMF). This includes the ASEAN Disclosure Standards for equity and plain debt securities (box 4.3), the ASEAN Trading Link, the Streamlined Review Framework for the ASEAN Common Prospectus, the Expedited Review Framework for Secondary Listings, the Framework for the cross-border offering of ASEAN Collective Investment Schemes and the ASEAN Corporate Governance Scorecard. The ACMF is also working on the ASEAN Capital Market Development Programme aimed at extending mutual assistance to all markets within the region to facilitate individual and regional market development. Further, the Working Committee on Capital Market Development (WC-CMD) is working on deepening and strengthening bond markets in the region, particularly towards enhancing the capacity and building critical capital market infrastructures. In addition, efforts to better integrate the region's bond markets are currently being undertaken by the Asian Bond Markets Initiative (ABMI) to develop local-currency denominated bond markets, and develop more accessible and well-functioning regional bond markets both for issuers and investors.

68. **Telecommunications, transport, and tourism services.** Substantial work on services integration is also taking place beyond the framework of AFAS negotiations. In particular, cooperation toward integration on telecommunications, transport, and tourism falls within the purview of the respective sectoral ministries.[41] These sectoral initiatives go outside the coverage of the AFAS work insofar as they do not seek to liberalize services per se, but rather focus on "cooperation" measures that may assist the integration process. Cooperation initiatives have focused largely on infrastructure issues like promoting connectivity, enhancing dialog, and increasing domestic capacity. Sectoral discussions on cooperation have also

[41] The regional ministerial bodies involved are, respectively, the ASEAN Telecommunications and IT Ministers Meeting (TELMIN), the ASEAN Transport Ministers Meeting (ATM), and the ASEAN Tourism Ministers Meeting (M-ATM).

addressed some issues on domestic cooperation, such as development of common quality and safety standards.

Box 4.3 Regulatory Cooperation in Financial Services

The securities regulators in Malaysia, Singapore, and Thailand on April 1, 2013, announced the implementation of the ASEAN Disclosure Standards Scheme for multijurisdictional offerings of equity and plain debt securities in ASEAN. The scheme aims to facilitate cross-border offerings of securities within the ASEAN region by harmonizing disclosure requirements, and to enhance the investment opportunities within the ASEAN capital markets. Under the scheme, issuers offering equity and plain debt securities in more than one of the above three countries will only need to comply with a single set of disclosure standards for prospectuses, known as the ASEAN Disclosure Standards.

The ASEAN Disclosure Standards are a set of common disclosure standards for prospectuses used in offers of shares and plain debt securities. They are based on standards on cross-border offerings set by the International Organization of Securities Commissions (IOSCO). Under the scheme, an issuer wishing to make multijurisdictional offerings would need to provide only a single set of disclosure documents that comply with the ASEAN Disclosure Standards to investors in each of the participating jurisdictions. This is expected to bring about greater efficiency and cost savings. The scheme will apply to offers of shares and plain debt securities only. It will not apply to options, warrants, or any other rights or interests in shares or debt securities; or to debt securities that are not plain debt securities.

The scheme replaces the ASEAN and Plus Standards Scheme that was announced on June 12, 2009. Under the ASEAN and Plus Standards Scheme, issuers preparing prospectuses for a multijurisdictional offer had to comply with a set of common disclosure standards, and with additional requirements (known as the Plus Standards) prescribed by each of the respective jurisdictions. The benefit of the current scheme over the previous one is the advantage of having a single set of fully harmonized disclosure standards, instead of having to comply with additional Plus Standards for each jurisdiction. Implementation of the scheme is on an opt-in basis for ASEAN Member States.

On 3 March 2015, the securities regulators of Malaysia, Singapore, and Thailand, and the Singapore Exchange (SGX), signed a Memorandum of Understanding to establish a Streamlined Review Framework for the ASEAN Common Prospectus. Under this framework, the review process for a multijurisdictional offering of equity or plain debt securities will be streamlined, as long as the prospectus is prepared in accordance with the ASEAN Disclosure Standards. Issuers planning to offer or list equity or plain debt securities will benefit from a shorter time to market and faster access to capital across participating countries.

Source: Rajah & Tann 2013.

69. **In addition to meaningful progress on regional liberalization through negotiations on air transport under the Transport Ministers Meeting, air transport officials have also made inroads toward regulatory cooperation.** ASEAN Member States have agreed to establish the ASEAN Single Aviation Market, which has led to the conclusion of three agreements on the reciprocal opening of air transport rights, and to the initiation of discussions on regulatory matters such as safety measures, airport standards, and navigation systems.

70. **On tourism services, the Task Force on ASEAN Tourism Standards has attempted to complement liberalization negotiations with common standards on tourism.** The Task Force, established by the tourism ministers, developed common principles that should guide domestic regulation on six aspects related to tourism services.[42] These principles are meant to develop comparable standards (and improve services) in order to increase quality and enhance the value of tourism services in the region.

[42] The six areas of regulatory principles include homestay, green hotels, food and beverage services, public restrooms, ecotourism, and tourism heritage.

However, tourism ministers have not addressed how other regulatory barriers may affect tourism services within the region.

71. **Regulatory issues in the telecommunications sector have so far focused largely on development of skills and exchanges of information.** However, the telecom ministers have set the bar high, calling for "cooperation and harmonization of telecommunications and IT policies and programs" under their purview, which leaves room for more substantial discussions on regulation in the future.[43]

72. **In these services sectors, regulatory cooperation focused on common principles and the harmonization of some regulatory standards.** Telecom and transport ministers do not address liberalization measures in the form of restrictions on market access and national treatment, which are understood to be covered by the AFAS negotiations. These ASEAN bodies and their efforts may, however, address the domestic regulation measures that may act as barriers to trade and investment in these services sectors.

73. **Finance Ministers and Central Banks have initiated a number of steps toward regulatory cooperation that are worth noting.** In the banking sector, the ASEAN Banking Integration Framework aims to promote greater access and treatment for ASEAN banks. In capital markets, to date, the ACMF has completed initiatives on harmonization of rules and regulations such as ASEAN Disclosure Standards for equity and plain debt securities (2013), the framework for the cross-border offering of ASEAN Collective Investment Schemes (2014), and the Streamlined Review Framework for Common Prospectus (2015), among others. In addition, the Working Committee on Capital Market Development (WC-CMD) closely monitors the bond market development in the region, including areas on market access and tax treatment for nonresidents.

74. **Services incidental to manufacturing, agriculture, fishery, forestry, and mining and quarrying.** A few services fall under the purview of the Coordinating Committee on Investment (CCI), which is the CCS equivalent in the realm of investment in goods. In 2001, the AFAS's scope was amended to transfer the negotiations on the liberalization of commercial presence on services incidental to manufacturing, agriculture, fishery, and mining and quarrying to the scope of the CCI, with the goal of ensuring that the commitments on services and goods relating to those sectors were consistent.

75. **Negotiations on investment under the CCI led to a broad investment agreement.** The ASEAN Comprehensive Investment Agreement (ACIA) follows standard practices for investment promotion and protection treaties, including principles on nondiscrimination in the establishment and operation of foreign investment, fair and equitable treatment, guarantees against expropriation, and access to international arbitration. These principles apply to services incidental to manufacturing, agriculture, fishery, and mining and quarrying, unless they are excluded from the main liberalization obligations on a negative-list basis.

76. **The obligations under the investment agreement apply to the services sectors only to the extent they are provided through the establishment of a commercial presence (Article 3.5 of ACIA).** Cross-border trade in those services incidental to goods remains in principle under the scope of the AFAS. However, lack of a common understanding on the scope of both agreements with regard to these incidental services has led to their being de facto absent from AFAS negotiations, especially on Modes 1, 2, and 4 of these sectors.

[43] See Ministerial Understanding on ASEAN Cooperation in Telecommunications and Information Technology, signed in 2001 (http://www.asean.org/communities/asean-economic-community/item/ministerial-understanding-on-asean-cooperation-in-telecommunications-and-information-technology).

Other bodies relevant to services disciplines

77. **Two more ASEAN bodies have agendas that have relevance to services trade.** These deal with regulatory cooperation and the settlement of trade disputes. Regulatory cooperation is being discussed by the High Level Task Force on Economic Integration in an advisory capacity.[44] The Task Force has set up the ASEAN Regulatory Reform Dialogue as a channel for exchanging views and information on regulatory reform efforts and policy measures, and discussing measures and activities to take forward ASEAN initiatives on regulatory-reform-related issues.[45]

78. **The initiative on regulatory reform is aimed at supporting the integration process.** It acknowledges the impact that domestic regulatory measures may have on trade and investment, and is focused on the exchanges of information in regional and international practices as a way to advance the discussion. To date, two symposiums have been held, which focused on current regulatory practices on telecommunications, transportation, finance, and other services.[46]

79. **The current agenda of the Regulatory Reform Dialogue does not include exploring common guidelines or principles on regulation.** In principle, the work of the Regulatory Reform Dialogue could complement the liberalization agenda conducted under the AFAS, but it does not yet provide for concrete steps toward the reduction of regulatory divergence that limits economic integration.

80. **The decision-making process.** Decision making on services integration follows the dynamics typical of trade negotiations. The main body involved in services liberalization, the CCS, operates as a negotiating body where member countries define modalities for the exchange of liberalization commitments. The CCS meets on average four times a year. The duration of the CCS meeting is two to three days, or a week if it includes its subsidiary bodies meeting in parallel and back-to-back with the CCS. The agenda for the meetings typically covers all issues subject to negotiations, with a focus on those areas that pose the greater liberalization challenges. In addition to the actual preferences negotiations, the group also addresses institutional and procedural issues on the negotiations, including negotiating modalities, identification of priority sectors for future rounds, linkages with other ASEAN negotiating groups, and other issues that may be relevant to the ASEAN Economic Ministers. The ASEAN Secretariat provides support to the negotiations.

81. **The decision-making procedures follow the principles of international trade negotiations.** Decisions are taken by consensus among all Member States and take the form of international agreements. Each agreement must be ratified internally in each of the Member Countries, following their constitutional or legal procedures, to be in force at least for that member. Some formal agreements like the AFAS follow standard ratification practices for international agreements and require ratification by all parties to enter into force.[47] The protocols containing the schedules of liberalization, which are international agreements in nature and differ from package to package, provide further information on the approval process.[48]

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[44] The High Level Task Force on Economic Integration is composed of high-ranking trade officials from all Member States. It is responsible for advising the economics ministries on all issues pertaining to economic integration and for advancing discussions on one specific area when instructed by the ministries. There are also other bodies discussing regulatory issues.

[45] ASEAN 2011b (http://www.asean.org/news/asean-secretariat-news/item/asean-s-regulatory-reform-dialogue-a-first).

[46] PhilStar.com (http://www.philstar.com/business/713357/asean-discuss-regulatory-reforms-jakarta-meet).

[47] For instance, Article XIV.3 of the AFAS provides that the agreement "shall enter into force upon the deposit of instruments of ratification or acceptance by all signatory governments with the Secretary-General of ASEAN."

[48] The Protocol to Implement the Eighth Package of Commitments under the AFAS establishes in that regard that "5. This Protocol and the commitments set out in its Annexes shall enter into force ninety (90) days after the date of

82. **Since 2007, the modalities for negotiations based on previously agreed benchmarks have been incorporated into the AEC Blueprint** (table 4.3). The benchmarks set out time frames and targets for commitments in terms of number of sectors and types of obligations, building up to 2015. By entry into force of the AEC Blueprint, ASEAN Member States should have no restrictions on cross-border trade and consumption abroad, should maintain no discriminatory or quantitative restrictions, and allow at least 70 percent foreign ownership on all service sectors, subject to flexibility and with some exceptions.

Table 4.3 Evolution of Negotiating Modalities

Round	Modalities	Description
Round 1 (1996–1998)	Request and offer	• Similar to the GATS • Including exchange of information on services regime
Round 2 (1999–2001)	Common subsectors	• Common subsector = a subsector where 4 or more Member States made commitments under the GATS and/or previous AFAS packages • Member States are requested to make offer for these subsectors
Round 3 (2002–2004)	Modified common subsector	Same as above, but threshold is modified to 3 or more Member States (instead of 4)
Round 4 (2005–2006)	2 tables of subsectors	• Require a minimum number of subsectors to be submitted that meet certain levels of commitment: • Table 1 = Mandatory subsectors • Table 2 = List of subsectors and ≧5 of them shall be scheduled
Round 5 onward (2007–present)	AEC Blueprint	Follow thresholds listed in the AEC Blueprint

83. **While the use of thresholds has served to increase negotiation efforts and advance the adoption of liberalization commitments, the dynamics of trade negotiations have also posed some limitations on the integration process.** For example, the negotiations and meetings are a significant burden for the least-developed economies, which face larger financial and human resource constraints to participate in ASEAN negotiations, on top of the numerous negotiations conducted by ASEAN as a group with its trading partners.

D. ASEAN's Progress in Services Liberalization through Negotiations

84. **Against this legal and institutional background, how much has AFAS contributed to integration of the services market in ASEAN? Is ASEAN on track to fulfilling the goal of a "single market and production base" for the services sector in 2015?** The following analysis reviews progress

signature. Member States undertake to complete their internal procedures for the entry into force of this Protocol and its Annexes. Each Member State shall, upon the completion of its internal procedures for the entry into force of this Protocol, notify the ASEAN Secretariat in writing. Where a Member State is unable to notify the completion of its internal procedures within ninety (90) days of the date of signature, the rights and obligations of that Member State under this Protocol and its Annexes shall commence on the date on which the Member State notifies the completion of its internal procedures. 6. For a Member State that is unable to submit its full commitments under the Eighth Package by the time of signing of this Protocol: (a) commitments that are submitted thereafter but before the entry into force of this Protocol and its Annexes, shall also enter into force ninety (90) days after the date of signature of this Protocol; and (b) commitments that are submitted after the entry into force of this Protocol and its Annexes shall enter into force upon their submission."

on the liberalization of services trade and investment under AFAS, and compares it with similar agreements from the region and abroad.

Assessing progress in services liberalization

85. **The effectiveness of the AFAS in promoting services liberalization can be assessed by the level of commitments undertaken by ASEAN Member States.** This evaluation is necessarily partial, since it cannot take into account the actual level of implementation of those obligations. However, it does help in considering general progress in the removal of limitations on services trade within the region in formal terms. A closer look at the sectors and types of measures that are currently maintained (at least at face value in the schedules of commitments in services) provides additional information on the remaining challenges to services liberalization. This also allows comparing the progress made by AFAS with ASEAN's other services agreements at the multilateral, regional, or bilateral level, thus better assessing the value added of ASEAN in liberalizing services among its Member States. Assessing the commitments also allows a comparison with the quantitative goals set out in the AEC Blueprint, and an evaluation of whether the process is advancing as originally scheduled.

86. This section focuses on services integration in the 10 ASEAN Member States and examines the degree of liberalization of trade in services in terms of commitments in the following three trade agreements:

- The General Agreement on Trade in Services (GATS)
- The ASEAN Framework Agreement on Services (AFAS)
- The ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA).

87. **The section draws on a simple database of commitments in services trade liberalization in the GATS, AFAS, and AANZFTA agreements.** While this tool cannot precisely measure the depth of FTA commitments and their impact on domestic laws and regulations, several empirical patterns emerge:

- ASEAN Member States **have advanced significantly in terms of commitments mad**e to services liberalization over the last 18 years, when the AFAS was signed. The **extent of commitments made under the AFAS generally exceeds the commitments made under the GATS.**
- Generally, the most commitments has been made by Singapore, and by countries that only recently acceded to the WTO (Cambodia, Lao PDR, and Vietnam).
- In the AFAS, **among the sectors that are still largely protected from outside investors are health and social services and transport—**all of them sectors that have a high empirical sensitivity to market opening.
- Neither agreement provides an equal degree of liberalization across the four modes of service delivery. **Modes 1 and 2 (cross-border supply and consumption abroad) exhibit the fewest restrictions, while Mode 3 (commercial presence)—arguably the most important mode for foreign service suppliers—**exhibits many remaining restrictions.

88. The section does not measure commitments on the movement of natural persons. As mentioned, commitments on that mode have been moved away from the sphere of the AFAS and are under negotiations.

General sectoral scope of AFAS commitments

89. How is the AFAS performing in terms of progress on liberalization? A first, broad picture describes the level of liberalization achieved so far under AFAS negotiations compared to other agreements among ASEAN Member States and abroad (figure 4.1). In order to portray this general picture, commitments are aggregated into full, partial, and unbound commitments. "Full" commitments reflect the amount of service

subsectors that feature no market access or national treatment discrimination, while "unbound" points to the number of subsectors that have commitments in neither market access nor national treatment

Figure 4.1 Level of Commitments in Trade Agreements

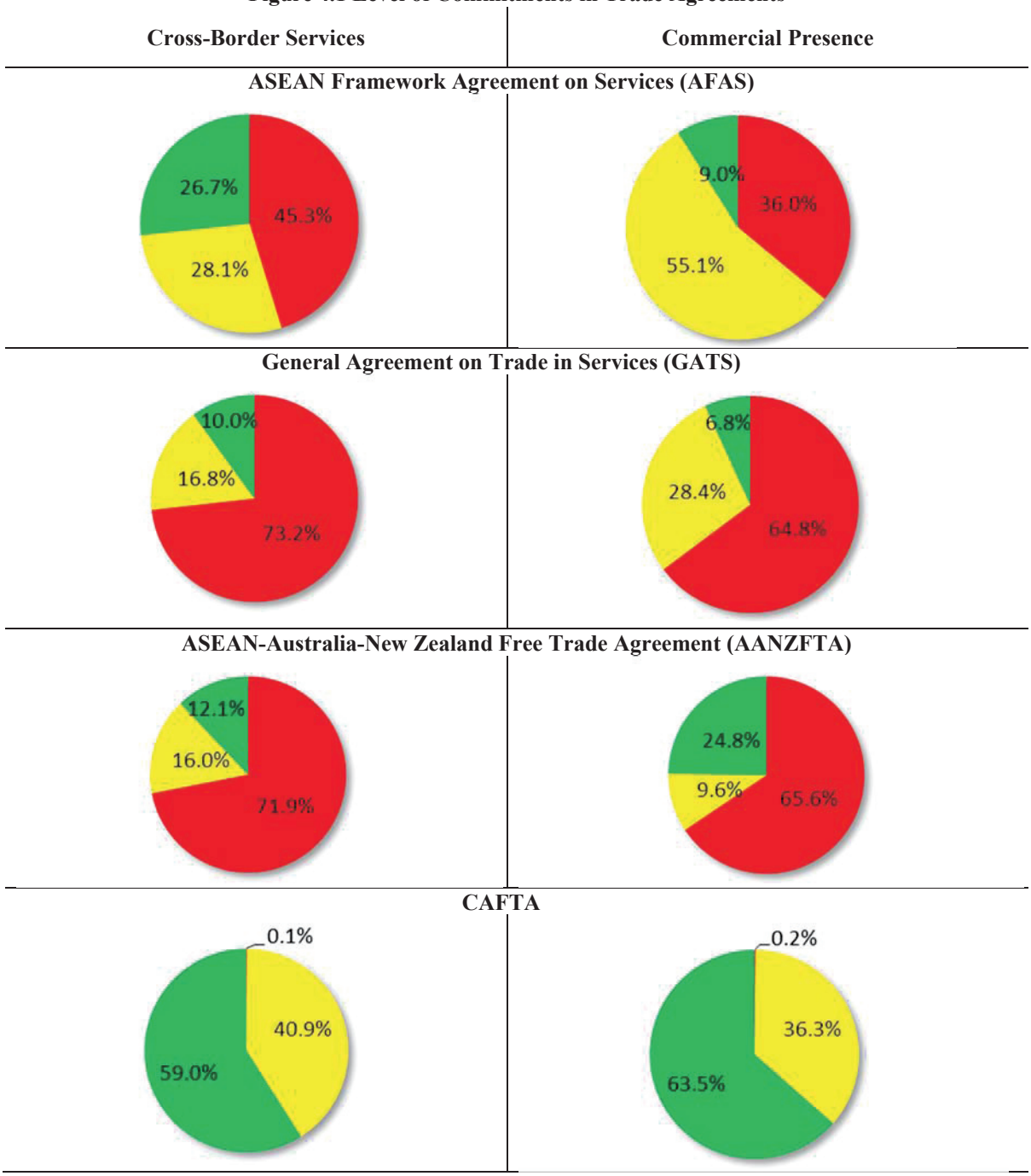
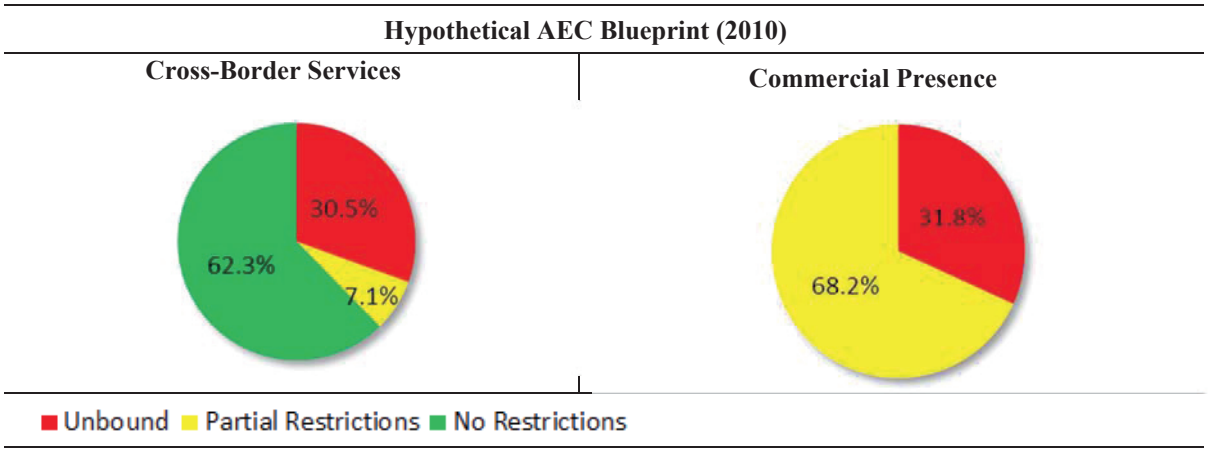


Figure 4.1 Level of Commitments in Trade Agreements (continued)



Source: Authors, based on commitments by ASEAN Member States under the AFAS (up to Seventh Package); GATS; AANZFTA; and by Central American countries in CAFTA.

90. **The AFAS and the GATS.** A first observation shows that the AFAS provides some meaningful progress over the GATS in terms of services liberalization. This is particularly the case for services provided through commercial presence, for which ASEAN Member States have almost doubled the aggregate number of committed services subsectors—expanding it from a total of 35 percent to about 65 percent of covered subsectors.[49] Services provided through cross-border supply have also seen a reduction of the uncommitted sector, as would be expected, but the total number of uncommitted sectors still remain high (45 percent). Some progress on cross-border trade can be seen, instead, in the amount of services subsectors that are fully open: almost 25 percent within the region, compared to only 10 percent at the multilateral level. This overall level of progress is compatible with earlier assessments, which have also noted the improvement of AFAS commitments over GATS commitments (Dee 2010; Fink and Molinuevo 2008).

91. **The AFAS and the AANZFTA.** The aggregate figures also show that the ASEAN–Australia–New Zealand FTA (AANZFTA) provides, in total, only marginal liberalization in services trade compared to the GATS. It is striking that the aggregate level of uncommitted sectors has not been reduced in the bilateral agreement compared to the GATS. Instead, the progress of the AANZFTA seems to have fallen on the removal of restrictions on foreign investment; while the overall number of committed subsectors has not changed between the AANZFTA and the GATS, the difference lies in that in AANZFTA, those subsectors are largely free of any market access or national treatment limitation. In fact, there are many more service subsectors free from restrictions in the AANZFTA than in the AFAS. This suggests that a number of limitations on commercial presence still found in AFAS schedules could easily be removed, and indeed are probably not applied in practice.

92. **In practice, this cautious approach to liberalization with third parties is needed for the AEC–AFAS' survival.** Services liberalization, in terms of the elimination of formal restrictions to trade in services, remains the main and only initiative on services in the ASEAN agenda. That is, no further steps toward services integration in ASEAN are being considered other than the elimination of market access and national treatment restrictions. The action plan and time frame set out by the AEC Blueprint confirms this. This means that greater liberalization commitments and wider sectoral coverage under the AANZFTA

[49] The data based on commitments made under the AFAS Seventh Package underestimate AFAS commitments, since they do not take into account the commitments made under the Eighth Package, the commitments made under Air Transport negotiations, and liberalization obligations affecting services ancillary to goods production adopted by ASEAN Member States under the ACIA.

would have meant nullifying in the agreements with third parties the preferences that ASEAN Member States are granting each other under the AEC–AFAS.

93. **The question remains how to ensure ASEAN preferences in a context of the proliferation of and increasingly ambitious trade agreements.** As ASEAN embarks on further negotiations with other countries in the region, limiting the sectoral scope of the agreements may not necessarily be an option. Indeed, it is likely that ASEAN+6 negotiations (the Regional Comprehensive Economic Partnership) involving trading powerhouses like China, Japan, and Korea, will demand liberalization commitments well beyond those offered under AANZFTA. Some ASEAN Member States are also involved in the Trans-Pacific Partnership (TPP) negotiations, which will likely go well beyond the current commitments under the AFAS, perhaps closer to other agreements promoted by the United States, such as the Central America Free Trade Agreement (CAFTA). ASEAN Member States will need to deepen the regional preferences beyond those offered to third parties to ensure the progress of the integration process—and, in fact, the mere existence of an ASEAN services integration agenda.

94. **The AFAS and CAFTA.** Finally, a cross-regional comparison shows a striking contrast between the liberalization achieved by the AFAS and Central American countries. Figure 4.2 depicts the liberalization commitments undertaken by Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua in their free trade agreement with the United States concluded in 2004—called CAFTA. AFAS aggregate sectoral coverage, which amounts to 55 and 65 percent for Modes 1 and 3, respectively, pales in comparison with the whopping 99.8 percent of sectoral reach featured by CAFTA. Under CAFTA, a negative list agreement, Central American countries have undertaken commitments in every services subsector, save for two subsectors omitted by the Dominican Republic and El Salvador. Furthermore, well over half of services subsectors are free of any quantitative restrictions or discriminatory measures, compared to only one-quarter and one-tenth in the case of ASEAN for cross-border trade and commercial presence, respectively. The negotiating dynamics of the small Central American economies in an agreement with the United States are clearly different from the ones between ASEAN Member States, but the case of CAFTA does provide an example of the liberalization potential of a free trade agreement. This is so even though CAFTA's ultimate ambition is much more moderated than that of ASEAN, since it does not intend to integrate the services markets, but only to eliminate market access and national treatment restrictions. This suggests that the ASEAN Economic Community and the AFAS still remain far from free trade in services, even in terms of purely formal liberalization.

95. **The constraining issue is not whether the current AFAS commitments provide for free trade in services.** ASEAN Member States have set out a time frame in the AEC Blueprint meant to progressively lead toward the "single market and production base" in 2015. The time frame features the liberalization requirements for successive rounds of negotiations, pointing to the number of new sectors that must be scheduled and, roughly, the nature of the obligations. The current level of liberalization of AFAS should thus be measured against those requirements in order to assess whether ASEAN is indeed on track with the goals it has set out—formally, at least.

96. **The AFAS and the AEC Blueprint.** The last row of figure 4.1 depicts the level of commitments for services trade of a hypothetical "AEC Blueprint" schedule. Those parameters relate to the Eight Package of AFAS Commitments, the last round of commitments in force—the Eighth Package. These figures are subject to several strong assumptions about how the liberalization obligations apply in practice, namely (a) the liberalization requirements of the AEC are rather broad and lack specificity, (b) they refer to parameters of liberalization of national treatment measures that are not publicly available, and (c) commitments are also subject to a "15 percent" degree of flexibility, but how that 15 percent is calculated or applied is also

not public.[50] In fact, the lack of clarity on such rules is another substantial shortcoming in the transparency of the system. It not only prevents third parties from understanding the details of the services integration process, but it effectively suggests that some basic rules on the functioning of ASEAN are not meant to be publicly disclosed.

97. **Despite the limited progress of the AFAS compared to other trade agreements, ASEAN Member States are broadly on schedule with their AEC goals.** The figures suggest that, in the aggregate, the sectoral scope of the AFAS schedule is close to what should be expected from the AEC Blueprint and the various flexibility understandings surrounding it—particularly for commercial presence. For this mode of service supply, the aggregate of 36 percent uncommitted sectors is in line with the 32 percent of the hypothetical Blueprint. Instead, some greater progress may be needed in cross-border supply, both in terms of committed sectors, and level of openness of those commitments. ASEAN Member States do remain somewhat behind schedule, however, in implementation of the Eighth Package of commitments, and negotiations of the ninth should be more advanced in the Blueprint schedule.

98. **The question remains, however, whether the current plan for services integration can successfully lead to a single market in services trade.** In a single market, service providers should not face additional regulatory restrictions when acting in multiple jurisdictions of the unified market, so that once they have complied with the laws and regulations of one jurisdiction, their ability to provide services or establish themselves in other markets is guaranteed. This is not the case under the current ASEAN model, where service providers, like a provider from any third country, are subject to the regulatory requirements of both the domestic and destination market. These include both the entry and operation requirements that are legitimate regulations to ensure the quality and reliability of the services. In other words, once market access and national treatment obligations are fully assumed by a country, that is, full liberalization commitments are adopted, providers need in addition to overcome nondiscriminatory barriers related to the regulatory environment that affects trade in services. These regulatory barriers include the actual regulations, their implementation, and enforcement. Market access and national treatment commitment do not necessarily provide access to a market if the regulatory environment is too burdensome. In fact, that level of ambition seems to go well beyond the actual steps envisaged for 2015 in the AEC Blueprint.

Measures in AFAS schedules

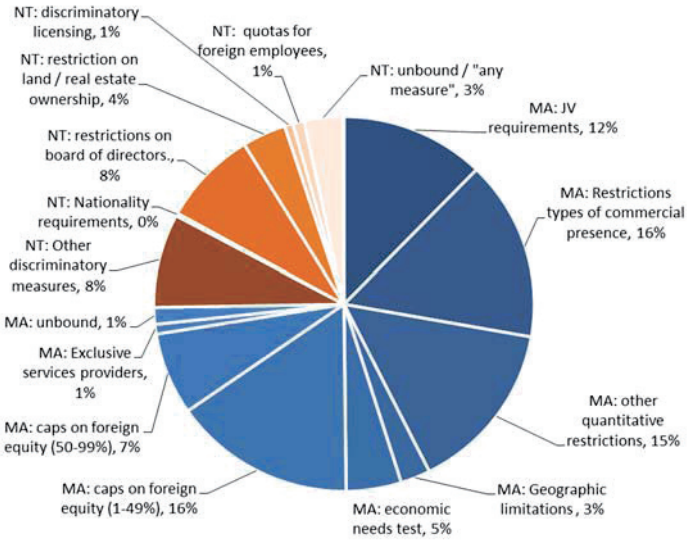
99. **ASEAN Member States have listed a broad range of restrictions on commercial presence in their AFAS schedules.** A closer look at the measures listed in the Member States' schedules provides further guidance on the remaining challenges of liberalization. Figure 4.2 displays the types of restrictions on services found in the Seventh Package of AFAS commitments.

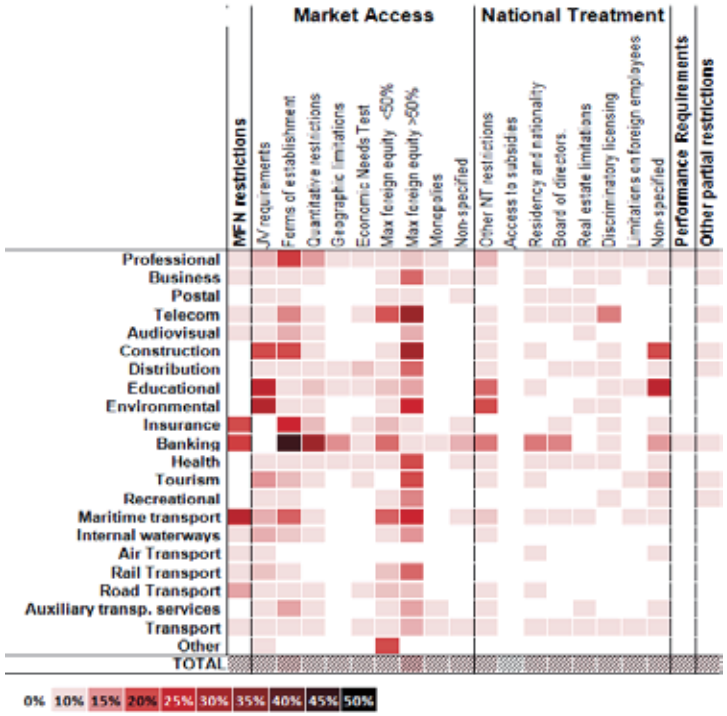
100. **The large majority of restrictions relate to measures affecting market access.** That is, however, in line with the AEC Blueprint, which gives priority to the removal of discriminatory barriers. But, restrictions on market access go well beyond the limitations on foreign participation foreseen by the Blueprint, which were to allow at least 51 percent foreign ownership by 2010. Indeed, those restrictions (caps on foreign ownership between 1 percent and 49 percent) account for only 16 percent of total restrictions. While restrictions on foreign majority ownership were to have already been abolished, ASEAN Member States have made use of their flexibility to maintain such restrictions, which account for 7 percent

[50] For the purpose of elaborating these figures, the following are assumed: (a) a 15 percent flexibility is reflected in subsector-specific deviations from the market access or national treatment obligations, distributed in equal parts between Modes 1 and 3, calculated over the total of 154 subsectors listed in this database and distributed discretionally among them, including on priority sectors; and (b) the parameters for Mode 3 liberalization currently allow one limitation on national treatment per subsector (Dee 2009), which is not applied to priority sectors (health, tourism, and logistics).

of the total. Yet, the allowance for restrictions on foreign ownership at all in a process of market integration is puzzling. Requiring domestic participation, even in minority stakes, de facto entails that service suppliers cannot move within the "single market" without substantial alterations in their corporate ownership.

Figure 4.2 Restrictions on Services Trade Under the AFAS





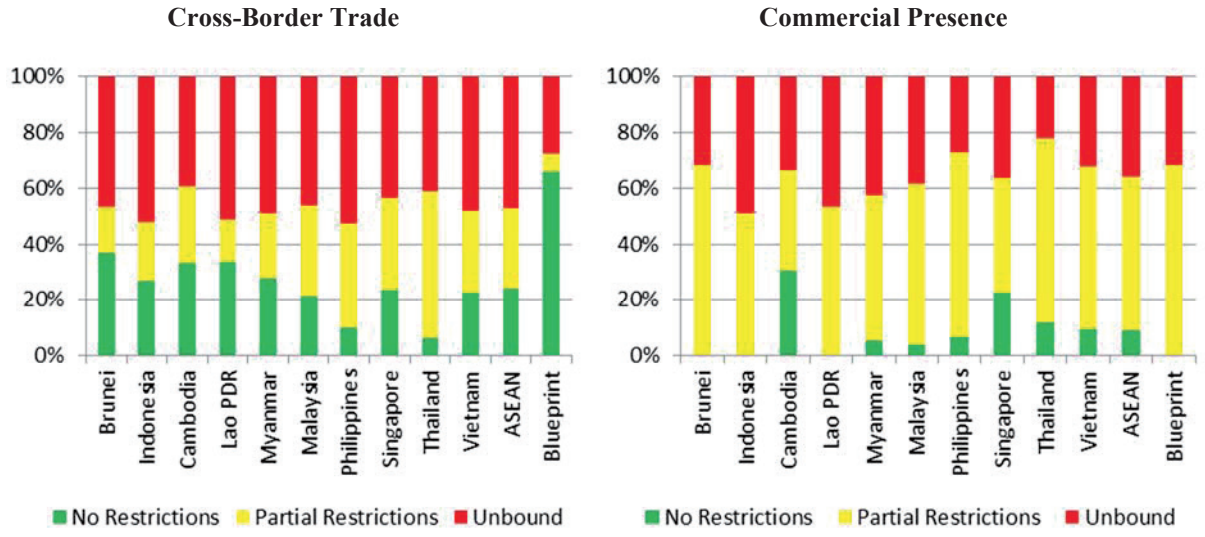
Source: Authors based on commitments by ASEAN Member States under the AFAS (up to Seventh Package).Note: JV = Joint Venture; MA = Market Access; NT = National Treatment.

101. **Other types of restrictions are also numerous,** such as restrictions on the types of commercial presence (often found in financial services and professional services), joint-venture requirements (telecoms, professional, and transport services), and "other" quantitative restrictions (financial services).

Commitments across ASEAN Member States

102. **While the AEC Blueprint sets out the same rules for everybody, not all ASEAN Member States are liberalizing services trade at the same pace.** In cross-border trade in services, subsectors subject to market access and national treatment commitments range between 40 and 50 percent for all Member States, but the degree of liberalization among committed services varies (Figure 4.3). Brunei Darussalam, Cambodia, and Lao PDR maintain no limitation to cross-border around or above 35 percent of service subsectors, whereas the Philippines and Thailand offer equally unrestricted access in less than 10 percent of their services list. Still, the benchmark of the hypothetical blueprint, at over 60 percent fully liberalized subsectors, remains distant even for the most ambitious countries.

Figure 4.3 Level of Commitments, AFAS



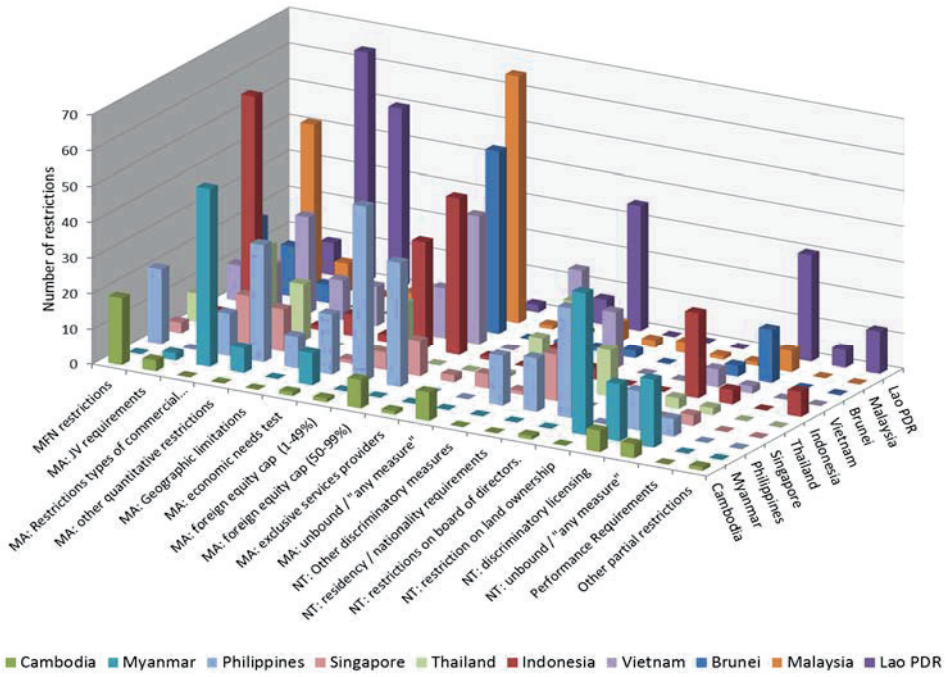
Source: Authors, based on commitments by ASEAN Member States under the AFAS (up to the Seventh Package).

103. **Commitments on commercial presence appear much closer to the Blueprint, at least for some Member States.** Indeed, commitments show a rather important variation among countries: committed services subsectors range from 88 percent (Thailand) to as low as 53 percent in the case of Lao PDR. However, the ASEAN average level of commitments is in line with the hypothetical blueprint, which suggests that not all members face similar difficulties for matching the blueprint schedules. A country-level picture of AFAS commitments also offers a preview of the countries' policies on investment in services: Cambodia and Singapore appear to be the most ambitious, offering 30 and 22 percent of services subsectors, respectively, with no formal barriers to foreign investment.

104. **Important differences also remain in the sectoral scope and types of restrictions that each ASEAN member applies.** As is evident from figure 4.4, some countries appear close to the sectoral scope required by the AEC Blueprint at this stage, especially on commercial presence, while other countries seem to have fallen behind in the scheduling of commitments. For instance, Lao PDR has inscribed restrictions on the type of commercial presence and/or "other" quantitative limitations in at least one-third of services

subsectors, while these measures are hardly used by other Member States like Brunei Darussalam, Cambodia, Singapore, or Vietnam. Indonesia and Malaysia have scheduled together over two-thirds of the joint ventures required of the whole region. Indonesia and the Philippines account for more than half the foreign equity limitations below 51 percent. In contrast, Myanmar has scheduled no limitations at all on foreign equity participation.[51]

Figure 4.4 Restrictions on Commercial Presence in AFAS Schedules



Source: Authors, based on commitments by ASEAN Member States in under AFAS (up to the seventh package).
Note: JV = Joint Venture; MA = Market Access; NT = National Treatment.

105. **These differences in the policies affecting trade and investment in services suggest that the "single market" still remains a distant goal.** In practice, however, these schedules do not mean that any of these countries in fact maintain this depicted level or openness or restrictiveness, or even the listed restrictions. Since there is no mechanism to assess implementation in the regulatory framework, these data say little about the actual services policies of ASEAN Member States, and can only serve as a reference vis-à-vis the AEC–AFAS obligations. From this perspective, however, the stark differences in sectoral coverage, as well as policies vis-à-vis the service sectors, are a reminder of the strong effort still needed to meet the AEC goals by 2015.

The need for an implementation monitoring mechanism

106. **The discussion above has focused on commitments adopted by the ASEAN Member States, and the measures they have referred to in such schedules.** Whether such commitments actually reflect the legal and regulatory framework of each ASEAN Member State is another matter. Chapter 2 of this

[51] Some experts point out that landownership restrictions are in fact not covered by the AFAS. Should there be such an informal understanding between ASEAN Member States in that the landownership policies fall beyond the scope of the AFAS, it should be made explicit and publicly available.

report attempts to cast some light in that regard by assessing the restrictiveness of services policies in ASEAN in several key sectors. However, a general understanding of the level of implementation of AFAS commitments would require a comprehensive review and assessment of the laws and regulations of ASEAN Member States.

107. **The difficulty in assessing the implementation of the AFAS in actual domestic laws and regulations is one of the major weaknesses of the system.** The AEC framework does not currently feature a procedure to identify how the ASEAN obligations and commitments are adopted by each member. That is, ASEAN Member States lack the ability to determine whether the AFAS has an actual effect in reducing restrictions on trade and investment in services. Absent such a mechanism, progress made in the regional agreements is purely nominal, or remains subject to anecdotal evidence of regulatory amendments or cases of noncompliance. In the context of the WTO, the institution that indirectly but effectively monitors implementation is the dispute settlement body, since WTO members tend to be concerned with being found in violation of WTO agreements. On the contrary, lack of establishment of ASEAN dispute settlement bodies, and general reliance on the "ASEAN way" by the members, have led to a system that has no incentives to implement ASEAN disciplines and no accountability for noncompliance. The lack of an adequate monitoring mechanism does not limit the transparency of the agreements, but casts doubts on the effectiveness of the services market integration as a whole.

108. **Unlike in the case of the GATS, an AFAS implementation monitoring body does not necessarily have to be linked to dispute resolution.** Instead, it could rely on gathering information from different sources on the implementation of the AFAS and other ASEAN agreements, in order to identify potential failures to implement. Such details could be provided by governments of other ASEAN Member States or, more importantly, by the stakeholders directly affected by those measures—the service providers. This information could be reviewed by a regional body and made publicly available, enhancing transparency. The discussion at the regional level and the disclosure of the measures would exert peer pressure on the ASEAN member under scrutiny, incentivizing the amendment of nonconforming measures and promoting implementation of the AFAS commitments.

109. **The AFAS monitoring mechanism would complement efforts already under way to reduce regulatory barriers to trade in goods.** Under the framework of the ASEAN Trade in Goods Agreement, ASEAN members are developing a mechanism similar to the one outlined above to reduce unnecessary nontariff measures to merchandise trade. An AFAS monitoring mechanism could build on this experience and expand implementation efforts to trade in services, thus ensuring the achievement of AEC goals and promoting effective integration of the services markets.

E. Conclusions and Policy Recommendations

110. **The chapter has confirmed that the AFAS delivered significant progress in commitments to the liberalization of intraregional trade and investment in services in ASEAN.** Indeed, commitments on market access and national treatment of ASEAN service suppliers have generally advanced on time with the schedule set out in the AEC. However, a comparison with other agreements highlights the modest levels of ambition of the AEC–AFAS, which fall short of the liberalization provided by many free trade agreements.

111. **To make further and deeper progress in the regional integration in services, ASEAN Member States need to direct their attention to regulatory barriers to trade and investment.** The current framework provided by AFAS fails to deliver effective integration in services due to pervasive regulatory barriers, bringing about a shallow level of integration. This, together with the limited liberalization ambition, entails that the conclusion of more ambitious free trade agreements by ASEAN Member States can de facto override the intraregional services integration agenda. To overcome this, ASEAN Member

States need to deepen regional services integration by developing common rules and principles, and enhancing cooperation on domestic regulation on trade and investment in services. Strengthening mechanisms to monitor and enforce the implementation of trade commitments would also foster greater integration by ensuring uniform and timely compliance with ASEAN obligations.

112. **The analysis also suggests that the AFAS structure has important shortcomings that limit transparency and clarity of the system.** This affects participation by smaller economies, whose limited resources are stressed by a complex and opaque structure. Lack of transparency also inhibits the reach of AFAS to the general public, which limits the practical effects of the agreement and reduces the overall legitimacy of the services integration process.

113. **Finally, the review here of the AEC–AFAS framework has helped identify some important policy recommendations for ASEAN Member States to address these challenges.** These policies are discussed below, grouped into four broad categories according to the main goal that each recommendation serves: (1) deepening integration in trade and investment in services, (2) ensuring implementation, (3) improving transparency, and (4) strengthening institutions and promoting the participation of smaller Member States. The categories and the measures are ranked from the perspective of how to enhance integration in services in ASEAN. A final category puts forward suggestions to promote the participation of ASEAN's smaller economics in the services integration process. The recommendations attempt to offer practical solutions to the main challenges identified in the study, many of them without requiring major changes in the existing framework, but rather working around existing rules and institutions.

1. Deepening integration in trade and investment in services

Addressing regulatory barriers

114. **Addressing regulatory barriers to trade in services should be the main priority in order to deepen integration in services and realize an ASEAN single market.** To that end, ASEAN Member States need to go beyond the negotiation of commitments on market access and national treatment and focus on regulatory cooperation and the harmonization of domestic regulatory frameworks. This section discusses a broad approach, and there is a more detailed discussion on this topic in Chapter 5, which addresses the forward-looking agenda of regulatory cooperation and harmonization.

115. **Regulatory burden is likely to be addressed more easily in a regional context than in a multilateral context.** This is because partners to regional integration are fewer and tend to share greater economic ties and legal traditions. The key question is how to achieve this goal. In other words, what mechanism can countries use to overcome the regulatory burden that service providers face because of differences in regulatory requirements to fulfill both home and host-country requirements? Mutual recognition, together with minimum harmonization requirements, has been identified, in different forums like APEC, the OECD, and in integration agreements like the EU, as a way forward to facilitate trade, even though mutual recognition has proven to be very difficult to negotiate and manage in practice, particularly from a political economy point of view. And yet, this has been the only available tool that countries have proposed to move forward.

116. **Regulatory cooperation should take place at two different levels of regulation.**[52] Cooperation at a horizontal level would require establishing common general principles that would guide domestic regulation on services trade and investment. At a minimum, ASEAN Member States should recognize that domestic laws and regulations should conform to certain principles of good regulation, such as

[52] Enhancing regulatory cooperation and harmonization is a key part of the forward-looking agenda, a subject discussed in more detail in Chapter 5.

transparency, consultations (both public and interagency), due process, and efficiency. To that end, ASEAN Member States can build on existing instruments, such as the APEC–OECD Integrated Checklist on Regulatory Reform, to establish certain basic procedures that must be complied with in the regulation-making process (box 4.4). In addition, common ASEAN guidelines may provide further guidance on aspects related to licensing procedures and standards, ensuring that domestic procedures in all ASEAN Member States respond to common regulatory objectives, able to prevent market failures and pursue social goals, without further impairing regional trade and investment in services. This would ensure that service providers registered in one ASEAN country can meet the requirements in other jurisdictions. Agreeing on such common regulatory goals is an essential step toward ensuring harmonization of regulation and eventual mutual recognition of licenses and authorizations. Although it may work differently for each mode of supply, common regulatory principles and harmonization of regulation is a key step for the realization of a single market in all modes.

Box 4.4 Good Regulatory Principles:
Excerpts from the APEC–OECD Integrated Checklist on Regulatory Reform

Regulatory reform refers to changes that improve regulatory quality to enhance the economic performance, cost-effectiveness, or legal quality of regulations and related government formalities.

A. Horizontal Dimension

A1. To what extent is there an integrated policy for regulatory reform that sets out principles dealing with regulatory, competition and market openness policies?

A5. To what extent has regulatory reform, including policies dealing with regulatory quality, competition, and market openness, been encouraged and coordinated at all levels of government (e.g., Federal, state, local, supranational)?

A6. Are the policies, laws, regulations, practices, procedures and decision making transparent, consistent, comprehensible and accessible to users both inside and outside government, and to domestic as well as foreign parties? And is effectiveness regularly assessed?

A8. To what extent are there effective interministerial mechanisms for managing and coordinating regulatory reform and integrating competition and market openness considerations into regulatory management systems?

B. Regulatory Policy

B2. Are the legal basis and the economic and social impacts of drafts of new regulations reviewed? What performance measurements are being envisaged for reviewing the economic and social impacts of new regulations?

B4. To what extent are rules, regulatory institutions, and the regulatory management process transparent, clear, and predictable to users both inside and outside government?

B5. Are there effective public consultation mechanisms and procedures, including prior notification, open to regulated parties and other stakeholders, nongovernmental organisations, the private sector, advisory bodies, accreditation bodies, standards-development organisations and other governments?

B8. To what extent have measures been taken to assure compliance with and enforcement of regulations?

C. Competition Policy

C9. To what extent does the competition law apply broadly to all activities in the economy, including both goods and services, as well as to both public and private activities, except for those excluded?

C12. In the absence of a competition law, to what extent is there an effective framework or mechanism for deterring and addressing private anticompetitive conduct?

D. Market Openness Policies

D2. To what extent does the government promote approaches to regulation and its implementation that are trade friendly and avoid unnecessary burdens on economic actors?

D8. To what extent are measures implemented in the countries accepted as being equivalent to domestic measures?

117. **More detailed regulatory cooperation principles should be developed on a sectoral basis, in particular for heavily regulated services.** This would follow the steps already taken in ASEAN in some services, like air transport and some financial services, to develop regulatory cooperation principles. Other key service sectors that would greatly benefit from common regional rules include land and water transport, telecommunications, and professional services, as well as those identified as ASEAN Priority Integration Sectors.

118. **Discussions on regulatory cooperation on the different services can take place either under the umbrella of the AFAS–AEC framework or under the already established sectoral bodies.** Regardless of the grouping taking the lead, however, cooperation between "trade in services" and "sectoral" bodies should be enhanced. Trade negotiators can focus on reducing regulatory restrictions to the services market, while sectoral expertise would ensure a sound regulatory framework for the sector that prevents market failures and achieves common policy goals.

119. **In addition, ASEAN Member States need to ensure that the administration of domestic regulation is not carried out in a way that invalidates the common regulatory objectives.** ASEAN Member States may pursue this goal by developing common guidelines on the administration of regulation and administrative procedures. Such guidelines may develop model forms and information requirements and promote the use of a one-stop shop for licensing and registration procedures. The development of these guidelines, that go beyond the integration of the services markets, could be taken up by the High Level Task Force on Economic Integration.

Completing intraregional liberalization and integration

120. **Completing the intraregional liberalization of services trade and investment is a requirement for the establishment of an ASEAN single market.** This entails the removal of all limitations on market access and discriminatory measures, including caps on foreign equity. On occasion, however, public order, safety of services, or prudential reasons may justify some restrictions, particularly regarding quantitative measures. In order to achieve this level of integration, ASEAN Member States should go further in their liberalization effort than currently envisaged under the AEC–AFAS framework. In particular, ASEAN should:

- go beyond the current requirements on foreign equity limitations, providing that any ASEAN person or company may have full ownership over its branches and subsidiaries in other ASEAN countries, as some ASEAN Member States already do in practice
- remove the 15 percent flexibility rule, except for the smaller ASEAN Member States
- record any remaining restrictions under a "negative list," which would highlight the achievements in terms of liberalization and improve transparency.

121. Such an initiative would make the liberalization of services trade comparable to that achieved on investment in the manufacturing sector. Indeed, to level the playing field between investment in the manufacturing and service sectors, ASEAN Member States may wish to increasingly incorporate investment in services under the scope of the ACIA, especially those services with greater linkages to trade in goods.

2. Ensuring implementation

122. **A major shortcoming under the current AFAS is the inability to monitor and, where needed, compel the implementation of commitments in services trade.** In fact, the lack of information on the level of implementation is such that there is no clear understanding of to what extent and how liberalization commitments are actually reflected on the ASEAN Member States' domestic laws and regulations. The

establishment of an Implementation Monitoring Mechanism, and improvement of the existing ASEAN dispute settlement mechanism, would prove valuable to that end.

123. **Creating an AFAS Implementation Monitoring Mechanism.** One initiative to address implementation shortfalls would be establishing an AFAS Implementation Monitoring Mechanism. The Monitoring Mechanism would review the level of implementation of AFAS commitments by ASEAN Member States, based on information provided by other members and/or private services suppliers to complement self-reporting information. As in the case of the review process for nontariff barriers, the involvement of the private sector—the ultimate beneficiaries of the integration process—is essential to ensure practical effects of the agreements. The Monitoring Mechanism would exert peer pressure in cases of nonimplementation, and it would allow clarification of their position to Member States who are fully compliant with their commitments.

124. **Establishing an interpretative procedure in dispute settlement.** The improvement and application of the dispute settlement mechanism is another key step to ensure implementation of the commitments. Ongoing efforts to improve the system should be strengthened, with a view to coming to a prompt conclusion. A renewed dispute settlement mechanism should include an interpretative procedure, for which ASEAN Member States could consult on the terms of the agreements and commitments without the need for a formal dispute with another member, in line with the successful experience with these procedures in other regional integration processes.

125. **Clarifying the scope of the Dispute Settlement Mechanism.** The ongoing review of the dispute settlement mechanism should also clarify the scope and other vague aspects of the EDSM and/or its successor. In particular, ASEAN Member States should:

- explain the relationship between the EDSM and the ASEAN Charter of Dispute Settlement Mechanism
- make clear the scope of the EDSM and/or its successor, by updating the list of "covered agreements" and defining in clear terms what subsequent agreements may fall under their purview
- spell out the relationship between the Enhanced Dispute Settlement Mechanism and the WTO Dispute Settlement Mechanism, providing guidance on whether and how WTO jurisprudence may or may not inform ASEAN dispute resolution.

3. Improving transparency

126. **The sensitivities of negotiating modalities might have contributed to transparency gaps in the services integration process, and there may be other cost-effective ways to promote transparency in the ASEAN services integration process to complement the current approach of using formal treaties.** To a large extent, this is because ASEAN has so far no other means of expression than formal international treaties, such as agreements, protocols, and ministerial declarations. These formal instruments are costly and cumbersome, because they typically require a complex administrative and legal effort.

ASEAN communications

127. **ASEAN could consider alternative non-binding mechanisms to provide greater clarity and transparency to ASEAN bodies, procedures and agreements**. The report has identified certain areas where better clarity will be of value, including the intricate relationships between ASEAN agreements and multilateral agreements in terms of the application of GATS disciplines to AFAS commitments. Such mechanisms would not only foster greater transparency, but also certainty which would improve the environment to trade and invest within the region, as well as with the rest of the world. For example, the

WTO Secretariat issues non-binding technical notes on applicable WTO decisions, while the European Commission issues non-legally binding Explanatory Notes[53].

4. Strengthening institutions and promoting participation of smaller Member States

128. **Amending the institutional framework and negotiating modalities to make it more oriented toward greater regulatory cooperation is a high priority.** The use of capital-led trade negotiations does not offer sufficient dynamism or incentives to cooperate and pursue regulatory harmonization. In particular, the CCS tends to meet too sporadically and be burdened with a heavy and varied agenda. To overcome these limitations, ASEAN should consider converting the CCS into a Permanent Services Committee Expert Group, with the mandate to advance services discussions on the sectoral level through common policy and regulatory principles. The Permanent Group would be composed of dedicated government officials who could meet several times a month to help accelerate the services agenda.

129. **While the new Permanent Group would be valuable for the process as a whole, the main beneficiaries of this setting would be ASEAN's smaller economies.** Indeed, the Permanent Group would not only entail a more efficient use of resources, but would help consolidate expertise on service negotiations, which will facilitate dialog with other ministries and service regulatory bodies.

130. **This should be complemented with clearer guidelines on the mandates of the bodies dealing with services integration and greater cooperation among them.** This would include the Permanent Group and other sectoral bodies that are engaged in cooperation in services. By reducing unnecessary complexity, smaller economies can free up resources to engage more actively in the regulatory discussions.

[53] EC's Explanatory Notes contain practical and informal guidance on how EU law should be applied based on the views of the Commission's Directorate General of the relevant bodies. The views expressed in the Explanatory Notes, however, do not represent the views of the Commission, nor is the Commission bound by any of the views expressed therein. The EC's Explanatory Notes are not legally binding and aim to provide better understanding of EU legislation and guidance to Member States and businesses for better preparations, and are a work in progress. Interpretation of the Union Law is ultimately the role of the European Country of Justice, however.

Chapter 5. Advancing Regulatory Cooperation

The previous chapters have shown that while ASEAN economies can obtain large potential gains from services integration, including through trade liberalization, this has not been fully realized. A key finding is that domestic regulatory reforms and regional regulatory cooperation can further advance services integration of ASEAN economies. This chapter focuses on how ASEAN can deepen services integration through promoting regulatory reform and cooperation in the region. While the scope for regulatory cooperation in ASEAN is broad, significant challenges remain. There is potential to reap substantial, additional unexploited benefits from more effective regulatory cooperation. Regulatory cooperation refers to the range of institutional and procedural frameworks within which national governments, subnational governments, and the wider public can work together to build more integrated systems for rule making and implementation, subject to the constraints of democratic values such as accountability, openness, and sovereignty (OECD 2014). Regulatory cooperation can be pursued through different tools ranging from the informal, such as basic information sharing, to the more formal, such as mutual recognition arrangements and regulatory harmonization. They can occur unilaterally, bilaterally, regionally, or multilaterally. The EU experience is used to illustrate a forward-looking agenda for regulatory cooperation. The discussion also looks at a range of institutional limitations on Regulatory Cooperation that need to be addressed.

A. The Agenda for Regulatory Cooperation

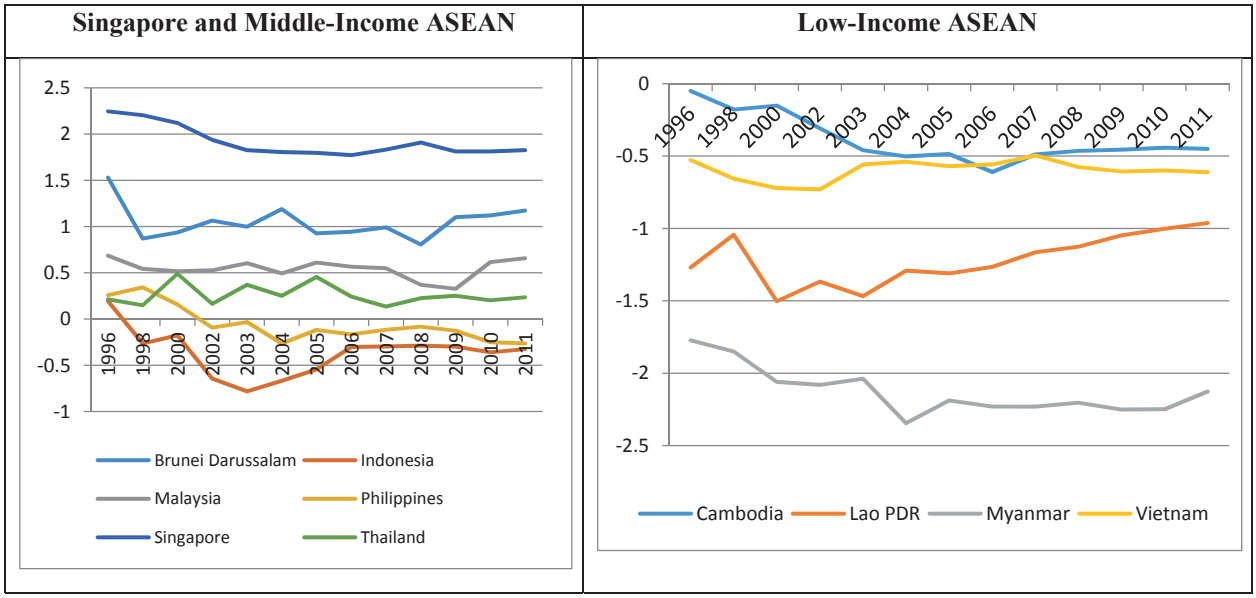
1. **A key policy priority that can be advanced through regional trade agreements is regulatory cooperation.** Services trade liberalization, as pursued under the ASEAN Framework Agreement on Services (AFAS), is a necessary but not sufficient condition for enhancing trade competitiveness. The main concern of trade agreements is with regulations that govern and restrict trade, such as regulations that affect foreign ownership or limit the number of service offers and service providers in a market. By eliminating such prima facie measures, service providers are in a position to expand the supply of services to new markets. Yet, in many cases service regulations aim at addressing market failures and achieving legitimate nontrade policy objectives. Market failures typically identified in the economic literature include the following (Mattoo and Sauvé 2003, 2008, 2010):

- monopolies in network-based services (for example, telecommunications, transportation, and energy services)
- asymmetric information in knowledge and intermediation-based services (for example, financial and professional services)
- externalities (for example, environmental externalities in tourism, transportation, or water services)
- the desire to ensure universal access in essential services (for example, health and education services).

2. **Regulatory cooperation is important for integrating services sectors, in general, and even more so for ASEAN economies because of diversity in quality of regulations** (figure 5.1). Although, regulatory matters are still to a large extent outside the current work of the AFAS, this is within the remit of the Asian Economic Community goals for free flow of services, and the services integration process in ASEAN can play a positive role in fostering services regulatory quality and governance. For all ASEAN Member States, regulatory quality has been stable since the entry into force of the AFAS (except for Brunei Darussalam and Malaysia), and has remained relatively modest except for Singapore, Brunei, and Malaysia (figure 5.1). Except for Singapore, Malaysia, and Brunei, all ASEAN economies rank in the bottom half of

countries worldwide (Worldwide Governance Indicators 2012 data). For the lower-income countries, the challenges in terms of regulatory quality are particularly high, and strong support from trading partners and international organizations will be required to improve it.

Figure 5.1 Regulatory Quality in ASEAN Economies is Heterogeneous



Source: Worldwide Governance Indicators.

3. **Regulatory cooperation would aim to reduce the regulatory burden through mutually beneficial trade facilitation measures, from information and experience sharing, capacity building, adoption of general principles and, where possible, harmonization.** The empirical literature identifies regulatory heterogeneity as a significant impediment to trade. Kox and Lejour (2005), for example, find a negative and significant effect of the level of regulations, as well as their heterogeneity on services trade. Kox, Lejour, and Montizaan (2005) find that the heterogeneity in regulation hampers bilateral services trade in the EU, as well as bilateral direct investment. They also assess the impact of the EU services directive in terms of lowering the intra-EU heterogeneity in product market regulation for services, and its effect on bilateral trade and investment in the internal market for services. They find that commercial services trade in the EU could increase by 30 to 60 percent and foreign direct investment stock in services could increase by 20 to 35 percent. These findings suggest that harmonization of regulations has a positive impact on services trade at the regional level among trading partners. Harmonization, or regulatory convergence, is at the extreme spectrum of regulatory cooperation. Because harmonization is not always feasible or may be too costly, EU member countries have complemented minimum levels of harmonization among Member States with mutual recognition.

4. **Mutual recognition is another means of collaboration.** It implies that countries accept that common policy objectives can be achieved through different means. Countries collaborate to accept differences in regulatory standards, as well as the conformity assessment of these standards. Because of the complex nature of regulatory cooperation, harmonization, and mutual recognition, it is useful and most promising to pursue regulatory cooperation at the regional level among like-minded countries striving to reach a common goal, such as ASEAN Member States (Mattoo and Sauvé 2011).

5. **Regulatory cooperation has both benefits and costs.** The higher the regulatory heterogeneity among countries, the higher the potential benefits of regulatory cooperation. The costs of regional regulatory cooperation depend on countries' institutional capacity, as well as regulatory preferences. For

example, least-developed countries will likely have more difficulty reaching regulatory levels or processes similar to developed countries. Moreover, if regulations already are adequate to achieve the prevailing policy objectives, adopting more complex regulations similar to developed countries may be unnecessarily costly. In this case, the country with the highest standard may be reluctant to cooperate in so far as this would mean adopting lower regulatory standards domestically. In such a situation, other approaches to regulatory cooperation can be explored, such as the sharing of information and best practices as well as capacity building.

6. **Regional trade agreements are also an opportunity to promote regulatory cooperation and, ideally, build optimal regulatory areas for services.** Such areas are composed of a set of countries whose welfare can potentially be maximized by regulatory convergence (Mattoo and Sauvé 2011). Closer regulatory cooperation that would boost the benefits of creating a truly integrated market, while minimizing costs created by differences in regulations and institutional capacity. Regulatory cooperation can be explored in three broad areas:

- regulatory cooperation, through harmonization or mutual recognition
- adoption of regulatory principles, in particular regarding the design, adoption, and application of regulations
- building regulatory capacity, which includes cooperation among regulatory bodies
- exchange of information for regulatory purposes and experiences on regulatory reforms
- identifying and adopting good regulatory practices in new areas.

7. **The scope for regulatory cooperation in ASEAN is broad.** ASEAN has been relatively successful in moving toward service markets integration, addressing the most significant impediments to trade embedded in regulations that affect services and foreign service providers. And yet, regulatory cooperation is uneven, and there is potential to reap substantial additional benefits. Although in the area of professional services, ASEAN Member States have agreed on mutual recognition arrangements for seven professional activities, there are several issues: (a) in two of the cases these agreements are framework agreements that require further negotiations of bilateral agreements to be fully operational; (b) implementation of these agreements is limited, because certain ASEAN Member States lack the required institutional infrastructure to apply the agreed commitments; and (c) there are legal questions on how much need there is to reform and adapt domestic legislation to the international obligations.

8. **Scope for regulatory cooperation also exists in other sectors not covered under AFAS.** In general, regulatory cooperation in ASEAN is not addressed in the context of AFAS, despite being envisioned under the first objective of AFAS. AFAS' main objectives, in practice, have focused on achieving the ASEAN Economic Community Blueprint goals, which have aimed to accelerate services commitments in countries' schedules. Some regulatory cooperation, in financial services and air transport, is being advanced outside of the AFAS negotiating framework. This is where ASEAN Member States discuss harmonization of regulations and infrastructure required to integrate services in the region. For example, while in the AFAS context the discussion that has been focusing on incorporating commitments on road or maritime transport services has shown significant progress, the discussion on harmonization of safety standards for road transportation or investment into port infrastructure to facilitate trade is undertaken under the umbrella of the Infrastructure Division in ASEAN Secretariat. This means that while formal integration under the AFAS may progress quickly because countries are committed to the increased incorporation of sectors in their services schedules, the real integration depends on regulatory harmonization among ASEAN Member States, and on implementation at the country level. This may have adversely affected the perception of stakeholders of the real progress of ASEAN services integration if seen only in the AFAS context. The implication of this is that services integration in ASEAN will require a more

comprehensive approach—one that looks at other sectors and regulatory cooperation more broadly than is currently offered under the AFAS.

B. Enhancing Regulatory Cooperation

9. **The ASEAN services integration model does not allow for regulatory competition. The AFAS model, which is based on the GATS/WTO agreement, provides for a national treatment approach to liberalization.** Under this model, services and service providers are granted equal treatment after being allowed full market access; that is, they face no limitations on market access, and there are no national treatment limitations or conditions that discriminate against foreign services and service providers, but they still need to comply with both the country of origin regulatory requirements and the destination market requirements.

10. **In the context of the ASEAN Economic Community goals, this model is insufficient to achieve seamless services trade flows, particularly where there is considerable regulatory heterogeneity.** Table 5.1 helps illustrate this point. The assumption in this table is that all market access barriers and national treatment limitations have already been eliminated. In this case, services and service providers confront four potential situations. In the case of the first quadrant, both the origin and the destination countries maintain their respective laws and regulations to allow services trade under any of the modes of supply. This means that the service supplier needs to fulfill all the regulations required providing services in the origin and destination countries, no trade facilitation or cooperation measure and no harmonization takes place, and thus there is a high regulatory burden. The other extreme is full regulatory cooperation, in which countries fully (or substantially) have harmonized their respective laws and regulations, allowing any service provider to freely move from one country to another to provide services. In theory, this is what would be expected in a country like the United States where, although individual states can still regulate services, by and large, service providers can move across the country to provide services if they fulfill certain specific requirements at the state level.

Table 5.1 Regulatory Cooperation

		Destination Country	
		National Treatment	Regulatory Cooperation
Country of Origin	National Treatment	I No Harmonization High Regulatory Burden	II Mutual Recognition Medium Regulatory Burden
	Regulatory Cooperation	III Exchange of Information Medium/High Regulatory Burden	IV Harmonization Low Regulatory Burden

11. **There are two additional, lighter, regulatory cooperation approaches.** In quadrant II, there is some sort of regulatory cooperation, usually mutual recognition agreements that facilitate trade, and there is medium regulatory burden. This is, in theory, what the EU initially aimed to achieve. Service providers duly established in any of the EU Member States according to that Member State's laws and regulations could provide services under any mode of supply provided by the Treaty of Rome. This approach may risk promoting regulatory competition, which created fears among stakeholders that there would be a race to the bottom to a lighter level but poorer quality of regulations (Rubalcaba 2007). The approach evolved and was combined with some sort of minimum common requirement that all the providers in all Member States needed to fulfill, for instance, on financial services. Under quadrant III, some cooperation among the

countries may take place, usually in the form of information exchange and collaboration among regulators, which may help service providers. This can be the case of financial services industries, where regulators can exchange information on financial services institutions operating in their jurisdiction. In this case, the impact on the reduction of the regulatory burden is indirect and may be limited. In ASEAN, where harmonization may be limited, regulatory cooperation is being done through mutual recognition arrangements, phased-in participation based on readiness, collaboration, and information exchange that may help services providers.

12. **Countries regulate similar issues differently, including in some cases opting not to regulate.** For example, in the context of the EU, Mustilli and Pelkmans (2013a) find that despite significant liberalization progress among EU countries, a high level of regulatory heterogeneity among countries remains (box 5.1). In this case, regulatory heterogeneity is purely about differences among regulations, not their intensity or impact on restricting competition, and only alters the fixed costs of entry, which may be disproportionately high for small and medium enterprises. As has been shown by the empirical literature, regulatory heterogeneity may have a strong negative impact on service flows (in this case integration; see Kox and Lejour 2005). In the context of the EU, mutual recognition has a positive impact in three dimensions that affect heterogeneity: regulatory and administrative opacity, the area of explicit barriers to trade and investment, and the area of barriers to competition (Brujin, Kox, and Lejour 2006). Box 5.1 presents lessons from the EU's efforts to accelerate implementation of services integration through its services directive of 2006 and then introducing a mutual evaluation process.

Box 5.1 Lessons of Experience from the European Union's Implementation and Evaluation of Services Integration

Although the ASEAN Economic Community goals do not refer to the creation of a common market, the EU's experience of integrating services markets may offer relevant insights. The EU has highlighted the role of regulatory barriers to trade as major obstacles to the common market in the services sector. In an assessment of the internal market for services, conducted in 2002, the European Commission concluded that the internal market for services was far from being a reality, due to the persistence of legal barriers and the increasing challenges posed by "nonlegal" barriers. The European Commission characterized "legal barriers" as those deriving directly or indirectly from a legal constraint and that may prohibit, impede, or render less advantageous the provisions of services. Main sources of such legal barriers were found to be divergent national regulations, problems relating to the behavior of national authorities, and the legal uncertainty caused by the complexity of some cross-border situations. In addition, nonlegal barriers arise from the behavior of administrations, including the use of discretionary powers or heavy and nontransparent procedures that favor domestic operators, as well as lack of access to regulation and inconsistent administrative practices (European Commission 2002).

In this context, the EU issued Services Directive 2006/123 to help accelerate services integration, and two unusual approaches were followed to support its implementation. First, a detailed handbook for implementation was published, and second, a multiyear cooperation effort in several joint implementation committees (Member States and the Commission) was established. In the EU-27,[a] about 35,000 service provisions were checked. This domestic screening was bound to uncover many illegitimate restrictions that had gone unnoticed, all of which have been removed. In addition, art. 39 of the directive imposed a "mutual evaluation" among Member States of the implementation and screening in 2010, again a uniquely cooperative exercise. The mutual evaluation report (European Commission 2011) reveals in great detail how much has been achieved by this joint exercise among the Member States. The upshot is that the removal of barriers, including hidden discrimination, has been far more rigorous and extensive than anyone could reasonably have expected. It is also clear that the mutual evaluation among the EU Member States has given rise to numerous discussions about the regulatory rationale of lingering restrictions. These discussions have included topics such as the justification and scope or boundaries of market failures, and the assessment of the proportionality of the tools of government intervention. In other words, the evaluation has had a "better regulation" effect, as well. Intra-EU market access has improved considerably, and EU enforcement will be less problematic than initially feared.

Box 5.1 Lessons of Experience from the European Union's Implementation and Evaluation of Services Integration (continued)

Another innovative mechanism of "mutual evaluation" has been included in the current EU Services Directive. Article 39 of the directive provides for a review process of Member States in two different contexts and with two different objectives (European Commission 2007). First, a review of authorization schemes and certain establishment-related requirements is mandated. The aim is to assess these requirements in light of the directive. In this context, unjustified or disproportionate authorization schemes and other requirements should be abolished or amended. Second, a review of the requirements applied to establish service providers in another Member State to provide services is mandated. In this case, an assessment of the consistency of the application of these requirements with the provisions of the directive is required.

In addition, Member States are mandated to report any changes in the requirements, including new requirements they apply or are planning to apply. The aim of this provision is to achieve transparency and legal certainty for service providers, in particular small and medium enterprises wishing to provide cross-border services. A report and subsequent updates are communicated to the other Member States, and the European Commission produces on an annual basis "analysis and orientations on the application of these provisions in the context of this Directive."

The principles recognized in the Services Directive are further supported by a regime harmonizing the conditions for the establishment of firms. These rules are embodied in the framework of EU Company Law. The ultimate goal of this framework is to ensure that regulatory heterogeneity among EU Member States does not prevent companies from establishing themselves in the territory of other EU Members States to provide services. While the rules on company law go beyond the services sector, since they apply to firms on any economic activity, they are particularly relevant to the integration of the services market, since the establishment of a commercial presence remains the main mode of supply for service suppliers. Since the 1960s, the EU has advanced toward the freedom of establishment through the development of a regime on company law oriented to harmonizing the main regulatory requirements applicable to firms from an EU Member State that wishes to establish itself in any other Member State, while recognizing each Member State's ability to maintain substantial authority to safeguard legitimate domestic policy concerns. The EU experience offers valuable guidance on the kind of issues that need to be addressed in order to reduce regulatory heterogeneity; in particular, EU directives and regulations address key issues of company law such as company formation requirements and procedures, corporate governance, capital maintenance, mergers and acquisitions, accounting and audit, and market regulation.

Source: Mustilli and Pelkmans 2013a, 2013b.
Note: a. EU-27: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

13. **International cooperation, more broadly, can take place in other forms, as well. One of the recommendations of this report is consideration by all ASEAN Member States of adopting basic good regulatory practices, as discussed in Chapter 3.** One of the guiding principles of good regulatory practices is transparency, including through providing sufficient opportunities for comments for interested parties and sharing information with counterparts. In the context of an economic community, this may also mean allowing trading partners to participate in the regulatory process. For example, the EU services directive mandates a list of essential information that Member States must make easily accessible through the "points of single contact" to service providers and service recipients. In addition, this directive obliges Member States to give each other mutual assistance, in particular to reply to information requests and to carry out, if necessary, factual checks, inspections, and investigations. It also requires creating a communication network among regulatory and supervisory authorities with the aim, primarily, of mutual assistance. In such cases, regulatory cooperation can facilitate agreement and common understandings of the issue or on underlying technical or scientific issues, and contribute to informing all phases of the rulemaking process. In addition, cooperation can address existing regulatory differences and help avoid future regulatory differences (see Rubalcaba 2007; Davies 2012; GAO 2013).

14. **Further integration in the services market can be pursued through regulatory cooperation among ASEAN Member States,** for example in the area of company law, so as to facilitate cross-border mobility of service providers. Following the EU experience, ASEAN Member States may wish to consider addressing basic requirements for the establishment of companies, including areas like compulsory disclosure of information, and power of representation of company organs. Requirements on disclosure, in particular, may include the harmonization of information requirements and the establishment of an official company register accessible by all Member States.

C. Institutional Limitations on Promoting the Regulatory Cooperation Agenda

15. **The AEC–AFAS institutional framework underpinning trade negotiations has not yet been fully effective in promoting integration of the services markets in the region, due in part to inadequate emphasis on regulatory cooperation.** The goals of trade negotiations, the way they are led, the manner in which the resulting obligations are adopted, and, importantly, the transparency of the process, have been successful in removing the most glaring formal restrictions to trade in services, but not in addressing implementation challenges. Further, their impact on reducing the regulatory divergence among Member States - which is critical for the effective regional integration of the services market - has been limited. Two issues stand out in particular in creating this outcome: (a) the narrow scope of negotiations, and (b) inadequate transparency. These are discussed below.

Narrow scope of negotiations

16. **The scope of trade negotiations has been narrow, with a strong focus on liberalization measures but to the neglect of promoting regulatory cooperation.** Policy coordination discussions aimed at overcoming regulatory heterogeneity and barriers do not form part of the negotiating agenda. In the broader ASEAN framework, common regulatory policies have been advanced for specific sectors, largely separating such discussion from trade liberalization talks. Commercial aviation stands out as a case in point. The factors discussed below combine to explain the limited potential to advance regulatory cooperation for the services market under the current AFAS institutional framework:

- ***Grand bargain dynamics.*** Discussions under the AFAS follow the trade negotiations tradition in tackling multiple services sectors in parallel. From a negotiating point of view, this has the benefit of allowing for a "grand bargain" in which concerns with commitments in specific sectors may be compensated by preferences obtained in other sectors. This format creates incentives for all parties to reduce their barriers to trade, but does not provide a channel for addressing regulatory coordination issues. Furthermore, bundling commitments in multiple sectors in the negotiations may also lead to the undesired result of stalling progress on some sectors because of concerns on others, thus slowing the whole process of services liberalization.
- ***A vague and ambiguous mandate on regulatory measures.*** Trade agreements rarely feature extensive and detailed provisions on domestic regulation. Instead, they tend to rely on vague, ambiguous language that leaves ample space to keep subtle regulatory concerns off the negotiating table. Advancing regulatory cooperation requires specific guidance that is not well reflected in the current AEC–AFAS disciplines. In the absence of such guidance, negotiations tend to steer away from thorny, often highly technical talks on services regulation.
- ***Composition of negotiating groups.*** Trade negotiations are led, logically, by trade negotiators. Trade negotiators, however, may lack the technical expertise to make substantial contributions on services regulation, for which they typically have to refer back to their capitals to seek guidance from the concerned line ministries. As a result, any regional initiative on regulatory integration on services trade is subject to lengthy and cumbersome procedures.

- ***Lack of formal cooperation channels.*** This problem is exacerbated by the lack of formal cooperation channels among the different ASEAN bodies. Representatives in some institutions attempt to overcome that by promoting consultations and information exchanges with representatives from related bodies. For instance, negotiators involved in negotiations on transport and logistics in the Coordinating Community on Services (CCS) have reached out to their counterparts working under the Transport Ministries Meeting to learn about their work and to consider areas of common interest. However, the lack of specific procedures to this end has resulted in these consultations taking a long time to materialize, with many months between meetings, thus limiting the actual effectiveness of a positive initiative. The effectiveness of interagency coordination also varies across ASEAN Member States.

Transparency

17. **Greater transparency can facilitate progress in regulatory cooperation.** Lack of transparency has affected procedures in the decision-making systems and obscured the scope and meaning of the decisions. This has exacerbated the complexity of the system, to the detriment of the smaller partners, in particular. It also limits the potential for progress in the regional discussions, and altogether reduces the impact of the integration process. In addition, the opaqueness of the system means that the ASEAN integration process remains distant from the general public.

18. **Internal transparency in the decision-making process.** International trade negotiations tend, by nature, to be secretive. Each party keeps its strategies and sectoral policies confidential in order to be able to reap the most preferences from the other parties, while minimizing its own concessions during the negotiations. While in some cases this mercantilist logic may at times be relaxed, giving room for some greater reciprocal disclosure, transparency in the decision-making process is not among the highest priorities in trade negotiations.

19. **In contrast to the elimination of restrictions through trade negotiations, the reduction of regulatory obstacles for integrating services markets requires a higher degree of collaboration than can be afforded by the trade negotiation process.** Indeed, while elimination of formal restrictions can be done on a quid-pro-quo basis, regulatory cooperation must be based on the establishment of common regulatory goals and principles, taking into account the current policies and regulations in place, and the challenges faced by the different countries. Trade negotiations do not offer the mechanisms for the type of collaborative decision making needed to advance into deeper services market integration.

20. **Available information on services rules is limited to international treaties.** The limited public information on ASEAN services rules is also a result of the nature of the decisions that embody any understanding between the parties. As discussed earlier, all decisions related to services negotiations take the form of international treaties. The references to these decisions as "agreements," "frameworks," or "protocols" does not change their legal nature, which requires a number of legal steps to enter into force, including, in many countries, parliamentary ratification. Once these instruments are properly ratified and entered into force, they are made public through different means, including online access. Thus, the system is fully transparent in the sense that all formal decisions are not only publicly available, but have also been ratified by domestic legislative bodies.

21. **This leads to only the most relevant regional decisions being reflected in actual instruments, leaving a number of other rules and understandings in the dark.** Indeed, procedural rules on the functioning of the different bodies, understanding of the interpretation of certain rules, and other arrangements that do not warrant a full international agreement are not officially reflected in any instrument, nor are they made otherwise public.

22. **Limited access to ASEAN procedural rules and understandings makes the process complex and opaque.** This adversely affects the smaller Member States, such as Cambodia, Lao PDR, Myanmar, and Vietnam, in particular. It also curbs the knowledge and interest of the general public in ASEAN market integration efforts, including by academia, think tanks, or private stakeholders, whose inputs could be valuable to the advancement of the regional integration process.

23. **While this limitation on information is the result of the ASEAN decision-making process, other forums offer some alternatives on how to increase transparency within this institutional framework.** In the WTO, for instance, the secretariat often publishes "Notes from the Secretariat" that explain to the Member States certain aspects of the negotiations or the agreements. The content of these notes is not binding on the Member States, nor does it entail an authoritative interpretation of the agreements, but it is understood that it does reflect some general understanding among the Member States on that issue. The notes, among other measures, help increase the transparency of the negotiations and inform about the rules and procedures, improving the legitimacy and spurring participation from academia, governments, and other interested parties.

24. **Another factor constraining transparency of the ASEAN services integration efforts is the limited user-friendliness of the information that is publicly available.** Not only is the current framework for services negotiations complex, but the information it provides is limited, scattered across multiple documents, and presented in uninviting trade-negotiations jargon. To a large extent, this is due to the fact that ASEAN information media tends to reproduce verbatim the agreements and protocols as their sources of information. The ASEAN Secretariat has published a number a reports for general dissemination that improve on this. However, the reach of those publications is limited and, while they are made generally available online, the organization of ASEAN Secretariat's website (following the complex ASEAN institutional structure in chronological order) is hardly a welcome mat to the uninitiated. This poor and rather technical information on the ASEAN services framework fails to communicate the importance of these rules to a broader audience, which further limits the impact of the integration process. Entrepreneurs who are not familiar with ASEAN and general international trade technicalities cannot relate their business activities to the ASEAN integration process, and thus fail to understand its benefits and remain distant from the discussion.

25. **A related problem to the lack of transparency is the complex institutional structure for services integration in ASEAN.** While much of it is not directly related to services trade, the broad scope of services negotiations, which touches upon a number of different sectors and policies, exacerbates this problem. As noted above, at least six negotiating bodies have mandates on services integration, be it through liberalization of formal restrictions or through cooperation. In effect, the different work agendas do not stem as much from their mandates (some of which are not publicly available) as from their actual practices. Most mandates are vague and ambiguous enough to create certain overlaps in the organizations' goals and work agenda. The lack of standardization in the decision-making process adds to this complex framework. Rules and procedures may appear ad hoc, or are often modified to fit the different working groups and bodies.

26. **Ultimately, the smaller ASEAN Member States are the ones more heavily affected by this complex institutional framework.** Smaller administrations, such as those of Cambodia, Lao PDR, Myanmar, and Vietnam, are more hardly pressed to stay up to speed with the negotiations on services trade and investment in the different ASEAN bodies. Streamlining negotiating issues and providing for clearer guidelines in the mandates of the bodies dealing with services integration would foster efficiency of the system and facilitate greater and more active engagement from lower-income ASEAN Member States.

D. Conclusion

27. **Two consistent themes have run through this report.** First, most ASEAN economies and the region have yet to fully realize the large potential gains from and complementarities in services trade and integration. Second, domestic regulatory policy reforms and cooperation will be necessary to deepen integration in services and enhance ASEAN economies' performance and competitiveness. Services integration has a strong potential to contribute to economic growth in the region by reducing the costs of intermediate inputs for other sectors in the economy, creating a new source of value and innovation, and by providing attractive offers to domestic and foreign consumers.

28. **One reason for the uneven services trade performance and integration appears to be services trade restrictiveness within ASEAN.** Analysis based on information from a new database of services trade restrictions shows that the regulatory regime in most ASEAN Member States (AMS) is more restrictive than in comparator countries outside Asia. Also, there has been only minor progress in reducing services trade restrictiveness since the adoption of the AEC Blueprint in November 2007. One explanation for the limited impact is the fact that actual service market policies in AMS are more liberal than the countries' AFAS commitments, suggesting that the latter serve primarily as a tool to reassure investors and trading partners against policy reversals, rather than as means to reform policies on the ground. Several bilateral agreements that some AMS have concluded with partners outside the region are also more ambitious in their scope and extent than what has been committed regionally. Hence, there seems room for AMS to further advance their integration efforts.

29. **Because actual service market policies in AMS tend to be more liberal than the countries' AFAS commitments, the latter result in limited regional preferences.** In most sectors, ASEAN economies are not integrating faster or more profoundly than with the rest of the world. Yet, some regional preferences emerge out of air transport liberalization and mutual recognition agreements that provide incremental value to Member States.

30. **Concerning the institutional arrangements, the ASEAN Economic Community and the AFAS have generally provided a useful platform for negotiations on the reduction of formal services trade restrictions, but have not been effective in promoting deeper integration through regulatory reform and cooperation.** The existing institutions have made it possible to make progress in multiple sectors simultaneously. However, the commitments and negotiation-focused approach of the AFAS seems less suitable for promoting deeper integration through regulatory reform and cooperation. Indeed, the largest benefits from regional integration of services markets arguably accrue through regulatory cooperation, which is an area where ASEAN has not advanced to a significant extent. Several mutual recognition arrangements have been concluded, but the extent of their implementation is unclear, and their practical impacts seem limited to date.

31. **The institutional assessment also revealed that the existing AFAS commitments can be further improved to realize the creation of a single services market.** Several bilateral agreements that some ASEAN Member States have concluded with partners outside the region contain commitments in few areas which are more ambitious in the extent to which they advance services sector integration. Hence, there seems room for ASEAN Member States to further advance their integration efforts in order to realize the aim of a single regional services market by 2015.

32. **The findings from case study analysis highlighted the pockets of success in services in various ASEAN countries, and the complementarity of private sector initiatives and government support for success in services exports.** For example, the strong trade performance of higher education services in Malaysia, medical tourism in Thailand, and back-office processing in the Philippines have been based on private investments that were accompanied by an enabling business and regulatory environment, as well as

an active government role in establishing and monitoring quality standards. Also, the public authorities often have a crucial role in mitigating adverse distributional effects and social hardship that might result from trade-induced structural adjustment in social sectors.

33. **Going forward, the ASEAN services integration process could usefully be refocused on stronger efforts to pursue regulatory cooperation and increased attention to the implementation of commitments, including with respect to mutual recognition arrangements.** ASEAN has embarked on a promising path to service market integration, but there is a large potential to further accelerate and deepen reforms, and thereby catch up with developments in other emerging regions around the world. Indeed, experiences in other regional integration areas, including those in the European Union, show that the required reform processes can be complex and laborious, but the potential rewards in terms of competitiveness, growth, and employment are such that these efforts clearly seem worthwhile.

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ASEAN Integration Monitoring Report

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"One Vision, One Identity, One Community"

"Working for a World Free of Poverty"

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The Association of Southeast Asian Nations (ASEAN) was established on August 8, 1967. The Member States of the Association are Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. The ASEAN Secretariat is based in Jakarta, Indonesia

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Foreword

Since the adoption of the ASEAN Economic Community (AEC) Blueprint in 2007, ASEAN has undertaken various efforts to monitor its implementation. Building upon the AEC Scorecard, this inaugural ASEAN Integration Monitoring Report (AIMR) assesses the progress in four AEC-related dimensions: merchandise trade, trade facilitation, services trade and investment. It focuses on policy and market integration outcomes achieved in ASEAN Member States (AMS), as part of the first pillar of the AEC formation process.

Released by the ASEAN Integration Monitoring Office (AIMO) of the ASEAN Secretariat, together with the World Bank - East Asia Pacific Region, the Report is the first component of the ASEAN Community Monitoring and Evaluation Program (AECMEP). It is expected to be released annually to provide a regular update on the state of integration in ASEAN. In this regard, we would like to extend our appreciation to the World Bank for assisting in strengthening ASEAN's monitoring and analytical capacities as well as the ASEAN-Australia Development Cooperation Program (AADCP) II for its support in implementing the AECMEP.

The AIMR shows that ASEAN's broader economic agenda has brought significant gains to AMS. As a trade-creating block, together with the improvement of trade facilitation, ASEAN integration has led to an increase in intra-ASEAN trade, parallel with an increase in ASEAN's trade with the rest of the world. ASEAN also had modest contributions to the development of the services sector and the enhancement of foreign direct investment (FDI), both for extra- and intra- regional inflows. Finally, AEC efforts also help in narrowing the development gap and accelerating development in CLMV countries, whose share of GDP in ASEAN grew from 3.5% in 1990 to nearly 10% in 2011. This is further reflected in the implementation rate of 79.7 % of the AEC Scorecard as of August 2013.

Despite these achievements, there remain several areas where implementation has been limited. Although ASEAN's gains came from enhancing trade facilitation, services and investments, efforts are still needed in these critical areas as well as in the transport sector. Domestic regulatory reforms, enhanced capacities, strong internal coordination and sufficient budgets are imperatives in order to address the implementation challenges. The AIMR further suggests priorities for future actions for the effective implementation of the AEC 2015 goals.

To complement the AIMR and further enhance ASEAN's monitoring capabilities, the AECMEP will also develop the components of integration of trade in services: the ASEAN database of trade in services and the ASEAN-World Bank Services Regional Integration Report. We hope that this Report will be a useful document for ASEAN officials and policy-makers, serving as the key monitoring report used to track AEC's progress, at both regional and national levels, to ensure its timely realization by 2015.

Le Luong Minh
Secretary General
Association of South East Asian Nations

Foreword

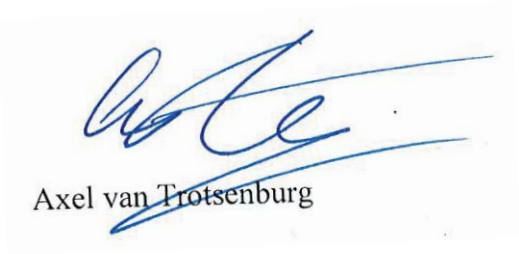
The Association of Southeast Asian Nations (ASEAN) is a community of more than 600 million people living in ten countries in one of the most dynamic regions of the world. Consistent with this, ASEAN's share of world GDP and world trade has sharply increased over the past decades. In 2003, ASEAN's regional integration agenda was significantly deepened when ASEAN Member States adopted the ambitious goal of forming an ASEAN Economic Community (AEC) by 2015. These goals were crystallized in the highly specific targets set for creating a "single market and production base" in the ASEAN Economic Community Blueprint of 2007, signed by the Heads of the Governments of the ASEAN countries.

As the global economy is still recovering from the deep financial and economic crisis of 2008 ASEAN's regional integration agenda has become even more important. It is clear that as the world economy recovers, the high income economies of North America and Western Europe will need to undergo significant fiscal and structural changes, including lowering consumption and import growth. As a result they will not be the same robust destination markets for manufacturing exports as they were in the past. Emerging and developing economies will have to rely more on South-South and regional trade. Beyond the need to sustain trade in goods, it is also clear that the high and middle economies of ASEAN and in other parts of the developing world will now need to focus more on boosting their productivity through diversifying into high end manufacturing and services. The ASEAN Economic Community's bold vision of achieving the free flow of goods, services, investment, and skilled labor in the region is precisely what is needed to achieve higher productivity growth and economic diversification.

It is in this context that I am delighted with the collaboration of the ASEAN Integration Monitoring Office of the ASEAN Secretariat and the World Bank's staff from the East Asia and Pacific region and the Trade and the Research departments on this *ASEAN Integration Monitoring Report.* The report has also benefited from several rounds of presentations, consultations and reviews involving the officials of the ASEAN Member States.

The report provides some important findings and guidance on going forward. The report finds that the ASEAN economic integration agenda has already provided important benefits to the Member States by boosting regional trade flows without adversely affecting the global integration agenda. Integration efforts have also helped to improve trade logistics, lower aggregate trade costs and significantly increase regional investment flows. Progress in services integration, however, has been modest. It is also clear that the potential gains from further integration in all these spheres remain large. The report highlights important pending challenges to achieving the AEC 2015 goals that lie in implementing the services integration agenda as well as the dangers posed by the use of non-tariff measures. It identifies a number of policy and institutional measures that ASEAN can take to address these issues.

Lastly, let me note that this report is the first of a series of outputs under the ASEAN Economic Community Monitoring and Evaluation program that is being carried out jointly by ASEAN Secretariat and World Bank staff. We thank the government of Australia for funding most of this work through their technical assistance program for ASEAN. We are hopeful that this program will only be the first of many such collaborative programs in the future.



Regional Vice President
East Asia and Pacific Region
The World Bank

ACRONYMS AND ABBREVIATIONS

AADCP II	ASEAN-Australia Development Cooperation Program
ACD	ASEAN Cosmetic Directive
ACI	Air Connectivity Index
ACIA	ASEAN Comprehensive Investment Agreement
AEC	ASEAN Economic Community
AECMEP	ASEAN Economic Community and Monitoring and Evaluation Program
AEM	ASEAN Economic Ministers
AFAS	ASEAN Framework Agreement on Services
AFTA	ASEAN Free Trade Area
AHEEERR	ASEAN Harmonized Electrical And Electronic Equipment Regulatory Regime
AHTN	ASEAN Harmonized Tariff Nomenclature
AIA	ASEAN Investment Agreement
AIMO	ASEAN Integration Monitoring Office
AIMR	ASEAN Integration Monitoring Report
AMS	ASEAN Member States
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ASEAN+3	Three of Ten ASEAN Economies
ASEAN+6	Six of Ten ASEAN Economies
ASEC	ASEAN Secretariat
ASW	ASEAN Single Window
ATIGA	ASEAN Trade in Goods Agreement
ATF	ASEAN Trade Facilitation
ATWG	Air Transport Working Group
BPO	Business Processing Outsourcing
CARICOM	Caribbean Common Market
CBM	Central Bank of Myanmar
CCS	Coordinating Community on Services
CEPT	Common Effective Preferential Tariff Scheme
CLMV	Cambodia, Laos, Myanmar, and Viet Nam
DTIS	Diagnostic Trade Integration Study
EAP	East Asia and Pacific
EAPCE	East Asia and Pacific Chief Economist's Office
EASPW	East Asia PREM Sector
EE	Electrical and Electronic Equipment
ERIA	Economic Research Institute for ASEAN
FEP	Foreign Equity Participation
FDI	Foreign Direct Investment
GMP	Good Manufacturing Practice
GTA	Global Trade Alert
JPA	Junior Professional Associate
JCC	Joint Consultative Committee
ICT	Information and Communications Technology
IGA	ASEAN Agreement for Promotion and Protection of Investment
IL	Tariff-Reduction – Inclusion List
ILP	Import Licensing Procedures
ISO	International Organization for Standardization
LSCI	Linear Shipping Connectivity Index
SL	Tariff-Reduction – Sensitive List
HSL	Tariff-Reduction – Highly Sensitive List
LPI	Logistics Performance Index
MOF	Minister of Finance
MOT	Minister of Trade
MTO	Merchandise Trade Openness
MTII	Merchandise Trade Intensity Index
MFNs	Most Favored Nations
MRAs	Multinational Regional Agreements
MTR	Mid-Term Review
NAFTA	North American Free Trade Organization
NTBs	Non-Tariff Barriers
NTMs	Non-Tariff Measures
OECD	Organization for Economic Cooperation and Development
PIS	Policy Integration Sectors
PREM	Poverty Reduction and Economic Management
RIA	Regulatory Impact Assessment
ROO	Rules of Origin
RTA	Regional Trade Agreement
SEOM	Senior Economic Officials' Meetings
SPCD	Strategic Program of Customs Development
SPS	Sanitary or Phytosanitary Measures
STRI	Services Trade Restrictiveness Index
TPR	Trade Policy Review
TRQ	Tariff-Rate Quotas
UNCTAD	United Nations Conference on Trade and Development
UNECE	United Nations Economic Commission of Europe
USITC	United States International Trade Commission
WB	World Bank
WCFSL	Working Committee on Financial Services Liberalization
WCO	World Customs Organization
WEF	World Economic Forum
WDI	World Development Indicators
WDR	World Development Report
WTI	World Trade Indicators
WTO	World Trade Organization

Preface

This report has been jointly produced by the Association of Southeast Asian Nations—ASEAN Secretariat (ASEAN Integration Monitoring Office) and the World Bank (Office of the Chief Economist, East Asia and Pacific Region) as part of the Advisory Services program of the World Bank for ASEAN. These advisory services are being provided under the ASEAN Economic Community Monitoring and Evaluation Program (AECMEP) financed by the ASEAN-Australia Development Cooperation Program, Phase II (AADCP II) and World Bank non-lending technical assistance. The World Bank also gratefully acknowledges support from the Government of Korea that funded part of the work for this report.

The focus of the report is on policy and market integration outcomes achieved in ASEAN Member States (AMS) as part of the Pillar One of the ASEAN Economic Community (AEC) formation process. The aim is to assess progress drawing on evidence from a large range of indicators on policies and outcomes. The report then suggests priorities for future actions for implementing the AEC 2015 goals. This report is based on the Inception Report presented to and endorsed by the Senior Economic Officials' Meetings of the ASEAN last year and on the presentation on early findings also to the SEOM. The earlier version of this report was also presented to the 45th ASEAN Economic Ministers' Meetings in Bandar Seri Begawan, Brunei Darussalam in August 2013. This report is intended to complement the recent Mid-Term Review Report by the Economic Research Institute for ASEAN and East Asia (ERIA, 2012), which has focused more on progress with agreements and commitments for achieving AEC 2015 goals.

This report was written by a team of ASEAN Secretariat and World Bank (WB) staff, consultants led by Aladdin Rillo and Pitchaya Sirivunnabood from ASEAN Secretariat, and by Ahmad Ahsan and Jean-Christophe Maur from the World Bank. Other team members were Khin Maung Nyunt (AADCP II), Mikiko Imai Ollison (Doing Business Team, WB), Gianni Zanini, Peter Walkenhorst, Ben Shepherd, Lili Yang Yi, Simon Evenett and Erna Munawadi (Consultants, WB). Rohan Singh (JPA, EAPCE) provided invaluable research and overall assistance throughout the preparation of this report. Mildred Gonzalvez (EASPW) processed the report and Nishi Widge edited it. The report benefited from extensive comments provided by ASEAN Secretariat officials in the Trade and Facilitation Division, Services and Investment Division, and Infrastructure Division, and comments were received from ASEAN Member States' officials in their review of the report in May 2013. The team thanks Dr. Lim Hong Hin, Deputy Secretary General of ASEAN for ASEAN Economic Community and Bert Hofman, Regional Chief Economist, East Asia and Pacific region, the World Bank for helpful comments and guidance.

ASEAN Integration Monitoring Report

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Overview

A. A Region at the Forefront of Global Integration and Poverty Reduction

1. **The regional economic integration agenda became a priority for the Association of Southeast Asian Nations (ASEAN) from the early 1990s as the political and security concerns of the Cold War diminished and the Association turned its focus towards economic goals**.[1] A series of treaties and agreements put regional integration at the center of the economic agenda. These agreements included the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS), the ASEAN Agreement for Promotion and Protection of Investment (IGA), and the Framework Agreement on the ASEAN Investment Agreement (AIA), all signed in the 1990s.

2. **The 1997 East Asian Crisis, which adversely hit the East Asian economies and particularly the ASEAN economies of Thailand, Malaysia, Indonesia, and the Philippines, provided further impetus to the regional integration agenda**. Creating a larger regional market was seen to be important for attracting investors who had become cautious, and for building more resilience to macro-financial stability. The integration agenda was significantly deepened through the 2003 declaration for achieving the ASEAN Economic Community (AEC) in 2015 by setting up a 'single market and production base' for the 10 countries in the Association of 600 million people whose aggregate nominal GDP is currently USD 2.1 trillion (PPPD 3.3 trillion). More recently, new trade and investment treaties such as the ASEAN Trade in Good Agreement (ATIGA) and the ASEAN Comprehensive Investment Agreement (ACIA) have further deepened integration goals to accelerate progress towards the AEC goals.

3. **ASEAN's goal for integration goes beyond trade to include efforts to deepen intra-regional socio-economic ties**. In December 1997, the Association adopted a vision for 2020, emphasizing the objective of "*…transforming ASEAN into a stable, prosperous, and highly competitive region with equitable economic development, and reduced poverty and socio-economic disparities.*" To achieve this, ASEAN members agreed to an ASEAN Economic Community (AEC) Blueprint, with the aim of achieving a single market and production base by 2015. The goals of this regional integration agreement have been to drive deep economic integration, accelerate growth and boost development. In doing this, the AEC also seeks to bridge the development divide amongst ASEAN countries.

4. **ASEAN's efforts to deepen integration have renewed importance as the global economy enters a new phase**. As members of the most dynamic and enduring regional organization in the developing world, ASEAN countries have grown rapidly over the past three decades—at twice the rate of the world economic growth—and as a result their share in global GDP has doubled. The lower income ASEAN countries—Cambodia, Laos and Viet Nam—have enjoyed even faster growth, as their share of world GDP has tripled. Poverty reduction was also significant across all ASEAN countries over this period, declining by nearly half in some ASEAN countries. This rapid growth and poverty reduction was based on sound macroeconomic management, high rates of investment, especially in human development and infrastructure, and the rapid growth of exports mainly to the advanced economies in North America and Europe.

[1] ASEAN was formed in 1967. The members of ASEAN are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam. They are referred to as ASEAN Member States (AMS) and member states in this report.

5. **As the world economy struggles to come out of a crisis, ASEAN economies will have to search for new sources of growth in regional markets**. The traditional export markets of G7 countries will be dampened, as those economies will grow slowly in the medium term under the burden of large debts and deficits. As a result, 2012 marked a watershed when the external trade did not contribute to the growth of the East Asian economies. In this context, stimulating domestic demand based on a rapidly rising middle class and regional demand through creating a large integrated ASEAN market of USD 2 trillion will provide new sources of growth on the demand side, especially in services. On the supply side, the freer flow of investment, technology and services across the region under AEC will boost productivity and supply. Last, but not least, the deep integration of AEC will provide a strong platform for the larger economic integration being discussed under the ASEAN + 3 and ASEAN + 6 umbrellas.

B. Objectives of the ASEAN Integration Monitoring Report (AIMR): Taking Stock of ASEAN's Contribution to Trade Integration

6. **This report, jointly produced by the ASEAN Secretariat and the World Bank, focuses on policy and market integration outcomes achieved in ASEAN Member States (AMS) as part of the ASEAN Economic Community (AEC) formation process under Pillar One**.[2] Under this pillar, ASEAN will form a single market and production base with free flow of goods, services, investment, skilled labor, and a 'freer flow' of capital.[3] The aim is to assess progress of AMS regional and global trade integration, drawing on evidence from a large range of indicators on policies and outcomes. The focus of this report is to assess whether ASEAN policies are associated with measurable progress in participation in international and regional trade in goods, services and investment, through increased and more diversified trade flows. The report also attempts to highlight sectors where ASEAN and its Member States have been more successful, and conversely, sectors where progress is still needed.

7. **In so doing, the AIMR strives towards using recent international data and indicators where available**. Indicators such as the Logistics Performance Index or the Services Trade Restrictiveness Index help shed additional light on fundamental elements of international trade. They also provide more comprehensive and robust measures of reform and their impact. The focus on this new breed of indicators is also a first attempt to address the need for better information about complex regulatory dimensions of trade integration, which are an integral part of the ASEAN agenda but are not yet very well analyzed. This point is elaborated in the policy recommendations below.

8. **This AIMR is also expected to be the first of an annual report series providing a regular update on the state of trade integration in the ASEAN region**. This is part of an effort to assess the

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[2] This report has been jointly produced by the Association of South-East Asian Nations—ASEAN (ASEAN Integration Monitoring Office) and the World Bank (Office of the Chief Economist, East Asia and Pacific Region) as part of the Advisory Services program of the World Bank for ASEAN. Staff of both organizations contributed to drafting the report and reviewing it based on comments received from ASEC, AMS and WB officials.

[3] "An ASEAN single market and production base shall comprise five core elements: "(i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) freer flow of capital; and (v) free flow of skilled labor." ASEAN Economic Community Blueprint, para 9, ASEAN, 2009.

relevance and importance of the ASEAN process and reflect on it, while providing a new venue for dialogue among AMS and their constituents.

9. **The focus of the AIMR is on policy outcomes of ASEAN integration.** By design the report details ASEAN policy commitments, but does not provide a comprehensive assessment of progress towards meeting these commitments. This work was undertaken in a comprehensive manner in the *ASEAN Economic Community Blueprint Mid-Term Review: Integrative Report* and the companion country reports detailing the state of implementation in each ASEAN Member (ERIA, 2012). The report refers to this body of work and should be read as complementing ERIA studies' findings.

10. **A key finding of the AIMR is that ASEAN and the AEC agendas have already brought important gains to the AMS**. This finding is consistent with a range of empirical research, mostly using computable general equilibrium *ex ante* simulations on the potential impact of ASEAN on GDP growth. These studies consistently show a positive potential impact from ASEAN integration. According to one of the earlier studies (Plummer and Yue's, 2009), the deep integration measures envisaged under the ASEAN Economic Community would lead to an increase in welfare of about 5.3 percent or about USD 69 billion in 2009 incomes. This is more than six times larger than the effect estimated for simply having free trade under AFTA. Other important results on the impact of the formation of AEC in 2015 include:

- Increase in per-capita incomes by 26 percent to 38 percent in the resource-rich original group of ASEAN countries compared to the baseline, including the effects of higher FDI;
- Greater inflow of FDI with an increase in FDI stocks by 28 to 63 percent;
- Increase in growth rates by 0.5 percent to 1.0 percent points;
- Expanded trade in goods;
- More competitive consumer markets leading to a cheaper and wider range of goods and services;
- Lower cost of capital;
- Reduced skill shortages due to flexible labor markets; and
- Narrower development gaps as the less developed CLMV (Cambodia, Laos, Myanmar and Viet Nam) group gains most in productivity from regional integration.

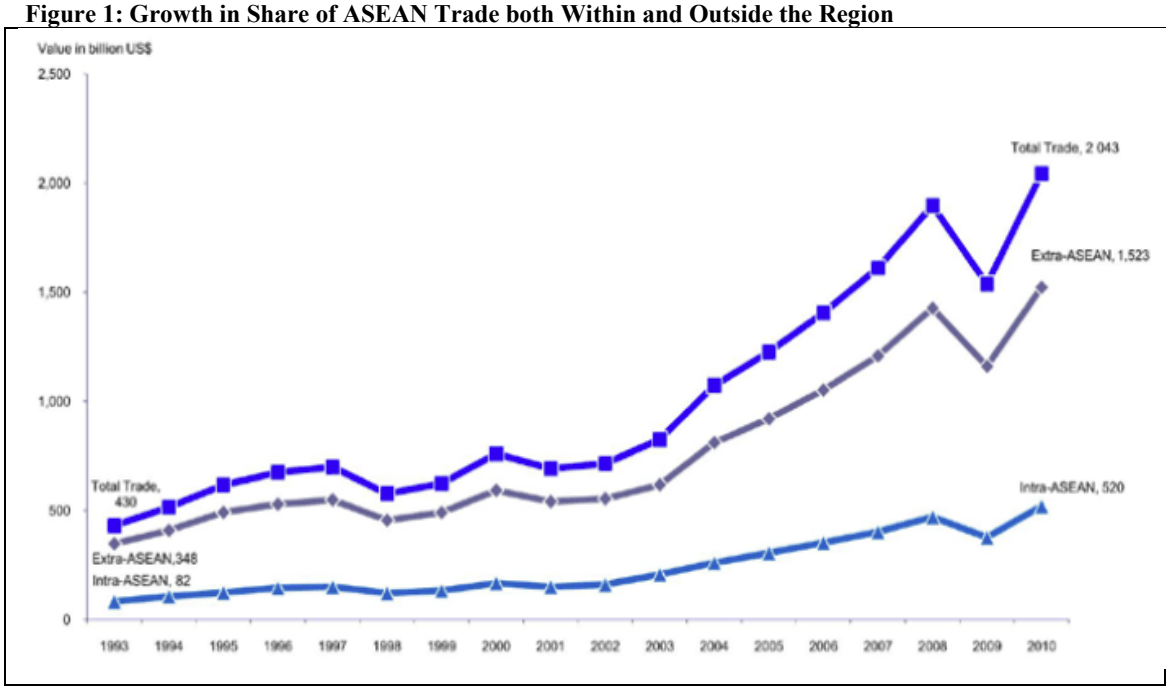
11. **More recent studies also find significant gains from deeper integration measures under AEC.** The most recent research, conducted as part of the AEC Mid-Term Review (AEC-MTR) by ERIA (2012) for eight ASEAN countries (excluding Brunei and Myanmar due to data availability), finds the most significant gains arising from service liberalization, which leads to a higher growth rate for Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam. A positive effect of trade facilitation, infrastructure and logistics on trade cost is also expected for many of these countries.

12. **This report finds that gains from integration to ASEAN have come from five directions. First, ASEAN economic integration has been trade-creating (increased trade with 'lower cost' partners and welfare) and not trade-diverting (reduced trade with lower-cost partners and welfare).** As a result, ASEAN integration has not taken place at the expense of global integration, but has in fact been a 'building block' for world trade rather than a 'stumbling-block.' Two pieces of evidence suggest this. As noted in Chapter 1, AMS have made significant progress in almost eliminating ASEAN tariffs on regional trade (to less than one percent on average), while also

reducing tariffs on trade with other countries. Further, evidence suggests that regional tariff liberalizations actually induce a faster decline in external tariffs than would otherwise occur. For instance, if imports of a product faced a 10 percent MFN tariff but 0 tariffs if sourced from other ASEAN members, then the ASEAN importing country would subsequently tend to reduce its MFN tariff on that product by between 2 ½ and 4 ½ percentage points (Calvo-Pardo et al, 2009). Corroborating research found that products receiving preferential treatment in Indonesia, the Philippines, and Thailand under the ASEAN Free Trade Agreement underwent greater reduction in MFN tariffs than non-preferential products by between one and five percentage points. As a result, the margin of preferences—and the incentives to trade—for intra-ASEAN trade remained small and did not divert trade away from non-ASEAN partners.

13. **The trend in direction of trade also confirms that ASEAN integration was trade creating: as intra-ASEAN trade expanded trade with the rest of the world also increased proportionately**—that is, the share of trade with the rest of the world did not decline. The explanation for this growth of ASEAN's trade with the rest of the world lies in the structure of ASEAN's trade; its intermediate goods, intra-industry nature of trade within the ASEAN region, and exports of final goods to outside the region all contributed to this growth. This proportionate growth of extra-ASEAN trade is shown in Figure 1.

Figure 1: Growth in Share of ASEAN Trade both Within and Outside the Region



Source: ASEAN Stats, Staff Estimates

14. **The fact that ASEAN's share of trade with the rest of the world did not decrease suggests that ASEAN's integration has been welfare enhancing for at least two reasons**. First, because regional liberalization did not divert trade away from more efficient partners to less efficient regional partners, efficiency was maintained. Second, it also helped to maintain the efficiency of ASEAN producers and their competitiveness in global markets because it increased the sophistication of the region's exports through the production of a wide range of intermediate goods.

15. **While the share of intra ASEAN trade has stayed at a stable and seemingly small share of 25 percent of total ASEAN trade, in reality it represents a high degree of integration**. Measured by the trade intensity indicator, which compares regional trade to global trade with the region, ASEAN is highly integrated compared to other regional organizations such as the European Union or the North American Free Trade Organization (NAFTA).

16. **Second, improvements in trade facilitation through ASEAN integration have helped, leading to greater trade and efficiency gains.** Overall, trade costs in ASEAN are generally lower than elsewhere, both in intra- and extra-regional trade. Indeed, intra-regional trade costs in ASEAN are comparable to those in NAFTA, which is indicative of a high level of economic integration. Further, ASEAN substantially reduced its level of trade costs between 1996 and 2001, although improvements appear to have slowed afterward. These improvements over the past decade have significantly lowered trade costs by more than 15 percent on average within ASEAN and by about eight percent with the rest of the world. Trade costs for the ASEAN-5 countries have substantially fallen over recent years, by as much as 50 percent between 1990 and 2007. This, in turn, has led to an increase in trade flows. Other research, using a broader measure of trade costs than international transport costs, shows that trade costs have fallen substantially over recent years, by between five and ten percent from 2001 to 2007. However, performance differs substantially across countries. For example, while Viet Nam stands out as having experienced major trade cost reductions, performance improvements have been more moderate in other ASEAN countries.

17. **Third, the AEC agenda has contributed modestly to services sector development and trade by providing a push for services trade liberalization commitments that go beyond similar efforts in the World Trade Organization (WTO)**. A comparison of AFAS commitments with similar reforms has been made with commitments under the General Agreement on Trade in Services (GATS) in six countries for which detailed survey-based policy data is available. Except for Viet Nam, AFAS commitments call for a more liberal policy in the retailing and transportation sectors than in WTO Doha Rounds.[4] Moreover, in some sectors and countries, AFAS commitments imply a more open services trade regime than the policies that were implemented in 2007/08. Overall, there also seems to have been some progress in implementation in areas such as air and road transport, and movement of professionals in the areas of engineering and architecture.

18. **Fourth, ASEAN integration has helped to attract FDI, both from outside and particularly from inside the region**. A key goal in forming AEC was to raise investment and particularly FDI in the ASEAN region. As investors became shy in the wake of the ASEAN financial crisis of 1997, the larger market size created by the ASEAN Economic Community was expected to attract investment. As Chapter 4 on FDI makes clear, ASEAN integration has been significant in attracting FDI to ASEAN countries, although the destinations remain highly concentrated. FDI to ASEAN countries increased from USD 20 billion in 2001 to USD 94 billion in 2010. Within the ASEAN region, FDI flows have also increased markedly from an average of USD 5 billion in the 1990s to USD 13 billion in the last three years. Attractive factor prices and good connectivity in the region have no doubt played a key role in drawing FDI to the region.

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[4] For the methodology of the services data collection see paper, "Guide to the Services Trade Restrictions Database" (Borchert, Gootiiz and Mattoo, 2012b) and in supplementary material available at http://iresearch.worldbank.org/servicetrade. Details on the comparison with GATS are provided in Chapter 3.

19. **However, there is also good evidence that ASEAN integration efforts had a direct impact on increasing foreign investment with important beneficial impact**. Regional integration has been found to increase the attractiveness of the region to foreign investors, and ASEAN in no exception. There is also a suggestion that FDI not only supplies ASEAN countries with necessary funds, but also helps in exporting outside the region. This has positive dynamic implications for ASEAN countries in that these investments are not tariff-jumping FDI but efficient FDI; they are highly productive and well paying, are conduits of technology, and create positive spillovers for other firms.

20. **Finally, the AEC has also helped to stimulate the development of lower income CLMV countries and bridge the development divide** (although the divide still remains vast). As a result, the share of GDP of CLMV countries in ASEAN has increased from around 3.5 percent in 1990 to nearly 10 percent in 2011. As noted earlier, the share of GDP of these countries in the global economy has also increased markedly.

21. **There are, however, several areas where actual progress in implementation in integration has been limited.** Chief among these are AEC's goals to remove non-tariff barriers to trade, achieve integration of services especially through liberalizing foreign investment thresholds in services, and improve some areas of trade facilitation. These are discussed below.

C. Broad Findings from the Report

22. **ASEAN integration has progressed in parallel with global integration**. Global and regional trade flows in ASEAN have been closely intertwined with goods, services and investments. For instance, non-ASEAN investors also generate intra-ASEAN investments, and an important portion of intra-regional trade in goods takes place in the context of global supply chains. Similarly, for investments, the ratio of intra-ASEAN FDI to total FDI in ASEAN increased from eight percent in 2000 to 20 percent in 2011, and continues to rise. Baldwin (2012) shows that intra-industry trade in ASEAN—an indicator of "supply-chain trade"—is high in absolute levels for intra-ASEAN. However, there are also suggestions that more can be achieved as this level is not yet as high as it is for trade among developed countries (EU regional trade or trade between the EU and the US).

23. **Broadly defined, the ASEAN agenda of regional integration has been implemented concurrently with the opening of market access to non-ASEAN traders**. The AEC Blueprint envisages a region fully integrated into the global economy, indicating the open nature of the ASEAN regional integration model (Soesastro, 2008; ERIA, 2012). It was discussed earlier how preferential tariff liberalization in ASEAN proceeded alongside MFN liberalization. The same is true for investment policies: access of FDI to markets and, conversely, restrictions to market access have been applied largely on a non-preferential basis. The emphasis on trade facilitation naturally supports ASEAN's open regionalism objective as reductions in trade transaction policy costs tend to benefit all traders indiscriminately.

24. **Looking forward, ASEAN should continue as a facilitator of better integration of its members' economies into the global trading system and pursue an open regionalism agenda**. This agenda can build on three features: ASM complementarities, deep integration, and implementation.

25. **The high trade complementarity of some ASEAN countries to the region—indicating that exports of those ASEAN member countries are in high demand in other countries of the region—points to significant gains from further trade within ASEAN**. Important differences in economic structures among ASEAN members point out differences and complementarities in comparative advantage. Recent research in other countries suggests that integration of the services sectors can also stimulate productivity growth in manufacturing and other sectors in ASEAN countries and bring significant gains. Overall, the research suggests that creating the AEC could increase annual income growth (conservatively) on the order of 0.5-1 percent of GDP and increase FDI stocks by 28 percent to 63 percent (or USD117-USD264 billion relative to 2006 inward FDI stocks)[1] through greater regional trade in both goods and services.

26. **Supply chains are only as strong as their weakest links: complementarities among member countries should be developed through the help of the ASEAN integration agenda**. Two instances illustrate this potential: i) there are numerous areas of trade integration that must be tackled at the regional or sub-regional level, such as mutual recognition of rules and procedures, suggesting that ASEAN members should seek mutually beneficial solutions; and ii) ASEAN members can draw on best practices and knowledge from within the region to improve their overall trading environment. As pointed out by Soesastro (2008), successful production fragmentation in the region rests on the possibility to shift part of the production base to less developed economies, where costs are cheaper, provided that the cost of connecting to the supply chain (transport and logistics, and input services) is also lowered. In turn, participation in global supply chains is a source of growth and economic diversification for less developed countries.

27. **A key finding of this report is the areas of commonality that arise in the four trade integration pillars examined: goods, services, trade facilitation, and investment**. This reflects that ASEAN members have achieved significant liberalization with respect to market access in several of these areas. Trade rules whose sole purpose is to explicitly discriminate against foreign suppliers, such as tariffs, prohibitions and limitations aimed at foreign economic agents (ASEAN and non-ASEAN), have come down.

28. **As this report also shows, while there remain several areas (non-tariff measures, services, investment) where progress must still be achieved to meet and expand existing liberalization commitments**, **the overall integration agenda should also now include regulatory measures that remain largely unaddressed.** Non-tariff measures and barriers (goods), red tape and transaction costs (trade facilitation), entry or operational restrictions affecting foreign service providers (including transport, third-party logistics, distribution that helps determine trade facilitation outcomes), and FDI policies, all have a common important regulatory agenda that affects international trade and needs to be addressed.

29. **Regulatory barriers impeding trade are different from traditional trade barriers such as tariffs and are potentially numerous and pervasive**. Regulations are core to international trade, and as such are already recognized in the AEC agenda, be it standards to ensure the safe movement of goods, regulations to guarantee efficient and competitive markets in services and investment, or procedures that dictate how borders are managed. Facilitating trade implies reducing or eliminating altogether the discriminatory incidence of these regulations and diminishing compliance costs while meeting the regulatory objectives. However, tackling such issues requires more than just commitments to the elimination of flagrantly discriminatory barriers.

30. **The across-the-board regulatory challenge has implications in terms of how to move forward in pursuing the ASEAN integration objective**. Going forward, there needs to be more emphasis on putting in place and strengthening mechanisms that enable better collective management of these regulations. In practice, this entails improving information and transparency on measures that are often complex and opaque: creating focal points, agreeing on specific performance indicators, etc. Some of these reporting efforts are recognized in the AEC Blueprint but have not always been met by member states (such as the Trade Facilitation Assessment Framework and Indicators), or they offer an incomplete picture of the reality of barriers to trade (for instance the notification mechanism of non-tariff barriers). Another important and complementary element addresses accountability—via establishing baselines, measurement, and transparency to allow stakeholders to monitor progress and outcomes. The ASEAN Scorecard is a right move in this direction.

31. **A second dimension of the regulatory agenda is setting up processes that help address the unnecessary costs that regulatory barriers may create**. This requires the involvement of regulatory experts and stakeholders who are directly involved with these regulations. It also includes incorporating the private sector, which can provide views about lowering costs while guaranteeing compliance. There are often several government ministries and agencies concerned with a given regulation (such as establishment of a foreign firm) or trade process (such as border crossing), and involvement of them all facilitates coordination of their actions and mutually agreeable solutions. One key aspect of addressing regulatory barriers is that the integration process should be operational in purpose—it should try to facilitate the circulation of information through better understanding of how regulations work (for instance, by conducting regulatory audits), and look out for solutions to regulatory problems (through exchanges around best practices).

32. **Given that regulatory issues pervade goods, services and investment integration policies, and affect regional supply chains in more than one way, it would be advisable for the ASEAN membership to also think holistically in terms of supply-chain policy strategies**. This recommendation echoes the conclusion of a recent report (WEF, 2013). It also reflects on initiatives by the ASEAN membership to draw more inclusive visions such as in the *Master Plan on ASEAN Connectivity* (2010). This would involve looking for indicators of performance that capture the entirety of the supply chain and not just some of its discrete components, and setting up coordinating mechanisms that enable linkages to be created between areas that are traditionally negotiated and managed separately (for instance, linking trade facilitation efforts with liberalization of logistics and transport services).

33. **Going beyond commitments, the ASEAN membership must now focus on implementation and the institutions supporting it.** Arguably, implementation should be a chief concern for any international agreement, but insisting on implementation carries a deeper meaning when considering non-tariff barriers, transaction costs or operational restrictions. The reason is that it is likely impossible to come up with a complete catalog of possible measures impeding trade, and even less likely to come up with simple and harmonized solutions to reduce these barriers. Merely calling for the elimination of non-tariff barriers is not enough. Looking at implementation through the establishment of mechanisms of monitoring, consultation and exchange of best practice described above has some implications in the context of the role of ASEAN and its institutions, including increasing the focus on monitoring, bringing on board technical expertise, devising arrangements that

enable satisfactory redress (both informal and formal), and increasing resources devoted to this overall effort.

34. **It is now widely agreed that a key task for ASEAN will be to prioritize the actions and targets set out in the highly comprehensive AEC Blueprint**. The discussion on the different areas of Pillar 1 in the rest of this Overview identifies the priorities set by the AIMR. These priorities are based on two general principles. First, policy measures that remove clear impediments to *regional* trade in goods and services and investment flows need to be prioritized over actions that are country specific. Second, the priority should now be to go beyond ensuring compliance with market access commitments to implementation. Under this scenario there needs to be greater efforts to benchmark the current status of policies and regulations and monitor changes therein in support of regional integration, especially in the case of non-tariff trade barriers and services trade. These points are elaborated below.

D. Progress and Challenges in Trade in Goods

35. **Among AEC goals, ASEAN has made substantial progress in integrating goods markets and opening up trade in goods**. Intra-ASEAN elimination of tariff protection has been achieved completely for Singapore and Brunei. Indonesia, Malaysia, Philippines, and Thailand have also eliminated tariffs on almost all imports from other member states since 2010, except on agriculture sensitive goods and a few other goods not subject to liberalization under ATIGA. CLMV countries have also made rapid progress, but Cambodia needs to accelerate its tariff reduction schedule to meet the subgroup-specific AEC target by 2015.[5] At present, while ASEAN is highly integrated, the potential for higher gains from trade is very much possible given the complementarity of trade patterns of some ASEAN countries with others, that is, several ASEAN countries export goods that are imported by other countries.

36. **Low and declining MFN tariffs by ASEAN countries have contributed to low intra-ASEAN preference margins, which in turn help explain the low utilization rates of ATIGA preferences, especially in some member states.** With already liberal and recently simplified rules of origin for intra-ASEAN trade, the only avenue for ASEAN to boost preference utilization rates might be a targeted technical assistance and information campaign to reach traders of those goods with still sizeable preference margins and in those countries with utilization rates around or below 20 percent**.** However, with further preference erosion to be expected as ASEAN Member States will likely move further on MFN tariff and peak reduction, boosting the utilization rates of such shrinking preferences should not be a priority concern for ASEAN.

37. **In contrast to tariff reform, there has been little progress by ASEAN Member States in identifying and eliminating their 'trade-barrier' elements in their non-tariff measures (virtually all implemented on an MFN basis), despite it being an explicit AEC Blueprint goal.** However, their wholesale elimination is not a realistic medium-term goal even if limited to 'core' trade-restrictive measures; even these might have been adopted to meet legitimate objectives such as public

[5] For CMLV countries, tariffs on all goods should be eliminated by 2015, except for the seven percent flexibility products for which the deadline is 2018. Other exceptions to tariff elimination for all ASEAN members are contained in schedules D (sensitive goods whose tariffs can be maintained at 0-5 percent) and H (goods not subject to liberalization). CLMV benefit from a longer time period to implement the liberalization of schedule D: 2013 for Viet Nam, 2015 for Lao PDR and Myanmar, and 2017 for Cambodia.

health or consumer protection, and thus require revision but not elimination. ASEAN needs to instead recognize the complexity and diversity of non-tariff measures (NTMs) and adopt a goal of streamlining rather than eliminating them. This entails reviewing cumbersome domestic regulations with a supply-chain approach and in consultation with private sector associations (of producers, downstream users, and final consumers) to make them more targeted, simple, and effective, while minimizing any trade-restricting impact.

38. **Most of the ASEAN economies impose not only non-tariff barriers (NTBs) on imports, but also maintain high export restrictions, both in absolute terms and in comparison to other relevant regional groupings.** Most member states require export licensing (except for the Philippines) or impose export taxes (except Brunei, the Philippines, and Singapore) for at least some products, including on intra-ASEAN trade. ASEAN needs to pursue a program of drastic reduction of export restrictions, especially on intra-ASEAN trade.

39. **In the short term, this report recommends that ASEAN persuade both its members and its trading partners to roll back all new trade-restrictive measures introduced since the start of the global financial crisis. It also recommends that ASEAN avoid restricting commerce via introducing new or stricter NTMs, by its members and also by its trading partners**. Furthermore, in developing a new, fresh medium-term agenda for regulatory (including NTM) reform, ASEAN should adopt a coherent approach across countries and ministries and consider vesting more authority in the Secretariat (accompanied by adequate financial resources) to review national regulations, expand region-wide consultations with industry and assess member compliance with any future regionally-agreed guidelines or directives. In addition, this report recommends a promising medium-term action agenda, drawing on proposals by ASEAN's 2012 Chair, Cambodia, to start streamlining NTMs by:

(i) improving the classification of NTMs according to the UNCTAD guidelines adopted in February 2012;
(ii) updating and verifying country lists in an open process driven by the ASEAN Secretariat rather than on a voluntary basis by individual member states;
(iii) eliminating, with only few exceptions, all quantity control measures comprising non-automatic licensing, import and export quotas and prohibitions, and all foreign exchange at least for intra-ASEAN trade though it may not be possible or practical to police such limitations;[6]
(iv) identifying the other most egregious trade-restrictive measures, with help not only from the private sector (as foreseen in article 42 of ATIGA) but also with sectoral regulatory impact assessments to be launched urgently;
(v) deciding in ASEAN bodies on national level regulatory modifications as well as regional harmonization actions necessary to eliminate or minimize the trade-restrictive impact of the NTM measures identified; and

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[6] Myanmar, the only ASEAN Member State with foreign exchange controls, should also eliminate such restrictions. It is indeed expected to do so in the very near future, as foreign trade and financial sanctions are being lifted. The Central Bank of Myanmar (CBM) introduced an exchange rate system in the form of the official peg with a managed float unifying the exchange rates with assistance from the International Monetary Fund. Accordingly, CBM began a managed float system on April 1, 2012, dismantling the existing multiple exchange rate system. A new currency regime was commenced on April 2, 2012 by setting a daily reference exchange rate of Myanmar Kyat to the dollar by the CBM in line with its value on the market rate as announced at www.cbm.gob.mm.

(vi) planning an in-depth regional study of NTMs, possibly under Phase II of the AEC Monitoring and Evaluation Capacity Building Program (AECMEP) collaborative project between the ASEAN Secretariat and the World Bank.

40. **Overall, the trends over the last seven years for various indicators point to a high degree of intra-regional merchandise trade integration within ASEAN, which is increasing at a faster pace than its GDP, though not faster than its trade with the rest of the world**. Measured in terms of indicators such as regional trade intensity, merchandise trade in ASEAN is more integrated than other regional groups such as EU or MERCOSUR in Latin America. They also paint a picture of a recent resumption of the historical expansion of ASEAN trade with the rest of the world. This picture is consistent with the hypothesis of ASEAN being a force for trade creation rather than trade diversion. Not only has trade increased, there has also been an increase in the diversification and sophistication of exports in most ASEAN countries. Although still behind, ASEAN 6 high and middle income countries compare well by the number of goods exported with that of the EU 27 countries. However, Brunei, Cambodia, Lao PDR, and Myanmar all suffer from a relatively low export diversification. Only Indonesia, with its predominance of natural resources, and possibly Cambodia, are moving in the wrong direction toward more export concentration. They should consider policies to reverse this trend.

E. Trade Facilitation

41. **The AEC Blueprint has rightly identified trade facilitation as an essential piece of international trade integration**. Customs reform through simplification, harmonization and modernization of procedures is the centerpiece of these efforts. The ASEAN agenda is ambitious, with the objective of strong integration of national customs systems through the ASEAN single window and ASEAN e-customs. The adoption of some high-level international standards, such as preconized by the Revised Kyoto Convention, is also on the agenda, although not all modern customs management elements are present.

42. **The ASEAN trade facilitation agenda is not only about customs reform; it needs to be broadened to include other essential elements**. Facilitation is also about ensuring that implementation of product standards and phytosanitary measures and the provisions of transport and logistics services do not unduly impede trade. The streamlining of standards is an area that, while clearly identified as a priority by both ASEAN governments and the private sector, has recorded modest and limited progress. It should become a focus of future work with emphasis on sectoral approach and results, starting with transparency.

43. **In its identification of logistics services as a key component of integration, ASEAN is a pioneer.** This overall progress in facilitating trade is reflected in key international indicators. Both Doing Business (DB) and Logistics Performance Index (LPI) indicators show that the region is a strong performer compared to other regions of the world and that it has demonstrated measurable progress over the past five years. As noted, this performance has been reflected in the significant decline in trade costs both within ASEAN and outside ASEAN trade. ASEAN as a group can also benefit from the experience of Singapore, the leading world performer. However the DB and LPI indicators also show areas in need of improvement: ASEAN does not perform as well as ASEAN+6 countries; there is a wide disparity of performance within ASEAN with three of the CLMV countries lagging.

44. **Further, progress has been uneven in the critical area of transport.** In the air transport sector there has been both progress and growth, but the slow implementation of the multilateral agreements by some AMS have impeded the full realization of the ASEAN open sky regime so far. On the other hand, little has been achieved in the maritime sector (this is not a priority sector) and this translates into poor connectivity and inadequate progress in trade facilitation for several ASEAN members.

45. **This report proposes the following priorities for advancing the AEC's trade facilitation agenda:**

(i) **Reform of customs** is a vast and challenging agenda that includes advanced techniques that may not be reachable to all ASEAN partners, especially those with capacity needs. Given this, it might be perhaps desirable to consider establishing some order of priorities rather than expanding the agenda at all costs. For instance, facilitation measures that absolutely require regional or cross-country coordination, such as transit and the harmonization agenda, could be prioritized over those that can be carried out by AMS individually. Another criterion to follow might be to focus on simplification and streamlining first, before moving on to the more challenging modernization features of this agenda. Last but not least, not all reforms have the same value: it would be useful to put first the reforms that provide the most immediate gains.

(ii) A comprehensive look at all elements of the **trade supply chain** is needed for successful integration into regional and global value chains. Partial reform only achieves modest gains and only countries that have undertaken a global approach to facilitate trade have made significant headway. The various elements of the AEC framework dealing with transport and logistics, and services and customs seem to be pursued independently; this probably limits opportunity for reforms (for instance different AMS line ministries may be involved in each initiative) and likely prevents useful linkages from being made.

(iii) The **streamlining of institutional responsibilities and improvements in inter-agency coordination is another priority**. For instance, the Philippines has numerous agencies involved in trade facilitation. In Cambodia, the involvement of two customs entities, customs and CamControl, delays customs processing. In Viet Nam there is poor coordination among the various trade facilitation measures that are undertaken. The program of National Single Windows should go some way towards addressing some of these issues, but ASEAN cooperation could also help by looking at the role of agencies other than customs, at the border.

(iv) **Governance of trade procedures**, including informal payments and the additional burden of pre-shipment inspections, remains a concern in several countries in the region. Therefore, a priority is clearly to improve human capital and institutional strengthening. In this context, transparency and monitoring have an important role to play in providing incentives for reform and good governance. An important pending task is the carrying out of trade facilitation assessment on a biennial basis by individual AMS. Such assessments will measure performance and help lay out more detailed roadmaps for improving trade facilitation. The effective use of notification and creation of a repository of regulation are two other important agendas that ASEAN should meet.

(v) Focusing on **capacity building initiatives**, such as those already identified in the AEC Blueprint, will be critical and can benefit from the experience and expertise of the most advanced

members of the region. Thus, using ASEAN to develop tools of cooperation between member states would help address some of these issues. These tools could include: expert sectoral committees, programs of secondary support among countries, and the reinforcement of the ASEAN Secretariat's own expertise and participation in international standard setting bodies.

(vi) While there has been significant progress in National Single Window in countries such as Indonesia, Philippines and Singapore, there has been less progress in other countries. In the run-up to the AEC 2015 targets perhaps a **focus on implementing the National Single Window** agenda in AMS has become important.

F. Services

46. **The services sector integration goals of the AEC present the biggest challenge and also the biggest opportunities for the region.** Services, already an important source of both output and employment in ASEAN economies, will be increasingly critical in the future. On average, the sector contributed more than 40 percent of total value-added and more than 50 percent of total employment in 2010. Some ASEAN countries, particularly Singapore, Malaysia and the Philippines, have already become significant exporters of modern services in sectors such as professional and information services, transport and communication technology, business processing outsourcing (BPO), higher education, and health tourism. On the demand side, as per capita income rises further, the demand for services will grow rapidly. On the supply side, finance, communications, information technology, higher education and transport will provide inputs for high end manufacturing sectors and sophisticated service sectors. Thus, a more competitive services sector will lead to a more competitive manufacturing sector, an increase in overall productivity and export opportunities for the services sector.

47. **While growth in services has been encouraging in recent years, the services sector in ASEAN economies still remains relatively underdeveloped.** In particular, the relative importance of services in GDP and trade is less than what would be expected given the levels of income and development in the AMS. Moreover, regulations affecting services in ASEAN countries are relatively more restrictive compared to other regions and across different modes of services provision, and particularly for professional and transport services.

48. **In this context, while the AEC goals for ASEAN provide useful and detailed targets for the integration of services in the ASEAN region, progress has been mixed and modest.** Overall, there has been progress in meeting sectoral commitment targets until the 8th Package of AFAS. However, while in terms of commitments AFAS often goes beyond GATS commitments or Doha Round offers, this rarely leads to changes in the regulations that are applied in AMS. Hence, the impact on trade and competitiveness of ASEAN economies is limited to the potential effect on investment from strengthened assurances against a policy rollback. According to the analysis of services trade data, this effect has not been sufficiently strong to trigger a large expansion of intra-ASEAN services trade.

49. **In fact, for most countries and sectors the commitments to liberalize services contained in AFAS fall short of the policies that were implemented in 2007/08 already**. In other words, countries are ahead of AFAS and the main impact from implementation of the AFAS commitments will be to provide assurance to regional investors that any potential reversals in the trend towards greater services trade integration will be more limited than under the WTO provisions. One result of

this is that the growth of services trade has outpaced goods trade globally and in AMS. ASEAN countries such as Singapore, the Philippines and Malaysia have already become significant exporters of modern services in sectors such as professional services and information and communication technology, BPO, higher education and health tourism. Despite these improvements, the services sector in ASEAN economies is still relatively underdeveloped. While the contribution of services growth has picked up in the last decade, the share of services in GDP remains relatively low for ASEAN economies compared to countries in other regions.

50. **Another example of mixed progress comes from one of the integration efforts concerning the eight mutual recognition arrangements (MRA) for professional services that have been concluded among AMS**. Indeed, international experience suggests that the most pronounced benefits from regional integration in services come from the harmonization of the regulatory environment and the convergence of policy regimes through the creation of common standards and institutions. Yet, the conclusion of MRAs can only generate the hoped-for benefits in terms of market integration if the arrangements are properly implemented and not compromised by national regulations. Recently, however, ASEAN has taken a new approach to this issue through the signing of an Agreement on the Movement of Natural Persons in late 2012. This agreement is a step in the right direction, as it has introduced enough flexibility to help facilitate faster implementation in the movement of skilled workers; however it is too early to evaluate its effectiveness.

51. **Three priorities emerge in the task of implementing AEC Blueprint goals.**

(i) The past focus of reform discussions in the Coordinating Committee on Services (CCS) on improving market access now needs to be supplemented by renewed focus on the implementation of **regulatory reforms**. Doing so will help to move more quickly towards the objective of the AEC Blueprint of creating a unified services market in ASEAN. The domestic regulatory reform agenda, which helps to implement commitments and ensure that external liberalization takes place after adequate prudential and pro-competitive and institutional measures are in place, has now become a priority. Here, shifting the attention of regulators and policy makers towards creating this agenda and then towards a unified services market with common rules and procedures is often a more promising avenue to foster regional integration.

(ii) Upgrading **technical capacity** on sectoral involvement in services trade negotiations and reforms has become urgent. Steps in this direction could range from the occasional organization of information exchanges among sectoral regulators to the delegation of negotiating authority from the CCS to new sectoral working groups. This would help the role of the CSS to evolve towards ensuring overall coherence and broad-based progress on services integration. Also, a systemic work program to implement domestic regulatory reforms might facilitate the implementation of services commitments.

(iii) Bridging the existing divide in **regulatory capacity** among AMS. As the data analysis has demonstrated, there is considerable diversity within ASEAN with some strong services exporters, such as Singapore or the Philippines, and several less well-positioned countries that are just starting to integrate their services sectors into international markets. Moreover, in the STRI-analysis, the CLMV appear as being relatively open to services trade. Yet, these AMS are still in the process of codifying their existing regulations, and creating transparent and consistent policy regimes in the different services sub-sectors is an important step in the development process. On the other hand, many of the more advanced AMS have mature services sectors and well-established prudential and consumer

protection measures in place and would benefit from a regulatory easing and its pro-competitive impacts. These diverging situations and needs might best be appreciated and dealt with in discussions of sectoral experts rather than trade policy generalists. Also, the regular meetings of sectoral officials from AMS might help to spread information on best practices and useful approaches to regulatory challenges in the individual sub-sectors.

G. Foreign Direct Investment

52. **The role of foreign investments in ASEAN global integration has grown noticeably over the past decade, even taking into account the financial crisis of 2008.** The perception of ASEAN countries as destinations for foreign investments is very positive with several ASEAN members among the top world destinations, so this favorable trend can be expected to continue in the international environment. Remarkably, intra-regional investments have taken a central role in this context. The share of intra-regional FDI is rising, a result of the confidence in future opportunities in the region and the relative stability offered by the region in contrast to the rest of the world.

53. **The distribution of foreign investments in the region is, however, very uneven: three fourths of investments are concentrated in five countries, and half in one country (Singapore).** While this reflects the economic size and development disparities in the region, it also follows the level of regional and global integration of the various economies in the region. Therefore, if ASEAN is to keep attracting productive foreign investments, it must keep pushing not only investment reforms but also other trade and business environment reforms that are part of the blueprint package and beyond. Indeed, reduction of barriers to trade and facilitation of trade flows offer guarantees to investors of returns on their productive investments.

54. **The characteristics of foreign investment in ASEAN, mainly directed towards global and regional supply chain manufacturing, suggest that there are still important barriers to integration.** If these were removed it would make the region even more attractive to foreign investors. Arguably, this applies even more to the CLM (Cambodia, Lao PDR, and Myanmar) group, which is in need of substantial reform progress and increase in FDIs.

55. **In terms of investment policies, progress is needed in several directions**. The most visible aspect of it is restrictions to levels of foreign equity cap. Good reforms have been made, but the region overall is still lagging behind East Asian and OECD countries as measured by investment restrictiveness data. ACIA does not cover all sectors, in particular services. Significant restrictions in telecoms, electricity and banking—all of which are important inputs into economic activities—are prevalent in a majority of AMS and still far from the 2015 objective of free and open investment. Overall progress in services areas is needed now that there is movement towards opening in manufacturing and agriculture.

56. **The institutional approach of the ACIA towards liberalization of investment would also benefit from improvements**. As it stands, there is considerable leeway for creating reservations to liberalization and the use of negative lists is not very transparent. Less visible, but also important, are regulations such as performance requirements, restrictions on capital movements, and constraints on movement of labor that can also restrict investments. Such conditions are still relatively frequent in the ASEAN countries and are contradictory to the principle of equal treatment of foreign and national investors affirmed in the ATIGA. Implementation or facilitation of investment is also very important. Regulations that are not directly related to investment, such as land access (which is part of the

reservations to liberalization), visa policies, and screening policies for regulatory purposes and tax exemptions may further limit foreign presence. A survey of businesses conducted by ERIA (Economic Research Institute for ASEAN and East Asia) indicates that great importance is attached to such measures by foreign investors, which suggests that further joint efforts to streamline these policies will be welcome.

57. **The facilitation of the investment agenda is closely related to the need to improve monitoring and transparency of policies.** The Coordinating Committee on Investment provides a forum to exchange information, and the decision to create a peer review mechanism will provide a monitoring of the implementation of the ACIA. ASEAN countries have started implementing the peer review mechanism since 2012.

Chapter 1: Trends and Patterns of Merchandise Trade

A. Key Findings

1. **Intra-ASEAN elimination of tariff protection has been achieved completely for Singapore and Brunei.** Indonesia, Malaysia, and to a lesser extent, the Philippines and Thailand have also eliminated tariffs since 2010 on almost all imports from other member states, except on agriculture sensitive goods and a few others not subject to liberalization under the ASEAN Trade in Goods Agreement (ATIGA). CLMV (Cambodia, Laos, Myanmar, and Viet Nam) countries have also made large and rapid progress, but Cambodia needs to accelerate its tariff reduction schedule of 93 percent of tariff lines with zero duty to meet the subgroup-specific ASEAN Economic Community (AEC) target by 2015.

2. **Low and declining most favored nation (MFN) tariffs by ASEAN countries have contributed to low intra-ASEAN preference margins, which in turn help explain the low utilization rates of ATIGA preferences, especially in some member states.** With already liberal and recently simplified rules of origin for intra-ASEAN trade, the only avenue for ASEAN to boost preference utilization rates might be targeted technical assistance and information campaigns to reach traders of those goods with still sizeable preference margins and in those countries with utilization rates around or below 20 percent**.** However, with further preference erosion to be expected as ASEAN Member States likely move further on MFN tariff and peak reduction, boosting the utilization rates of such shrinking preferences should not be a priority for ASEAN.

3. **In contrast to tariff reform, there has been little progress by ASEAN Member States in the elimination of their non-tariff barriers (NTBs), despite it being an explicit AEC Blueprint goal**. However, their wholesale elimination is not a realistic medium-term goal, even if limited to 'core' trade-restrictive measures, as even these might have been adopted to meet legitimate objectives such as public health or consumer protection. ASEAN needs instead to recognize the complexity and diversity of non-tariff measures (NTMs) and adopt a goal of streamlining rather than eliminating them. This entails reviewing cumbersome domestic regulations with a supply-chain approach and in consultation with private sector associations (of producers, downstream users, and final consumers) making them more targeted, simple, and effective, while minimizing any trade-restricting impact. At the same time, ASEAN should pressure both its members and its trading partners to roll back all new trade-restrictive measures introduced since the start of the global financial crisis and avoid introducing new or stricter NTMs, especially those affecting regional partners. Furthermore, in developing a new, fresh agenda for regulatory (including NTM) reform, ASEAN Member States should consider vesting more authority in the Secretariat—accompanied by adequate financial resources—to review national regulations, expand region-wide consultations with industry, and assess member compliance with any future regionally-agreed guidelines or directives.

4. **Most of the ASEAN economies impose not only NTBs on imports, but also maintain high export restrictions, both in absolute terms and in comparison to other relevant regional groupings.** Most member states require export licensing (except for the Philippines) or impose export taxes (except for Brunei, the Philippines, and Singapore) at least for some products, including on intra-ASEAN trade. ASEAN needs to pursue a program of drastic reduction of export restrictions, especially on intra-ASEAN trade, as part of its accelerated move towards regional economic integration under AEC.

5. **Taken together, the trends over the last seven years for various indicators point to a high degree of intra-regional merchandise trade integration within ASEAN**, which is increasing at a faster pace than its GDP, though not faster than its trade with the rest of the world. They also paint a picture of a recent resumption of the historical expansion of ASEAN trade with the rest of the world. This picture is consistent with the hypothesis of ASEAN being a force for trade creation rather than trade diversion.

6. **In terms of export performance, Brunei, Cambodia, Lao PDR, and Myanmar all suffer from relatively low export diversification**. However, Indonesia, and possibly Cambodia, are moving in the wrong direction toward more export concentration and should consider policies to reverse this trend.

B. AEC Blueprint Goals for Free Flow of Goods (Tariffs and Non-Tariff Measures)

7. **In the AEC Blueprint, the ultimate goal for its first pillar is to transform ASEAN "into a single market and production base"** through free movement of goods (covered in this and the next chapters), of services and investment (covered in Chapters 3 and 4), of skilled labor (to be covered in the forthcoming regional services trade study), and freer flow of capital. The rationale for removing all man-made barriers to flows of produced and tradable goods and services, including resources, is to achieve better economic allocation.

8. **The goal of completely removing intra-regional tariffs is a worthy and straightforward endeavor that all free-trade areas and customs or economic unions have tackled or need to tackle.** In fact, tariff removal is both a first and necessary step towards regional economic integration. The ASEAN Free Trade Area (AFTA) was established in 1992 with the signing of the Agreement on the Common Effective Preferential Tariff Scheme (CEPT), under which ASEAN Member States (AMS) began in1993 successive rounds of intra-ASEAN tariff reductions. The approach has consisted of an accelerated elimination of tariffs for products in the Inclusion List (IL), progressive shifting of products from the Sensitive List (SL) into the IL, and reduction of tariffs to a 0-5 percent range for products in the SL and in the Highly Sensitive List (HSL).

9. **In 2003, a Protocol for the Elimination of Import Duties was adopted to push integration forward.** Since then, most applied intra-ASEAN tariffs (excluding products in SL and HSL) were reduced to zero by 2010 for the older members (the ASEAN-6 group of Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand). The new members (the CLMV group: Cambodia, Lao PDR, Myanmar, and Viet Nam) were offered flexibility on seven percent of their tariff lines and thus are expected to reach only by 2018 the same zero target as the older members.

10. **At the 14th ASEAN Summit in February 2009, ASEAN leaders signed a new ATIGA.** The aim was to integrate all existing ASEAN initiatives related to trade in goods into a comprehensive framework, by consolidating and streamlining all the provisions in CEPT-AFTA and relevant economic cooperation agreements. The agreement contains a number of key features to improve AFTA's rules-based system and also to enhance transparency, certainty, and predictability within the broader ASEAN legal framework.

11. **Besides subsuming and accelerating the previous tariff elimination commitments, ATIGA as well as the AEC Blueprint cover three other key sets of policy actions that are critical for promoting the free flow of goods and the broadening and deepening of regional economic**

integration. These are: (i) the removal of non-tariff barriers (NTBs) and minimization of the trade-restricting effects of other non-tariff measures (NTMs), (ii) the strengthening of trade facilitation, and (iii) the harmonization of standards, conformity laws and technical regulations. They also address trade remedy measures and rules of origin.

12. **This chapter focuses only on merchandise trade policy (in tariffs and non-tariff measures) and on ASEAN regional and global merchandise trade integration and performance**, while the next chapter will address progress and challenges in trade facilitation.

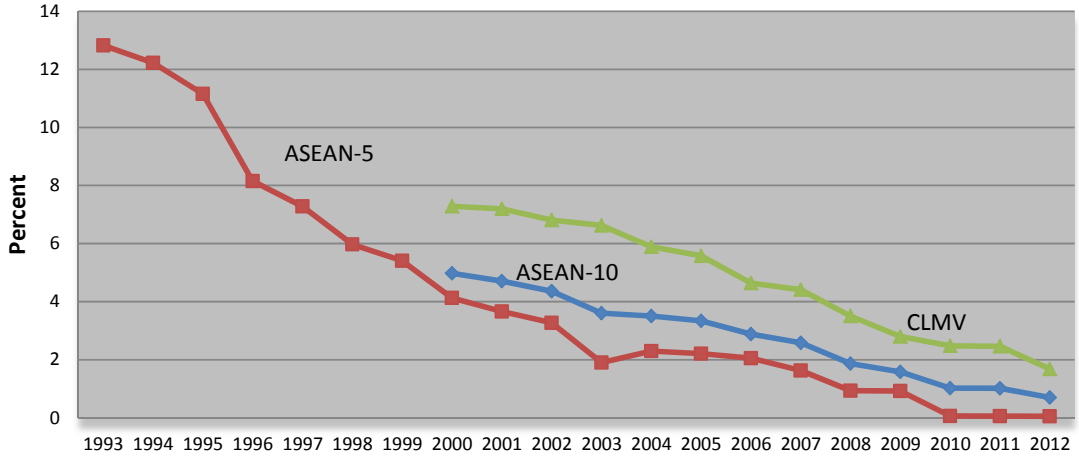
Progress in Eliminating Intra-ASEAN Tariffs

13. **ATIGA entered into force on May 17, 2010, marking a milestone in ASEAN merchandise trade liberalization and facilitation agendas through 2015 and beyond.** As of June 2012, all AMS have issued the necessary legal enactment at the national level to implement commitments taken on the reduction or elimination of intra-ASEAN import duties under Article 19 of ATIGA as well as previous commitments under the CEPT scheme.

14. **Tariffs for the ASEAN-6 countries have been eliminated since 2010 as scheduled under ATIGA.** Tariffs that are not subject to be eliminated under ATIGA are those on few products contained in schedule D (agriculture sensitive goods whose tariffs can be maintained at 0-5 percent) and schedule H (goods not subject to liberalization in terms of tariffs and non-tariffs). With Singapore's preferential tariff on all products already at zero percent since 1997, and Brunei Darussalam recently reducing them also to zero, the ASEAN-6 simple cross-country average CEPT tariff is about 0.05 percent, which compares well with other customs unions and free-trade areas like North American Free Trade Organization (NAFTA) (the latter at 0.03 percent). Even excluding Singapore, the average intra-ASEAN preferential tariff for ASEAN-5 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, and Thailand) under the CEPT scheme has been gradually reduced from 4.1 in 2000 to almost zero (0.06) percent by 2012, as shown in Figure 1.1.

Figure 1. 1: Intra-ASEAN Preferential Tariffs, 1993-2012

Average CEPT Rates, 1993-2012



Source: ASEC database

15. **For CLMV, the average CEPT tariff declined from 7.3 percent in 2000 to just below 2.5 percent since 2010 (2.46 percent by 2012).** During this same period, Cambodia was consistently the country applying the highest CEPT tariff, still at 4.8 percent on average in 2012, up from 4.6 percent in 2010, contrary to expectations. Despite the overall trend of reducing CEPT tariffs, divergence among ASEAN countries increased in recent years (with the coefficient of variation increasing from 0.6 to 1.6), due to the much slower pace of tariff elimination by CLMV countries compared to ASEAN-5 countries.

16. **Looking at the same issue from a different angle, by 2012 almost 100 percent (99.1 percent) of the ASEAN-6 tariff lines carried a zero percent preferential duty under CEPT-AFTA, as illustrated in Table 1.1 below.** The incidence of preferential tariff lines with a higher than five percent duty is tiny: 0.37 percent for the Philippines, 0.18 percent for Indonesia, 0.10 percent for Malaysia, and zero for the other ASEAN-6 countries. This group of countries has indeed already achieved the tariff-related AEC 2015 target.

17. **For CLMV countries, the share of tariff lines at zero percent preferential duty in 2012 jumped to 67.6 percent, up from less than a half in 2011 (Table 1.1 below).** These countries all appear to be on their way to achieving their group-specific AEC target of 93 percent of all tariff lines that are subject to tariff eliminations with a zero percent duty.[7] Within the group, however, there is considerable variation in the incidence and average level of still-greater-than-zero percent CEPT tariffs. Incidence is a high 60 percent for Cambodia, which thus must move faster and deeper to achieve the 2015 AEC target mentioned above. Incidence is 21 percent for Laos, with Myanmar and

[7] For CLMV countries, tariffs on all goods should be eliminated by 2015, with flexibility for seven percent of products for which the deadline is 2018. Other exceptions to tariff elimination for all ASEAN members are contained in schedules D and H as explained in footnote 5. Here too, CLMV benefit from longer time periods to implement the liberalization of schedule D: 2013 for Viet Nam, 2015 for Lao PDR and Myanmar, and 2017 for Cambodia.

Viet Nam around 20-26 percent. However, even for this subgroup of countries, most of the still-greater-than-zero percent CEPT tariffs carry duties of less than five percent. Only 1.6 percent of their tariff lines (ranging from zero percent for Myanmar to 3.43 percent for Lao PDR) are still subject to a preferential rate above five percent.

Table 1. 1: Share of Tariff Lines at 0% Preferential Duty

Country	2012 ATIGA Schedule			2012 ATIGA Schedule
	0% duty	>0% duty	Other	0% duty
Brunei D.	99.07		0.93	99.1
Indonesia (AHTN 2007)	98.72	0.18	1.10	98.7
Malaysia	98.69	0.54	0.78	98.7
Philippines	98.63	1.06	0.31	98.6
Singapore	100.00		0.00	100.0
Thailand (AHTN 2007)	99.84	0.16	0.00	99.8
ASEAN-6	**99.11**	**0.35**	**0.54**	**99.16**
Cambodia	40.29	59.71	0.00	93.0
Lao PDR	78.87	21.13	0.00	93.0
Myanmar	79.42	19.87	0.71	93.0
Vietnam	71.75	26.22	2.04	93.0
CLMV	**67.58**	31.73	0.69	**93.00**
Total ASEAN	**87.24**	**12.17**	**0.60**	**96.70**

Source: ASEAN Secretariat, as of May 2012

Utilization and Margins of Intra-ASEAN Preferences

18. **The main issue with the CEPT scheme is actual preference utilization, which though on the rise from 2005 was still very low in 2010 (latest available year) for most ASEAN countries (see Table 1.2)**. While the value of imports by ASEAN-9 under CEPT, that is, trade using Form-D, increased from USD 9.2 billion in 2005 to USD 26 billion in 2010, preference utilization rates range from almost zero for Myanmar (0.5 percent), Brunei (3.3 percent) and Lao PDR (3.4 percent), to a modest level for Malaysia (11.1 percent), Viet Nam (13.4 percent), Indonesia (19 percent), and Thailand (22.6 percent). Only imports by Cambodia and the Philippines show significant preference utilization rates of 47.1 percent and 41.1 percent, respectively.

19. **A striking aspect of ASEAN preference utilization is that for any member state it differs by a wide margin depending on its ASEAN trading partner.** For instance, in the case of Indonesia, its CEPT utilization rates in 2010 ranged from a very high 86.2 percent for imports from Myanmar to a very low 4.9 percent for imports from Singapore.[8] A similar pattern of widely differing utilization rates by trading partner can be observed for most other ASEAN countries (Table 1.2).

[8] Indonesian imports from Thailand show a CEPT utilization rate of 56 percent, from Lao PDR 30.6 percent, from the Philippines 33.1 percent, from Malaysia 19 percent, and from Cambodia 10 percent.

Table 1. 2: ATIGA Preference Utilization from 2005-2010
(0 percent share of intra-ASEAN imports)

	2005	2006	2007	2008	2009	2010
ASEAN-9 (simple cross-country average)	9.0	13.3	7.9	4.8	14.3	18.0
AS-5 (simple cross-country average)	9.0	8.6	9.1	5.5	22.1	19.4
Brunei	0.9	1.3	N/A	2.6	N/A	3.3
Indonesia	3.0	N/A	0.3	N/A	N/A	19.0
Malaysia	5.4	2.75	3.5	N/A	12.5	11.1
Philippines	19.5	18.16	20.6	N/A	38.6	41.2
Thailand	16.4	12.32	12.2	8.3	15.2	22.6
Singapore	N/A	N/A	N/A	N/A	N/A	N/A
CLMV (simple cross-country average)	8.8	19.6	5.5	4.3	6.4	16.1
CLM (simple cross-country average)	N/A	19.9	0.3	1.5	1.6	17.0
Cambodia	N/A	N/A	N/A	N/A	N/A	47.1
Laos	N/A	39.44	N/A	2.6	2.84	3.4
Myanmar	N/A	0.3	0.34	0.34	0.37	0.5
Viet Nam	8.8	19.1	10.7	9.9	16.1	13.4

Source: ASEANStats Form D utilization estimates by national customs agencies.

20. **Such varied preference utilization by importing country and by trading partner could in theory be due to high costs in satisfying CEPT-ATIGA's Rules of Origin (ROOs).** The basic CEPT-ATIGA Rules of Origin (ROO), however, were fairly liberal to start with, indeed much more liberal than for EU and US preference schemes, as is commonly the case for many South-South trading arrangements. They require a minimum regional value-added of 40 percent or a change of tariff classification at the 4-digit level. This general rule applies for most goods, except for some that are subject to more restrictive specific product rules (at 6-digit level classification). Nonetheless, to enhance the utilization of CEPT preferences by ASEAN importers, ASEAN adopted in recent years a number of initiatives to simplify implementation of its ROO. These initiatives include development of a self-certification system (Form D) for two pilot projects, improvements of the conventional certificate of origin (CO) regime, and studies of the most appropriate ROO for certain sectors, beginning with automotive and iron and steel.[9]

21. **Low and declining MFN tariffs by ASEAN countries appear to be the main reason for the low utilization rates of CEPT preferences, as they have given rise to very low intra-ASEAN preference margins**. Since 2000, in parallel with the reduction of CEPT tariffs, ASEAN countries have indeed gradually reduced applied MFN tariffs. With Singapore's MFN tariff already at zero percent, ASEAN-5 countries reduced their applied MFN tariffs from 9.1 percent to 6.4 percent between 2000 and 2011. Within this group, Thailand stands out as having halved its MFN tariff, from 18.5 percent to 9.7 percent. During the same period, Cambodia and Viet Nam brought down their

[9] The first pilot project was implemented starting in November 2010 by participating member states Brunei Darussalam, Malaysia, Singapore, and Thailand. The memorandum of understanding implementing the second pilot project, which also includes Indonesia, Lao PDR, and Philippines, was signed in August 2012 and the target date for its implementation is June 2013.

applied MFN tariffs from above 16 percent to 14.2 percent and 9.8 percent, respectively, with much of the reduction implemented in the first two years following their WTO accession (in 2004 for Cambodia and in 2006 for Viet Nam).[10]

22. **ASEAN countries have also moved to adopt schedules with much lower tariff dispersion and fewer tariff peaks than in the early 1990s (see Table 1.3 below), with the exception of Lao PDR that has moved in 2008 in the opposite direction**. Some countries, however, still retain extremely high peaks on some products, with a maximum rate of 100 percent for Viet Nam, 136 percent for Thailand, and 150 percent for Indonesia on non-tobacco and non-alcoholic products. Others like Brunei, Cambodia, Lao PDR, Malaysia, Thailand, and Viet Nam stand out for still having a comparatively high incidence of international tariff peaks. Higher MFN duty rates than 15 percent (the 'international peak' threshold) affect close to or larger than 20 percent of their tariff lines for either primary or manufactured products. Comparable shares for developing countries in Asia and Eastern Europe and Central Asia are below 16 percent. For primary goods in particular, Viet Nam, Lao PDR, and Thailand have comparatively very high shares of international peaks, 33 percent, 34 percent, and 38 percent, respectively.

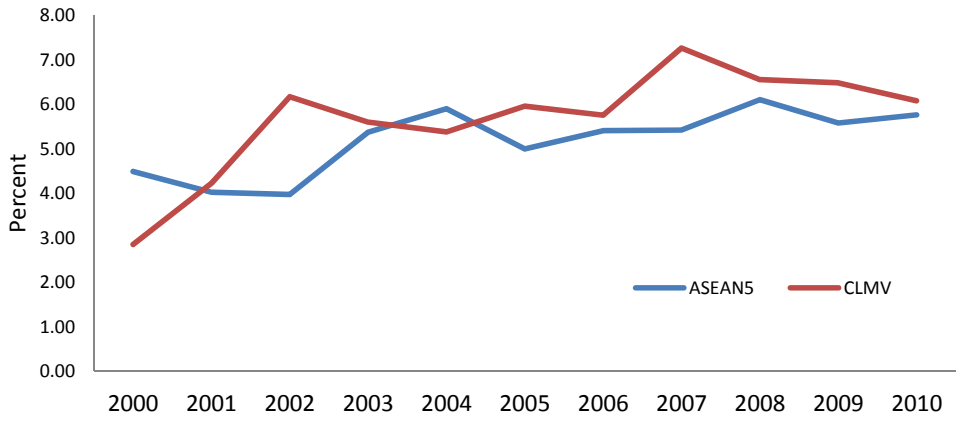
Table 1. 3: ASEAN International Peaks in MFN Tariffs
(% tariff lines with applied rates above 15%)

	All Products						All	Primary	Manufactured
Country Name (latest year)	1990	1995	2000	2005	2010		2008-10	2008-10	2008-10
Brunei Darussalam (2010)				23.2	20.8		20.8	1.2	24.5
Cambodia (2008)				20.8			19.7	19.3	19.7
Indonesia (2010)	47.8	39.0	10.5	7.9	7.0		7.0	2.4	7.8
Lao PDR (2008)			11.2	16.6			20.4	34.3	19.1
Malaysia (2009)				22.5			16.9	3.5	24.1
Myanmar (2008)				5.6			4.1	2.8	4.2
Philippines	59.4	56.5	7.5	4.8	5.4		5.4	7.3	5.1
Singapore		0.0		0.1	0.0		0.0	0.0	0.0
Thailand (2009)		57.0	46.9	22.1			20.5	38.6	16.4
Vietnam				33.4	23.6		23.6	33.2	22.2
Developing East Asia & Pacific			30.1	17.6	13.2		13.2	16.0	12.7
Developing Europe & Central Asia			0.1	14.1	7.9		7.9	15.7	6.2
European Union	11.5	7.4	4.6	4.0	1.9		1.9	6.3	0.2

Source: World Bank Data (http://data.worldbank.org) and staff estimates using WITS, based on data from UNCTAD's TRAINS database

[10] Non ad-valorem MFN tariffs are frequent (23 percent incidence) only in Thailand. For intra-ASEAN trade, specific tariffs survive only for highly sensitive or 'non-allowed' products under CEPT-AFTA, which are a small share of tariff lines for ASEAN-5, but a larger share for CLMV countries. TRQs in agriculture have relatively low frequency (five percent in Thailand and Malaysia), but again they remain on the books for intra-ASEAN only for the highly sensitive and non-allowed products under CEPT-AFTA.

Figure 1. 2: Low Preferential Margins Largely Explain Low Preference Utilization



Source: TRAINS downloaded via WITS (average preferential margins between MFN and CEPT tariffs)

23. **Despite the persistence of some tariff peaks in some member states, as a result of their move toward low MFN rates and fewer peaks, all ASEAN countries have very low average preference margins:** four-to-six percent for ASEAN-5 (it is zero percent for Singapore) and three-to-seven percent for CLMV countries. Such margins are at the low end of the broad range documented in the literature of 3-25 percent under which preference utilization (or smuggling) does not pay. Below a country-dependent threshold in such a range, importers just do not bother with documenting compliance with ROO and other requirements for preference utilization and smugglers change occupation or focus on prohibited items only.[11]

C. The ASEAN Approach for Eliminating NTBs

24. **Trade economists and lawyers have drawn an important distinction between non-tariff measures (NTMs) and non-tariff barriers (NTBs).** The latter are the 'harmful' version of the former, wherein trade restrictiveness, whether or not deliberate, exceeds what is needed to secure the measure's non-trade (often safety, environmental or social) objectives. Conceptually, the various types of NTMs can be categorized as either NTMs and/or NTBs (or core NTMs), and given color codes—green, amber, or red—to classify them according to their trade-restricting potential, as in the agricultural negotiations at the WTO or in the Global Trade Alert (GTA) database. Such distinctions and the associated frequency indicators may be necessary first steps to highlight the trade barrier aspects of a country's NTM regime, but are unlikely to result in progress towards NTB elimination (see Cadot et al. 2012). This is because, typically, what matters on the ground has more to do with how measures are applied rather than with which measures are applied. For instance, a seemingly

[11] A World Bank (2007) study concluded that since intra-ASEAN trade was largely in electronics and computer components where the preferential margin was about five percent, importers just paid the applied MFN rates and did not bother to utilize AFTA rates. Manchin and Pelkmans-Balaoing (2007) in their study of East Asia's web of regional and bilateral Free Trade Agreements (FTAs) and Rules of Origin (ROO) also concluded that intra-regional trade is boosted and preference utilized only when margins are higher than 10-25 percent.

innocuous technical standard may create unnecessary trade-restricting problems if it implemented by certifying foreign production facilities. Also, a mild sanitary or phytosanitary (SPS) measure may be highly trade-inhibiting if it requires every shipment to be inspected rather than using risk profiling, thus minimizing the number of physical inspections. In other words, the devil is in the details.

25. **Nonetheless, the AEC Blueprint identified NTBs as the main protection instrument currently used by many ASEAN Member States against imports from the rest of ASEAN to "impede the free flow of goods in the region," and mandated their full elimination**. ASEAN was expected to take the following priority actions to achieve the above stated goal:

i. Enhance transparency by abiding to the Protocol on Notification Procedure and set up an effective Surveillance Mechanism.

ii. Abide by the commitment of a standstill and roll-back on NTBs.

iii. Remove all NTBs by 2010 for ASEAN-5, by 2012 for the Philippines, and by 2015 with flexibilities to 2018 for CLMV, in accordance with the agreed Work Program on NTB elimination.

iv. Enhance transparency of NTMs.

v. Where possible, work towards having regional rules and regulations consistent with international best practices.

26. **In the mid-1990s, ASEAN included in its list of NTBs, customs surcharges, technical measures, product characteristic requirements, and monopolistic measures**. Following the UNCTAD classification of that period, it eventually also added quantitative controls to its list.[12] ASEAN's NTBs reform modalities included eliminating import surcharges, mutually recognizing or harmonizing product standards, adopting pro-competition and market access measures to address monopolistic behavior, and more recently (under the AEC Blueprint) also the elimination of quantitative restrictions. The largely ineffective implementation approach throughout the 2000s was through voluntary offers by member states.

27. **The current implementation approach appears to be more of the same.** It relies on a list of NTMs (inclusive of NTBs, its trade-restricting subset) submitted by each country, but not to be verified or challenged by any other member country or by the ASEAN Secretariat staff.[13] Each member state is expected to prioritize and develop a work program to eliminate its NTBs. The only new and promising elements are that ASEAN has also initiated consultations with industry associations, starting in three priority sectors, that is, automotive, electronics and textiles, to determine which NTMs significantly affect the cost of doing business and of trading regionally and to explore

[12] Different organizations and researchers have slightly different concepts of what to include among core NTBs, since many measures have also legitimate social goals and may not have been adopted primarily in order to restrict trade. Kee, Nicita and Olarreaga (2008, 2009), for instance, treat as core NTBs only the following categories: price control measures (TRAINS codes 6100, 6200 and 6300), which are not captured in the ASEC database; quantity restrictions (TRAINS codes 3100, 3200 and 3300); monopolistic measures (TRAINS code 7000); and technical regulations (TRAINS code 8100). See http://www.worldbank.org/trade/otri .

[13] ASEAN Non-Tariff Measure Database, available at http://www.aseansec.org/16355.htm, with 2009-2011 country submissions (Lao PDR was the last country completing its submission in 2011).

feasible ways to reduce their trade-restricting effect. Additionally, ASEAN has agreed to develop a set of guidelines for import licensing procedures (ILP), prohibitions, and quantitative restriction with a view to eliminating the NTB components of these measures.

28. **So far, however, there has been little real progress in the elimination by ASEAN Member States of their NTBs, in contrast to the tariff reform agenda.** Only Malaysia and Thailand have offered a few NTBs for elimination and ASEAN has succeeded only in adopting a mutual recognition agreement (MRA) on cosmetics, largely resulting from a strong push by industry leaders. Moreover, as illustrated in the next three sections of this chapter, ASEAN has neither been able to stem the tide of foreign trade partners, nor has it been able to prevent some ASEAN governments from imposing harmful trade measures affecting ASEAN Member States (as well as the rest of the world). Unless ASEAN Member States stick to the current and still largely voluntary approach to NTM reform at the national level, it is difficult to be optimistic about progress in this area.

29. **In reviewing the challenges and proposing a reform agenda of NTMs worldwide, it will be important to avoid using an inappropriate, overly broad definition of NTMs.** It is now clear that by focusing solely or principally on the trade-restricting impact of NTMs, and not recognizing their other, often legitimate, policy objectives, has contributed to slow progress in policy dialog and negotiations at both multilateral and regional levels (Cadot, et. al 2012). Such disappointing results are particularly striking at the regional level, where NTM elimination and harmonization have been high on the agenda of regional secretariats for years but haven't seen much action on the ground. Escaping from the current impasse requires recognizing the complexity and diversity of NTMs and adopting a goal of streamlining rather than eliminating them. Their proposed toolkit for doing so is described in Box 1.1.

30. **A complementary approach recently proposed in a flagship World Economic Forum (WEF) report prepared in collaboration with Bain & Company and the World Bank stresses reviewing all NTBs, trade facilitation, services, and investment regulations from a supply-chain perspective**. This approach envisages close consultations with industry associations to include producers and downstream users (WEF 2013).[14] Furthermore, in developing a new, fresh agenda for regulatory (and NTM) reform, ASEAN should adopt a coherent approach across member states and across ministries. It should also consider vesting a greater role for the Secretariat—accompanied by adequate financial resources—for reviewing national regulations, expanding region-wide consultations with industry, and assessing member compliance with any future regionally-agreed guidelines or directives. This report also endorses the following concrete proposals by Cambodia, ASEAN's 2012 Chair, for a new NTM reform agenda:

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[14] One of the key recommendations proposed in the report is to "create a focal point within government with a mandate to coordinate and oversee all regulation that directly affects supply chain efficiency. Given the importance of tipping points, governments need to design policy with an economy-wide vision and the recognition that different clusters of policies affect industry-specific supply chains. Improving supply chain performance requires coherence and coordination across many government agencies and collaboration with industry. Governments should create a high-level body to oversee all regulation directly affecting the supply chain." World Economic Forum (2013), Enabling Trade: Valuing Growth Opportunities, Geneva, available at http://www3.weforum.org/docs/WEF_SCT_EnablingTrade_Report_2013.pdf

i. Improve the classification of NTMs according to the UNCTAD guidelines adopted in February 2012.

ii. Update and verify country lists in an open process driven by the ASEAN Secretariat, rather than on a voluntary basis by individual member states.

iii. Eliminate, with only few exceptions, all quantity control measures comprising non-automatic licensing, import and export quotas and prohibitions, and all foreign exchange at least for intra-ASEAN trade (though it may not be possible or practical to police such limitations).[15]

iv. Identify the other most egregious trade-restrictive measures with help not only from the private sector (as foreseen in article 42 of ATIGA), but also with sectoral, supply-chain-based regulatory impact assessments to be launched urgently.

v. Decide in ASEAN bodies on the regulatory modifications at the national level, as well as regional harmonization actions necessary to eliminate or minimize the trade-restrictive impact of the measures identified as per point.

vi. Plan an in-depth regional study of NTMs, possibly under Phase II of the AEC Monitoring and Evaluation Capacity Building Program (AECMEP) collaborative project between the ASEAN Secretariat and the World Bank.

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[15] Myanmar, the only ASEAN Member State with foreign exchange controls, should also eliminate such restrictions. It is indeed expected to do so in the very near future, as foreign trade and financial sanctions are being lifted. The Central Bank of Myanmar (CBM) introduced an exchange rate system in the form of the official peg with a managed float unifying the exchange rates with assistance from the International Monetary Fund. Accordingly, the CBM began a managed float system on April 1, 2012, dismantling the existing multiple exchange rate system. A new currency regime was commenced on April 2, 2012, by setting a daily reference exchange rate of Myanmar Kyat to the dollar by the CBM in line with its value on the market rate as announced at www.cbm.gov.mn

Box 1. 1: Streamlining Non-Tariff Measures: A Toolkit for Policy Makers

The underlying philosophy of the proposed toolkit by Cadot et al. 2012 is similar to what is known as 'regulatory improvement' or 'regulatory impact assessment' (RIA). Dealing with existing measures has the advantage of responding to an immediate need and focusing on measures whose effects are known. However, the regulatory improvement of existing NTMs should be thought of as only the first stage of a process of regulatory improvements that will also cover the new NTMs, to prevent having to start streamlining efforts all over again when poorly designed new measures keep on appearing.

The toolkit proposes that governments put in place adequate structures to make streamlining NTMs an owned and sustained effort. Technical assistance on regulatory improvements, whether by development agencies or consulting firms, has mostly focused on 'quick wins,' useful to gather short-term political support and momentum. A more sustainable institutional setup would ensure continuity in the process of improving the trade competitiveness of firms as the business environment evolves and the stock of regulations grows. The process of regulatory improvement should be based on three pillars—dialog, analysis, and broad participation—by instituting the following:

- A body dedicated to public-private dialogue (for example, an NTM committee), serving as an entry point for the private sector to flag problems and contribute to solutions. As ASEAN has started doing, problems should be identified first at the country level through consultations with the private sector and strategic solutions be sought through private/public dialogue.
- A technical team dedicated to carrying out careful technical analysis (for example, a permanent secretariat for the NTM committee), with capabilities akin to those of a productivity or competition commission and helping to move from dialogue and strategic solutions to concrete policy and regulatory proposals.
- A process to seek inputs from outside expertise and line ministries involved in the issuance and enforcement of NTMs to ensure broad participation and ownership.

With adequate technical assistance and use of local resources, such as universities and think tanks, sufficiently detailed technical analysis should and can be carried out, but the institutional review setup should be adjusted to local capabilities. For instance, when the NTM committee secretariat does not have sufficient internal capabilities, it may act simply as a hub to coordinate analytical inputs from outside and inside the relevant economic and line ministries and business associations. In the case of some NTMs that aim at addressing non-trade yet legitimate policy objectives, only a full-fledged cost-benefit analysis would help all concerned parties reach a consensus, such as an alternative, less trade-restrictive measure that achieves the same policy objective.

The toolkit also highlights the point stressed by the private sector in the countries surveyed by the study that NTMs should support domestic firms' competitiveness. Mexico's experience in the 1990s shows that regulatory reform (of which NTM streamlining is an integral part) was demanded by domestic private operators as a way of reducing the cost of doing business domestically and across borders. Regional agreements also offer excellent opportunities to anchor regulatory reforms, as the examples of Indonesia and other countries in Eastern Europe and Africa illustrate.

Source: Cadot, Olivier, Mariem Malouche, and Sebastián Sáez (2012), Streamlining Non-Tariff Measures—A Toolkit for Policy Makers, The World Bank, at http://go.worldbank.org/J7UIR24LY0

Patterns of ASEAN Non-Tariff Measures[16]

31. **Older studies on NTMs for the Asia region (for example, ESCAP 2000, Bhattacharyya and Mukhopadhyaya 2002, and Bhattacharyya 1999) pointed out that since much of regional exports were labor-intensive products, particularly textiles and garments, the tariff quotas and technical regulations regarding labeling by developed countries significantly affected Asian export volumes**. More recently, Basu and Kuwahara (2010), who analyzed the survey results under a joint UNCTAD-World Bank project on NTMs in five developing countries, of which two are in ASEAN, concluded that NTMs were pervasive in affecting their exports, and especially their agricultural exports. In the Philippines, 90 per cent of the 303 surveyed exporters reported facing 1-5 NTMs in their destination markets, and another nine percent reported facing 6-10 NTMs. Companies facing export-related restrictions by their own government accounted for eight percent of the total. The number of total NTM-affected products was very high at 4,842, of which 70 percent were agricultural products. In Thailand, the survey covered 4,435 companies, 81 percent and 44 percent of which faced technical barriers and Sanitary or Phytosanitary (SPS) measures, respectively, in their destination markets. The largest number of cases involved rice, followed by crustaceans and fruits.

32. **A recent study (World Bank, 2008) reported around 2,000 technical and SPS measures (commonly classified as non-core NTMs) and 1,500 quantity restrictions (commonly considered core NTMs or NTBs) implemented by ASEAN countries, jointly representing about 90 percent of their notified measures to the WTO during 2003/04.** The remaining 10 percent included price controls, finance measures, non-automatic licensing and monopolistic measures. Ando and Obashi (2009) constructed frequency ratios for 2007 for ASEAN by type of measure and by product groups. About 32 percent of ASEAN countries' tariff lines were found to be subject to non-core NTMs and 27 percent to core NTMs concentrated in five industry-groups: food, chemicals, light manufacturing, metals, and machinery.

33. **The rest of this section summarizes the patterns of ASEAN NTMs on the basis of member states' official notifications to the ASEAN Secretariat (Brunei and Cambodia for the year 2010, all other countries for 2009).** As shown in Figure 1.3, NTMs with the highest incidence are non-automatic licensing (31.8 percent of total ASEAN NTMs), technical regulations and quality standards (31.8 percent), prohibitions (21.4 percent), state trading administration (1.4 percent), automatic licensing (7.1 percent), discretionary import licensing/import monitoring (1.3 percent), technical regulation: pre-shipment inspection (0.9 percent) and technical measures (2 percent). Amounting to less than two percent of other NTMs were: tariff rate quotas (TRQs), internal taxes and charges, import bans and quotas, and selected importers' approvals.

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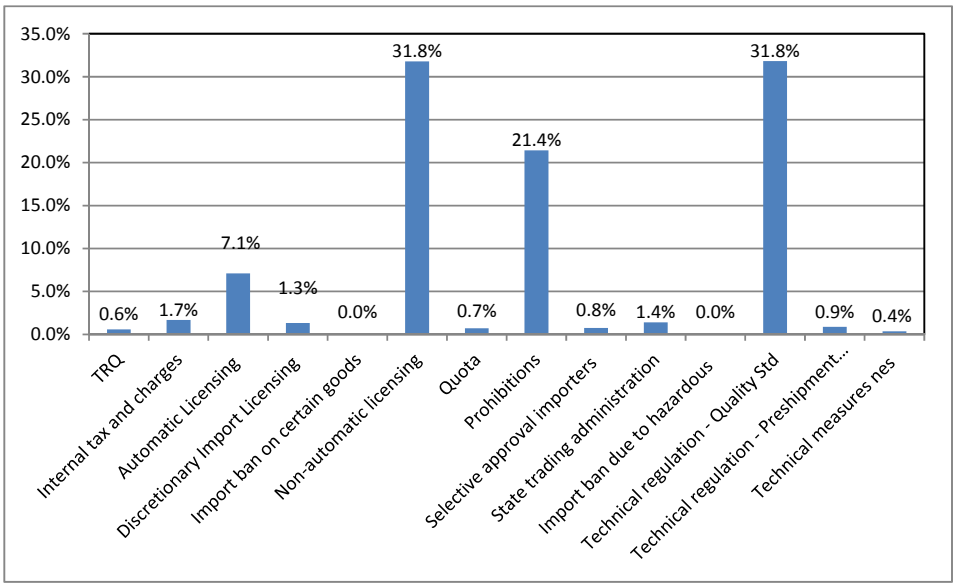
[16] A landmark study by OECD (2005), which also summarized the findings of other studies (Wilson 2000, Stephenson 1997, and Michalopoulos 1999), showed that NTMs – especially technical regulations, SPS measures, quantitative restrictions, trade remedies, and monopoly measures affecting trade in live animals and in machinery, electronic, chemical, textiles and garment products – represented important barriers to exports of developing countries toward the markets of developed countries.

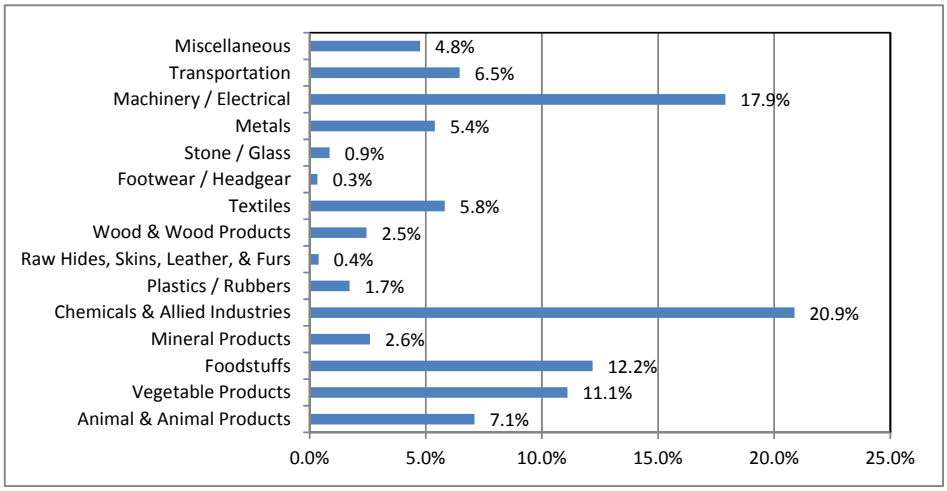
Figure 1. 3: NTMs in ASEAN by Type—Officially Notified



Source: AADCP II staff estimates based on ASEAN NTM database

34. **The product groups most frequently affected by NTMs are shown in Figure 1.4. Most affected product groups were chemical and allied industries (21 percent), machinery and electrical (18 percent), foodstuffs (12 percent), vegetable products (11 percent), animal and animal products, textiles, metals, plastic and rubber**. Raw hides, skin, leather and fur; mineral products, footwear, stone and glass accounted for less than two percent of the notified NTMs. At the country level, NTMs vary widely by both type and affected industry, and a summary of country patterns in Box 1.2. Box 1.3 illustrates in some more details Thailand's NTM regime.

Figure 1. 4: NTMs in ASEAN by Industry—Officially Notified



Source: AADCP II staff estimates based on ASEAN NTM database

35. **NTMs by ASEAN Member States, save for country-specific trade remedies, are believed to be applicable on an MFN basis.** All the NTMs notified by AMS to the ASEAN Secretariat (in Box 1.2) are MFN. While there may be others, the only known case of NTM 'regional preferences' is the one of Thailand not applying tariff quotas (a form of QR) on agricultural imports from its ASEAN trading partners (see Box 1.3). [17]

Box 1. 2: NTM Patterns by ASEAN Member States—Officially Notified

Indonesia's NTMs are spread among the most major types, with 38.8 percent (of its total NTMs notified to the ASEAN Secretariat) being technical regulations and quality standards, 25.2 percent prohibitions, 17.2 percent non-automatic licensing, 6.3 percent automatic licensing, 2.2 percent pre-shipment inspection. Thailand's NTMs include quality standard (37.6 percent), automatic licensing (18.1 percent), non-automatic licensing (17.6 percent), TRQ (10.9), prohibitions (9.5 percent) selected approval of importer (3.8 percent), and other technical measures (2.3 percent). In the Philippines, quality standard (77.2 percent), non-automatic licensing (10.5 percent), TRQs (5.1 percent), prohibitions (3 percent) and internal tax, charges and import levy (3.4 percent) dominate. In Viet Nam, 62.3 percent of NTMs are concerned with prohibitions, 16.2 percent with automatic licensing, 12.9 percent with quality standard, and 6.3 percent with a single channel for import.

In Brunei, major NTMs are more concentrated by types: non-automatic licensing (46.7 percent) technical regulations and quality standards (31.6 percent), automatic licensing (15.6 percent), and prohibitions (5.9 percent). Cambodia NTMs also cover four main types: non-automatic licensing (68.3 percent), technical regulation-quality standard (22.2 percent), prohibitions (6.4 percent), and automatic licensing (2.5 percent).

In Lao PDR, major NTM types are three: automatic licensing (45.5 percent), non-automatic licensing (27.8 percent) and prohibitions (26.5). Similarly, in Myanmar, non-automatic licensing accounts for 71.8 percent, followed by quality standards (23.1 percent) and prohibitions (5.45 percent). Malaysia's NTMs mainly comprise non-automatic licensing (62.5 percent), technical regulation-quality standard (29.4 percent), automatic licensing (1.5 percent), import monitoring (4 percent) and prohibitions (2.3 percent). In Singapore, 42.6 percent of NTMs are concerned with non-automatic licensing, 26.3 percent with prohibitions, 21.6 percent with quality standard, 2.3 with automatic licensing, 1.5 percent with pre-shipment inspections and 3.7 percent with import monitoring.

Source: AADCP II staff estimates based on ASEAN NTM database

[17] The GTA database covered in the next sections helps point out which ASEAN countries are affected by the NTMs of other ASEAN countries because of their trading pattern, but does not track their 'preferential' application, if any. All measures reported to the WTO, save trade remedies (see Table 1.6), are MFN.

Box 1. 3: Thailand's Import NTM Regime

According to Thailand's policy of open trade, the majority of merchandise products imported are duty and quota free. Over the past two decades, moreover, the government has reduced the number of non-tariff import barriers, including phasing out some import licensing on goods such as motorcycles, high-speed diesel engines, gasoline, and other fuels.

However, according to the latest WTO Trade Policy Review (WTO 2011) for Thailand, a number of non-tariff import restrictions persist, mostly for protection of infant industries, of farmer income, as well as for public health. Non-automatic import licensing, for instance, continues for silk goods, motor vehicles other than motorcycles, building stones, and 23 agricultural and agro-processed products, and the latter is also subject to tariff quotas. While most of these NTMs are applied across the board to imports from all its trading partners, Thailand does not apply any tariff quotas on imports from its ASEAN partners.

D. Recent Trade Measures Affecting ASEAN Countries[18]

36. **While greater integration of ASEAN economies into the world trading system has generated export and growth opportunities, globalization also exposes these economies to beggar-thy-neighbor actions taken by trading partners.** Since the beginning of the global financial crisis, ASEAN commercial interests—not just exporters, but also investors and nationals working abroad—have been frequently hit by measures taken by trading partners that favor their domestic firms. This does not suggest that ASEAN governments should disengage from regional and global markets. Rather, they should actively defend their interests and counter protectionist actions in international fora (such as WTO, G-20, APEC, and within ASEAN itself). Recent developments highlight why the world and also ASEAN countries need stronger, not weaker, globally and regionally binding trade rules and enforcement.

37. **That ASEAN commercial interests have been harmed by discriminatory actions of trading partners is now beyond doubt.** According to the independent protectionism monitoring initiative Global Trade Alert (GTA), since the first G20 crisis-related summit in November 2008, a total of 559 measures have been taken by governments, including by some ASEAN governments, which harm ASEAN exporters, overseas workers, and foreign investments. Most of these protectionist measures (469 or 83 percent) were still in force as of July 2012. A total of 80 new measures that harm ASEAN commercial interests have been adopted just in the twelve months to July 2012—an estimated number that is almost certain to be revised upwards, as murkier forms of protectionism are harder to document and are thus subject to reporting lags. ASEAN, on the other hand, has also benefited from the liberalizing and transparency-improving steps taken by foreign and ASEAN governments—in fact this has happened 202 times since November 2008, although only 156 of such liberalizing measures remain in force as of July 2012. Still, governments worldwide have taken nearly three times as many measures that harm ASEAN commercial interests than those that benefit them.

38. **A strong positive correlation exists across ASEAN Member States between export engagement in world markets and the frequency of protectionist hits against their commercial interests (see Figure 1.5).** The breakdown across ASEAN members is reported in Table 1.4 for

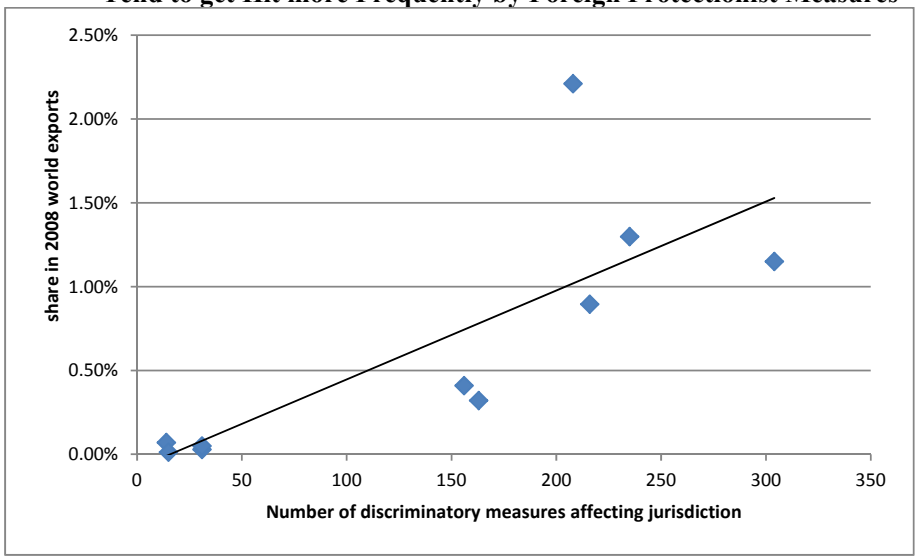
[18] This section is based on a background paper prepared for this report by Simon J. Evenett and Johannes Fritz. University of St. Gallen, drawing upon GTA analyses and database recently updated in June 2012 (www.globaltradealert.org).

discriminatory measures affecting a jurisdiction and for liberalizing (or transparency improving) measures benefiting a jurisdiction. Thailand is the ASEAN country affected by the most number of foreign measures (432) and Brunei by the least (24).

39. **That ASEAN countries need to remain vigilant about protectionism is indicated by the number of pending measures that would harm their commercial interests, if implemented.** At present, Indonesia, Malaysia, Singapore, Thailand, and Viet Nam each face the prospect of 30 or more protectionist measures hitting their commercial interests (see Table 1.4, Figure 1.6, and also column 8 of Table 1.5). Identifying and monitoring those measures ought to be a priority for these governments and for regional and international organizations. Should global economic prospects further deteriorate in 2013, then even more protectionism can be expected, adding to the foreign measures currently in the pipeline.

40. **In principle, governments can resort to a wide variety of means to discriminate against foreign commercial interests.** Erecting barriers to the importation of goods—through tariffs and quotas amongst others—was the preferred form of discrimination in the 1930s. Resorting to voluntary export restraints was common in the global economic downturn in the early 1980s. In the recent global economic crisis the composition of protectionism employed has changed again in ways that directly implicate the commercial interests of ASEAN economies (see Figure 1.5). Border measures remain important but they are by no means the only measures affecting ASEAN commercial interests. Adopting a narrow, border-based definition of protectionism could miss important broader developments.

Figure 1. 5: ASEAN Economies with Strong Export Performance Tend to get Hit more Frequently by Foreign Protectionist Measures



Source: Global Trade Alert database. Data accessed June 2012

41. **When foreign trading partners resort to tariffs against ASEAN merchandise imports, ASEAN countries often respond by resorting to NTMs affecting both imports from and exports to ASEAN.** Resorting to restrictive measures that affect services trade is less frequent but still important (especially on temporary migration, which is one of the four modes of cross-border service

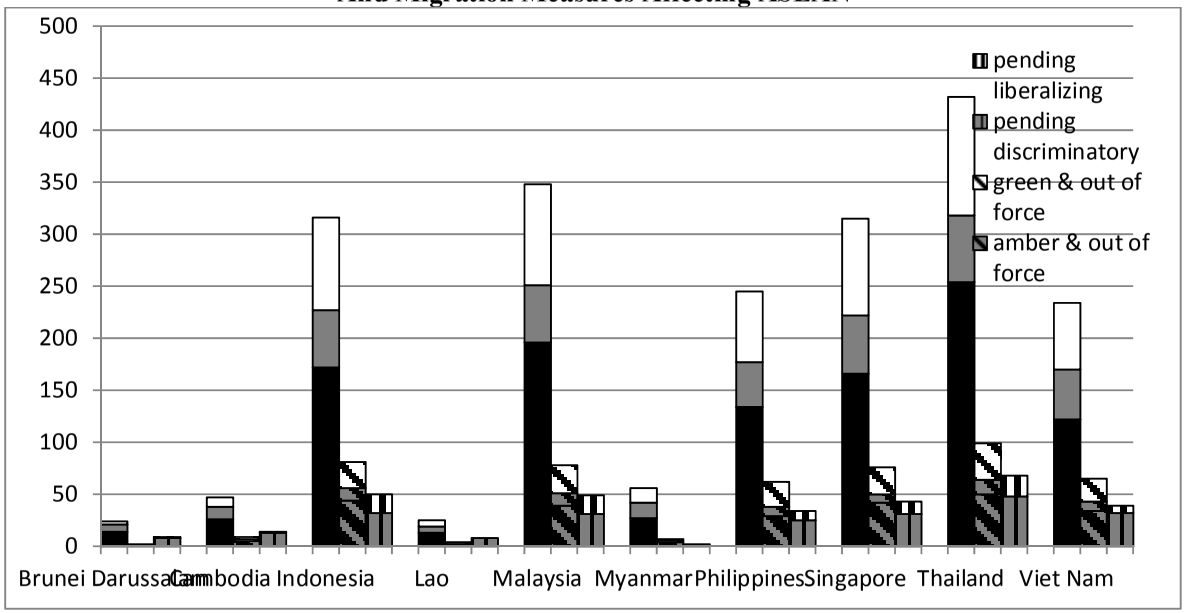
provision). In addition to the measures mentioned above (and illustrated in Figure 1.6), foreign subsidies can also do harm to ASEAN exports. Since November 2008, a total of 69 subsidies have been implemented worldwide that harm ASEAN commercial interests, 53 of which are still in effect. As shown in Table 1.5, the trading partners that appear in the top 10 list ranked by frequency of harmful measures implemented and affecting ASEAN economies are Argentina, China, India, and the Russian Federation. Some ASEAN countries, and especially Indonesia, have also taken various measures that harm other ASEAN economies (others are Malaysia and Viet Nam; see next section and also Table 1.6).

Table 1. 4: Measures Affecting ASEAN Countries Since First G20 Crisis-Related Summit in November 2008

Country	Total no. of measures affecting jurisdiction that are …			Total no. of discriminatory measures affecting jurisdiction that are …		Total number of likely discriminatory measures affecting jurisdiction that are …			Total number of liberalizing measures affecting jurisdiction that are …		
	currently in force	no longer in force	pending	currently in force	no longer in force	currently in force	no longer in force	pending	currently in force	no longer in force	pending
Brunei	24	2	9	14	0	7	1	8	3	1	1
Cambodia	47	9	14	26	5	12	2	13	9	2	1
Indonesia	316	81	50	172	44	55	12	32	89	25	18
Lao PDR	25	4	8	13	2	6	2	8	6	0	0
Malaysia	348	78	49	196	39	55	12	31	97	27	18
Myanmar	56	7	2	27	4	15	2	2	14	1	0
Philippines	245	62	34	134	29	43	9	25	68	24	9
Singapore	315	76	43	166	42	56	8	31	93	26	12
Thailand	432	99	68	254	50	64	14	48	114	35	20
Viet Nam	234	65	39	122	34	48	9	32	64	22	7

Source: Global Trade Alert database. Data accessed June 2012. The measures referred to as discriminatory and likely discriminatory in this table are categorized red and amber, respectively, in the GTA database. In most cases the difference between the latter and the former is the degree of certainty that the GTA team has that the measure discriminates against foreign commercial interests.

Figure 1. 6: Tariffs, Non-Tariff Measures (NTMs) And Migration Measures Affecting ASEAN



Source: Global Trade Alert database. Data accessed June 2012. Red and amber measures in the GTA database can be interpreted as protectionist, whereas green measures are liberalizing or transparency improving.

Table 1. 5: Which Trading Partners Have Hit ASEAN Economies The Most? In Some Cases Another ASEAN Member State

	Trading partners responsible for the most almost certainly protectionist measures implemented against a given ASEAN member since November 2008, ranked in descending order by the number of measures implemented (the latter being reported too after the trading partners name)								
ASEAN member	**Rank 1**	**Rank 2**	**Rank 3**	**Rank 4**	**Rank 5**	**Rank 6**	**Rank 7**	**Rank 8**	**Rank 9**
Brunei Darussalam	China, 6	Malaysia, 2	Indonesia, 2	India, 1	Viet Nam, 1	Republic of Korea, 1	United States, 1	Niger, 1	Nigeria, 1
Cambodia	China, 8	India, 7	Argentina, 3	Indonesia, 2	Viet Nam, 2	Republic of Korea, 2	South Africa, 2	Finland, 2	Ireland, 2
Indonesia	Argentina, 43	Russian Federation, 21	China, 19	India, 17	Brazil, 11	Viet Nam, 10	Ukraine, 8	Republic of Korea, 7	Pakistan, 7
Lao	China, 7	Viet Nam, 2	Argentina, 1	South Africa, 1	United States, 1	Belgium, 1	Japan, 1	Malaysia, 1	Thailand, 1
Malaysia	Argentina, 36	Indonesia, 28	Russian Federation, 22	India, 21	China, 20	Viet Nam, 12	Brazil, 10	South Africa, 9	Ireland, 8
Myanmar	China, 9	India, 6	Indonesia, 4	Argentina, 2	South Africa, 2	Republic of Korea, 2	Ukraine, 2	Sri Lanka, 2	Viet Nam, 1
Philippines	Argentina, 27	Ireland, 15	China, 14	Indonesia, 14	United Kingdom, 14	India, 11	Russian Federation, 10	Viet Nam, 8	France, 7
Singapore	Argentina, 29	Russian Federation, 28	Indonesia, 25	India, 18	China, 15	Viet Nam, 13	Brazil, 9	Poland, 8	Belarus, 8
Thailand	Argentina, 47	Russian Federation, 45	India, 27	Indonesia, 24	China, 18	Viet Nam, 16	Brazil, 12	France, 11	Poland, 11
Viet Nam	Argentina, 30	Russian Federation, 17	China, 16	Indonesia, 13	India, 12	Brazil, 7	Ukraine, 7	Poland, 6	France, 5

Source: Global Trade Alert database. Data accessed June 2012.

Recent Trade Measures Adopted by ASEAN Member States[19]

42. **ASEAN economies, especially Indonesia and to a lesser extent Viet Nam, Malaysia, and Thailand have also resorted to using protectionist measures during the global economic crisis, as summarized in Box 1.4 and illustrated in Figure 1.7.**[20] According to the GTA database, since the first G20 crisis-related summit in November 2008, and through June 2012, ASEAN governments have implemented 102 measures that harm foreign commercial interests, including other ASEAN Member States, over 90 per cent of which remain in force (93). During the same period, these governments introduced 29 measures that liberalize commerce or improve the transparency of their national trade regimes. This tendency to discriminate more than liberalize is, as noted earlier, a worldwide tendency. Still, these findings raise questions about the extent to which ASEAN governments, and especially Indonesia, have been able to hold the line against protectionist pressures at home.

Box 1. 4: Recent Merchandise Trade Measures by ASEAN—Summary by Instrument

Import tariffs represent by far the most frequent harmful measure to ASEAN commercial interests as well as the instrument ASEAN governments have resorted to most frequently when tilting the playing field in favor of domestic firms. Their total number far exceeds the number of liberalizing tariff measures. A third of tariff increases implemented since November 2008 are no longer in force. However. Indonesia and Viet Nam have imposed the most tariff measures among the ASEAN nations.

Import-related NTMs are the second most frequently used measure to harm the commercial interests of ASEAN members and the second most class of policies resorted to by ASEAN governments to limit trade. Thailand has been harmed by 126 foreign import NTMs, far more than any other ASEAN member. Meanwhile, Indonesia has implemented 16 such NTMs.

Export taxes (tariffs) by ASEAN countries are relatively rare. Also, foreign governments have only infrequently resorted to export tariffs that harm ASEAN commercial interests. Still, Indonesia, Malaysia, Singapore, and Thailand have seen their commercial interests harmed by eight or more export tariff increases since November 2008.

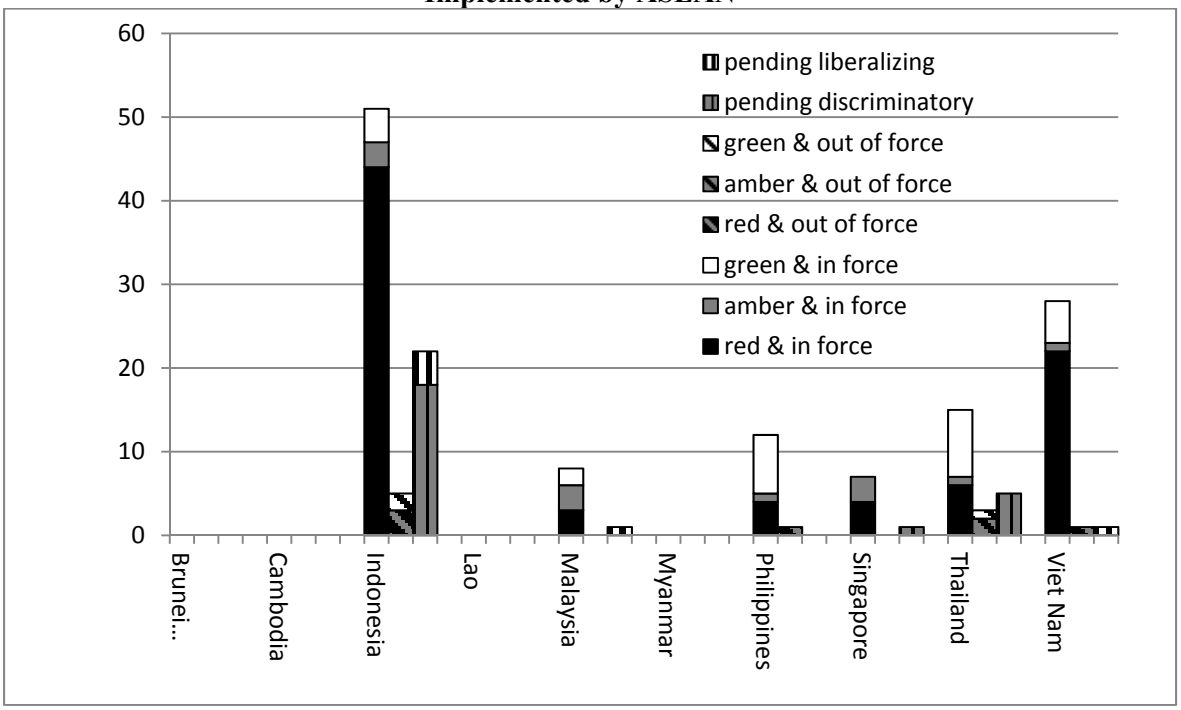
Export NTMs are resorted to by ASEAN and non-ASEAN governments more often than export tariffs. Most export NTMs disadvantage foreign commercial interests and few if any are trade promoting. Those export NTMs harming ASEAN commercial interests affect middle-income economies more often than lower-income ASEAN nations, probably reflecting the larger manufacturing sectors in the former.

Source: Simon J. Evenett and Johannes Fritz. University of St. Gallen, drawing upon the Global Trade Alert analyses and database recently updated in June 2012 (www.globaltradealert.org)

[19] The first part of this section is based on a background paper prepared for this report by Simon J. Evenett and Johannes Fritz. University of St. Gallen, drawing upon the GTA database recently updated in June 2012 (www.globaltradealert.org). The second part draws on a recent WTO report on trade policy developments and includes mention of specific concerns by ASEAN trading partners, trade remedies initiated and other trade measures taken by ASEAN countries during the period October 2011-April 2012. See the "Report to the Trade Policy Review Body (TPRB) from the Director-General on Trade-Related Developments", WTO, WT/TPR/OV/W/6, 28 June 2012, available at: http://www.wto.org/english/news_e/news12_e/devel_29jun12_e.htm

[20] As part of its AEC Scorecard Phase 2 project, the Economic Research Institute for ASEAN and East Asia (ERIA) singled out three most problematic NTMs—quantity control, monopolistic and finance measures—and developed what it calls a Core NTM Restrictiveness Index based on frequency indicators. Indonesia does stand out with a particularly high index value, followed by Viet Nam, although with a far lower score than Indonesia.

Figure 1. 7: Tariffs and Non-Tariff Measures (NTMs) Implemented by ASEAN



Source: Global Trade Alert database. Data accessed June 2012.

Box 1. 5: Myanmar NTMs from Discretionary to Automatic Licensing

Myanmar's trade policy reflected 'export first' and imports were subject to an administrative control regime. Under such regime, discretionary import licenses were issued by the Ministry of Commerce (MOC), depending on technical regulations on quality standards and foreign exchange availability from export proceedings. Although Myanmar's total official border trade increased substantially from USD 4.25 million in April 2012 to USD 13.23 million in June 2012, this regime discouraged even larger potential trade and instead encouraged illegal border trade, undermining consumer protection, competition and government revenues.

However, the Department of Border Trade (DBT) of the Ministry of Commerce (MOC) has very recently (since July 14, 2012) issued to local traders automatic licenses intended to permit trade in goods covering 165 categories of imports (fertilizers and veterinary medicines are excluded) and 135 categories of exports. Under the new rules, import transactions can be undertaken directly using retained foreign exchange earnings or Letter of Credit (LC) or Telegraphic Transfer (TT). The license fee must necessarily be paid in US dollar or the currency of the exporters' country (except for Bangladesh, for which the US dollar is prescribed).

The DBT officially opened a total of 11 border trade-crossing points, providing one-stop services for trade activities in collaboration with various other MOC departments. Three of these border outposts are with China, four with Thailand, two with India, and two with Bangladesh. To facilitate border trade further, the DBT also plans to grant Trader Registration Cards (TRC) to local licensed traders.

Source: News Bulletin of Export and Import, Ministry of Commerce, Myanmar, at www.commerce.gov.mm

43. **Indonesia featured as the most active amongst both G20 and ASEAN countries in introducing trade-restrictive measures on multiple fronts during the seven month period (October 2011-April 2012), covered by a WTO report last year that listed concerns raised by WTO members on trade practices**, No other ASEAN member state has followed this approach, except for the few exceptions mentioned below. Of the trade measures discussed below and listed in Table 1.7, many appear to affect not only extra-ASEAN but also ASEAN trading partners.

Table 1. 6: Policy Responses to Rice Price Increases during the Global Food Crisis

	ASEAN member countries*							
Policy responses	Cambodia	Indonesia	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam
Reduce import duties		X						
Increase supplies using reserves	X	X					X	
Build up reserves/stockpiles	X		X		X	X	X	X
Increase imports/relax restrictions		X			X		X	X
Increase export duties								
Impose export restrictions	X							X
Price controls/consumer subsidies	X	X	X		X		X	
Minimum support prices					X			X
Minimum export prices								
Subsidies to farmers					X			
Promote self-sufficiency			X	X	X			
Cash transfers						X		
Food rationing		X			X			

Note: Cambodia, Thailand and Vietnam are considered to be net exporting countries, whereas Indonesia, Malaysia, Myanmar, the Philippines and Singapore are net importing countries.

Source: Trade Knowledge Network, Policy Brief, June 2010.

44. **Specific trade concerns can be raised at any of the three regular meetings of the WTO SPS Committee each year.** In the three Committee meetings of June and October 2011 and March 2012, 14 new trade concerns were raised. Of these, three involved trade-restricting measures by three different ASEAN members: (i) US concerns regarding restrictions on imported fresh meat by the Philippines; (ii) EU concerns regarding Malaysia's import restrictions on pork and pork products; and US concerns regarding Indonesia's reduction of entry ports (from fourteen to four selected seaports equipped with stricter quarantine centers) for imports of some agricultural and horticultural products. The latter measure (adopted on December 14, 2011), which affected ports near Jakarta and other major urban centers, was aimed at making it difficult to serve sophisticated and rich urban consumers in Indonesia with imported fresh produce and fresh bulbous plants. All such non-tariff measures have been applied to all trading partners, thus also affecting other ASEAN countries.

45. **Regarding trade remedies, WTO reports say that, over the most recent period from October 2011 to April 2012, there has been a significant increase in the world in the number of countervailing duty, anti-dumping investigations, and safeguard investigations.** Regarding the former two trade remedies, ASEAN countries were not among the initiators, but Indonesia, Thailand, and Viet Nam were among the countries at the receiving end. Regarding the latter remedy, Indonesia was the most active WTO member in initiating three safeguards investigations during the same period (as well as previous periods), though all towards extra-ASEAN countries (see Table 1.6 below).

46. **However, most trade-related measures taken recently by other ASEAN countries either ended or reduced their trade-restricting effects.** In December 2011, the Philippines actually terminated anti-dumping duties on imports of clear float glass from Indonesia (imposed several years earlier). Myanmar and Thailand adjusted some of their licensing and tariff quota regulations (respectively), but towards a more flexible, liberal direction (see Box 1.5). According to press reports cited in WTO 2012, while Viet Nam did impose a trade restrictive measure in the form of an import quota on salt (fixed at 102,000 tons) for the year 2012, it also reduced import tariffs on 1,000 items, that is, meat and meat by-products, and export tariffs (from 17 percent to 14 percent) on certain products, that is, coal, processed limestone.

Table 1. 7: Trade Measures Adopted by ASEAN Countries, October 2011-May 2012

	MEASURES NOTIFIED TO OR VERIFIED BY WTO	Status
Indonesia	New Indonesian tariffs and classification book (BTKI 2012) adjusting its classification system and facilitating import process	Effective 1 January 2012
Indonesia	New regulation on pre-shipment inspection on tire imports (HS 4011)	Effective 1 January 2012
Indonesia	New regulations on imports of certain products, i.e. rice (HS 1006.30.99); sodium tripolyphospate (sodium triphosphate) (HS 2835.31.90); used capital goods; ozone depleting substances; colour multifunction machine, colour photocopy machine, and colour printer machine; and iron and steel	
Indonesia	Export ban on raw and semi-processed rattan products (HS 1401.20). Certain rattan (HS 4601; 4602; 9401; 9403) can only be exported by firms holding export licenses on forestry products. Exports require an independent surveyor for	Effective 1 January 2012
Indonesia	Decree of Ministry of Agriculture (14 December 2011) on the importation of fresh bulbous plants reducing (from 14 to 4) the list of entry points (selected seaports equipped with stricter quarantine centres) for imports of agricultural and	
Indonesia	Threshold of mining and coal production prioritizing the supply to domestic needs at a benchmark price in accordance with effective price in the international market. Mechanism in place in order to manage and prevent shortages	Effective 6 February 2012
Indonesia	Import procedures for used capital goods (but not scrap) (HS Chapters 84; 85; 87; 88; 90) implemented. Used capital goods can only be imported by a direct user, reconditioning, manufacturing, and health equipment supplier companies. The goods are subjected to a technical inspection by a surveyor in the country of origin.	Effective 13 February 2012 to 31 December 2013
Indonesia	Decree of Minister of Agriculture No. 03/Permentan/OT.140/1/2012 on Horticultural Product Import Recommendation introducing import quota system on fresh and processed fruits and vegetables (HS Chapters 06; 07; 08; 09; 20; 21)	Effective 1 May 2012
Indonesia	Initiation on 20 January 2012 of safeguard investigation on imports of articles of finished casing and tubing with yield strength of over 75,000 psi and worked pipe-	
Indonesia	Initiation on 27 January 2012 of safeguard investigation on imports of "Mackerel", excluding fillets, livers and roes, fresh or chilled, or frozen (HS	
Indonesia	New import regulations on procurement, circulation, sale, supervision, and control on alcoholic beverages	Effective 1 March 2012
Indonesia	Termination on 13 April 2012 (without measure) of safeguard investigation on imports of conveyor belts or belting reinforced only with metal of a width exceeding 20 cm (HS 4010.11.10) (initiated on 3 November 2011)	
Philippines	Termination on 7 December 2011 of anti-dumping duties on imports of clear float glass (HS 7005.29) from Indonesia (imposed on 8 December 2000)	
Thailand	Authorization to import certain food products, i.e. not-fat dry milk (HS 0402.10.30; 0402.10.90), soybeans (HS 1201.00.10; 1201.00.90), soybean meal (HS 2304.00.00), and potatoes (HS 0701.10.00; 0701.90.00), on top of implemented tariff quota at lower in-quota tariff rates. Quota allocation for these	Effective 1 January 2012
Viet Nam	Reduction of import tariffs (from 40% to 35%) on beer	Effective 1 January 2012
Viet Nam	Import quotas for tobacco material	
Viet Nam	Additional procedures requiring that importers of certain motor vehicles (up to 9 seats) present an affidavit establishing their commercial status (i.e. importer,	
	MEASURES REPORTED BY BUT NOT VERIFIED BY WTO STAFF	
Myanmar	Scheme granting import permits for cars (built no earlier than 1995) in exchange of a car older than 30 years	Effective 19 September 2011
Viet Nam	Proposed reduction of export tariffs on certain products, i.e. coal, processed limestone (from 17% to 14%)	
Viet Nam	Proposed reduction of import tariffs on 1,000 items, i.e. meat and by-products	
Viet Nam	Import quota on salt fixed at 102,000 tonnes for the year 2012	

Source: WTO 2012, at http://www.wto.org/english/news_e/news12_e/devel_29jun12_e.htm

ASEAN Export Restrictions

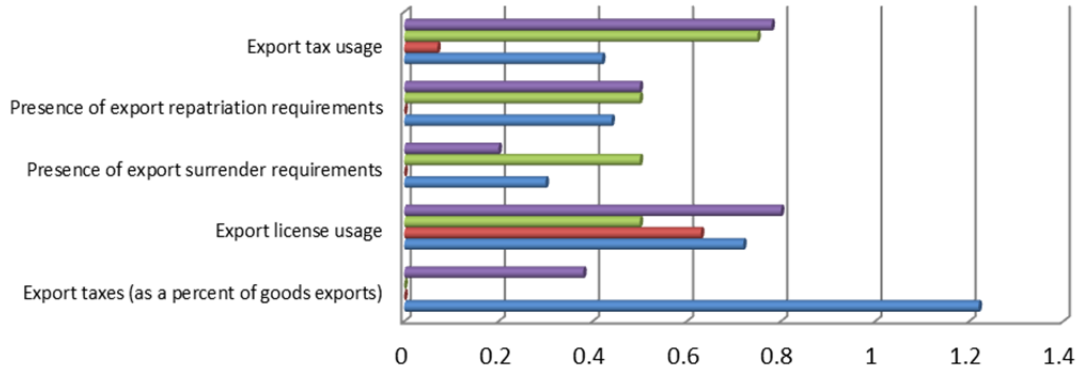
47. **Export controls are normally of two types—export taxes and quantitative restrictions.** They are mostly imposed by low-income and lower-middle economies on agricultural products and raw materials, for the common purpose of generating government revenues and/or protecting domestic consumers and infant industries using such goods. Although quantitative limitations are generally prohibited under the WTO, Article XI of the GATT allows export taxes, as they are considered the least damaging export control measure. However, in some regional trade agreements, that is, the European Union (EU), North American Free Trade Agreement (NAFTA), and the Caribbean Common Market (CARICOM), export duties on intra-regional trade are prohibited.

48. **Taking advantage of a lack of ASEAN-wide discipline on export restrictions, many ASEAN Member States instead impose various export measures**. They particularly did so to ensure adequate domestic supplies of essential agricultural products in the wake of the global food crisis during 2007/08, when the international market prices of many staples rose dramatically, triggering riots among urban consumers and jeopardizing food security in many countries. Governments in the region that experienced a surge in the exports of such commodities reacted by imposing export controls and building up domestic reserves or stockpiles. Table 1.8 shows the variety of policy responses of selected ASEAN Member States to the sharp global price increases of rice.

49. **ATIGA Article 44 states that each member state shall notify the other member states of any existing import licensing procedures, including any new licensing procedure and any modification.** However, no such official information is available to the ASEAN Secretariat. The available unofficial information shows that most of the ASEAN governments impose export licensing, except for the Philippines, while many others impose export taxes, except for Brunei, Philippines, and Singapore. The cases of Thailand and Indonesia are illustrated in Boxes 1.6 and 1.7.

50. **Figure 1.8 compares selected indicators of export restrictions in 2009 (or latest available year) among various country groupings—ASEAN, MERCOSUR, EU-27, and the entire WTO membership.** The European Union had the lowest usage of export restrictions, while ASEAN appears to have deployed such instruments as much or more than the other comparators. Box 1.6 illustrates the specific case of export restrictions on nickel and coal by Indonesia, and Box 1.7 summarizes the export restrictions regime for Thailand.

Figure 1. 8: Comparison of Export Restriction Indicators



	Export taxes (as a percent of goods exports)	Export license usage	Presence of export surrender requirements	Presence of export repatriation requirements	Export tax usage
ASEAN	0.38	0.8	0.2	0.5	0.78
MERCOSUR	0	0.5	0.5	0.5	0.75
EU27	0	0.63	0	0	0.07
WTO	1.22	0.72	0.3	0.44	0.42

Source: World Trade Indicators 2009/10, World Bank (www.worldbank.org/wti)

Box 1. 6: Indonesia's Restrictions on Nickel and Coal Exports

Indonesia is one of the world's largest exporters of minerals, including nickel and coal, but it only processes domestically a small amount of its mining production. As a result, Indonesia imports large amounts of semi-finished products to fulfill local industrial demand.

For instance, against proven nickel reserves of 577 million tons, the companies processing nickel ore domestically into, for example, ferronickel and nickel matte, have a limited annual production capacity, around only 80,000 tons, all of which is in turn exported. Thus, most domestic users of nickel, mainly in the construction, oil and gas, automotive, electronics and machinery sectors, need to import semi-finished products such as stainless steel and nickel alloy, which are not domestically produced.

To boost investment in downstream processing and refining domestically and increase value-added for minerals, the government has already adopted and is considering various export restrictions, so as to make available to domestic users mineral products and (coal- or gas-based) electricity generation at lower than world-market prices. [21] To this goal, the government passed the 2009 Mining and Coal Law mandating a total ban on raw minerals exports in 2014.[22]

In the meantime, Indonesia adopted a fresh wave of new ministerial regulations[23] and imposed a 20 percent export tax effective February 6, 2012 pertaining to the export of 65 different types of raw minerals (excluding coal). The reason for these measures is to stem interim increases in the export of mining products, as miners crank up production ahead of the full ban in 2014. Nickel ore exports, for example, experienced an eight-fold jump over their 2008 level, to 33 million tons in 2011. Under the new regulations, export requirements include an obligation for mining companies to obtain 'clean-and-clear' status for their activities, to pay all tax and a non-tax financial obligation, and to submit a comprehensive proposal on their business plans for the creation of added-value to their mining products.

The above mentioned regulations did not include new taxes or restrictions on coal exports, because coal miners have different legal arrangements from other mining companies in terms of royalties and taxation, enshrined in law and government regulations, which ministerial decrees cannot alter. According to the terms of such contracts, major coal miners pay 13.5 percent royalties to the government from their gross revenue and up to a 45 percent corporate income tax on their profit. To secure domestic supplies, coal-mining companies are also already bound by a domestic market obligation, that is, to allocate a certain amount of output for sale on the local market.

The raw mineral export ban in 2014, however, will apply to coal, too. More coal-fired power plants are coming on stream this year and in the next few years to meet rising electricity demand, while also reducing PT Perusahaan Listrik Negara (PLN)'s dependency on diesel fuel. PLN is the largest coal consumer in Indonesia. The company forecasts that it will absorb 54 million tons of coal this year, 87.5 million tons next year and 95.3 million tons in 2014. The export ban will ensure that PLN and other domestic users will not have to compete with foreign users and that they will have coal available at below world market prices.

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[21] Similar considerations apply to the non-minerals sector, too. For instance, Indonesia implemented in January 2012 a new export ban on raw and semi-processed rattan products (HS 1401.20). Certain rattan can only be exported by firms holding export licenses on forestry products, subject to technical and pre-shipment verification by an independent surveyor.

[22] By introducing a total ban, the Indonesian government hopes that new investment, particularly in smelters, will flow into the nation and help expand the local downstream sector.

[23] Minister of Energy and Mineral Resources Regulation no. 7, year 2012 regarding the "Improvement of Mineral Added Values through Mineral Processing and Refining," Minister of Trade (MOT) Regulation No. 29/M-DAG/PER/5/2012 concerning "Provision of Mining Product Export" and Minister of Finance (MOF) Regulation No.75/PMK/.011/2012 on "Payment of an Additional Export Tax."

Table 1. 8: Export Restrictions Indicators in ASEAN

Country	Export taxes (percent of goods exports)	Export license usage	Export tax usage	Presence of export surrender requirements	Presence of export repatriation requirements
Cambodia	0.77	1	1	0	1
Lao PDR	0.29	1	1	1	1
Thailand	0.08	1	1	0	1
Brunei	..	1	0	0	0
Indonesia	..	1	1	0	0
Malaysia	..	1	1	0	1
Myanmar	..	N/A	1	1	0
Philippines	..	0	0	0	0
Singapore	..	1	..	0	0
Viet Nam	..	1	1	0	1

Source: World Trade Indicators 2009/10, World Bank

Box 1. 7: Thailand's Export Restrictions

Thailand has been a country with a policy of export-led development for over three decades, with its exports mostly manufactured and processed goods and its imports mostly raw materials and machines. It has eliminated all export subsidies but maintains incentive schemes (internationally sanctioned) that promote and facilitate exports such as bonded warehouses, duty drawbacks, and tax refunds for import duties and VAT.

It also deploys a variety of export measures, many for environmental, public health, and intellectual property protection purposes. These include (i) export registration to ensure quality and food security but also to prevent or minimize price competition among exporters; (ii) export licensing to manage export quotas mostly linked to 'voluntary' implementation of bilateral agreements; (iii) export taxes for food security (that is, to keep domestic commodity prices lower than international prices). According to the latest Trade Policy Review (TPR) of Thailand by the WTO, a limited number of products, mostly unprocessed wood, are subject to export taxes, with applied rates of tax lower than the statutory maximums.

Many such measures are consistent with international obligations, but others (which favor domestic consumers or producers) harm the commercial interests of trading partners including those of other ASEAN countries.

E. Merchandise Trade Integration Outcomes

51. **The list of merchandise trade outcome indicators to assess trade performance and integration could be long, given the availability of merchandise data disaggregated by product, trading partner, and export and import flows**. This section shall first summarize the trends and patterns of a commonly used but often misguiding trade indicator and it will then turn to two other main indicators that are better suited to measure intra-regional integration. While intra-regional trade expansion is often due to a welfare-enhancing trade creation effect, it can also theoretically be due to a welfare-reducing trade diversion effect. Thus, this section will also analyse other dimensions of the region's and member countries' trade performance and

integration that can shed light on possible trade diversion effects, such as their extra-regional trade openness and growth as well as complementarity indices. All trade outcome indicators used for this section are based on import data (originating from customs data), as they are considered more reliable than export estimates (compiled by national statistical agencies).[24]

52. **The trends and patterns of intra-ASEAN trade integration have been recently analysed and illustrated at the country, regional, and sectoral levels in a forthcoming report by ERIA (2012), whose key findings are summarized next.[25]** The analysis by the Economic Research Institute for ASEAN (ERIA) relies on the regional trade share (the share of intra-ASEAN trade to total ASEAN trade, with trade taken by ERIA to be imports plus exports divided by 2), a commonly used indicator of intra-regional integration. This indicator, however, has the major drawback that its increase necessarily implies a decrease in global integration. This is an undesirable property for an indicator of intra-regional integration for a traditionally open region like ASEAN, and as per its commitment under the fourth pillar of its AEC Blueprint to foster the region's global integration. Stagnation in this indicator does not necessarily mean stagnant intra-ASEAN trade; it indicates solely that the balance between intra- and extra-ASEAN trade remains the same.

53. **Be it as it may, ERIA finds that ASEAN's trade share has risen gradually from 19 percent in 1990 to 25 percent in 2000, settling then in the range of 26-27 percent since 2003**. The flat trend observed in recent years is the sum total of contrasting trends for imports, exports and overall trade at the country and sectoral levels. A rising intra-ASEAN trade share in some countries (especially Indonesia, but also the Philippines and Viet Nam) is counteracted by declining intra-ASEAN trade share in some other countries (for example, Malaysia, Singapore and Thailand). Similarly, a rising intra-ASEAN trade share in some sectors (for example, in motor vehicles, soaps, lubricants, essential oils, perfumes, and cosmetics) is counteracted by declining intra-ASEAN trade share in some other sectors, including the top ASEAN export sector of electrical machinery, equipment and parts.[26]

54. **A better integration indicator for an open region like ASEAN is the intra-regional Merchandise Trade Openness (Intra-ASEAN MTO, defined here as intra-regional imports as a share of regional GDP).** An increase in this indicator, unlike the trade share mentioned above, is fully compatible with an increase in the region's relative trade (openness) with the rest of the world. As shown in Figure 1.9 (second panel), in the pre-global crisis years (2004-2008) the cross-country (simple) average value of this indicator for ASEAN was 15.2 percent, with a peak in 2008 of 16 percent. During the global crisis years of 2009-2010, the intra-ASEAN MTO fell to 14.6 percent (two-year average), but it rebounded to a record high 22.7 percent in 2011.

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[24] It should be noted that the ADB-ARIC (Asian Development Bank—Asia Regional Integration Center) database includes some indicators based on both import and export data (and divided by 2) as well as on either import or export data (http://www.aric.adb.org/indicator.php).

[25] See Chapter 3 of the "Mid Term Review of the ASEAN Economic Community (AEC) Blueprint", by the Economic Research Institute for ASEAN and East Asia (ERIA), forthcoming in 2012

[26] ERIA explains this decline in intra-ASEAN trade of the top export for ASEAN with the rise of China at the center of the electronics and electrical equipment production network in East Asia

Thus, as measured by this indicator, intra-regional integration has increased during the past seven years, due to increased intra-ASEAN trade by all countries except by the Philippines and Singapore.[27] With the much bigger EU-15 and NAFTA blocs being around 17 percent and six percent, respectively, an MTO level for ASEAN of almost 16 percent also suggests a comparatively very high level of intra-regional integration.[28]

55. **A more complex indicator, which is less size-dependent (and thus more internationally comparable) than the trade openness indicator discussed above, is the intra-ASEAN Merchandise Trade Intensity Index (Intra-ASEAN MTII).** It is the ratio of the intra-regional trade share (out of total country or regional trade, depending whether it is computed for a country or a region) to the share of world trade with the country or region (out of total world trade). As above, only imports are used to estimate this indicator. A value of 1 for this indicator indicates that intra-regional trade is right in line with the region's importance in world trade. A value of more than 1 indicates that intra-regional trade is larger than expected given the importance of the region in world trade. As illustrated in Figure 1.10 below, the intra-ASEAN MTII shows a declining trend from its 2006 peak (6.3) to its 2011 trough (5.8). Its absolute level, however, remains much higher than for the EU-15 and EU-27 and for NAFTA (1.9-2.1) in recent years, confirming ASEAN's comparatively very high level of intra-regional integration.

56. **There has been a modest but positive convergence among ASEAN Member States on intra-ASEAN trade openness, with the coefficient of variation moving from an average of 0.7 from 2004-2008 to an average of 0.6 during the most recent three-year period 2009-2011**. In trade intensity, however, there was no convergence at all, with the coefficient of variation unchanged at 0.5. As shown in Figure 1.9 (first panel), intra-ASEAN trade openness rose strongly between these two periods for Brunei, Cambodia and Lao PDR, and more modestly for Thailand. The trend for Singapore has been of a large and steady decline (from 42 percent to 31 percent of GDP between 2004 and 2011), though the country remains near the top of the list of most integrated ASEAN economies. The Philippines, Myanmar, and Viet Nam experienced large downward swings in their intra-ASEAN integration at the height of the global financial crisis from 2009-2010, but their provisional 2011 estimates show a marked rebound; Viet Nam is already above its pre-global crisis level.

[27] The trade-weighted version of this indicator, which gives more weight to the larger member states, shows intra-regional integration dropping during the global crisis years and rebounding by 2011 to its 2004 level of 14.7 percent.

[28] Both the trade share and the trade openness indicators are highly sensitive to the size of the country (or region): the smaller the country/region, the larger the openness indicator usually is; conversely, the bigger the country/region, the larger the trade share out of total trade is. Thus, neither is useful for simple international comparison or benchmarking with other regions whose economic sizes and production and trading structures are likely to be very different from ASEAN's. These indicators can be used for international comparisons only when analyzed with econometric tools that can take into account relative economic size and distance.

Figure 1. 9: Intra-ASEAN Trade Openness has Increased, Except for Singapore, which however Remains the most Regionally Integrated

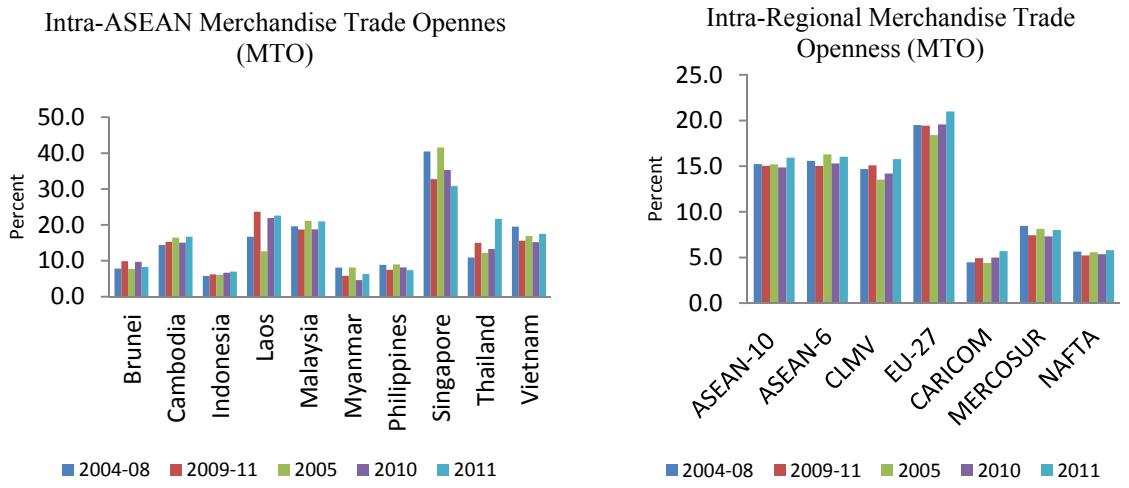
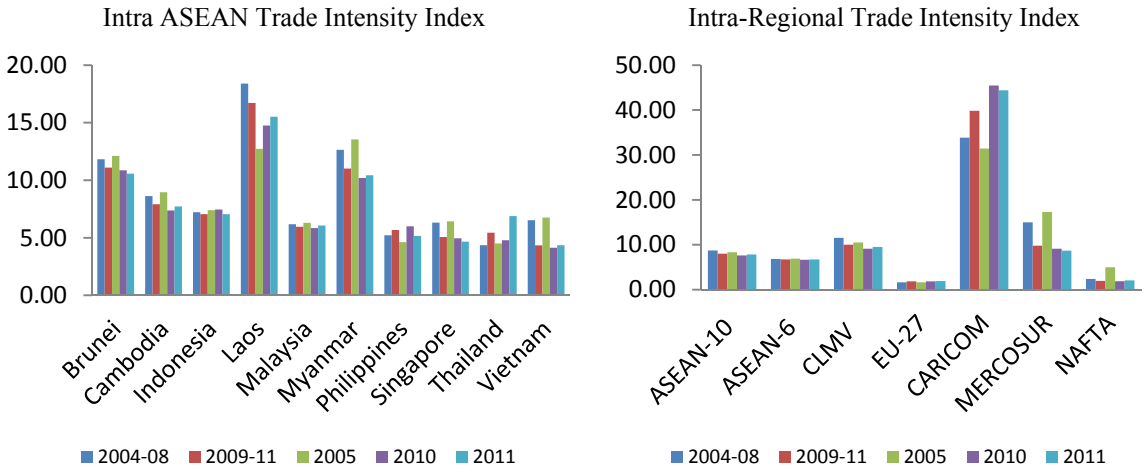


Figure 1. 10: Intra-ASEAN Trade Intensity has been Declining Modestly, But From Very High Levels and Remains Much Higher than for EU and for NAFTA



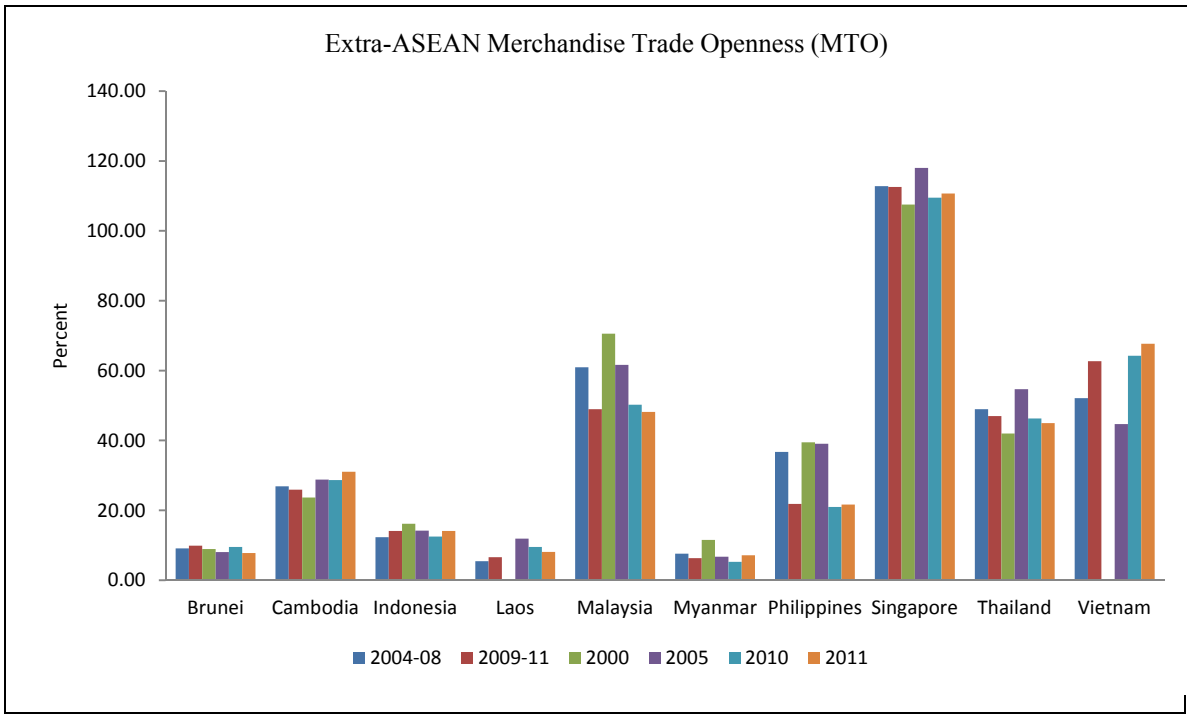
Source: Estimates from COMTRADE accessed through WITS, as of July 2012.

57. **As shown in Figure 1.10 (first panel), Lao PDR and Myanmar are the most integrated economies within ASEAN countries in terms of their trade intensity (MTII), followed at a distance by Brunei and Cambodia, all displaying higher MTIIs than the ASEAN average.** Thailand, Singapore and Viet Nam are the countries with the lowest levels of intra-ASEAN integration according to this indicator, but still at levels more than double what would be expected given their importance in world trade. With respect to changes over time, only

the Philippines and Thailand experienced rising intra-regional trade intensity, as all other countries showed varying degrees of decline between 2004 and 2011.

58. **Figure 1.11 shows the evolution of ASEAN's global (extra-ASEAN) merchandise trade since the mid-2000s.** Overall, ASEAN's extra-regional imports in 2009 contracted by more than 22 percent from their 2008 level, while ASEAN's intra-regional total imports still managed to increase, though only by a modest four percent. The Philippines, Indonesia, Malaysia, and to a much lesser degree Singapore and Thailand, show absolute declines in 2009 in their imports from the rest of the world. The turnaround, however, has been quick and strong. Total trade by ASEAN between 2009 and 2011 has expanded by 56 percent, almost equally well balanced between exports and imports and between intra- and extra-ASEAN. The weakest total trade rebound at 33 percent was registered by Lao PDR (due to an actual drop in its intra-ASEAN exports and only a sluggish increase in imports from the rest of the region), and the strongest by Indonesia and Viet Nam with 79 percent and 62 percent, respectively.

Figure 1. 11: Global Openness has Increased for Some, Decreased for Other ASEAN Countries



Source: ASEAN stats, based on recorded imports by member states.

59. **Taken together, the trends over the last seven years for intra-ASEAN trade share, trade openness indicators and trade growth rates, all point to a high degree of intra-regional merchandise trade integration within ASEAN**, which is increasing at a faster pace than its GDP, though not faster than its trade with the rest of the world. They also paint a picture of a recent resumption of the historical expansion of ASEAN trade with the rest of the world.

Prima facie, they support the commonly held belief that ASEAN regional integration is trade creating, rather than trade diverting.

60. **A strong intra-regional trade in intermediate and capital goods—the factory Asia effect—is commonly believed to be the source of ASEAN's high intra-regional overall merchandise trade integration (see Brulhart 2008 background paper for WDR 2009), but this appears to be the case only up to the year 2000.** As shown in Figure 1.12, intra-ASEAN trade in combined intermediate and capital products used to dominate total intra-ASEAN trade, rising rapidly from 1995 to reach a peak in 2000 at over 80 percent of total intra-ASEAN trade.[29] Since then, however, the share of capital goods has declined, while the share of intermediate goods took the opposite direction and increased steadily. The net result was a decline in the combined share of intra-ASEAN trade in these two categories to below 70 percent. Looking at the same issue from a different angle, intra-industry trade (that is, two-way trade in the same product category) rose strongly for ASEAN-6, Viet Nam and Cambodia through the year 2000, as shown in Figure 1.13.[30] What is a remarkable and strong indication of a new kind of intra-ASEAN trade integration is the recent upward trend (see Figure 1.12) in the share of primary goods traded regionally, which doubled from eight to 16 percent between 2000 and 2010, and in the share of final consumer goods, which almost doubled from just above 10 to just below 20 percent over the same period.

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[29] The classification used to calculate the primary, intermediate, capital, and consumer goods in this paper is based on Broad Economic Categories (BEC)'s classification, SITC3 nomenclature. Primary goods is sum of 11 21, and 31; intermediate goods is sum of 12, 22, and 32; capital goods is sum of 41 and 42; while consumer, including transport equipment goods is sum of 51, 52, 53, 61,62,and 63.

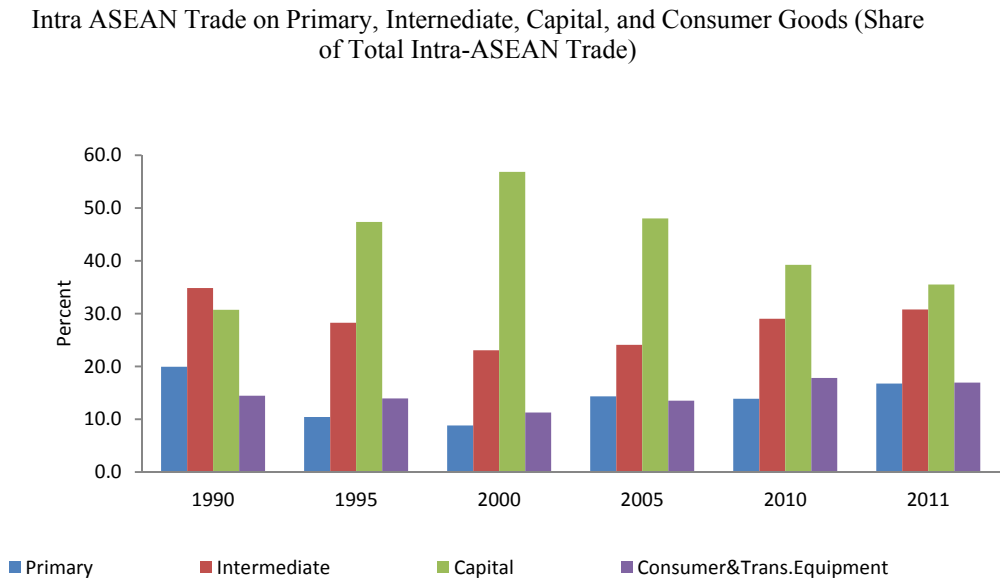
[30] Intra-industry trade flows are conventionally defined as the two-way exchange of goods within standard industrial classifications. Thus, for any particular product class *i*, an index of the extent of intra-industry trade in the product class *i* between countries A and B is given by the following ratio:

$$IIT_{i,AB} = \left[\frac{(X_i+M_i)-|X_i-M_i|}{(X_i+M_i)}\right].100 \quad \text{..... (1)}$$

This index takes the minimum value of zero when there are no products in the same class that are both imported and exported, and the maximum value of 100 when all trade is intra-industry (in this case X_i is equal to M_i). The indices reported in this chapter have been computed according to bilateral indices of intra-industry trade in the product class *i* between country A and all its trading partners. Bilateral indices are obtained as a weighted average of the bilateral indices [1] for each partner country B, using as weights the share of total trade of A accounted for by trade with B for each two digit SITC revision 3 product class.

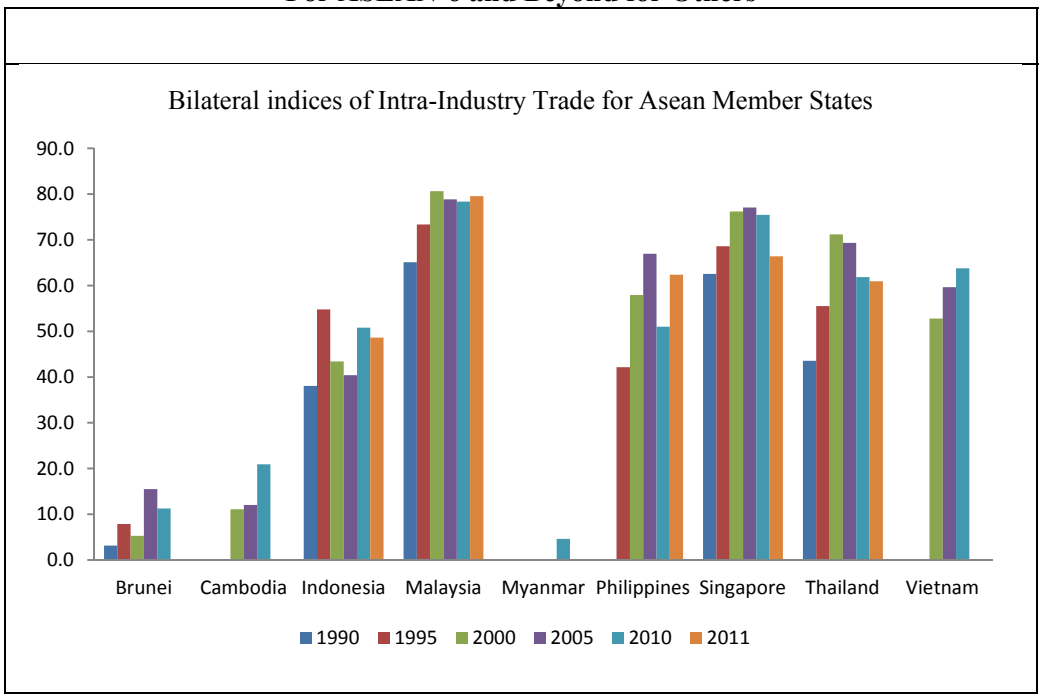
$$ITT_{AB} = \sum_i \left[\frac{X_i+M_i-|X_i-M_i|}{X_i+M_i}\right].\left[\frac{(X_i+M_i)}{\sum_i(X_i+M_i)}\right].100 \quad \text{.....(2)}$$

Figure 1. 12: Intra-ASEAN Trade by Major Components



Source: COMTRADE accessed through WITS, as of July 2012.

Figure 1. 13: Intra-Industry Trade Rose Strongly Through 2000 For ASEAN-6 and Beyond for Others



Source: COMTRADE accessed through WITS, as of July 2012

61. **The question of trade creation versus trade diversion for a regional trade arrangement raised at the start of this section can also be analyzed ex-ante by looking at trade complementarity between potential or actual trade partners.** Country A is likely to have a comparative advantage in products that it exports substantially to the world (that is, without the help of tariff preferences); if they are products in which B has a comparative disadvantage (because it imports a lot of it from the rest of the world), well then A and B should marry. Basically, a high degree of complementary between an ASEAN member country and the rest of ASEAN would indicate more favorable prospects for a successful trade arrangement and high likelihood of trade creation instead of trade diversion. A low degree would instead raise questions as to the possibility for trade diverting effects from preferential liberalization and whether significant gains from integration with regional partners can be expected. [31]

62. **As illustrated in Figure 1.14, Brunei, Cambodia, Myanmar and Viet Nam display high trade complementarity with the rest of ASEAN as well as with the extra-ASEAN grouping**. Trade complementarity, however, is quite low for all other ASEAN Member States. Only for Cambodia, Viet Nam, and Indonesia is trade complementarity higher with the rest of ASEAN than with the extra-ASEAN grouping. Thus, prima facie, concerns about future trade diversion appear justified.

63. **Nonetheless, given the relatively low level of MFN average tariffs (reproduced in Figure 1.14) and the modest average margins of CEPT-AFTA preferences, economic theory as well as recent econometric analyses suggest that ASEAN has not been trade diverting and has in fact helped external liberalization.**[32] This argument is collaborated also by the evidence on the strong historical growth and very recent rebound of extra-ASEAN trade documented above.

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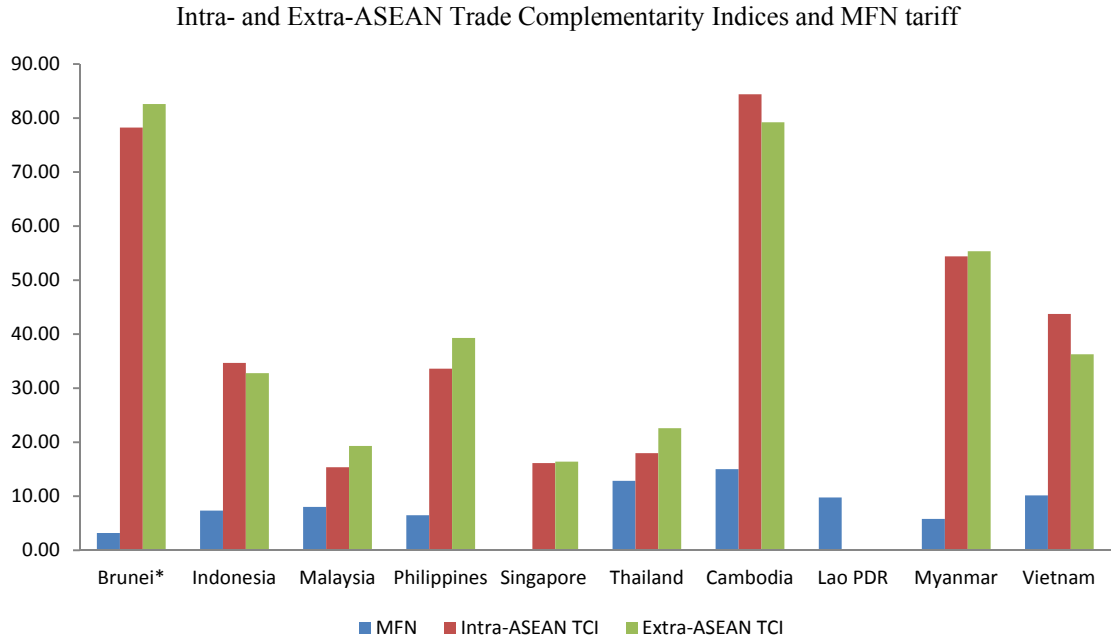
[31] A bilateral complementarity index can take values in the range 0-100, with 0 indicating no complementarity (that is, perfect overlap of reciprocal trade flows) overlap and 100 indicating a perfect match in the import export pattern. Intuitively, this indicator is best thought of as a correlation between country A's exports to the rest of the world with country B's (or the rest of the region) imports from the rest of the world.

[32] See the 2009 paper by Hector Calvo-Pardo, Caroline Freund, and Emanuel Ornelas "ASEAN Free Trade Agreement: Impact on Trade Flows and External Trade Barriers," using detailed data on trade and tariffs from 1992-2007) and by Rohini et al. (2011) who calculated the impact of ASEAN integration on intra-regional and extra-regional trade and find that it to be among the highest of the sample of preferential trade agreements they study. See also the recent empirical analysis by Okabe and Urata (2012) using gravity modeling to determine the impact (trade creating effect) of CEPT tariff reduction on intra-ASEAN imports or exports using bilateral trade flows of AMS among themselves and with the countries in the rest of the world.

Figure 1. 14: ASEAN Trade Complementary Indices, 2006-2010



Source: Staff estimates.

Merchandise Export Diversification

64. **ASEAN countries are mostly at a stage where export product diversification is thought to be among the milestones of development.** For the majority of ASEAN countries (and the overwhelming share of ASEAN population) except for Brunei, Cambodia, Myanmar and Laos[33], exports are well diversified, and increasingly so during the last decade, as shown in Figures 1.15 and 1.16 that present various indicators of export product and market diversification from the World Trade Indicators (WTI) database.[34]

65. **The number of 3-digit SITC products exported between 2000 and 2011 by Malaysia, Philippines and Thailand has risen, but only slightly so: from 250 increased to 259 for Malaysia, from 221 to 234 for the Philippines, and from 242 to 250 for Thailand.[35]** Indonesia experienced an increase in the number of its exports in the early 2000s, reaching a peak in 2004 with 255, but declining afterward to a low of 243. The trend for Singapore is virtually flat. These

[33] The WTI database is available at www.worldbank.org/wti. Note that for Lao PDR some indicators are not available due to lack of data in COMTRADE and in WTI, the two international databases used for this section. However, country-specific information on Lao PDR is available from a recent Diagnostic Trade Integration Study (DTIS, World Bank 2012). Group values are simple cross-country averages.

[34] Similar indicators are available also on the import side, but those are not included and analyzed in this report.

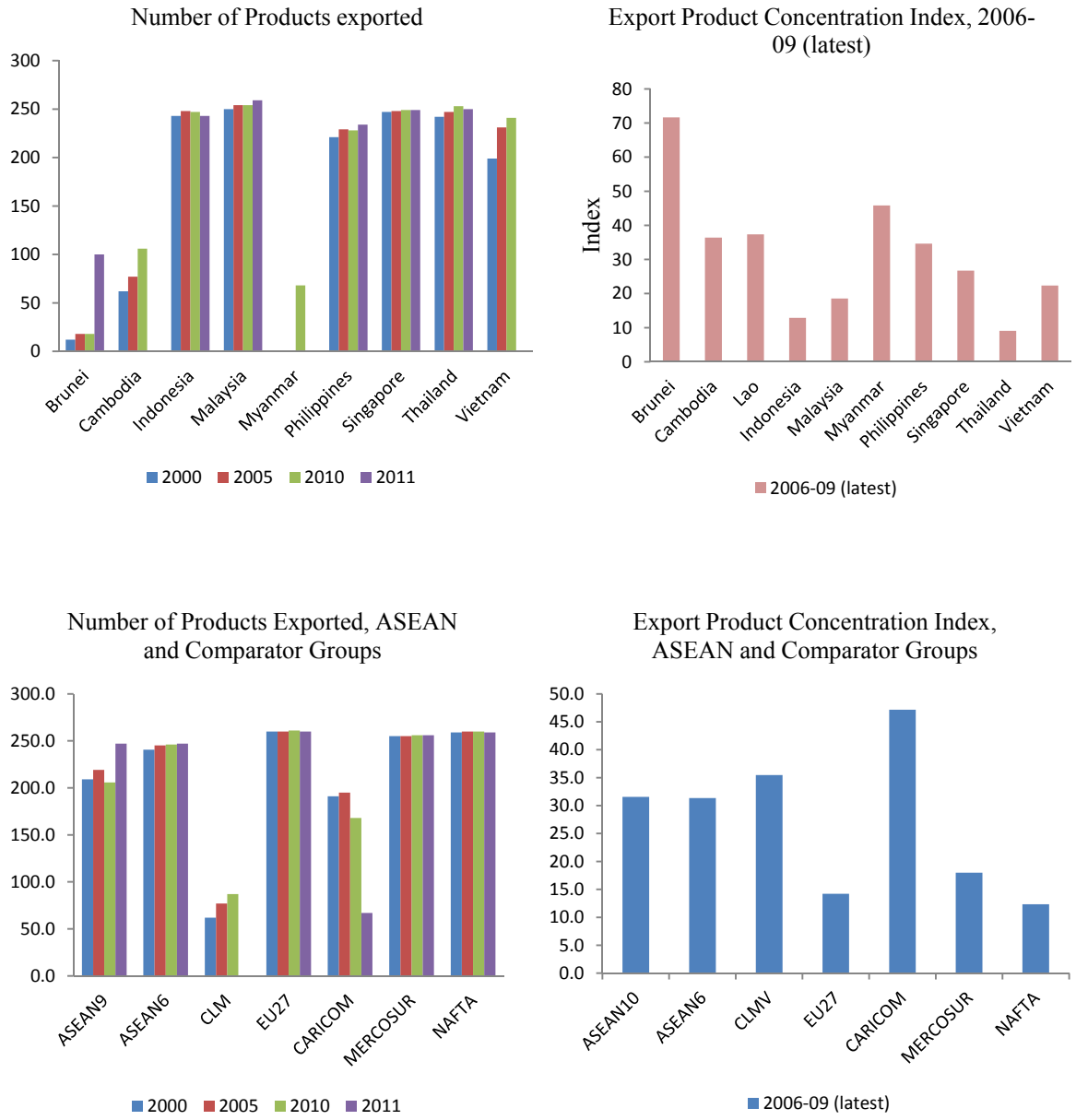
[35] Number of Products Exported is calculated at the 3-digit SITC, Revision 3 level, and includes only those products whose value exceeds USD 100,000.

countries, except the Philippines, have export (product) concentration indexes in a low range, from a value of 9 for Thailand to 27 for Singapore. Viet Nam is also well diversified, with both indicators in the same above-mentioned ranges that are better than the ASEAN-wide and the CARICOM-wide averages, and are close in value to those of relevant comparator regions (EU, NAFTA, MERCOSUR), as shown in the two bottom panels of Figure 1.15.

66. **The Philippines has a fairly high number of exported products, but its export concentration index of 34 is in the middle range, which also includes Laos with 37 and Myanmar with 46.** The export concentration index of Brunei (72) is in the high range. Laos and Myanmar as well as Brunei also export a small number of products (less than 100). All these indicators are considerably worse than the ASEAN-wide average and especially of the EU, NAFTA, and MERCOSUR averages.

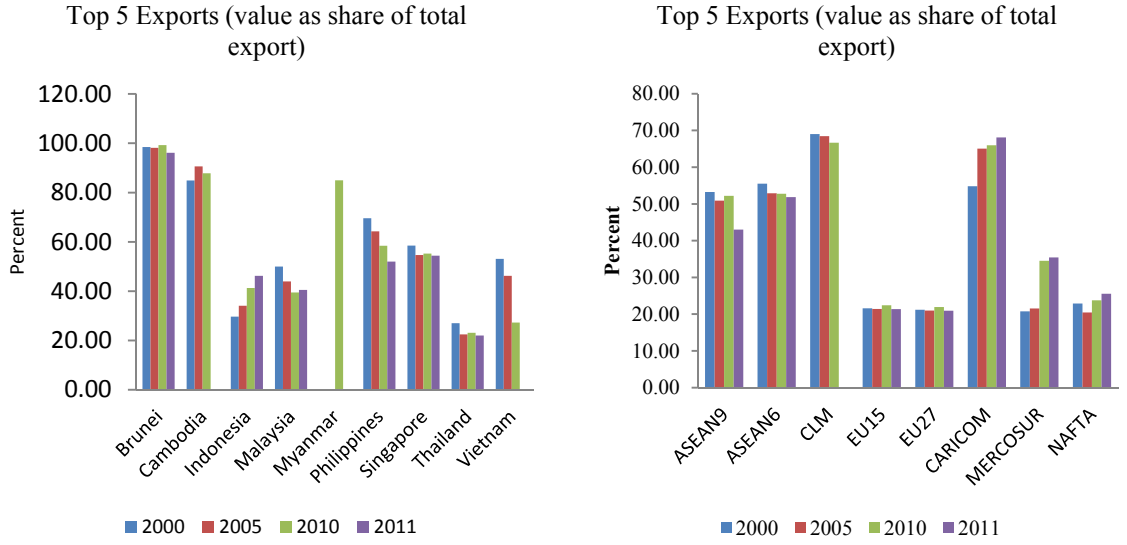
67. **A similar pattern is evident from Figure 1.16, which shows the share of total export value taken by the five top export products.** The lower such a share, the less concentrated the export basket is in a handful of commodities or manufactured goods. According to this alternative metric, Thailand, Viet Nam, Malaysia, and Indonesia have the lowest export concentration, following by the Philippines and Singapore. Brunei, Cambodia and Myanmar have very high indexes, between 80 and 100 percent, which are four times as high as for the same three international comparator groups mentioned above. The indexes for Malaysia, the Philippines, Singapore, Thailand, and Viet Nam have all been decreasing, but only Thailand's and Viet Nam's most recent values best EU and NAFTA averages.

Figure 1. 15: ASEAN and Comparators Number of Exports and Concentration Index



Note: Due to lack of recent data, values for Brunei in first panel of Figure 1.15 are for the years 2001-2004.
Source: U.N. COMTRADE as of June 2012 and World Trade Indicators, World Bank 2009/10, www.worldbank.org/wti

Figure 1. 16: ASEAN and Comparators' Shares of Five Top Export Products



Source: U.N. Comtrade as of June 2012 and World Trade Indicators, World Bank 2009/10, www.worldbank.org/wti

68. **In summary, only Indonesia is trending in the wrong direction according to two of the three product-related indicators discussed above, showing an increase in the value of this indicator (from 35 percent in 2000 to 46.2 percent in 2011) as well as a decrease in the number of exports (see above).** Cambodia is also showing deterioration (increase) in the share of five top exports. Brunei, Cambodia, Lao PDR and Myanmar also suffer from a low relative export diversification.

F. Conclusion and Policy Implications

69. **ASEAN has largely achieved its goal of eliminating tariffs on intra-ASEAN merchandise trade by 2010 for the ASEAN-6 countries, and remains on track for achieving by 2015 the goal for the CLMV countries (with flexibility until 2018).** Nonetheless, in order to achieve full tariff elimination as per the agreed 2015 deadline for the ASEAN Economic Community, CLMV countries could consider accelerating the implementation of their intra-ASEAN preferential tariffs reduction commitments. This would help them attain the high share (above 99 percent) of tariff lines with a 0 percent duty on intra-ASEAN imports.

70. **Import duties are an important source of tax revenue (excluding grants) in CLMV countries, representing 19.8, 10.3, and 24.2 percent in 2009 for Cambodia, Lao PDR, and Viet Nam, respectively.** For Lao PDR, simulations of the impact of ASEAN Free Trade Area (AFTA) commitments in a recent Diagnostic Trade Integration Study (DTIS, World Bank 2012) point to a sharp drop in tariff revenue and tax revenue, 76.3 percent and 25.1 percent respectively despite an increase in imports by 2.4 percent. Large-scale elimination of tariffs by Lao PDR also vis-à-vis ASEAN+1 partners implies only slightly higher increases in imports, but larger decreases in tariff and tax revenues and significant trade diversion away from non-preferential trading partners. Whether CLMV countries accelerate their preferential tariffs elimination

timetable, as recommended above, or stick to the agreed 2018 deadline, they will need to shift to other forms of indirect taxation to make up the inevitable tariff revenue loss.

71. **Regarding the low intra-ASEAN preference utilization, especially for some countries, there may not be much mileage to be gained from addressing the already liberal ROO.** Neither can many gains be expected from further simplification of documentary requirements and bureaucratic procedures at the border, which have already been scaled up from pilot projects in a few countries to all ASEAN Member States. With preference margins already at modest levels and further preference erosion to be expected, ASEAN Member States will likely move further on MFN tariff and peak reduction. A targeted technical assistance and information campaign to reach importers and exporters of those goods with still sizeable preference margins and in those countries with utilization rates around or below 20 percent might, however, help increase preference utilization, not only for ATIGA but also for other bilateral or unilateral preferential trade arrangements.

72. **With regard to NTMs, ASEAN should recognize that some of its commercial interests have been caught up in the global protectionist impulse since the onset of the global economic crisis.** Given that the region's prosperity depends in large part on successfully selling abroad and that, with the growing prevalence of international supply chains, own protectionism frequently harms domestic export competitiveness, ASEAN governments should resist the pressure to restrict commerce abroad as well as at home. As a matter of priority, ad-hoc trade-restrictive measures introduced since the start of the financial crisis (2008), and especially those affecting other ASEAN countries, should be rolled back and no new ones introduced.

73. **ASEAN should also recognize, in light of the discussion in Section C, that the wholesale elimination of all NTBs (those officially identified by each ASEAN country as well as the barrier elements of all other NTMs) is not a realistic medium-term goal, even if limited to 'core' trade restrictive measures.** ASEAN needs instead to recognize explicitly the complexity and diversity of NTMs and adopt a goal of streamlining rather than eliminating them. Taking into account the implied recommendations contained in Box 1 and those already put forward by Cambodia, the current ASEAN Chair, a promising medium-term action agenda to start streamlining NTMs would include the following:

(i) Improve the classification of NTMs, according to the UNCTAD guidelines adopted in February 2012.
(ii) Update and verify country lists in an open process driven by the ASEAN Secretariat, rather than on a voluntary basis by individual member states.
(iii) Eliminate with only few exceptions all quantity control measures, comprising non-automatic licensing, import and export quotas and prohibitions, and all foreign

exchange at least for intra-ASEAN trade though it may not be possible or practical to police such limitation.[36]

(iv) Identify the other most egregious trade-restrictive measures, with help not only from the private sector, as foreseen in article 42 of ATIGA, but also with sectoral regulatory impact assessments to be launched urgently.

(v) Decide in ASEAN bodies on the regulatory modifications at the national level as well as regional harmonization actions necessary to eliminate or minimize the trade-restrictive impact of the measures identified as per point (iii) above.

(vi) Report publicly on the decisions taken and their justification.

(vii) Plan an in-depth regional study of NTMs, possibly under Phase II of the AECMEP collaborative project between the ASEAN Secretariat and the World Bank.

74. **Taken together, the trends over the last seven years for intra-ASEAN trade share, the intra- and extra-ASEAN trade openness, nominal trade growth rates, and intra-ASEAN trade intensity all point to a high degree of intra-regional merchandise trade integration within ASEAN.** This integration is increasing at a faster pace than the region's GDP, though not faster than its trade with the rest of the world. They also paint a picture of a recent resumption of the historical expansion of ASEAN trade with the rest of the world. These developments suggest that ASEAN is a force for trade creation rather than trade diversion. To make further progress in ASEAN's intra-regional and global integration and export diversification goals, ASEAN and their member states need to look at at-the-border and beyond-the-border reforms in trade facilitation, in services trade, and in foreign direct investment regulations and promotion. These key issues are discussed in the next chapters of the report.

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[36] Myanmar, the only ASEAN Member State with foreign exchange controls, should also eliminate such restrictions. It is indeed expected to do so in the very near future, as foreign trade and financial sanctions are being lifted. The Central Bank of Myanmar (CBM) introduced an exchange rate system in the form of the official peg with a managed float unifying the exchange rates with assistance from the International Monetary Fund. Accordingly, the CBM began a managed float system on April 1, 2012 dismantling the existing multiple exchange rate system. New currency regime was commenced on April 2, 2012 by setting a daily reference exchange rate of Myanmar Kyat to the dollar by the CBM in line with its value on the market rate as announced at www.cbm.gob.mm.

Chapter 2: Trade Facilitation and Logistics

A. Key Findings

1. **A strong emphasis on the facilitation of trade flows**. The AEC Blueprint has rightly identified trade facilitation as an essential piece of international trade integration. Customs reform through simplification, harmonization and modernization of procedures is the centerpiece of these efforts, but trade facilitation overlaps to a large extent with ASEAN's agendas covering non-tariff measures and services. The ASEAN agenda is ambitious, with the objective of strong integration of national customs systems through the ASEAN single window and ASEAN e-customs. The adoption of some high-level international standards, such as preconized by the revised Kyoto Convention is also on the agenda, although not all modern customs management elements are present. This is in keeping with the gradual approach favored by ASEAN, but also recognizing that all ASEAN members are not on the same level of advancement. However, strong progress has been registered, with the CLMV adopting important harmonization and modernization steps. Importantly, many of the policy and administrative changes required to improve trade facilitation can be undertaken by individual AMS acting unilaterally, which means that there is real scope for countries to undertake reforms at different rates, starting from different baselines, and for catch up to occur over time.

2. **The ASEAN trade facilitation agenda is not only about customs reform.** Facilitation is also about ensuring that implementation of product standards and phytosanitary measures, and the provision of transport and logistics services do not unduly impede trade. The streamlining of standards is an area that while clearly identified has recorded modest and limited progress. It should become a focus of future work with emphasis on sectoral approach and results, starting with transparency. In its identification of logistics services as a key component, ASEAN is a precursor.

3. **In the area of transport, progress has been uneven**. In the air transport sector there has been very good progress and good growth of the air transport industry, but the slow implementation of the multilateral agreements by some AMS has impeded rapid progress towards the ASEAN open sky regime, which is scheduled to be achieved by 2015. Not very much has been achieved in the maritime sector on the other hand, and this translates to poor connectivity for several ASEAN members, and very likely a lack of trade facilitation.

4. **This overall progress in facilitating trade is reflected in key international indicators.** Both Doing Business and Logistics Performance Index indicators show that the region is a strong performer compared to other regions of the world and that it has demonstrated measurable progress over the past five years. ASEAN as a group can also benefit from the experience of Singapore, the leading world performer. However, the indicators also show areas in need of improvement: ASEAN does not perform as well as Australia, China, India, Japan, New Zealand, and South Korea on average (hereinafter '+6 countries'), and there is a wide disparity of performance within ASEAN with three of the CLMV countries lagging. Finally, performance on

customs and infrastructure is relatively weaker. This is well acknowledged by the AEC Blueprint where these two sectors are prioritized.

5. **Trade costs have been falling, especially for intra-regional trade.** A new and all-inclusive measure of trade costs shows that these costs have been falling among ASEAN members, more rapidly than with the rest of the world, a possible sign of the effect of ASEAN integration and of some measure of regional preferences at work beyond just tariffs. Trade costs with the rest of the world have fallen too, in particular for two of the CLMV countries, Cambodia and Viet Nam, for which a measure is available. While for other ASEAN members costs have remained relatively more stagnant in the last decade, they are fairly low by international standards. A source of concern for some AMS, however, is that the +6 countries are even more cost competitive, thus showing the need for further progress.

A. Introduction: ASEAN Priorities in Trade Facilitation

6. **Trade facilitation is one of the key goals of the AEC Blueprint.** The AEC work program on trade facilitation focuses on harmonizing, simplifying and modernizing trade and customs processes and customs integration, the development of the ASEAN single window, and on Standards and Conformance. The concept of trade facilitation is, however, used differently in different contexts. At the WTO, for example, it essentially refers to the simplification of customs and border procedures. For the Asia-Pacific Economic Cooperation (APEC) economies, by contrast, trade facilitation has come to mean any policy measure that reduces the transaction costs associated with international trade. The second meaning is much broader than the first one, and presents a number of advantages for assessing country performance. In addition, it highlights the connections between ASEAN's core trade facilitation agenda and its activities in areas such as non-tariff measures and services. The Roadmap for the Integration of Logistics Services, for example, makes it clear that the work programs in these areas have many important synergies.

7. **ASEAN's emphasis in the trade facilitation section of the AEC Blueprint focuses largely on customs, border procedures and standards—and particularly the ASEAN Single Window**. However, this chapter takes a broader approach that includes the full range of trade costs impacting exporters and importers, including in particular logistics performance and transport connectivity, all of which are also an important part of the AEC Blueprint.

8. **One reason for doing so is that such an approach is consistent with the overall aim of this report to focus on actual trade integration outcomes and all policies to support those outcomes, instead of focusing on compliance with specific AEC Blueprint targets.** Another reason for such an approach is that some of these areas are included in other important ASEAN initiatives: for instance logistics in the context of services liberalization and transport. This is particularly important given that more than half of intra-ASEAN trade is dominated by trade in parts and components and intermediate goods, which are particularly sensitive to logistics performance. A third reason is because the trade facilitation agenda as described in this chapter is linked to the broader ASEAN economic integration agenda, in which policies dealing with sectors such as logistics and transport are key components. Broad-sense trade facilitation, which can be

understood as the endeavor to reduce international trade transaction costs that are affected by government policies, is necessarily one of the central pillars of goods market integration in the region, and this chapter aims to assess progress both in terms of policy initiatives and impacts on the ground, as measured by internationally comparable data.

9. **ASEAN countries have already achieved significant gains in trade facilitation and driving down trade costs as discussed later (see Annex to this chapter).** While there have been improvements in all ASEAN countries, there are, however, very large differences in trade facilitation outcomes among the member states. Other studies on ASEAN (Shepherd and Wilson, 2009) also show that the region stands to make significant economic gains from trade facilitation and that these gains could even be considerably larger than those from comparable tariff reductions. Moreover, the gains from reform come largely from improvements at home—in many cases, they can be harvested unilaterally, without waiting for trading partners to reach exactly the same stage of preparation. In line with the broad definition of trade facilitation, a comprehensive reform program would need to cover areas as diverse as transport infrastructure, services sector regulation, and customs administration. Of these, trade flows in ASEAN are particularly sensitive to improvements in transport infrastructure and information and communications technology (ICT). The Annex to this chapter shows that trade costs in ASEAN—which are one driver of trade flows—are highly sensitive to air connectivity and logistics performance. This result lines up well with the research suggesting that trade facilitation has a larger impact on certain types of trade, such as parts and components that are used by transnational production networks (Saslavsky and Shepherd, 2012). This is because such networks are based on the idea of efficient cross-border sourcing of selected inputs, and this is an area where trade facilitation reforms can impact directly.

10. **This chapter is organized in the following way: the next section, B, discusses progress in achieving AEC goals**. Section C looks at one of the key outcomes of trade facilitation policies, trade costs in ASEAN countries. This discussion uses a new and comprehensive measure of aggregate trade costs. Section D continues the discussion on trade facilitation performance by looking at other important outcome indicators. Section F discusses policy issues and implications.

ASEAN Priorities in Trade Facilitation

11. **To achieve an ASEAN single market and production base, as envisaged under the AEC Blueprint, five core elements are required.** One is free flow of goods, which involves elimination of tariffs and non-tariff measures, as well as reforms in the areas of rules of origin, trade facilitation, and standards and conformance. The free flow of goods can be accelerated through effective trade facilitation in order to reduce trade transaction costs in ASEAN. This will enhance export competitiveness, and facilitate the integration of ASEAN into a single market for goods, services, and investments, including a single production base.

12. **AMS have given a high priority to trade facilitation, as clearly emphasized in the AEC Blueprint. Several actions have been planned in order to reduce trade transaction**

costs in ASEAN. These include assessing trade facilitation conditions in ASEAN before developing and implementing a comprehensive trade facilitation work program. The work program fundamentally aims at simplifying, harmonizing, and standardizing trade and customs processes, procedures, and related information flows. In addition, rationalization of non-tariff measures and liberalization of backbone services markets such as transport and logistics—both of which are dealt with separately in the AEC Blueprint—can also contribute to lowering trade costs. The trade facilitation section of the AEC Blueprint establishes mechanisms promoting the transparency and visibility of regulations affecting trade. A regional trade facilitation cooperation mechanism and an ASEAN Trade Repository (ATR) will be established (Box 2.1). Also, a comprehensive capacity building program to ensure smooth implementation of the work program will be developed. Finally, the AEC Blueprint aims to achieve customs integration within the region, together with further development of the ASEAN Single Window (ASW). Importantly, ASW requires the establishment of a National Single Window (NSW) in each AMS (Box 2.2).

Box 2. 1: The ASEAN Framework for Trade Facilitation

The priority action of the Trade Facilitation Work Program for 2008/09 of the Strategic Schedule for AEC is to establish a Regional Trade Facilitation mechanism and establish the ASEAN Trade Facilitation Repository.

The ASEAN Trade Facilitation Joint Consultative Committee (ATF-JCC) was established and the first meeting was convened from July 7-8, 2010 in Thailand. The ATF-JCC aims at strengthening cooperation to promote efficient trade among AMS through trade facilitation reforms and measures. The ATF-JCC serves as a focal point and forum and creates a dialog among national facilitation bodies at the regional level. This forum promotes coordinating and collaborating policies, recommendations, action plans, and the implementation of trade.

AMS have done an assessment of trade facilitation. However, there has been slow progress after the suspension of the ATF-JCC by Senior Economic Officials' Meetings (SEOM) 3/42 in 2011.

Article 13 of the draft ATIGA stipulates that an ASEAN Trade Repository (ATR) shall be established and made accessible to the public through the internet. ATR shall contain trade related information such as: (i) tariff nomenclature; (ii) MFN tariffs, preferential tariffs offered under this Agreement and other Agreements of ASEAN with its Dialogue Partners; (iii) Rules of Origin; (iv) non-tariff measures; (v) national trade and customs laws and rules; (vi) procedures and documentary requirements; (vii) administrative rulings; (viii) best practices in trade facilitation applied by each member state; and (ix) list of authorized traders of member states.

Source: ASEC

B. Progress in Achieving AEC Goals

Good but uneven progress in achieving most of the Trade Facilitation goals

13. **At the 24th AFTA Council in 2010, the Comprehensive Trade Facilitation Work Program was endorsed with the purpose of simplifying, harmonizing, and standardizing trade and customs processes, procedures, and related information flows.** Subsequently,

ASEAN has developed a Work Program for the 2009-2015 period. ASEAN's progress in core areas is reviewed below.

Governance of reforms, monitoring and transparency

14. **Trade facilitation initiatives that have already been adopted include the establishment of national coordinating committees on trade facilitation and national focal points in each member state.** For sanitary and phytosanitary measures (SPS), a coordinating group on SPS has been established in the framework of the AFTA Council. These two approaches to governance reflect the fact that some trade facilitation reforms, such as streamlining of border processes, can be implemented unilaterally, but others are properly the subject of regional cooperation and agreement, as is the case for harmonization of standards, including SPS measures.

15. **In terms of improving the transparency of trade, ASEAN is working towards the establishment of ATR by 2015, in line with the timeline for realization of the AEC.** The ATR will serve as a gateway for regulatory information at regional and national levels. It will carry information on tariff nomenclature, preferential tariffs offered under the ATIGA, rules of origin, non-tariff measures, national trade and customs laws and regulations, documentary requirements, best practices in trade facilitation, and lists of authorized traders of the AMS. The idea is to provide accessible information sources via the internet where countries and organizations can post trade documents and related guidelines for members of the public—exporters, importers, traders, and government agencies—to use as a source of regional trade-related information. Currently, ASEAN is developing the technical design and mechanism of the ATR. In doing so, stock-taking on information at national level needs to be done, because all ASEAN Customs agencies have their websites established, but with different contents, formats, timeliness of information, and accessibility. As this information regarding trade facilitation may already be included in NSWs (see paragraph 12 above and Box 2.2 below), a review may be needed.

16. **Monitoring at country level was foreseen with the trade facilitation assessment of member states every two years.** This has yet to be delivered as noted in the Scorecard report of July 2012. The ASEAN Trade Facilitation Assessment Framework and Indicators, developed and subsequently endorsed by the ASEAN Free Trade Area (AFTA) Council as guidelines for AMS to assess trade facilitation progress in the region every two years, have been suspended since 2011.

Customs Reforms

17. **A chief focus of trade facilitation reform has been in the area of customs.** Efforts are being directed at removing barriers to trade at customs points mainly through the simplification and harmonization of customs procedures and modernization. More specifically, AMS have undertaken the following measures:

Modernization:	**Simplification through ASEAN harmonization:**
Establish pre-arrival clearance	Adoption of a uniform ASEAN Customs Declaration
Develop advance ruling for classification, valuation and origin determination	Implementation of the ASEAN Cargo Processing model
Implement the WTO Customs Valuation Agreement & develop ASEAN guidelines on valuation	Implementation of an ASEAN Transit System with the implementation of protocol 2 and 7 of ATIGA
Establish ASEAN guidelines for risk management	Accession to the ATA and other conventions on temporary admission
	Implementation of the ASEAN Harmonized Tariff Nomenclature and establishment of procedures for tariff classification rulings
Implementation of ASEAN e-Customs	
Development of an ASEAN Single Window	

18. **ASEAN Member States (AMS) have also committed to improving implementation of customs procedures.** This will be done through the development of training materials on customs modernization and essential customs techniques, as well as increasing transparency with the production of a compilation of national customs enforcement legislations.

19. **The modernization of customs techniques and procedures is being accelerated in order to reduce both the time required for the release of shipments from customs control, and associated processing costs.** For instance, the Strategic Program of Customs Development (SPCD) stipulates that any containerized shipment should be released within thirty minutes. ICT applications have been introduced in the customs clearance of goods in all AMS according to international standards.

20. **According to the AEC Scorecard (as of July 2012), customs facilitation has already been realized.** The ASEAN Harmonized Tariff Nomenclature (AHTN) was finalized in 2012, thereby providing a single harmonized tariff for firms doing business in ASEAN. Implementation of the WTO Customs Valuation Agreement has been done for nine of 10 members, and the ASEAN Customs Declaration for eight. The publication of legislation related to customs enforcement has also been done in seven of the AMS. In other areas progress is either more limited, such as for advance ruling, which is implemented in five countries or it is only partially implemented as in a couple of other countries. In general, the state of implementation reveals that where commitments have been met, this often has been after the initial (ambitious) deadlines. However, customs reform is an area in which AMS can benefit substantially from unilateral

reforms, and allowing for a process of catch up—particularly for the CLMV countries—is a natural extension of the reform process.

Box 2. 2: Progress Towards National and ASEAN Single Window

One AEC Blueprint objective is the operationalization of National Single Windows (NSWs), enabling a single submission of data and information, a single and synchronous processing of data and information, and a single decision making entity for customs clearance of cargo. The ASEAN NSW and the ASEAN Single Window initiative have spurred important efforts in the region to streamline border clearance. NSWs are by their nature reforms that can be carried out unilaterally—they benefit the implementing country regardless of what others do. The ASEAN Single Window, by contrast, requires extensive collaboration among AMS, and is necessarily a joint endeavor.

Singapore, with its TradeNet system, is a reference country for the implementation of an electronic single window. The system enables the submission of trade documents to all relevant authorities. A hundred percent of the trade declarations in Singapore are processed by TradeNet. In 2010, there were nine million trade permit applications processed per year and the average processing time was 10 minutes.[37]

Malaysia is the second ASEAN country that has implemented its NSW. It covered 99 percent of imports and 98 percent of exports in 2011. Out of 10,000 registered traders, 9,794 are single window users. The NSW currently links 30 government agencies, a number that should reach 50 by 2015.

Indonesia and the Philippines have made significant progress towards the objective of the NSW with implementation well under way. For the Philippines, the NSW links 38 agencies and is implemented in the key ports and airports and covers 95 percent of imports and 25 percent of exports. Yet only 25 percent of the 10,000 registered traders use the NSW. By 2015 all airports and ports should be covered and 50 agencies should be connected to the NSW.

In Indonesia, 14 agencies are linked to the NSW, a number expected to increase to 17 by 2015. Out of 22,575 registered traders, 7,500 (33 percent) use the single window.

Thailand is in the process of piloting its single window with 26 agencies involved. Brunei Darussalam is in the process of developing the systems architecture for its NSW and with essentially a major port and airport to include, is expected to progress rapidly. In Viet Nam efforts have been made to meet the 2012 deadline for CLMV countries for the implementation of the pilot phase of the NSW by establishing a national steering committee in 2008. Implementation of electronic customs, a pre-requisite for the NSW, is underway and it was expected that 80 percent of customs declarations would be electronic by end of 2011.

Three of the CLMV countries—Cambodia, Lao PDR, and Myanmar—are further away from a NSW. Myanmar has yet to start automating its customs clearance processes, while Lao PDR and Cambodia are working on implementing electronic systems. The preparation of the NSW is still in the initial stages in the countries, with coordination among stakeholders in the countries being established. Lao PDR launched in February 2012 a roadmap to its NSW. With the aim of reducing the NSW gap between the CLMV countries and the other AMS, priority actions include simplifying existing border procedures in preparation for the shift to a NSW system and, following that, simplification and automation of procedures. Once those two goals have been attained, it will be possible for the CLMV countries to move towards the integration of automatic processes that are requires for a NSW.

[37] Source: UNECE (2010).

Of course, establishment of an NSW is on its own not enough to ensure smooth and quick processing of all border documentation. If a large number of agencies are involved in processing, as is the case in some AMS, then even full implementation of an NSW will only reduce costs and times slightly for traders. It is important to combine progress towards an NSW with broader administrative and bureaucratic reforms, such that it becomes the impetus behind a generalized effort towards streamlining in the area of import transactions.

The next step in the process of regional integration is the ASEAN Single Window (ASW). As is clear from above, not all ASEAN Member States are able to participate at this stage, and thus only seven of them are participating in the pilot phase,[38] which will involve only the issuance of the ASEAN Preferential Certificate of Origin and the ASEAN Customs Declaration Document. The network architecture for the pilot project is being implemented.

Source: ERIA (2012)

21. **As of now, seven AMS—Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam—have committed to participate in the ASEAN Single Window (ASW) Pilot Project.** The ASW is now under development to provide an integrated platform of partnership among government agencies and end-users such as economic operators, transport operators, and logistics firms in the movement of goods. To support the implementation of the pilot project, key priorities include the implementation of ASW regional architecture design, and development of the legal framework. The development of the legal framework for implementing measures simplifying, harmonizing, and standardizing trade and customs regarding the ASW is now under discussion, and should be completed by 2013. Box 2.2 outlines experience in the development of NSWs in member states. ASEAN adopted the ASEAN Data Model in April 2008 and upgraded it to the ASEAN Data Model version 2.0 on the basis of international standards such as those of the World Customs Organization (WCO), the International Organization for Standardization (ISO) and the United Nations Economic Commission for Europe (UNECE). Additionally, the application of ICT in all areas including compilation of the technical capabilities of NSWs for connectivity and interoperability has been partially completed. Specifically, it has been completed and endorsed by AMS for component 1, namely design of the most feasible network architecture for the ASW that will allow the exchange of cargo clearance data in an integrated and secure environment. Implementation of component 2 is still ongoing, namely setting up network infrastructure agreed by the AMS to implement the pilot project. The third component of the ASW pilot project will evaluate its outcomes and formulate recommendations for the ASEAN-wide rollout of the ASW.

Standards and Conformance

22. **ASEAN's trade facilitation work extends beyond customs to include other areas, such as standards and conformance**. ASEAN is now seeking to develop product-specific Mutual Recognition Arrangements (MRAs) in conformity assessment so that product-related standards and regulations do not become technical barriers to trade. In line with the development of sectoral MRAs and harmonization of standards and regulatory regimes, ASEAN has developed

[38] Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Viet Nam.

the MRA on Good Manufacturing Practice (GMP) of Inspection of Manufactures of Medicinal Products and implemented the MRA for Electrical and Electronic Equipment (ASEAN EE MRA). A number of conformity assessment bodies have been listed and recognized under the ASEAN EE MRA. Currently 21 testing laboratories and four certification bodies are listed. At the same time, ASEAN has transposed the ASEAN Cosmetic Directive (ACD) into national legislation and put in place a notification system for the placement of cosmetic products. The endorsement of the ASEAN Regulatory Framework on Traditional Medicines and Health Supplements is expected to be finalized by December 31, 2013 as its transposition into national legislation of AMS is anticipated by the end of December 2015. Moreover, the region will implement the ASEAN Harmonized Electrical and Electronic Equipment Regulatory Regime (AHEEERR) to ensure the free flow of safe and quality EEE products in the region. Ratification of AHEEER by all AMS has now been completed, paving the way for full implementation.

C. Trade Costs in ASEAN

23. **Trade facilitation is a key determinant of trade costs, and trade costs have a decisive effect on ASEAN's trade pattern and performance**. All else being equal, bilateral routes with lower trade costs should see more exports than those with higher trade costs. Recent methodological advances in the international trade literature make it possible to obtain all-inclusive estimates of bilateral trade costs (Arvis et al., 2013). Thus, analyzing trade costs provides a good look at the overall effect of reforms that contribute to better integrate ASEAN economies to regional and global trade. This section examines the trends in trade costs in some detail to better understand the determinants of ASEAN's trade patterns, and their relationship to trade facilitation.

24. **From a policy point of view, the most important feature to note about the trade cost calculations (Arvis et al., 2013) is that they are 'top down,' in the sense that they infer the level of trade costs from observations on the pattern of trade and production across countries.** Trade costs calculated in this way include all factors that drive a wedge between export and import prices, including those for which data are not easily available, such as many non-tariff measures, the performance of backbone services sectors like transport and logistics, and other non-traditional trade policy measures. As a result of their top down, all-inclusive nature, these trade cost measures are much larger than traditional trade policy measures, such as average tariffs or trade restrictiveness indices (such as the one produced by the World Bank: see Kee et al., 2009). The reason for this is that these measures include both policy-related trade costs from all sources—between, at, and behind the border—and other 'natural' barriers such as geographical distance. Only part of the total level of trade costs is amenable to reduction through action by policymakers. In other words, trade facilitation can only reduce part of the overall level of trade costs reported here. It is important not to underestimate that part, however: even 'natural' barriers such as distance depend for their economic impacts on the operation of markets, such as those for international transportation, and thus can have a greater or lesser effect on trade depending on the policy regime in place. Figure 2.1 shows trade costs in manufacturing for the eight ASEAN member countries for which data are available, along with an average figure for the +6 countries. Each data point represents average trade costs between a country and the top ten

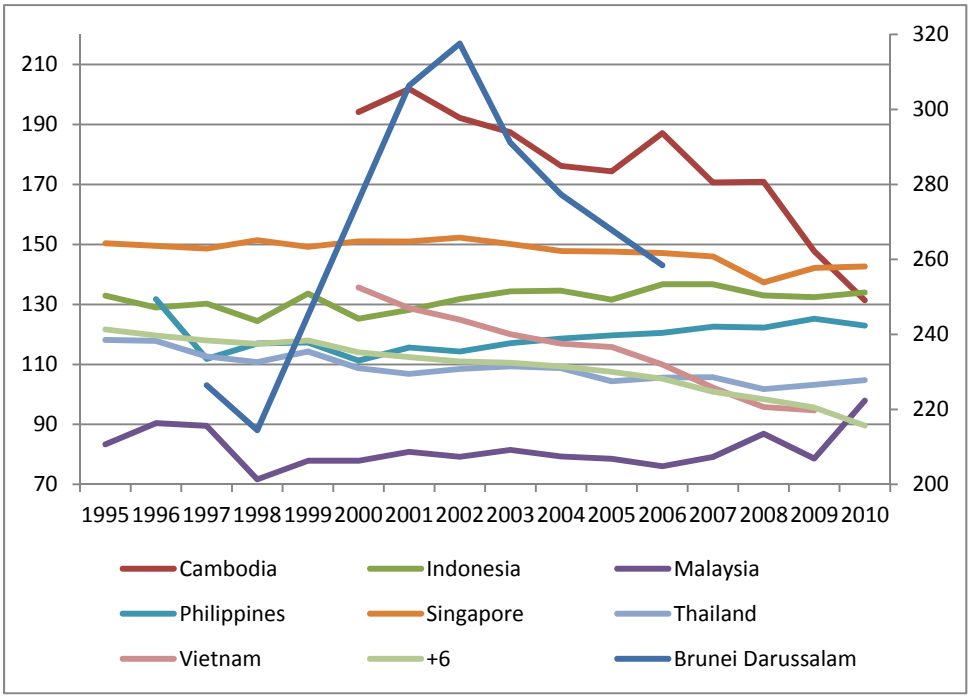
global importers, and can thus be considered an indication of trade costs with respect to the rest of the world. The first feature to note is that, as discussed above, ad valorem equivalents are very high compared with the level of average tariffs: total trade costs of 100-150 percent are common in ASEAN, and lie between the high- and upper-middle-income group averages. Given the range of per capita incomes in ASEAN, performance is thus quite strong relative to other regions, although the numbers at first glance appear high. However, only Malaysia, Viet Nam, and Thailand have levels of trade costs in manufactured goods that are comparable to the +6 group average. To take extra-regional examples as points of comparison, the USA had trade costs of 69 percent in 2010, and Germany had 66 percent, both of which are considerably lower than the levels seen in most AMS.

Box 2. 3: Measuring Trade Costs: Some Methodological Points

A number of caveats need to be kept in mind in interpreting trade costs data of the type computed by Arvis et al. (2013). First, for each country pair the measure represents the geometric average of trade costs in each direction. It is not possible to obtain estimates for each direction separately, but only the two together. Imputing causal effect to policy actions taken by one or other trading partner is therefore difficult. Second, trade costs calculated in this way are the ratio of international to domestic trade costs. A change in the ratio can occur due to a change in international trade costs—the main object of interest here—or in domestic trade costs (distribution costs), or in both simultaneously. Again, this makes attributing causality difficult. Finally, calculating ad valorem equivalent trade costs relies on a number of technical assumptions to which the results are sensitive. Although the level of trade costs is therefore subject to discussion in particular cases, the pattern of change of trade costs over time and across countries is much less sensitive to parameter assumptions, and is in fact highly robust. Thus, the focus is on the pattern of changes in trade costs.

Source: Authors

Figure 2. 1: Trade Costs in Manufactured Goods with Respect to the Top Ten Global Importers, Percent Ad Valorem Equivalent, ASEAN and +6 Countries



Note: Brunei Darussalam is represented on the right axis, while all other countries are on the left axis.

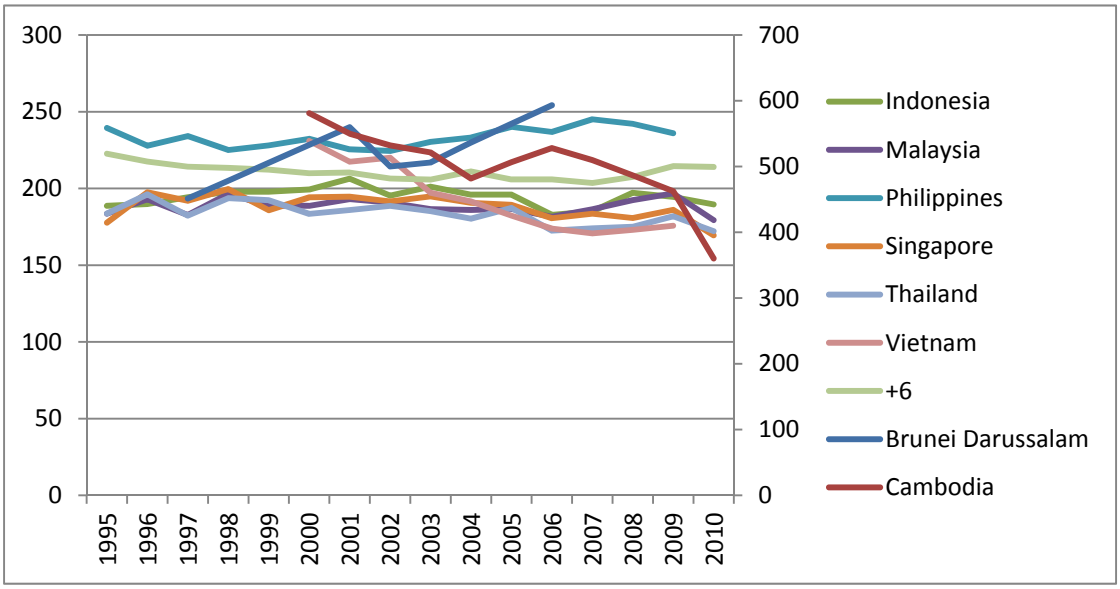
Source: Arvis et al. (2013).

25. **The second feature to note about Figure 2.1 is that trade costs have fallen over time in some ASEAN countries.** This is particularly evident in Cambodia, Viet Nam, and Thailand. This finding suggests that efforts at trade facilitation have been bearing some fruit in those countries, particularly in Cambodia and Viet Nam, although both countries started from relatively high baseline levels. This pattern of generally declining trade costs fits well with other results using data on international freight costs (reported by Findlay, 2009). However, the rate of decline of trade costs in ASEAN is generally slower than in the +6 group, where they fell by over 25 percent between 1995 and 2010. Only Cambodia and Viet Nam display comparable falls over a shorter period, which makes their performance all the more impressive.

26. **However, trade costs in agricultural goods have declined less.** Figure 2.2 shows the same information as in Figure 2.1, but for agricultural products as opposed to manufactured goods. As in all parts of the world, trade costs are substantially higher in agriculture than in manufacturing, which reflects the continued existence of significant policy barriers in markets for primary products. Comparing Figure 2.2 with the income group averages (reported by Arvis et

al., 2013) suggests that although the ASEAN numbers are very large in absolute terms, they are in fact quite moderate by international standards; a comparison with the +6 group average bears this point out. In line with experience in the rest of the world, however, trade costs in agriculture are relatively stable over time in ASEAN, except for the strong declines evident in Cambodia and Viet Nam. Comparing Figure 2.2 with Figure 2.1 suggests that trade facilitation efforts have mainly had an impact on exports of manufactured goods, not agricultural products, which potentially has negative implications in relative terms for those ASEAN member economies in which the agricultural sector remains relatively large, such as CLMV countries. As part of the process of enhancing ASEAN integration and bridging existing gaps between CLMV countries and other AMS, it will be important for CLMV countries to pay more attention than others to the types of trade facilitation measures that reduce trade costs in agricultural markets. Examples include improvements in transport infrastructure, as well as reductions in the barrier effects of SPS measures.

Figure 2. 2: Trade Costs in Agricultural Products with Respect to the Top Ten Global Importers, Percent Ad Valorem Equivalent



Note: Brunei Darussalam and Cambodia are represented on the right axis, while all other countries are represented on the left axis.

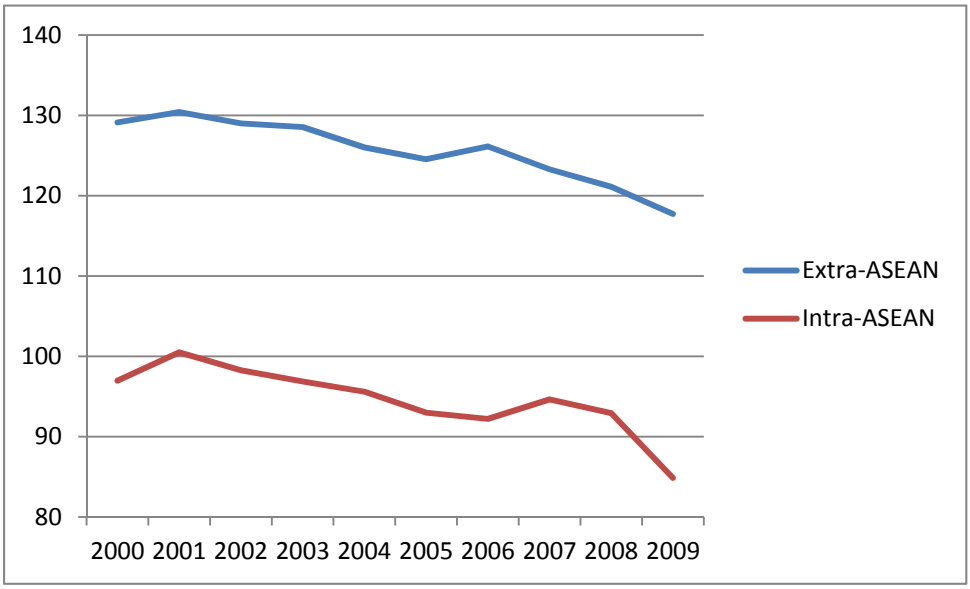
Source: Arvis et al. (2013).

27. **Finally, Figure 2.3 also shows that ASEAN's intra-regional trade costs for manufactured goods are substantially lower than extra-regional trade costs, and that both have been declining significantly.**[39] This finding is consistent with the particularly important role played by intra-regional trade in ASEAN's overall export pattern, as discussed above. The

[39] The same dataset can also be used to compare intra- versus extra-regional trade costs, where the latter are defined as the average trade costs between ASEAN member countries and the top ten global importers. To do so, the discussion here restricts consideration to the period of 2000-2009 in order to ensure a consistent sample for averaging purposes.

lesser distance involved in moving goods within the region as opposed to trading with other regions is one explanation for the difference between intra- and extra-regional trade costs. However, it is also likely that policies giving de jure or de facto preference to regional exports are also at work. Although there is thus some evidence of intra-regional preferences, the fact that intra- and extra-regional trade costs are both declining makes it likely that any trade diversion effects are relatively limited. This finding suggests that not only MFN tariff reductions, but also trade facilitation improvements, which tend to affect all partner countries simultaneously rather than singling out certain markets, can have trade creating effects.

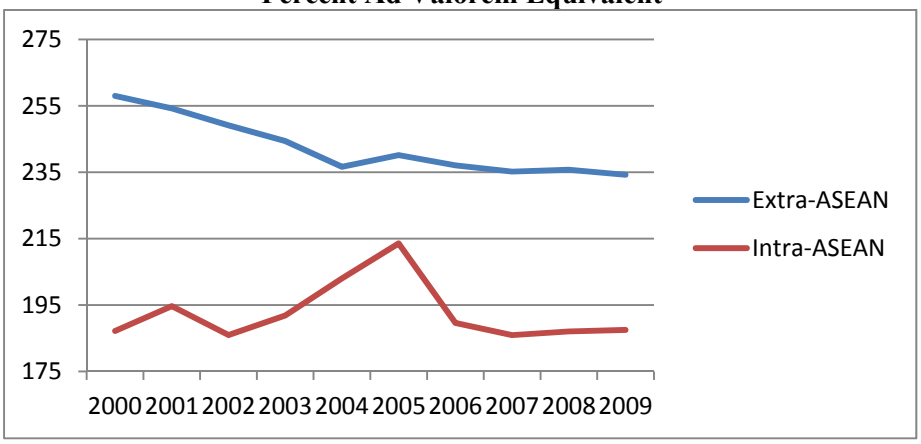
Figure 2. 3: Intra- and Extra-Regional Trade Costs of Manufactured Goods for ASEAN, 2000-2009, Percent Ad Valorem Equivalent



Source: Arvis et al. (2013).

28. **Figure 2.4 presents the same information for agricultural products. Intra- and extra-regional trade costs in agriculture are again much higher than in manufacturing.** Although there is some evidence of a decline in extra-regional trade costs in the first part of the sample period, trade costs in agriculture have been flat over recent years. Figure 2.4 thus provides further evidence that ASEAN's efforts at trade facilitation have primarily born fruit in the manufactured goods sectors, and not as yet in agriculture.

Figure 2. 4: Intra- and Extra-Regional Trade Costs of Agricultural Products for ASEAN, 2000-2009, Percent Ad Valorem Equivalent



Source: Arvis et al. (2013).

29. **Tables 2.1 and 2.2 present bilateral trade costs matrices for intra-ASEAN trade in manufacturing and agriculture respectively.** Three country pairs stand out as having particularly low trade costs in manufacturing: Malaysia and Thailand, Malaysia and Singapore, and Cambodia and Viet Nam. Geographical proximity obviously plays some role in this finding, but policy—including trade facilitation—must also play a role because other nearby country pairs, such as Malaysia and Indonesia, have noticeably higher trade costs. In agriculture, trade costs are generally high, but the Malaysia and Singapore country pair stands out as experiencing a much lower level of trade costs than other routes.

Table 2. 1: Bilateral Trade Costs of Manufacturing Among ASEAN Member Countries, 2009, Percent Ad Valorem Equivalent

	Cambodia	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam
Cambodia		133	85	153	84	70	46
Indonesia	133		60	122	97	89	100
Malaysia	85	60		66	51	40	54
Philippines	153	122	66		115	82	81
Singapore	84	97	51	115		98	105
Thailand	70	89	40	82	98		64
Viet Nam	46	100	54	81	105	64	

Source: Arvis et al. (2013)

Table 2. 2: Bilateral Trade Costs in Agriculture Among ASEAN Member Countries, 2009, Percent Ad Valorem Equivalent

	Cambodia	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam
Cambodia		499	289		202	181	137
Indonesia	499		132	223	110	177	159
Malaysia	289	132		229	81	111	139
Philippines		223	229		177	222	207
Singapore	202	110	81	177		123	133
Thailand	181	177	111	222	123		141
Viet Nam	137	159	139	207	133	141	

Source: Arvis et al. (2013).

30. **What determines trade costs? Recent research, based on data for the whole world, suggests that trade facilitation, transport connectivity and logistics are more important than distance in explaining trade costs (Arvis et al, 2013).** Although distance remains a very significant driver of trade costs, other factors—particularly maritime connectivity and logistics performance—also play a crucial role. As the discussion below shows, trade costs in ASEAN are much more sensitive than trade flows in the rest of the world to two important factors: air transport connectivity and logistics performance. Both factors are crucial in the context of regional production networks that are a notable feature of the trade landscape in the ASEAN region.

31. **Results from the econometric model in the Annex to this chapter show that air connectivity is a much more important factor influencing trade costs in ASEAN compared with other regions**: the relevant coefficients are much larger in absolute value in both manufacturing and agriculture. This finding is consistent with air freight playing a very important role in ASEAN trade flows, perhaps due to the extensive use of air transport and express delivery in the context of regional production networks. In any case, the important role of air transport highlights the importance of continued liberalization in this area—and of the services agenda more broadly—as discussed below.

32. **Model results also show that trade costs in ASEAN are relatively more sensitive to logistics performance**, at least in manufactured goods. Again, the relative coefficient is much larger in absolute value for the ASEAN only sample than for the full country sample. This finding is consistent with an important role for regional production networks in ASEAN, as they rely heavily on efficient transport and logistics to move component parts across borders during the assembly process. This result highlights the importance of trade facilitation in promoting additional ASEAN integration. Again, logistics is a key area of the AEC Blueprint's services agenda, and this finding highlights the important synergies between trade facilitation and trade in services.

33. **Policy has a crucial role to play in shaping factors like air and maritime transport connectivity (see further below) but also more broadly in terms of the trade facilitation environment that itself influences logistics performance outcomes.** Arvis et al. (2013) find that other policy variables, such as tariffs and membership of a regional trade agreement, are also significant determinants of trade costs, although their effects are weaker. This result is in line with much of the trade facilitation literature, which shows that the gains from reform can be larger than those from other trade policy reforms, such as substantial tariff cuts (Shepherd and Wilson, 2009). Interestingly, as can be seen in the Annex to this chapter, trade costs for country pairs with at least one ASEAN member are significantly lower than average. Although the effect of both countries being in ASEAN is less important, the fact that membership of one country has a substantial negative impact on trade costs suggests that concerted unilateral reform in areas like trade facilitation may be playing an important role in reducing trade costs in the region.

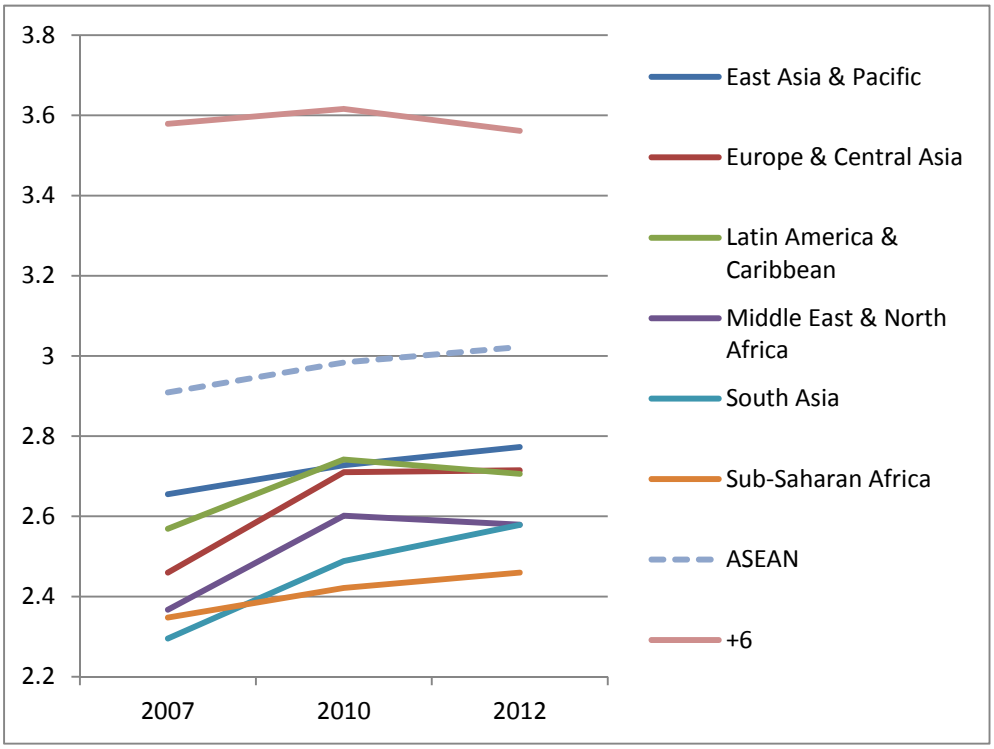
D. Measuring ASEAN's Trade Facilitation Performance

34. **Our review of recent trends in trade facilitation performance first starts with an assessment of the impact of reforms on the perception by private sector operators of the ease of using logistics, transport and border clearance services in their international trade transactions.** This analysis uses data provided by the 2012 Logistics Performance Index. Indicators of policy reform are examined next, using the World Bank's 2013 Doing Business database as a main source, but also drawing on other sources such as UNCTAD. In addition, USITC data on freight costs between AMS and the USA are also examined. On most of these dimensions, ASEAN economies show important improvements in trade logistics, although they are uneven across countries.

35. **According to the Midterm Review Report (ERIA, 2012), the average number of days to complete transactions is still high in ASEAN.** This includes transportation and handling, document preparation, customs clearance, technical control, and port and terminal handling. ERIA also highlights the diversity in logistics performance around the region. Ultimately, ASEAN's aim is to narrow this gap and engender seamless connectivity within the region. ERIA found improvements in the efficiency and quality of trade facilitation in Cambodia, Myanmar, and Lao PDR. According to their surveys in AMS, ASEAN's trade facilitation initiatives have increasingly helped streamline trade procedures and transactions. For example, customs modernization initiatives in CLMV countries, although not yet complete, are likely key reasons for the significant number of substantial improvements, as is the introduction of electronic payment of customs duties in the Philippines. Nonetheless, it is clear that significant challenges on trade facilitation still exist, including too many documentary requirements, complex and diverse permit processes, irregular and arbitrary payments, inefficient duty drawback systems, the need for further developments in automation, interconnectivity, and the single window. Consequently, ERIA recommended improvements such as minimizing the numbers of trade documents, reducing the physical inspection rate of goods, accelerating and encouraging the full roll out of NSWs, and extending the scope of ASW pilot projects.

36. **Results from the International LPI confirm that Singapore is a world leader in this area: it was ranked first globally in 2007 and 2012, and second in 2010.** Benchmarking regional performance against Singapore is therefore equivalent to using global best practice. On average, ASEAN is a strong performer in logistics and trade facilitation, and this has consistently been the case since the first LPI survey in 2007 (Figure 2.5). A steady pattern of improvement is evident from 2007 to 2012. This is particularly significant because, as shown in the Annex, trade costs in ASEAN are more sensitive to logistics performance than is the case on average in the rest of the world. In all three LPIs, ASEAN's average score is much higher than the average for any developing region, and is also higher than the upper-middle income group average. This result is striking given the range of per capita incomes in ASEAN, but the overall average masks considerable variation across member states.

Figure 2. 5: Internal LPI Scores, Averaged by World Bank Region (High Income Countries Excluded), ASEAN and the +6 Countries, 2007-2010



Note: Data are unavailable for Brunei Darussalam. +6 refers to China, India, Japan, Korea, Australia, and New Zealand.

Source: Logistics Performance Index 2007-2012.

Box 2. 4: The World Bank's Logistics Performance Index (LPI)

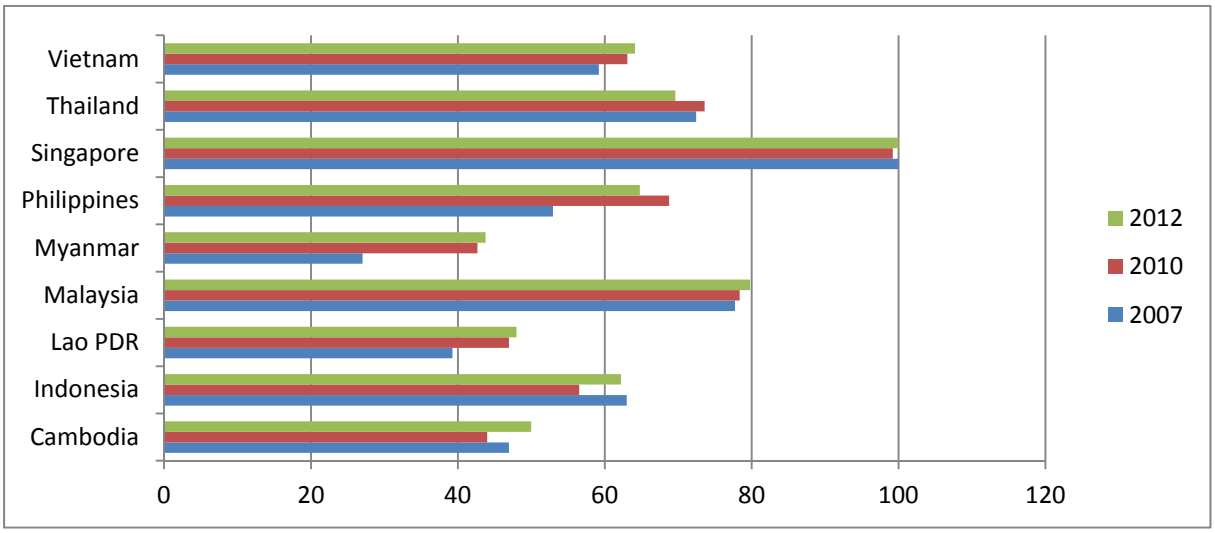
The LPI is the leading cross-country dataset on trade facilitation and logistics performance, covering up to 155 countries, including all ASEAN Member States except Brunei Darussalam. It is based on a survey of around 1,000 logistics professionals worldwide. Survey participations are first asked to provide qualitative information on the logistics environment in up to eight overseas markets with which they work (the International LPI). The International LPI is a weighted average of performance in six areas: efficiency of the clearance process; quality of trade and transport infrastructure; ease of arranging competitively priced shipments; competence and quality of logistics services; ability to track and trace consignments; and timeliness of shipments. In the second part of the survey (the Domestic LPI), participants provide information on the logistics environment in their own country, including time and cost parameters.

Source: Authors

37. **This variation in country performance is reflected in the fact that ASEAN's average is lower than the +6 group in all three years, although the gap narrowed somewhat in 2012**. The +6 group also includes a range of country income levels, but is primarily made up of high income countries, which goes some way towards explaining the gap in performance. The two non-high income countries in the group—India and China—are strong regional performers. There is thus considerable scope for catch up on trade facilitation and logistics performance in the context of ASEAN+6 integration efforts.

38. **In addition to highlighting the strong performance by some ASEAN member countries, individual scores also reinforce the general impression of improvement given by the regional average score from 2007 through 2012.** The Relative LPI—each country's score expressed as a percentage of the global top performer's score—shows consistent improvement over the last five years (Figure 2.6). Seven of the nine ASEAN member countries for which data are available have improved their International LPI score relative to the global leader between 2010 and 2012, which indicates that their performance is improving at a faster rate than elsewhere around the globe.

Figure 2. 6: International LPI Scores as a Percentage of the Top Performer, 2007-2012



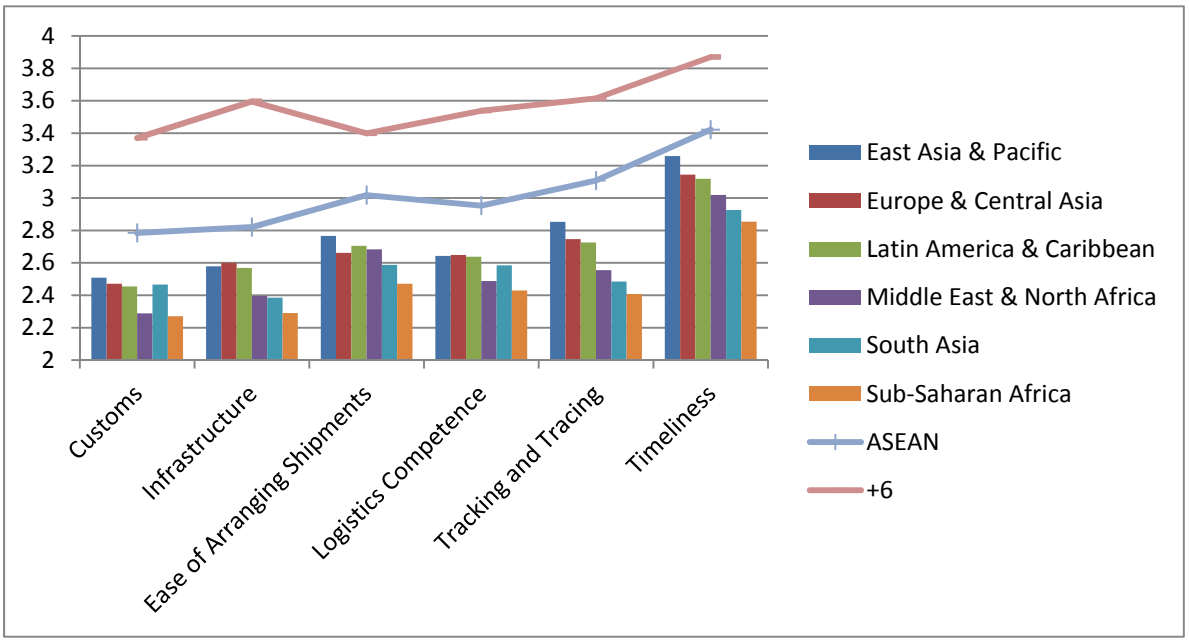
Source: Logistics Performance Index 2007-2012.

39. **According to the assessment of professionals on the ground, AMS on average perform consistently in all areas of logistics and trade facilitation.** Timeliness of delivery is a factor that stands out particularly strongly relative to other regions, and relative to scores in other core components of the International LPI (Figure 2.7). Performance in customs and infrastructure is relatively weaker than in other components, but still compares favorably with that of other developing regions. A comparison of performance with the +6 countries is again telling, however: the +6 countries out-perform ASEAN on every component of the LPI. The gap is particularly large in relative terms—over 20 percent—in infrastructure. Policymakers should therefore give particular attention to infrastructure, in ongoing efforts aimed at increasing integration among ASEAN countries.

40. **Again, the overall strong result for ASEAN masks considerable heterogeneity across individual AMS** (Figure 2.8). The higher per capita GDP AMS have already made substantial investments in areas such as infrastructure and customs reform—the latter in line with the emphasis of the AEC Blueprint—and this approach seems to be bearing some fruit. However, moving from the middle categories of logistics performance to the top category will require consistent improvement across areas and difficult additional investments. These include improvement of trade-related infrastructure, and development of private sector capacity in the area of logistics services, based on market-friendly regulations and openness to FDI in this sector. However, it can be seen in the Annex that such reforms can be expected to have tangible and significant benefits in terms of lower trade costs, and increased trade integration.

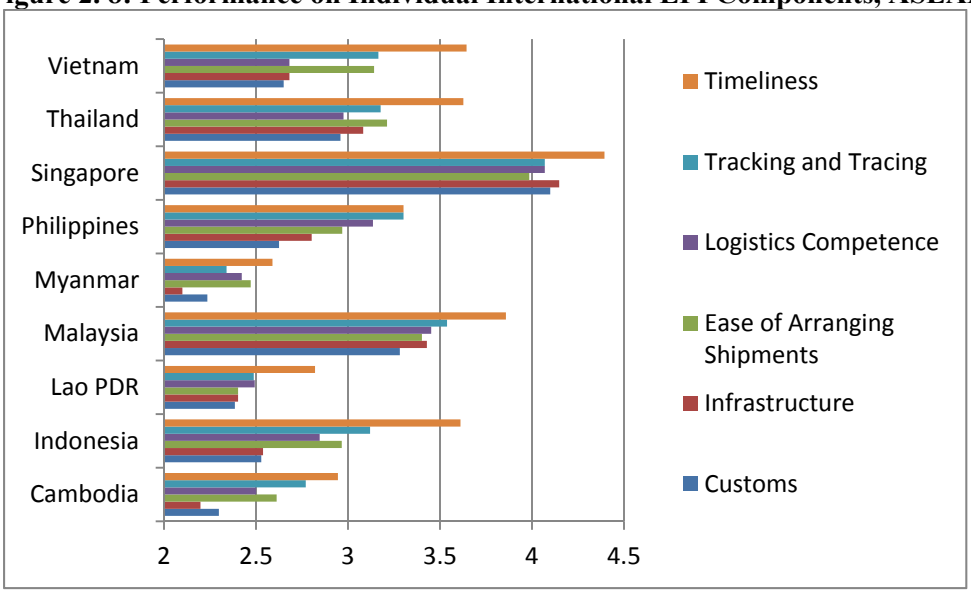
41. **In the CLMV countries, on the other hand, infrastructure and customs continue to represent significant drags on overall performance.** However, as discussed in further detail below, performance is not only a function of physical infrastructure, it also depends on efficient and effective regulation of transport and logistics services, an area in which continued efforts are required in many AMS. The objective of narrowing the gap between CLMV countries and the other AMS suggests that they should, with regional partners, give special attention to improving the quality and quantity of trade-related infrastructure, as well as the performance of customs and border agencies. The first aspect means not only paying attention to ports and airports, but also internal routes that are commercially important, such as key roads linking international gateways with production sites. In terms of customs and border procedures, the reforms required to move towards implementation of an NSW will do much to improve the trading environment, and should be a priority for CLMV countries.

Figure 2. 7: Performance on Individual International LPI components, Averaged by World Bank Region (High Income Countries Excluded), ASEAN and the +6 Countries



Source: Logistics Performance Index 2012.

Figure 2. 8: Performance on Individual International LPI Components, ASEAN

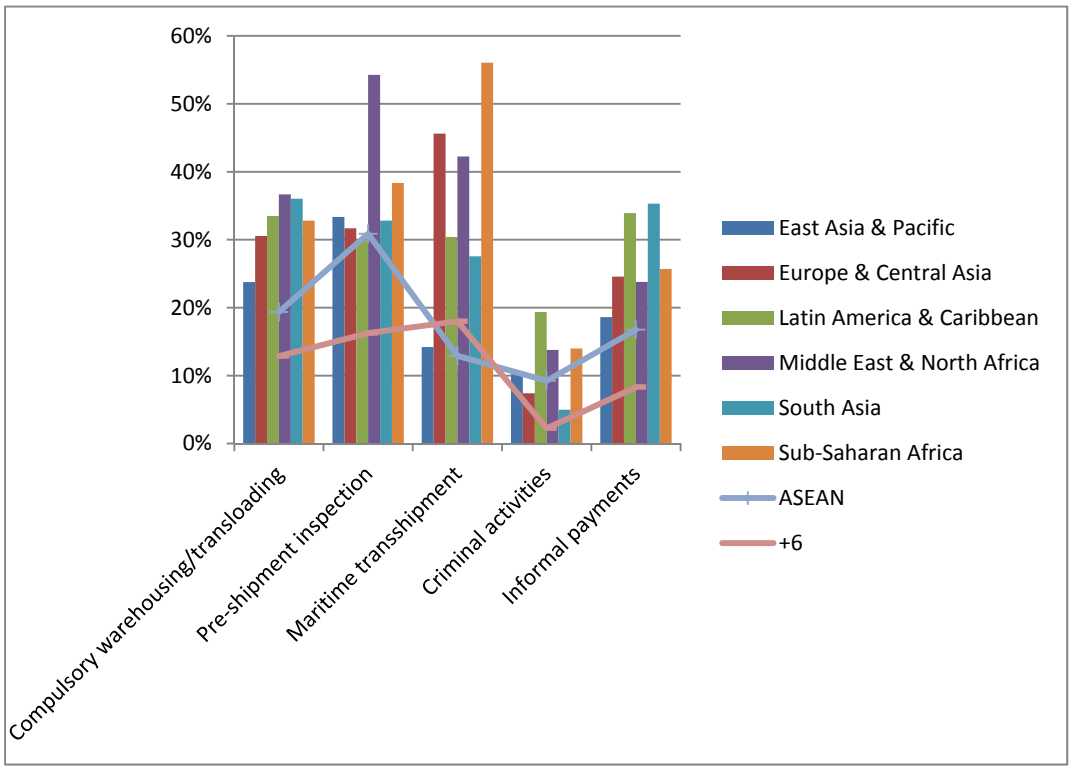


Source: Logistics Performance Index 2012.

42. **Because a supply chain is only as strong as its weakest link, major delays at particular points can constitute significant burdens on overall performance**. The Domestic LPI makes it possible to identify the prevalence of different sources of delay in the context of logistics operations. Logistics operations in ASEAN generally suffer from less prevalent delays than in other developing regions (Figure 2.9). Performance is particularly strong in relative terms in compulsory warehousing, maritime trans-shipment, and informal payments.

43. **In contrast, governance of the supply chain and the prevalence of informal payments is a serious issue in some ASEAN countries, such as Cambodia, Indonesia, and to a lesser extent, the Philippines and Viet Nam.** By contrast, performance is more in line with that of other developing regions in pre-shipment inspection and in criminal activities. Comparing ASEAN's performance with that of the +6 countries again suggests that there is a significant gap in most areas: the +6 countries report fewer delays from all sources except maritime trans-shipment, and the differences are substantial in most cases. Overall supply chain performance is therefore likely to be significantly stronger in the +6 countries than in ASEAN, and this is an area policymakers will need to address going forward.

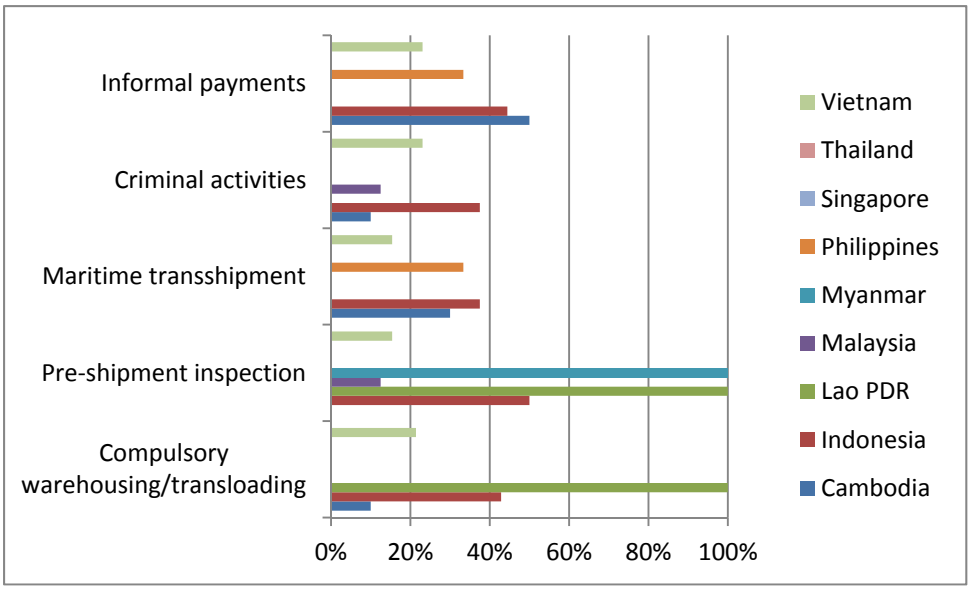
Figure 2. 9: Major Delays from Stated Sources, Percentage of Respondents, Averaged by World Bank Region (High Income Countries Excluded), ASEAN and the +6 Countries



Source: Logistics Performance Index 2012.

44. **However, results for individual AMS display considerable variations around these averages (Figure 2.10).** Respondents from Singapore and Thailand do not report any major sources of delay, whereas all respondents from Lao PDR report major delays stemming from compulsory warehousing and pre-shipment inspection, and the same is true of pre-shipment inspection in Myanmar. Although the region's performance on average is strong in the area of informal payments, the data suggest that significant problems persist in Cambodia and Indonesia, and to a lesser extent, in the Philippines and Viet Nam. Addressing these sources of delay should be important priorities for policymakers going forward, as they have the potential to impose significant burdens on supply chain operators.

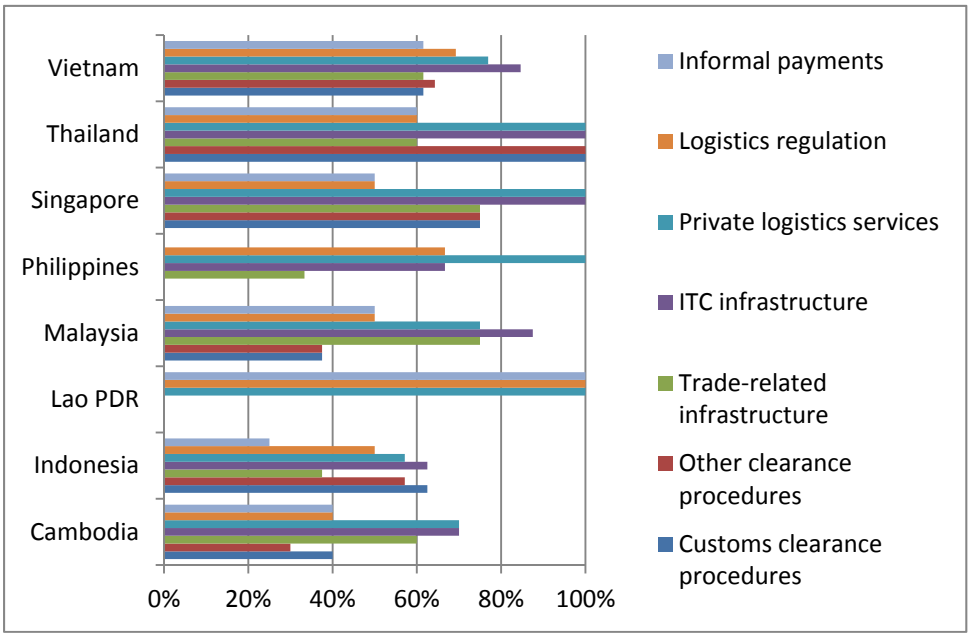
Figure 2. 10: Major Delays from Stated Sources, Percentage of Respondents, ASEAN



Source: Logistics Performance Index 2012.

45. **There is indeed evidence from the domestic LPI data that ASEAN has been consistently improving its logistics performance over recent years.** In the 2012 survey, logistics operators identified a number of areas that have improved since the previous edition of the LPI (2010) (Figure 2.11). The strongest improvements are seen in the development of private logistics services, and the spread of information and communication technologies. In two other areas—logistics regulation and informal payments—the level of improvement is generally weaker. Logistics regulation is an important area because it is tied to the integration agenda behind the AEC, in which logistics is one of the priority services sectors but implementation on the ground has been found to be lagging in some countries (see below). In all cases, however, experiences differ notably across AMS. Significant improvement is evident in a variety of areas in regional leader Singapore, as well as in Thailand and Viet Nam. There is also evidence of improvement starting from a weak baseline in Lao PDR, but data are not available in all areas. Improvements are more limited in Cambodia and Indonesia.

Figure 2. 11: Improvements in the Logistics Environment, Percentage of Respondents, ASEAN



Source: Logistics Performance Index 2012.

46. **The LPI data also suggest that customs and border procedures are improving throughout the region, particularly in Thailand and Singapore, as well as in Viet Nam and Indonesia.** This evidence sits well with the results of a survey conducted by ERIA, in which over half of respondents indicated improvements in various customs processes. These included the submission of forms for clearance, inspection and release of goods, tariff classification, obtaining certificates of origin, payment of customs duties, and getting certificates, permits, or licenses from agriculture and health departments. As discussed further in Chapter 3, the AEC Blueprint includes a number of priority services sectors for liberalization. Air transport is one of the four original priority service sectors, and it is discussed in further detail below as it is of particular relevance for trade facilitation. Maritime transport is included as part of logistics, which is the fifth priority sector. Although liberalization undertakings to date have been more limited, this sector is due to be liberalized under the AEC Blueprint.

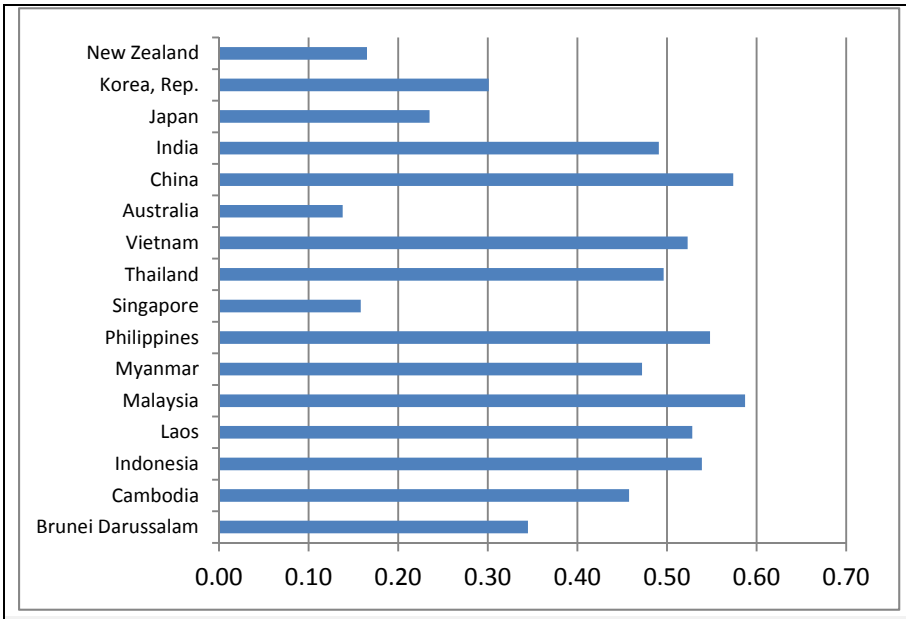
Box 2. 5: Logistics Services in the ASEAN Economic Community (AEC)

Logistics is the fifth priority service sector identified by the AEC Blueprint. Due to its nature, logistics is really a cluster of interlinked activities. There is no international industry classification that treats logistics as an independent sector. The Roadmap for the Integration of Logistics Services therefore outlines 44 separate actions in sectors including: maritime cargo handling; storage and warehousing; freight transport agencies; other auxiliary services; packaging services; customs clearance services; maritime transport services; air freight services; rail freight services; and road freight transport services. There are obviously important synergies between the logistics agenda (services), investment, and trade facilitation, which AMS can exploit to maximize the gains from reform.

Liberalization in logistics is due slightly later than the four original sectors. However, by 2013 foreign equity limits in logistics service providers are to be raised to at least 70 percent, which could encourage substantial cross-border investment in this sector. Liberalizing investment in this way could provide an important impetus to growth and consolidation in a sector where scale effects and network development are particularly important. Foreign equity limits should already have been raised to at least 51 percent, but USITC (2010) finds cause for concern in a number of AMS. According to industry sources cited in the report, lower restrictions on foreign investment continued to apply as of the date of writing in Thailand, Philippines, and Indonesia, for example. It is thus possible that there is a substantial implementation gap in terms of the planned liberalization of the logistics sector, and AMS will need to give the matter renewed attention as the 2013 deadline for raising foreign equity limits to 70 percent looms.

Consistent with these concerns, Hollweg and Wong (2009) report that a range of restrictive measures against foreign service providers in six key sectors (customs, investment, movement of people, maritime, aviation, and road transport) continue to apply in AMS (Figure 2.12). The average restrictiveness score in ASEAN is 0.47, compared with a more liberal score of 0.35 in the +6 countries. The comparison between the two groups is even more striking when it is noted that the +6 group average is strongly influenced by the relatively restrictive policy regimes in place in India and China. Among the ASEAN countries, only high-income Singapore has a level of restrictiveness that is comparable to that of the +6 group, excluding China and India. Overall, the data suggest that much remains to be done in terms of integrating the logistics sector within ASEAN. This view is reinforced by the multi-faceted nature of the Roadmap for the Integration of ASEAN Logistics, which covers a wide range of areas in transport, trade facilitation and customs, and logistics services. Indeed, the Roadmap highlights the important synergies between trade facilitation and services. However, by excluding maritime cabotage from the areas of reform, the Roadmap forgoes an important source of potential trade facilitation gains, particularly for archipelagic AMS. In addition to restrictions on commercial presence, policies that limit competition in crucial sectors like transport, such as those limiting hours of operation or the range of services that can be offered by foreign companies, contribute to the overall level of restrictiveness observed in ASEAN.

Figure 2. 12: Logistics Restrictiveness Index for Foreign Services Providers, ASEAN+6



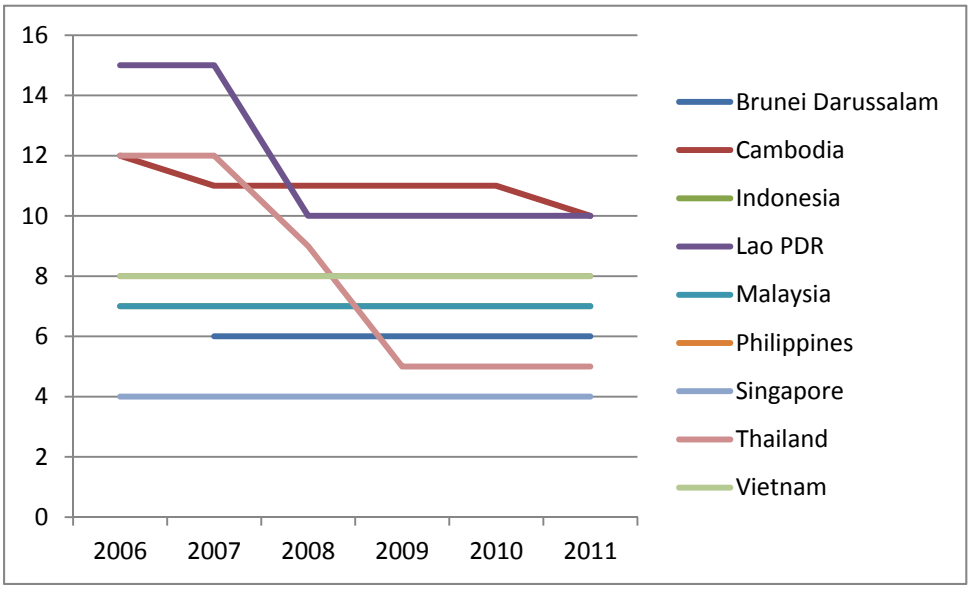
Source: Hollweg and Wong (2009).

Assessing Policy Progress in ASEAN

47. **Whereas the LPI takes an outcome-based approach to measuring performance in trade facilitation and logistics, data from the World Bank's Doing Business project provide more detailed information on the red-tape barriers affecting international trade transactions.** Figure 2.13 presents data on the number of documents required for import transactions in ASEAN member countries over the last five years. The number is stable in most countries: only Lao PDR, Thailand, and to a lesser extent Cambodia exhibit evidence of substantial recent reductions in import red tape. Most countries are still some distance away from regional (and global) best practice in Singapore, where only four documents are required for imports (bill of lading, commercial invoice, import declaration, and packing list).[40] Achieving the target of a regional average of four documents by 2015 remains a significant challenge for most AMS, although the trend is clearly in the right direction: the average number of documents required for imports was nine in 2006 compared with seven in 2011. The finding that customs and other border formalities still appear to require additional reforms in many AMS is in line with the business survey data reported by Findlay (2009). As discussed below, the implementation of a Single Window system throughout the region will be important in reforming customs and border procedures going forward.

[40] By contrast, Cambodia requires in addition the following documents: certificate of origin, a cargo release order, import permit, insurance certificate, tax certificate, and terminal handling receipts.

Figure 2. 13: Documents Required to Import in ASEAN Member Countries, 2006-2011



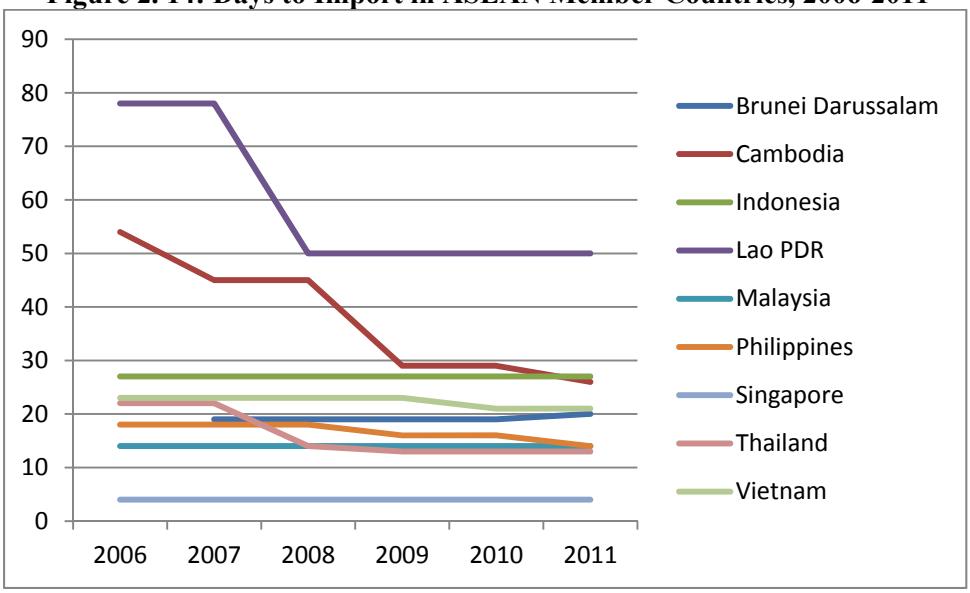
Note: Philippines and Viet Nam are both constant at eight documents throughout the entire period.
Source: Doing Business 2012.

48. **Figure 2.14 presents similar information for the number of days taken to import goods.** Given that document preparation usually represents a substantial part of the overall time required to conduct an import transaction, it is not surprising that the overall result is similar to that for all documents; the only major reductions in time are in Lao PDR, Cambodia, and Thailand, with smaller reductions in the Philippines and Viet Nam. As was the case for import documents, the target of a regional average of 14 days is ambitious and will require substantial additional actions from most ASEAN member countries. However, as with documents, the trend is clearly in the right direction: the regional average time to import fell from 30 days in 2006 to 21 days in 2011. Taking Figures 2.13 and 2.14 together suggests that only a limited amount of administrative streamlining has been taking place on the import side in ASEAN, and there is clearly greater scope in most countries for additional measures to reduce the red-tape burdens affecting traders.

49. **The lion's share of the time it takes to import and export is taken by document preparation (Figure 2.15), clearly highlighting the scope for improvement in bureaucratic processes in order to speed up trade transactions**. There are considerable differences in performance—from one day in the case of Singapore, to 29 days in Laos. While the results achieved by Singapore may be difficult to replicate in large countries with many entry points and without similar electronic information infrastructure, comparison with the better performers in

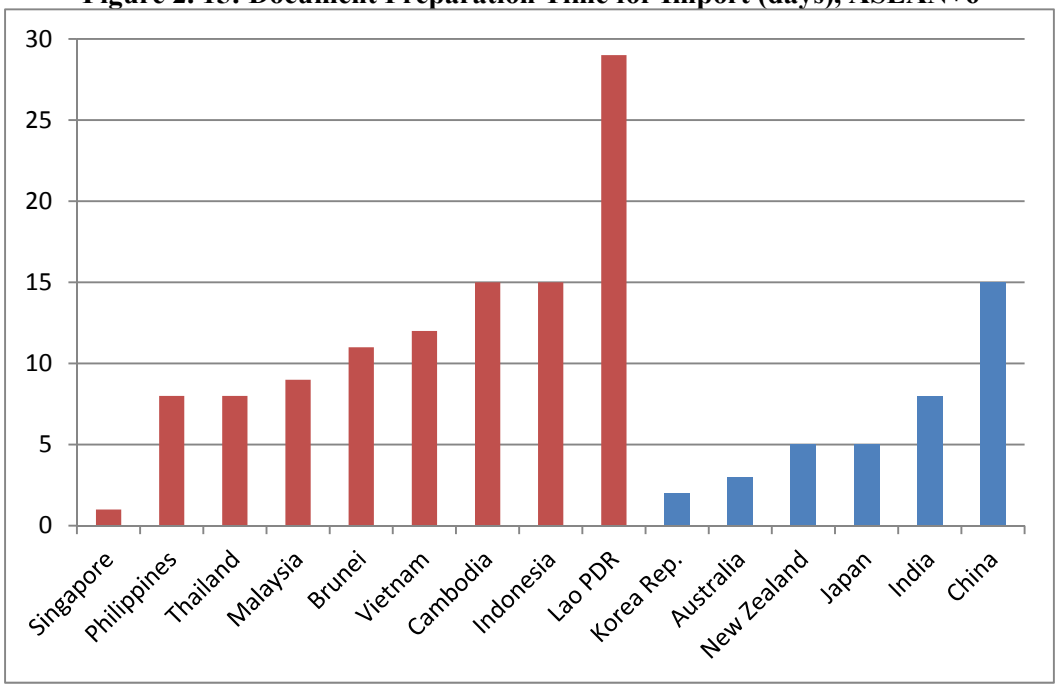
ASEAN and among its ASEAN+6 partners (Philippines, Thailand and India) suggests scope for significant reduction in the number of days.

Figure 2. 14: Days to Import in ASEAN Member Countries, 2006-2011



Source: Doing Business 2012

Figure 2. 15: Document Preparation Time for Import (days), ASEAN+6

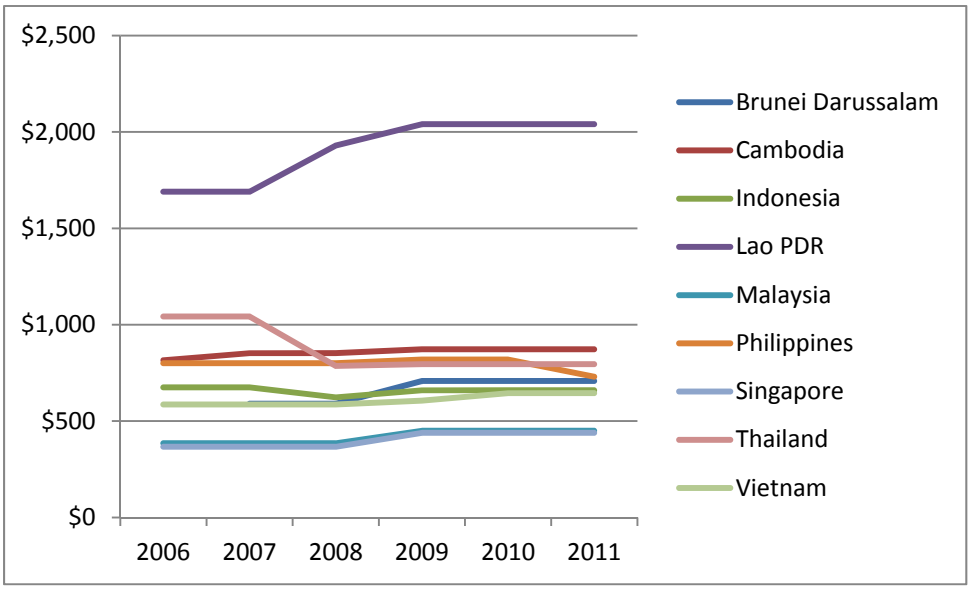


Source: Doing Business 2012

50. **Costs for importing, another key indicator of trade facilitation, have generally increased slightly or remained stable**. Figure 2.16 shows Doing Business data on the cost to import in ASEAN countries. Only in Thailand has the significant reduction in red tape referred to

above translated into substantially lower import costs. In Lao PDR, by contrast, reductions in the time and number of documents required for imports have not been followed by corresponding changes in cost: the cost of importing has actually increased substantially in recent years. Again, Singapore represents an important stock of regional best practice in terms of low cost trade transactions, followed closely in this case by Malaysia. The 2015 target of a regional average level of USD 625 seems difficult to achieve at this point, given that average import costs have increased from USD 795 to USD 815 over the period 2006-2011.

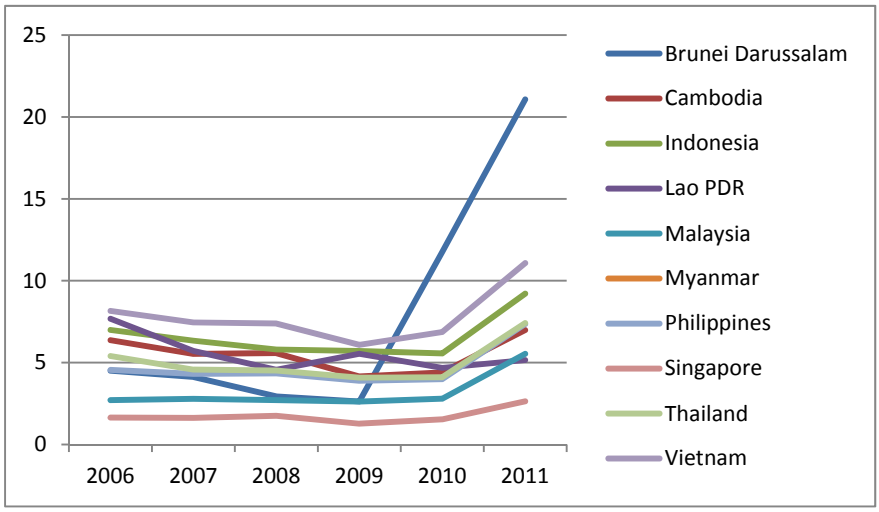
Figure 2. 16: Cost to Import (USD) in ASEAN Member Countries, 2006-2011



Source: Doing Business.

51. **The slow progress in reducing import costs is reflected in freight cost data.** Whereas the Doing Business cost data focus on the movement of goods from their point of arrival in the importing country to the buyer's warehouse, the US International Trade Commission reports data on international freight costs—that is, the cost of moving goods between, rather than within, countries. Figure 2.17 shows these data for ASEAN exports to the USA between 2006 and 2011. Between 2006 and 2010, freight rates fell from 5.4 percent to 5.1 percent of the value of imports. Rates increased sharply in 2011, but it remains to be seen whether that jump represents a single year outlier observation or the beginning of an upward trend. In any case, further action is necessary to bring ASEAN member countries into line with the target of four percent by 2015; currently only Singapore is below this threshold (2.6 percent).

Figure 2. 17: Total Freight Costs from ASEAN Member Countries to USA, Percent of Import Value

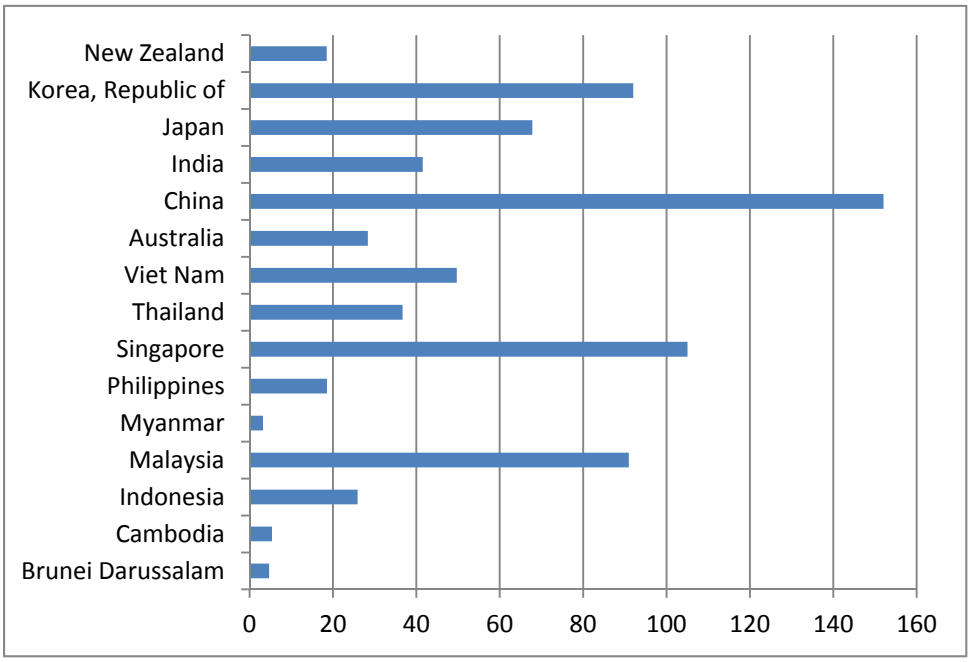


Source: ASEAN Secretariat; US International Trade Commission.

52. **In addition to the simplification of documents and processes, another area in which ASEAN member countries have been active is the transport sector.** Important steps have been taken towards the liberalization of air transport markets, although much remains to be done in some countries (see Box 2.6). These efforts are expected to translate into improved connectivity for ASEAN countries, and this outcome can be investigated using the World Bank's Air Connectivity Index and UNCTAD's Liner Shipping Connectivity Index (for maritime transport). Both approaches would examine trade facilitation from the point of view of services sector integration and competitiveness, because the two are intimately linked. The Annex to this chapter shows that trade costs in ASEAN are particularly sensitive to connectivity, and most notably air connectivity, which means that reforms in this area can have important trade benefits for AMS.

53. **UNCTAD's Liner Shipping Connectivity Index (LSCI) is a weighted average of a number of characteristics of the liner shipping market in each country.** It is only calculated for countries that have direct maritime access, so no data are available for Lao PDR. The LSCI summarizes data in the following dimensions: the number of ships that provide service; their combined carrying capacity; the number of companies that provide service; the number of services; and the size of the largest vessel. Data in Figure 2.18 show that there are significant performance differences among ASEAN countries, and between ASEAN and the +6 group. The average LSCI score for ASEAN is 38, whereas it is 67 for the +6 countries. China outperforms all ASEAN countries in terms of connectivity, and only Malaysia and Singapore have scores comparable with that of Korea. Scores in Brunei Darussalam, Cambodia, and Myanmar are very low, which is consistent with these countries remaining relatively marginalized from international shipping routes. Viet Nam's performance stands out, however, as relatively strong compared with its level of per capita income: its score is higher than the scores of India, Thailand, and Indonesia.

Figure 2. 18: Liner Shipping Connectivity Index Scores for the ASEAN+6 Countries 2011 (mac.2004=100)

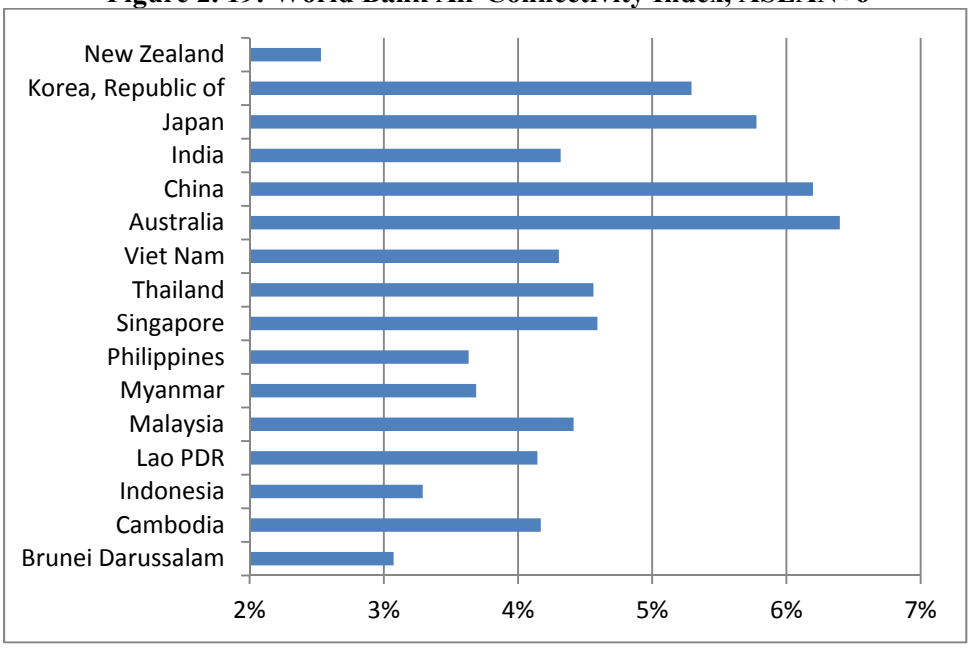


Note: The LSCI is not calculated for Lao PDR, as it is landlocked.
Source: UNCTAD.

54. **The World Bank's Air Connectivity Index (Arvis and Shepherd, 2011) uses a different approach from UNCTAD's LSCI.** This approach leverages the network structure of international air transport flows to measure connectivity as the total 'push' or 'pull' a country exercises with respect to the rest of the world, taking account of both direct and indirect connections. It is, therefore, a measure of connectivity that is more grounded in network analysis methods than the linear model behind UNCTAD's LSCI. Results in Figure 2.19 again show that average connectivity in ASEAN is lower than in the +6 group—3.5 percent versus 4.6 percent—although the gap is much narrower than in the case of maritime transport. Performance is also more homogeneous within the ASEAN group than was the case for the LSCI, which reflects the fact that all countries in the region are relatively distant from the central air transport hubs of USA and Europe. Nonetheless, the comparison between connectivity scores in maritime and air transport suggests that progress has been more uniform in the latter case, and that performance is now more comparable to the +6 group.

55. **Given the geographical features of the region, however, there is scope and need for improving connectivity further. This requires a multi-faceted approach, as set out in the ASEAN Master Plan on Connectivity (ASEAN, 2010).** Physical infrastructure is one part of this approach. Upgrading of ports and airports remains a priority in some countries. For instance, the planned expansion of port facilities in Indonesia will help improve both inter- and intra-national connectivity.

Figure 2. 19: World Bank Air Connectivity Index, ASEAN+6



Source: Arvis and Shepherd (2011).

56. **As highlighted by UNCTAD's LSCI, the development of transport services markets is also important**. Fostering competition and removing market entry barriers can help lower prices and expand the range of services offered.

57. **In the case of air transport, the evidence (Arvis and Shepherd, 2011) suggests that performance is strongly correlated with the degree of policy liberalization in air transport markets, achieved through bilateral and plurilateral agreements.** Although ASEAN has taken significant steps forward in this area, much remains to be done (see Box 2.6). Even more work is required in the maritime transport sector. Although the progressive liberalization of the sector is foreshadowed by the Roadmap towards an Integrated and Competitive Maritime Transport in ASEAN, implementation on the ground remains limited. For the archipelagic ASEAN member countries, the effective exclusion of cabotage from the liberalization agenda suggests that substantial trade gains are being foregone. The integration of regional air and maritime transport markets could have a significant positive effect on connectivity, which would in turn help support the continued development of networked production within the region.

58. **In the 1990s, ASEAN governments started to liberalize their domestic and international aviation sectors, but it was not until the late 1990s that regional liberalization of air transport was initiated**. The 1997 ASEAN Plan of Action in Transport and Communications referred to the development of a competitive air services policy. Around this period the development of an ASEAN Open-Sky Policy started being considered.

Box 2. 6: Air Transport Liberalization: From Open Skies to the ASEAN Single Aviation Market

In contrast with many other areas of trade facilitation, air services require joint action because they inherently involve at least two, and sometimes more, countries. At the 1995 fifth ASEAN summit in Bangkok, members included the development of an Open Sky Policy in the Plan of Action for Transport and Communications (1994-1996). At the same time, ASEAN members adopted a Framework Agreement on Services (AFAS) to liberalize services trade, including air transport.

In 2002, the ASEAN Memorandum of Understanding (MOU) on Air Freight Services was signed. This liberalization was limited only to all-cargo services up to 100 tons weekly based on a point-to-point route, with no limitations on frequency and aircraft type. The MOU provides for first, second, third, fourth, and fifth freedom rights within the region. In 2007, the agreement was amended to increase the authorized capacity to 250 tons weekly.

It was not until the Bali ASEAN leaders' summit in October 2003 that liberalization in air transport was formally identified as one of 11 priority sectors. The Road Map for Integration of Air Travel Sector (RIATS) was subsequently adopted in November 2004, together with an Action Plan for ASEAN Air Transport Integration and Liberalization 2005-2010. Both instruments laid down a 2015 date for achieving what is effectively an open-skies regime for the entire ASEAN region. They also foresaw the full liberalization of air freight services by December 2008, and ASEAN-wide liberalization of scheduled passenger services, with no limitation in fifth freedom traffic rights for the capital cities of each member country by 2010.

Under the Road Map, the ASEAN "2+X" approach was adopted, according to which two or more ASEAN member countries could sign an agreement on a plurilateral, multilateral or sub-regional basis that other AMS could join when ready.

The Multilateral Agreement on Air Services (MAAS) and the Multilateral Agreement on the Full Liberalization of Passenger Air Services (MAFLPAS) were signed by all AMS in May 2009 and November 2010. Both agreements followed the agreement the Multilateral Agreement on the Full Liberalization of All Cargo Air Services (MAFLAFS) signed 10 months earlier. The MAAS provides for unlimited traffic rights between members, including fifth freedom rights, more liberal provisions on tariffs, as well as no limitations on route structures, frequency, capacity, and the number of designated airlines. MAFLPAS has similar provisions.

Under the Road Map, full liberalization of third and fourth freedom rights between ASEAN capital cities was to be achieved by 31 December 2008. This was to be followed by the full liberalization of fifth freedom traffic rights between ASEAN capital cities by December 31, 2010. However, this has not yet been achieved because so far three AMS (Cambodia, Indonesia and Lao PDR) have not ratified MAFLPAS, and two AMS (Indonesia and the Philippines) have not ratified protocol 6 (on fifth freedom rights) of MAAS.[41]

[41] As of July 27, 2012.

Box 2. 7: Air Transport Liberalization: From Open Skies to the ASEAN Single Aviation Market (continued)

There are several sub-regional agreements, such as, among CLMV, the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT), and Brunei, Indonesia, Malaysia and Philippines East ASEAN Growth Area (BIMPEAGA), which allow for up to fifth freedom rights and potentially more liberal measures.

With respect to bilateral liberalization agreements with third partners, ASEAN is now engaging as a regional grouping; ASEAN has already secured an agreement with China opening third and fourth freedom rights without limitations. Negotiations are now underway to deepen this agreement with the Republic of Korea and India.

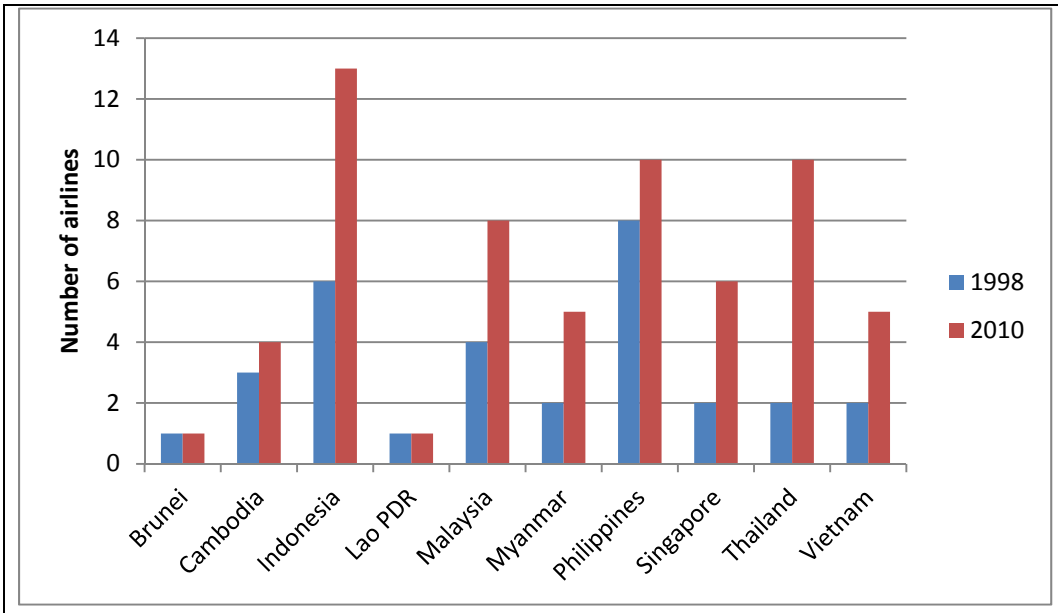
Spurred by the liberalization of the ASEAN air market, the number of airlines in the region doubled between 1998 and 2010, notably with the entry of several low cost carriers. Airlines have established subsidiaries in ASEAN member countries, taking advantage of liberal rules for investment in order to expand their regional supply and in some instances circumvent the non-implementation of fifth freedom rights. Malaysia's low cost carrier AirAsia engaged in joint ventures to form Thai AirAsia in Thailand, Indonesia Air Asia, and Philippines Air Asia.[42]

The next step for ASEAN nations should be the development of the ASEAN Single Aviation Market (ASAM). ASAM aspires to consolidate the existing Open Skies agreements and to be broader in scope, covering all the elements of economic operation of airlines (market access, including 7th freedom rights, and the concept of ASEAN community carrier, tariffs, consumer protection, non-scheduled flights, airport rules, etc.) some of which are not covered yet but for which negotiations are ongoing. The ASAM is also considering extension to regulatory aspects of air safety and security and air traffic management, with the objective of an ASEAN-wide air traffic control system.

Source: Authors compilation

[42] Tham (2008).

Figure 2. 20: The Growth of Airline Companies in ASEAN, 1998-2010



Source: Master Plan on ASEAN Connectivity (2011), Tham (2008), ERIA ASEAN Strategic Transport Plan 2011-2015; Developing ASEAN's Single Aviation Market report (2008).

E. Conclusion and Policy Implications

59. **ASEAN has made good but uneven progress in trade facilitation in most areas.** There has been very good progress in modernizing customs and good progress in implementing National Single Windows, though full implementation is still pending in most countries. However, customs integration is still held up. There has been a decline in overall trade costs and improvement in logistics performance. But import and customs documentation requirements and freight and import costs are still high. While progress in air connectivity has been notable, the larger connectivity agenda is still pending. Making additional progress towards the AEC Blueprint's goals in the areas of non-tariff measures and services is an important part of improving the broader trade facilitation environment. Many trade facilitation reforms depend more on the individual policies of countries rather than on ASEAN's common policies. Nevertheless, ASEAN has an important role in promoting best international practices, achieving harmonization, mutual recognition, and interconnectedness among its members. Some policy implications in terms of way forward for AMS are enumerated below.

60. **Trade facilitation should be addressed comprehensively, from a supply chain perspective**. ASEAN is increasingly becoming a regional production platform through the international integration of supply chain processes. That trend can only continue and intensify if policy attention is given to the full range of determinants of supply chain performance, focusing

on time, cost, and, above all, uncertainty. Arvis et al. (2012) argue that those countries that are successful in improving supply chain performance tend to do so by moving forward on multiple fronts simultaneously, because a supply chain is only as strong as its weakest link. Addressing the root causes of delays and uncertainty—including logistics regulation, transport markets, infrastructure, and governance—will be important priorities for AMS moving forward. Again, it is important for AMS to exploit synergies between their work on trade facilitation and work in other areas—particularly non-tariff measures and services—to ensure maximum progress.

61. **Administrative streamlining is one important way in which supply chain costs can be reduced**, **thereby facilitating trade.** Recent data show that although there has been progress within ASEAN on reducing the number of administrative formalities involved in trade transactions, there is still much room for improvement in many countries. Indeed, the ambitious targets set by ASEAN will only be reached if efforts are redoubled in this area. One issue that deserves further attention in some countries is the number of agencies involved in trade. For instance, in Cambodia, the existence of two customs entities (customs itself and CamControl) delays customs processing. In Viet Nam, there is poor coordination among the various trade facilitation measures that are undertaken. To some extent, the program of National Single Windows should go some way towards addressing some of these issues, but it is not a solution on its own without additional administrative streamlining. In any case, only some AMS have made significant progress towards implementation of this program. In addition to facilitating information flows, it is also necessary to consolidate and rationalize administrative functions. Also, ASEAN-wide cooperation could help streamline the performance of agencies involved in the border clearance process, looking beyond customs to consider the full range of administrative agencies that deal with export and import transactions.

62. **In tandem with administrative streamlining, it will be important to improve supply chain governance in some countries**. Unofficial payments and other criminal activities are serious issues for trade facilitation performance in some AMS. Research shows that improving trade facilitation performance by reducing time and formalities is in fact one way of improving supply chain governance, because it decreases the incentive for traders to engage in informal activities (Shepherd, 2009). In addition to administrative streamlining, improvements in human capital and institutional strengthening are also important for better supply chain governance. Increasing transparency can also help, and the biennial Trade Facilitation Assessments by individual AMS can play an important role in this regard. The same is true of the planned ASEAN Trade Repository.

63. **As part of a comprehensive approach, trade facilitation reforms should go beyond administrative streamlining to deal with the integration of key services markets across the region**. Logistics and air transport services have already seen considerable progress being made within the region, but much remains to be done in terms of creating single regional markets for these services. The same point applies with greater force to maritime transport, and it is notable that maritime cabotage is currently not part of the ASEAN integration agenda—potentially foregoing significant welfare gains, particularly for archipelagic AMS. Integration of regional trade services markets could help reduce prices, expand the range of services available, and

improve efficiency. One part of a successful integration strategy will be openness to investment from outside the region in key areas of transport and logistics services. Japan, for example, is now investing heavily in core services markets in ASEAN with the aim of establishing regional hubs that can then supply services ASEAN-wide (see more in Chapter 3 of this report). The result of more integrated regional services markets would be an increase in regional goods trade, and particularly trade within production networks that rely on well-functioning services markets for their growth. Continued liberalization of key services markets is therefore an important aspect of trade facilitation, which overlaps with the services component of the AEC Blueprint.

64. **Given the repository of global best practice within ASEAN, targeted capacity building can play an important role in improving trade facilitation performance**. Although performance in many areas is quite heterogeneous across AMS, the presence of global supply chain leader Singapore is a valuable regional asset. The same is true of the increasingly close relationship with the +6 countries, many of which outperform ASEAN on average in several areas of trade facilitation. There is much that AMS can learn from regional experience; the development of targeted programs of capacity building in the areas identified above could help loosen existing constraints and improve trade facilitation performance across the region.

Technical Annex to Chapter 2: Impact of ASEAN Integration on Trade Costs and Logistics Indicators

1. **This Annex examines the impact of ASEAN economic integration on intra- and extra-regional trade costs, and provides some indications as to the likely effects on trade flows.** Particular attention is paid to identifying the sources of trade costs that are most important in the ASEAN context, and highlighting the different sensitivities of trade in manufactured goods and agricultural products to changes in trade costs. Whereas previous work on measuring the effects of ASEAN integration has used gravity modeling, this Annex uses a new approach that makes it possible to focus directly on the links between different policy variables and trade costs. Therefore, it provides important evidence on the mechanisms available to enhance market integration in the region.

Trade Impacts of ASEAN: A Review of the Evidence

2. **A number of previous papers have attempted to quantify the impact of improving market integration in ASEAN.** Two contributions focus on tariffs in particular. Manchin and Pelkmans-Balaoing (2008) use a gravity model to show that ASEAN Free Trade Area (AFTA) preferences have a positive and significant effect on intra-regional trade. They also find, however, that a threshold effect is in operation: very small preference margins do not have any significant impact on trade, whereas larger preferences do.

3. **Calvo-Pardo et al. (2009) take a broader approach to tariffs by looking at both intra- and extra-regional trade.** They do not use a gravity model approach, but instead use fixed effects to control for a wide range of unobserved influences on trade flows. In line with Manchin and Pelkmans-Balaoing (2008), they also find that AFTA preferences are associated with more intra-regional trade. In addition, however, their results also suggest that AFTA tends to promote trade with non-members too. They suggest that one reason for the complementarity between intra- and extra-regional trade is that trade flows within ASEAN consist of a relatively high proportion of intermediate goods. As a result, liberalization of intra-regional trade flows tends to lead to greater regional exports of final goods in addition to increased intra-regional trade in intermediates.

4. **The authors also investigate the relationship between intra-regional trade liberalization in ASEAN and extra-regional liberalization in the form of reduced tariffs vis-à-vis the rest of the world.** In line with their results for trade flows, they find that preferential liberalization tends to be associated with tariff reductions for other trading partners too. ASEAN therefore tends to act as a building block, rather than a stumbling block, in relation to multilateral liberalization. Taking these two sets of results together, the findings of Calvo-Pardo et al. (2009) tend to suggest on a policy level that ASEAN's effects are primarily trade creating, and that any trade diversion is likely to be slight.

5. **Tariffs, of course, are not the only item on the ASEAN economic integration agenda**. Shepherd and Wilson (2009) take a broader approach, focusing on trade facilitation. They use a

gravity model to assess the sensitivity of intra-ASEAN trade flows to changes in the four main dimensions of trade facilitation defined as: efficiency of maritime ports; efficiency of airports; the extent of irregular payments in relation to import/export licenses; and the level of competition among internet service providers as a proxy for the regulation of backbone services sectors. They find that trade flows in Southeast Asia are particularly sensitive to the quality of air transport infrastructure, and the performance of backbone services sectors. Using the gravity model for counterfactual simulations suggests that improving trade facilitation performance in each country to the regional average could result in substantial trade gains, well in excess of those produced by comparable tariff reductions. Improving the quality of port facilities in this way could increase intraregional trade by 7.5 percent, or USD 22 billion.

6. **A number of more recent contributions have used alternative methodological approaches to examine the landscape of trade costs in ASEAN, rather than just focusing on particular factors**, **such as tariffs or trade facilitation, and their links to trade flows.** Sourdin and Pomfret (2009) use the gap between import (CIF) and export (FOB) prices reported by Australia to develop an index of trade costs for ASEAN countries. In line with the results reported in Chapter 2, they find that trade costs for the ASEAN-5 have fallen substantially over recent years, perhaps by as much as 50 percent between 1990 and 2007.[43]

7. **Other measures of trade costs also confirm the decline of trade costs in some ASEAN countries.** Shepherd (2010), for instance, uses a different measure of trade costs, calculated using a similar methodology to the one applied in Chapter 2 of this report. The study covers a broader range of factors than the data considered by Sourdin and Pomfret (2009), which essentially capture international transport costs. The author finds that even this broader measure of trade costs has fallen substantially over recent years, by between five and 10 percent between 2001 and 2007. Performance differs substantially across countries, however, with Viet Nam standing out as having experienced major trade cost reductions, whereas performance improvements are more moderate in other ASEAN countries.

8. **In another study, Duval and Utoktham (2010) take a similar approach to calculating trade costs, and examine ASEAN in comparative perspective with other Asian sub-regions.** They find that trade costs in ASEAN are generally lower than elsewhere, both in intra- and extra-regional dimensions. Intra-regional trade costs in ASEAN are indeed found to be comparable to those in NAFTA, which the authors conclude is indicative of a high level of economic integration. ASEAN substantially reduced its level of trade costs between 1996 and 2001, but improvements appear to have been much slower afterwards.

9. **Although there is thus a growing body of work on trade costs in ASEAN, as well as the roles played by tariffs and trade facilitation in promoting trade, there is still much to be done in terms of understanding the determinants of trade costs in the region.** Recent work has shown that trade costs have been reduced in recent years, but has not examined the policy

[43] Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

factors at work behind that outcome. The present chapter represents a contribution moving in that direction, as it breaks down the overall trade costs observed in ASEAN into components stemming from geographical and historical links, tariffs, transport and trade facilitation, logistics performance, and behind-the-border barriers.

Trade Costs Dataset and Model

10. **Arvis et al. (2013) use newly collected data on trade and production in 178 countries to infer estimates of trade costs in agriculture and manufactured goods for the 1995-2010 period.** Their approach is based on the inverse gravity methodology of Novy (2012). Whereas traditional gravity modeling provides estimates of the sensitivity of trade flows with respect to particular trade cost factors, inverse gravity modeling calculates trade costs based on the observed pattern of intra- and international trade across countries. It is then possible to use econometric methods to decompose trade costs into their component parts, using data on observable trade cost factors. This approach produces two sets of results. The first, discussed in Chapter 2, is a set of estimates of the level and rate of change of trade costs for particular countries and groups. The second set of results, the focus of the discussion here, estimates the extent to which different policy and non-policy factors affect trade costs.

11. **As in Chapter 2, the trade costs estimates used in this part of the analysis include all factors that drive a wedge between export and import prices.** Therefore, they take account of factors like geographical distance—which makes exporting and importing more costly—as well as traditional and non-traditional policy measures that affect the transaction costs associated with international trade. These measures of trade costs are thus all inclusive, in the sense that they cover both observable and unobservable factors.

12. **The data used for the analysis are discussed in detail in Arvis et al. (2013).** Variables, definitions, and sources are set out in Table 2.3. In broad terms, the data used to calculate trade costs come from the following sources: WITS-Comtrade for international trade data, adjusted in certain cases to account for re-exports; UN national accounts data and the World Development Indicators for domestic production data, estimated on the basis of value-added when data on a gross shipments basis are missing; and; an assumed elasticity of substitution among varieties within a sector equal to eight. The remaining variables used for the econometric model are standard indicators of trade costs from the gravity model literature, covering policy and non-policy factors.

Table 2. 3: Data and Sources

Variable	Definition	Year	Source
ACI	Geometric average of country i's and j's scores on the Air Connectivity Index.	2007	World Bank
ASEAN (Both)	Dummy variable equal to unity if countries i and j are both ASEAN Member States.	na	Authors
ASEAN (One)	Dummy variable equal to unity if one of countries i and j is an ASEAN Member State and the other country is not.	na	Authors
Colony	Dummy variable equal to unity if countries i and j were ever in a colonial relationship.	na	CEPII
Common Border	Dummy variable equal to unity if countries i and j share a common land border.	na	CEPII
Common Colonizer	Dummy variable equal to unity if countries i and j were colonized by the same power.	na	CEPII
Common Language (Ethno.)	Dummy variable equal to unity if countries i and j share a common language (ethnographic basis).	na	CEPII
Common Language (Official)	Dummy variable equal to unity if countries i and j share a common official language.	na	CEPII
Distance	Great circle distance between the two principal cities of countries i and j.	na	CEPII
Entry Costs	Geometric average of the cost of starting a business in country i and country j.	2005	Doing Business
Exchange Rate	Geometric average of the average official USD exchange rate of country i and country j (LCU per USD).	2005	World Development Indicators
Import Costs	Geometric average of the cost of importing goods in country i and country j.	2006	Doing Business
Landlocked	Dummy variable equal to unity if countries i and j are both landlocked.	na	CEPII
LPI	Geometric average of country i's and j's scores on the Logistics Performance Index.	2007	World Bank
LSCI	Geometric average of country i's and j's scores on the Liner Shipping Connectivity Index.	2005	UNCTAD
RTA	Dummy variable equal to unity if countries I and j are members of the same RTA.	2005	De Sousa (Forthcoming)
Same Country	Dummy variable equal to unity if countries i and j were ever part of the same country.	na	CEPII
Tariff	Geometric average of unity plus the trade-weighted average effectively applied tariff applied to i to j's exports and by j to i's exports.	2005	TRAINS
Trade Costs	Geometric average of international trade costs from i to j and from j to i relative to domestic trade costs in both countries; in ad valorem equivalent terms. See Arvis et al. (Forthcoming) for full details.	2005	Arvis et al. (2013)

Results and Discussion

13. **Table 2.4 presents regression results using log (trade costs) as the dependent variable. The table is therefore an econometric decomposition of trade costs into their observable component parts.** The first two columns use the full sample of countries for which data are available, excluding those that are landlocked. Landlocked countries are dropped from the sample because the goal here is to assess the impact of maritime connectivity on trade, and UNCTAD's LSCI is only calculated for countries with direct access to the sea.

14. **Considering column 1 (manufacturing) first, the results show most of the variables in the model have statistically significant coefficients with the expected signs and sensible magnitudes.** Distance, higher import costs, and higher market entry costs are both positively associated with trade costs, while geographical contiguity, a common language, a colonial link, membership of an RTA, a weaker exchange rate, better air and maritime connectivity, and stronger logistics performance are all negatively associated with trade costs. Interestingly, of the two ASEAN dummies, only ASEAN (one) has a statistically significant coefficient, although both dummies carry the expected negative sign. This result means that after controlling for other factors—including the average impact of RTA membership—trade costs within ASEAN are not substantially lower than for other country pairs, but trade costs for country pairs involving just one ASEAN member are significantly lower, by around six percent. This finding fits well with the results discussed above that tend to show that ASEAN produces minimal trade diversion. Indeed, our result is consistent with an important role for unilateral reform on a most favored nation (MFN) basis as part of the ASEAN liberalization process. In manufactured goods, there is little evidence that intra-regional preferences play a stronger role than would be expected based on the average relationship between trade costs and membership of a Regional Trade Agreement (RTA).

15. **Column 2 presents results for agriculture, again using the full sample.** Results are broadly similar to those for manufacturing, although Doing Business import costs have an unexpected negatively signed and statistically significant coefficient. There are also some important differences from a policy perspective. First, trade costs in agriculture are considerably less sensitive to transport connectivity than in manufacturing: the coefficient on maritime connectivity is smaller in absolute value, and the coefficient on air connectivity is no longer statistically significant. The same is true of logistics performance, which has a much smaller (in absolute value) coefficient in the agriculture regression. Improvements in these areas are thus of particular importance for exports of manufactured goods.

16. **The second important point of difference between the agriculture and manufacturing regressions relates to the impact of ASEAN.** In agriculture, both ASEAN dummies have negative coefficients that are statistically significant. The impact of both countries being ASEAN members is to reduce trade costs by around 20 percent compared with other country pairs. The impact of a single ASEAN member is to reduce trade costs by around 12 percent. Although there is evidence of significant intra-regional preferences in this case, the extent of trade diversion is still likely to be slight given that ASEAN membership reduces both intra- and extra-regional trade costs. This result contrasts with the raw data presented in Chapter 2, in which it is highlighted that trade costs in agriculture have been relatively flat in a dynamic sense over recent years. The regression results show that even though trade costs in agriculture are changing slowly, if at all, in ASEAN they still tend to be lower than comparable country pairs after controlling for other factors. Nonetheless, as highlighted in Chapter 2, trade costs in agriculture remain very high, and substantial additional work is required to reduce them.

Table 2. 4: Regression Results Using Log of Trade Costs as the Dependent Variable

	(1) Manufacturing	(2) Agriculture	(3) Manufacturing	(4) Agriculture
ASEAN (Both)	-0.082	-0.217**	-0.004	-0.079
	(0.390)	(0.011)	(0.984)	(0.577)
ASEAN (One)	-0.064***	-0.127***		
	(0.004)	(0.000)		
Log (Distance)	0.306***	0.189***	0.403***	0.078**
	(0.000)	(0.000)	(0.000)	(0.019)
Common Border	-0.315***	-0.228***	-0.147	-0.391***
	(0.000)	(0.000)	(0.383)	(0.000)
Common Language (Ethno.)	0.016	-0.047	0.225*	0.095
	(0.610)	(0.274)	(0.059)	(0.247)
Common Language (Official)	-0.156***	-0.088*	-0.201	-0.182*
	(0.000)	(0.052)	(0.157)	(0.052)
Colony	-0.167***	-0.136***	-0.366	-0.010
	(0.005)	(0.002)	(0.115)	(0.949)
Common Colonizer	-0.061*	0.006	0.089	0.029
	(0.064)	(0.863)	(0.181)	(0.615)
Same Country	-0.147	-0.171**	-0.001	-0.169
	(0.157)	(0.039)	(0.998)	(0.125)
Log(Tariff)	0.037	0.022	0.200	0.014
	(0.562)	(0.688)	(0.268)	(0.915)
RTA	-0.126***	-0.052	0.009	-0.139
	(0.000)	(0.122)	(0.954)	(0.201)
Log(Exchange Rate)	-0.010***	-0.003	-0.017***	-0.031***
	(0.000)	(0.401)	(0.001)	(0.000)
Log(LSCI)	-0.189***	-0.114***	-0.175***	-0.198***
	(0.000)	(0.000)	(0.000)	(0.000)
Log(ACI)	-0.035***	-0.011	-0.089**	-0.090***
	(0.002)	(0.491)	(0.020)	(0.009)
Log(LPI)	-0.418***	-0.126*	-0.735***	-0.147
	(0.000)	(0.069)	(0.000)	(0.342)
Log(Import Costs)	0.026*	-0.083***	-0.070*	-0.056
	(0.074)	(0.000)	(0.062)	(0.180)
Log(Entry Costs)	0.021***	0.031***	-0.039***	0.028*
	(0.000)	(0.000)	(0.003)	(0.050)
Constant	4.066***	5.953***	4.983***	6.747***
	(0.000)	(0.000)	(0.000)	(0.000)
Observations	2519	1552	474	345
R2	0.596	0.336	0.583	0.457

Note: Columns 1 and 2 include all countries for which data are available. Columns 3 and 4 only include country pairs with at least one ASEAN member country. P-values based on robust standard errors appear in parentheses below the parameter estimates. Statistical significance is indicated by * (10 percent), ** (5 percent), and *** (1 percent).

17. **Whereas the first two columns of Table 2.4 present results using the full country sample from Arvis et al. (2013), columns 3 and 4 limit consideration to country pairs including at least one ASEAN member.** The sample is therefore limited to intra- and extra-regional trade costs in ASEAN. It is important to be cautious in interpreting these results, as the sample size is much smaller than for columns 1 and 2. Nonetheless, some interesting results emerge. First, the level of the exchange rate matters much more for trade costs in ASEAN than it does elsewhere, both in manufacturing and agriculture. This finding is consistent with the export-led growth strategies followed by many AMS, in which a competitive exchange rate plays a key role.

18. **Second, air connectivity is a much more important factor influencing trade costs in ASEAN compared with other regions**: the relevant coefficients are much larger in absolute value in both manufacturing and agriculture. This finding is consistent with air freight playing a very important role in ASEAN trade flows, perhaps due to the extensive use of air transport and express delivery in the context of regional production networks. In any case, the important role of air transport highlights the importance of continued liberalization in this area, as discussed in Chapter 2.

19. **Third, trade costs in ASEAN are relatively more sensitive to logistics performance, at least in manufactured goods.** Again, the relative coefficient is much larger in absolute value for the ASEAN only sample than for the full country sample. This finding is consistent with an important role for regional production networks in ASEAN, as they rely heavily on efficient transport and logistics to move component parts across borders during the assembly process. Again, this result highlights the importance of trade facilitation in promoting additional ASEAN integration, as discussed in Chapter 2.

Simulation Results

20. **The econometric decomposition of trade costs, discussed in the previous section, can be used to undertake some simulations of the impact of reform. ASEAN has set ambitious trade facilitation targets for 2015, as mentioned in Chapter 2.** Progress towards those goals has been mixed, with some AMS recording strong performance to date and others continuing to lag well behind the announced goals. This section examines what the impact on trade costs would be if each AMS improved performance to the target level in three areas: logistics performance, Doing Business export costs, and Doing Business market entry costs.

21. **To conduct the simulations, it is possible to simply use the estimated elasticities from Table 2.4 column 1.** It is appropriate to use the full-sample regression rather than the sample limited to AMS only, as it provides more robust results due to increased size. Using the elasticities, it is a simple matter to calculate trade costs impacts. All that is necessary is to convert the difference between the baseline level and the target level into a percentage, and then use the elasticity to map that number to a percentage change in trade costs. In the case of Doing Business market entry restrictions, one can use the percentage changes in the number of days required for starting a business—which are the terms in which the ASEAN targets are couched—and apply

those same percentages to the associated entry costs used in the regressions. For each simulation, it is assumed that reform is unilateral, that is, it is not accompanied by reform in trading partners. The reason for this assumption is both due to the technical properties of the model, and the desire to isolate the effects of reform by individual economies on their own performance.

22. **Table 2.5 shows results for each AMS, subject to data limitations for Brunei Darussalam and Myanmar.** Because trade costs are relatively insensitive to changes in Doing Business import and entry costs, the reductions in trade costs that can be expected from reforms in those areas are relatively small. That is the case even though the proposed reforms themselves are major; for instance, the ASEAN target would require cuts of over 80 percent in some cases to the time required to start a business, and over 60 percent to the cost of importing. By contrast, results for the Logistics Performance Index are much stronger, even though the policy changes required are smaller (a maximum of a 35 percent improvement). Our results strongly suggest that improvements in logistics performance could have major impacts on ASEAN's trade costs, reducing them by 10-15 percent in some cases. The resulting increases in export and import activity could be expected to be correspondingly large. These simulation results therefore reinforce previous work discussed above and in Chapter 2, which highlights the importance of trade facilitation as a way of reducing trade costs and boosting extra- and intra-regional trade. Expansion of that agenda beyond customs to include the full scope of trade and transport facilitation, including logistics, would seem to be crucial. In doing so, as noted above, ASEAN can continue to leverage additional initiatives in associated areas, such as the priority liberalization of logistics services under the AEC Blueprint.

Table 2. 5: Simulated Reductions in Trade Costs from Meeting 2015 Reform Targets, Percent of Baseline

	Logistics Performance Index	Doing Business Import Costs	Doing Business Entry Costs
Brunei Darussalam	na	-0.23	-1.76
Cambodia	-10.40	-0.68	-1.68
Indonesia	-3.62	-0.06	-1.34
Lao PDR	-11.71	-1.78	-1.72
Malaysia	0.00	0.00	0.00
Myanmar	-14.68	na	na
Philippines	-2.42	-0.55	-1.11
Singapore	0.00	0.00	0.00
Thailand	-0.31	-0.49	-0.98
Viet Nam	-2.72	0.00	-1.29

Conclusion and Policy Implications

23. **This Annex has linked the policy targets from ASEAN's trade facilitation work with the key outcome indicator of extra- and intra-regional trade costs.** It has shown that a number of the priority trade facilitation areas for ASEAN, such as logistics performance, import costs, and market entry costs, can have substantial impacts on trade costs. Simulation evidence suggests that the projected improvements in logistics performance are likely to bring the biggest benefits in terms of lower trade costs compared with the other policy areas, even though the policy changes tend to be larger in those other areas. The reason is that logistics performance is very closely linked to the overall level of trade costs. Moreover, the econometric evidence presented here suggests that trade costs in ASEAN are more sensitive to logistics performance than is the case elsewhere around the world, perhaps because of the prevalence of regional production networks that rely heavily on the ability to move goods—particularly parts and components—across borders quickly, reliably, and frequently.

24. **In policy terms, these findings strengthen the case for giving renewed attention to trade facilitation in the context of ongoing efforts at regional integration under the AEC Blueprint.** Moreover, as noted in Chapter 2, trade facilitation is closely linked to other regional initiatives in areas such as logistics services. Given the key importance of logistics performance as a driver of trade costs, it will be important for policymakers to focus on achieving the liberalization goals for that sector set out in the AEC Blueprint. Over time, they will also need to expand that agenda to focus more on the regulatory burdens affecting logistics operators in addition to the impacts of foreign equity limits and other ownership restrictions. The presence in the region of world leader Singapore will undoubtedly be a force for broad-based upgrading and continued liberalization of logistics services around the region, although some AMS—particularly the CLMV countries—still have a lot of work to do in this area. In terms of sequencing, and focusing in particular on the need to narrow the gap between CLMV countries and other AMS, the first priority should be introducing competition into transport and logistics markets, including road transport, by means such as liberalization of foreign investment restriction and relaxation of other barriers to entry. Once markets are reasonably competitive, countries—in particular CLMV countries—can turn to deal with measures that make it more costly for transport and logistics operators to do business. One example for road transport arises from a lack of harmonization of licensing requirements and load levels, which requires cargo transfers and changes of driver at each border crossing. Making efforts to harmonize such requirements on a regional or sub-regional level, including unilaterally, can make it possible for transport operators to do business more cost-effectively, thereby reducing the level of trade costs.

25. **Beyond the specific targets set by ASEAN, the analyis presented here also suggests that well-functioning transport markets are particularly important to reducing trade costs around the region.** This is true of both maritime and air transport, but the latter takes on particular significance as trade costs in ASEAN are much more sensitive to air transport connectivity than are trade costs in other parts of the world. Air transport should therefore

continue to be a particular priority for ASEAN. Ongoing liberalization efforts can be extended and deepened, with the aim of developing a single aviation market within the region. In terms of building international connectivity, however, it will also be important for AMS to engage with major trading partners and major air transport hubs in Asia and elsewhere to build additional linkages and establish new services. As a network industry, air transport depends heavily on connectivity for performance, and there is much that ASEAN policymakers can do to continue to promote this important agenda.

Calculating Trade Costs

26. **Following Novy (2012), Arvis et al. (2013) calculate trade costs for up to 178 countries over the 1995-2010 period, treating agriculture and manufactures separately.** Their trade costs measure is defined as follows:

$$t_{ij} = t_{ji} = \left(\frac{\tau_{ij}\tau_{ji}}{\tau_{ii}\tau_{jj}}\right)^{\frac{1}{2}} - 1 = \left(\frac{X_{ii}X_{jj}}{X_{ij}X_{ji}}\right)^{\frac{1}{2(\sigma-1)}} - 1$$

where i and j index countries, the τ parameters are "iceberg" trade costs, and the X parameters are sales in different markets. For instance, X_{ii} is domestic sales of a product in country i, but X_{ij} is exports from country i to country j. Finally, σ is the intra-sectoral elasticity of substitution (among product varieties within a sector), and is assumed to be equal to eight (Novy, 2012) for all calculations here. The version of the trade costs measure presented above is derived from the CES gravity model of Anderson and Van Wincoop (2003), but Novy (2012) shows that alternative theoretical approaches can be used to obtain substantially similar results.

27. **As can be seen from the formula, trade costs as analyzed here and reported in Chapter 2 are the geometric average of trade costs from i and j and from j to i.** In all cases, trade costs capture the costs of international trade relative to those of shipping goods domestically (distribution). Intuitively, as the ratio of domestic sales ($X_{ii}X_{jj}$) relative to export sales ($X_{ij}X_{ji}$) increases, so too must the inferred trade costs between i and j.

Decomposing Trade Costs

28. **The estimating equation used for the trade costs decomposition discussed above takes the following form:**

$$\begin{aligned}\log \mathbf{t_{ij}} = \mathbf{b_0} &+ \mathbf{b_1 ASEAN(Both)_{ij}} + \mathbf{b_2 ASEAN(One)_{ij}} \\ &+ \mathbf{b_3} \log \mathbf{Distance_{ij}} + \mathbf{b_4 Border_{ij}} + \mathbf{b_5 LanguageEthno_{ij}} \\ &+ \mathbf{b_6 LanguageOff_{ij}} + \mathbf{b_7 Colony_{ij}} + \mathbf{b_8 CommonColonizer_{ij}} \\ &+ \mathbf{b_9 SameCountry_{ij}} \\ &+ \mathbf{b_{10}} \log \mathbf{Tariff_{ij}} \\ &+ \mathbf{b_{11}} \log \mathbf{ExchangeRate_{ij}} \\ &+ \mathbf{b_{12}} \log \mathbf{LSCI_{ij}} \\ &+ \mathbf{b_{13}} \log \mathbf{ACI_{ij}} \\ &+ \mathbf{b_{14}} \log \mathbf{LPI_{ij}} + \mathbf{b_{15}} \log \mathbf{ImportCosts_{ij}} + \mathbf{b_{16} logEntryCosts_{ij}} + \mathbf{e_{ij}}\end{aligned}$$

All variables are defined as in Table 1. Estimation is by OLS with robust standard errors. Each sector—agriculture and manufacturing—is estimated separately. The first two columns of the regression table include all available countries in the estimation sample, while the second two columns include only country pairs with at least one AMS. The ASEAN (One) dummy is dropped from the second regression because the reduced sample makes it collinear with the regression constant.

Chapter 3: Trends and Patterns in Services Trade and Policies

A. Introduction and Key Findings

1. **Services are an important and growing component of the global economy, and the growth of services trade has outpaced goods trade globally and in ASEAN Member States (AMS).** On average, services contributed more than 40 percent of total value-added and more than 50 percent of total employment in 2010. However, ASEAN economies have developed equally fast growing manufacturing economies, while the services sectors in AMS have been relatively closed to international trade and investment. Despite this, the services sector has already become an important source of both output and employment in these economies.

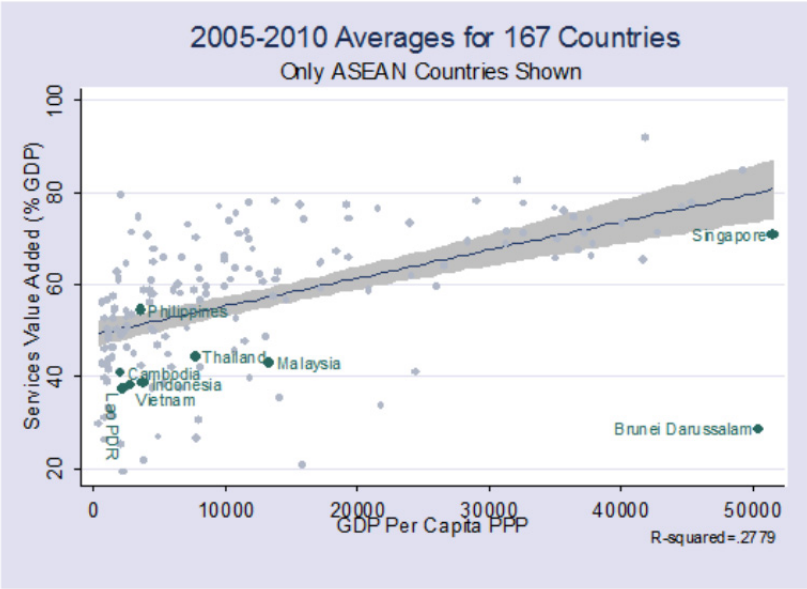
2. **Services will become increasingly critical in the future in ASEAN countries**. As per capita income rises further, the demand for services will grow rapidly in ASEAN economies. On the supply side, services will become more important both through direct and indirect contribution to economic growth by improving efficiency in other sectors of the economy. Given that many service sectors, such as finance, communications and transport, provide inputs for the manufacturing sectors and other service sectors, a shift toward developing an efficient services sector could contribute to the development of a competitive manufacturing sector and thus lead to an increase in overall productivity (see Box 3.1).

3. **Some ASEAN countries have already become significant exporters of modern services in sectors such as professional services and information and communication technology (ICT), including business processing outsourcing (BPO), higher education, and health tourism**. Most prominent among these is Singapore, where services make up 60 percent of the economy and account for 21 percent of exports. In a few years the Philippines became the third largest player in the global BPO market, accounting for 15 percent of the market output, after India (37 percent) and Canada (27 percent). In the Philippines, services exports as a percent of total exports increased from nine percent in 1999 to 21 percent in 2009 (Yi, 2011). Although Malaysia has had relatively more moderate success as a services exporter when compared with the case of India or the Philippines, areas such as higher education, Islamic finance, and medical and airline services are contributing to export diversification.

4. **The key finding of this chapter is that despite recent progress in services sector development, the services sector in ASEAN economies remains relatively underdeveloped and actual implementation in services integration has been limited.** In particular, the relative importance of services in GDP and trade is less than what would be expected given the levels of income and development in AMS. Also, while the AEC goals for ASEAN provide useful and detailed targets for the integration of services in the ASEAN region, progress has been mixed and modest. Overall, there has been progress in meeting sectoral commitment targets until the 8th Package of AFAS. But while in terms of commitments AFAS often goes beyond GATS commitments or Doha Round offers, this rarely leads to changes in the regulations that are applied in AMS. Three priorities emerge: (i) the need to focus on the implementation of services reforms to actually implement the commitments being made under AFAS negotiations; (ii) upgrading technical capacity and sectoral involvement in services trade negotiations (reforms will be important for this); and (iii) bridging the existing divide in regulatory capacity among AMS.

Box 3. 1: The Shift to Services and Services Trade and its Contribution to Productivity

International experience suggests that as part of the development process, the services sector outgrows agriculture, mining and manufacturing. As a result, more advanced economies tend to have a larger share of GDP and employment derived from services activities. This shift into services is particularly pronounced for upper-middle income countries.



The services sector grows faster in middle income countries, both due to higher demand for services and also because services contribute more to productivity growth in all sectors as the economies become more diverse and sophisticated. Recent research suggests that the contribution of services to manufacturing is particularly important. First, several studies have established a link between increased access to services and increases in productivity. Using firm level data for several years and controlling for services sector reforms and liberalization, access to services has been found to be significantly related to foreign investment in services and productivity growth of downstream manufacturing industries in countries and regions as diverse as Czech Republic, Chile, Ukraine, India, and even relatively less developed sub-Saharan African countries[44] (for India a significant positive relationship between FDI in services following liberalization (especially allowing foreign entry) and the performance of downstream domestic firms in manufacturing was found). Opening up producer or intermediate service sectors seems to be particularly effective in increasing export competitiveness and high-technology sectors.

Moreover, as the services sector grows and becomes more sophisticated, countries tend to engage increasingly in services trade. While there are some exceptional country cases of lower income countries with high services trade intensities, such as India and Turkey, the share of services exports in total exports generally expands as economies become richer. From a policy perspective, this observation suggests that policymakers will have to pay increasing attention to the appropriate, pro-competitive regulation of their services sector as their countries develop.

Source: The World Bank.

[44] Arnold, Mattoo and Javorcik (2011), Fernandes and Paunov (2012), Shepotylo and Vakhitov (2012), Aronold, Javorcik, Lipscomb and Mattoo (2012), Fink, Mattoo and Neagu (2005)

5. **Despite these improvements, the services sector in ASEAN economies is still relatively underdeveloped.** While the contribution of services growth has picked up in the past decade, the share of services in GDP remains relatively low for ASEAN economies compared to countries in other regions. Moreover, while most ASEAN countries are fairly open to goods trade, services trade openness lags behind. Regulations affecting services are relatively restrictive compared to service regimes in other regions, and vary widely from country to country and sector to sector. Also, restrictions remain high across modes of services provision and particularly for professional and transport services. Given the rapid pace of integration of ASEAN economies into the global trading system, and the intensifying pace of free trade agreement negotiations, it would be timely for their economic development to deepen and widen the integration and liberalization in services. Local services providers will be able to take advantage of new market openings and also benefit from new ideas and processes arising out of the opening up of the services sector.

6. **The ASEAN countries have clearly recognized the important role that services will play in future growth and development.** Thus, AEC's 2015 goals and ASEAN Framework Agreement on Services call for commitments to progressively open services sectors to international trade to achieve regional integration in services. The ASEAN Heads of State have proclaimed "the free flow of services is one of the important elements in realizing the ASEAN Economic Community, such that by 2015 there will be substantially no restrictions to ASEAN services suppliers in providing services, and in establishing companies across national borders within the region, subject to domestic regulations." (AEC Blueprint, pp. 10).

7. **In this context, the analysis in this chapter aims to take stock of recent services sector developments.** The chapter complements the ERIA Midterm Review report by focusing less on commitments made by AMS and the success in meeting jointly established commitment targets, and more on actual outcomes in services trade policies and in recent developments in services trade in the ASEAN region. Thus, the assessment investigates to what extent the commitments have triggered pro-trade reforms of regulatory regimes, and whether these, in turn, have fostered increased services trade. This attempt to measure progress on implementation and economic impacts is challenging due to deficiencies in the available information. However, a recently released database on services trade restrictions (Borchert, Gootiiz and Mattoo, 2012, World Bank Working Paper Series and http://iresearch.worldbank.org/servicestrade), as well as intra-regional trade data compiled by the ASEAN Secretariat, make it possible to shed some new light on the trends and patterns of services trade in the region. This review of services reforms is in preparation for an in-depth study of services integration that will be jointly carried out with the ASEAN Secretariat (ASEC) in 2013.

8. **The rest of the chapter is organized as follows**: Section B briefly discusses AEC's goals for free trade in services and progress in meeting these goals. In addition to drawing on secondary literature, this section also shows how commitments under ASEAN compare with those made under GATS agreements. Section C uses World Bank data on six ASEAN countries to discuss actual progress on liberalizing the services trade. Section D discusses recent development in services trade in the ASEAN region. Section E investigates the status of labor mobility within ASEAN, and Section F presents some critical issues concerning domestic regulatory reforms without which the services integration agenda cannot be implemented. Section G concludes the chapter by discussing policy issues and implications.

B. Progress in Achieving AEC Goals for Free Trade in Services

9. **In December 1995, ASEAN launched an ambitious services liberalization project called the ASEAN Framework Agreement on Services (AFAS).** This agreement set a schedule of services commitments and planned eight rounds of commitments to liberalize, all negotiated under the Coordinating Committee on Services (CCS). In addition, the Working Committee on Financial Services Liberalization (WCFSL) is carrying out negotiations on financial services, and the Air Transport Working Group (ATWG) is carrying out negotiations on air transport services. WCFSL has completed five packages of commitments and ATWG has completed seven packages.

10. **The main objectives of AFAS are to**: (i) enhance cooperation in services amongst AMS in order to improve efficiency and competitiveness, diversify production capacity, and increase supply and distribution of service suppliers within and outside ASEAN; (ii) substantially eliminate restrictions to trade in services amongst member states; and (iii) liberalize trade in services by expanding the depth and scope of liberalization beyond those undertaken by member states under GATS, with the aim of realizing a free trade area in services.

11. **The policy objectives of AFAS are to improve efficiency and competiveness, substantially eliminate trade restriction, and expand the scope and depth of AFAS beyond GATS.** The modality of implementation of AFAS is primarily based on GATS. The liberalization commitments were also initially based on the 'request and offer' approach during the first round (1996-1998), and then gradually moved to using a more systematic approach. This approach also used specific quantitative targets, timeline and threshold parameters, as reflected under the AEC Blueprint adopted in 2007 and other parameters as set by the ASEAN Economic Ministers (AEM). Based on the scorecard assessment on AFAS, it is commonly recognized that liberalization has been mostly successful in terms of scheduling commitments made by AMS. Some degree of 'flexibility' in commitments to meet threshold targets has also enabled AMS to continue liberalizing their services sectors.

12. **Clear liberalization targets have been laid out in the AEC Blueprint**.

- ASEAN Member States will substantially remove all restrictions on trade in services for five priority integration sectors (PIS): air transport, e-ASEAN, healthcare, and tourism by 2010, and logistics services by 2013; restrictions on all other services sectors would be removed by 2015.
- There will be no restrictions on Modes 1 (cross border supply of services) and 2 (service consumption abroad), with exceptions only allowed for bona fide regulatory reasons.
- In Mode 3 (commercial presence or foreign investment), countries will work towards allowing 70 percent foreign equity participation (FEP) by 2015, as well as removing other Market Access and National Treatment restrictions.
- Concerning Mode 4, discussions have been undertaken to free the flow of skilled labor. These include conclusion and implementation of the ASEAN Agreement on Movement of Natural Persons and the mutual recognition of professional qualifications.

13. **AMS made good progress in meeting sectoral commitment targets (under a liberal definition of commitments)**. The 7th and 8th package of commitments, however, faced delays due to a number of difficulties of AMS, including on allowing Mode 3 foreign investment that

exceeded 50 percent foreign ownership. Yet, as of the final quarter of 2012, all ASEAN countries have met the target for liberalization under the 8th Package of AFAS.

14. **While there are issues in meeting both market access and national treatment commitments under Mode 3**, **the most significant difficulties have arisen on the issue of providing majority foreign equity ownership**. Many ASEAN countries face significant challenge to meet the target of 51 percent of foreign equity participation. AMS have opted to use a 15 percent 'flexibility' option, including through committing other sectors instead of the priority (PIS) sub-sectors.

15. **Three points are worth stressing here.** First, the main obstacle seems to be in providing majority equity ownership. If one considers 49 percent ownership as the threshold, then AMS have done much better in committing to liberalization. If the Foreign Equity Participation (FEP) threshold continues to be a stumbling obstacle, as some AMS countries report, ASEAN may have to consider arrangements such as strategic and management control for foreign investors in firms as a way to make progress. How such arrangements could be implemented remains an issue for discussion.

16. **Second, significantly, it seems that progress in liberalizing Mode 3 restrictions have been least in the case of some middle income countries.** On the other hand, Cambodia, Myanmar, Viet Nam, and Indonesia have committed significantly more sub-sectors to Mode 3 liberalization thresholds. This raises important issues for domestic regulatory reforms and technicalities that are discussed in the final section.

17. **Third, encouragingly, progress has been better in some key sectors.** Overall, the recent ERIA study suggests that AMS such as Brunei, Cambodia, Indonesia, Laos, Malaysia, and Myanmar have done significantly better in committing to liberalize logistics sectors. Even Singapore, which has committed fewer subsectors, has made advanced commitments in telecommunications in both liberalization of overseas call market and allowing foreign ownership in local market. Malaysia and the Philippines opened up their local markets in 1995 and guaranteed market access in the international service sub-sector in 1998, despite no commitment in foreign control of telecom business.

18. **The recent study on the ASEAN financial sector integration also suggests some progress in recent years on meeting financial sector integration targets set under the Roadmap for Monetary and Financial Integration.** According to this study, ASEAN has completed most of the measures contributing to ASEAN financial integration in line with the AEC Blueprint targets, which follow a deferred timetable compared to other sectors. Financial sector integration is aimed to be achieved by 2020, five years after other sectors. However, the recent Joint Ministerial Statement (JMS) of the ASEAN Finance Ministers' meeting in Brunei Darussalam in April 2013 did not mention the 2020 deadline concerning areas relating to the roadmap for ASEAN monetary and financial integration (RIA-Fin). In particular, the said JMS stated a 2015 AEC deadline under the section on financial services liberalization. In this context, ASEAN countries have particularly stepped up their commitments to open their financial services in insurance and banking services. Integration of capital markets has also intensified. Local currency bond markets are being developed, while in the equity markets regional efforts have been enhanced to broaden and deepen liquidity and market linkages. To support freer capital mobility, ASEAN has successfully completed the mutual assessment process of identifying rules to progressively liberalize current account transactions, direct and portfolio investments, and for other types of flows within the region, in accordance with the ASEAN Financial Integration

Framework (AFIF). According to the ASEAN Integration Monitoring Office (AIMO), which monitors and supports the progress toward an AEC in the finance area, ASEAN had achieved 88.9 percent of what it had committed to facilitate free flow of financial services and freer flow of capital by the end of July 2013. However, the challenge for ASEAN is to improve the quality of financial integration, thereby making financial markets more resilient, particularly in the current global context. The ASEAN Financial Integration Monitoring Report (AFIMR) highlighted that it is crucial to: (a) continue market-driven ASEAN financial integration initiatives; and (b) promote macroeconomic convergence and policy coordination. The AFIMR also recommends that policies should continue to remain supportive of regional initiatives, that is, developing harmonized standards and rules, improving the payment and settlement system, and harmonizing accounting standards and regulations.

19. **Finally, in the area of skilled labor mobility in the ASEAN region, there has been some progress in recent years.** AMS have signed eight Mutual Recognition Arrangements based on specific occupations covering engineering, architecture, accountancy, surveying, nursing, dental and medical practitioners, and tourism. Progress in implementing these has also varied across sectors with some sectors such as engineering and architectural services being well ahead of others. Moreover, in November 2012, the ASEAN Agreement on the Movement of Natural Persons was signed. This is expected to accelerate progress in facilitating the movement of skilled professionals across the region.

20. **Although AMS are still behind schedule to meet the ambitious service sector integration targets, they have made significant commitments to liberalize regional trade in services**. These commitments now exceed commitments and offers made under the GATS negotiations in Uruguay and Doha rounds.

21. **A new database on services trade restrictions (http://iresearch.worldbank.org/servicestrade) released in June 2012 makes it possible to compare the situation and the state of reform implementation in 104 countries**.[45] The database focuses on policies that affect international trade in services, with the latter being defined as transactions that supply a service through cross-border delivery, through establishment of a commercial presence, or through the presence of a natural person (a real human being as a opposed to a legal entity). The information was obtained by scrutinizing publicly available sources and by administering a questionnaire.

22. **Six ASEAN countries—namely Cambodia, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam—are covered in the database with the documented information referring to the situation of several major services sectors during the financial downturn in 2007/08.** Policy instruments concerning all trading partners are collected and presented for five services sectors, which are financial services (banking and insurance), telecommunications, retail distribution, transportation, and professional services (accounting and legal). In addition to an inventory of measures, the database also contains quantitative estimates of the restrictiveness of each measure and mode of services supply that can be aggregated to the sectoral and country

[45] See http://iresearch.worldbank.org/servicestrade.

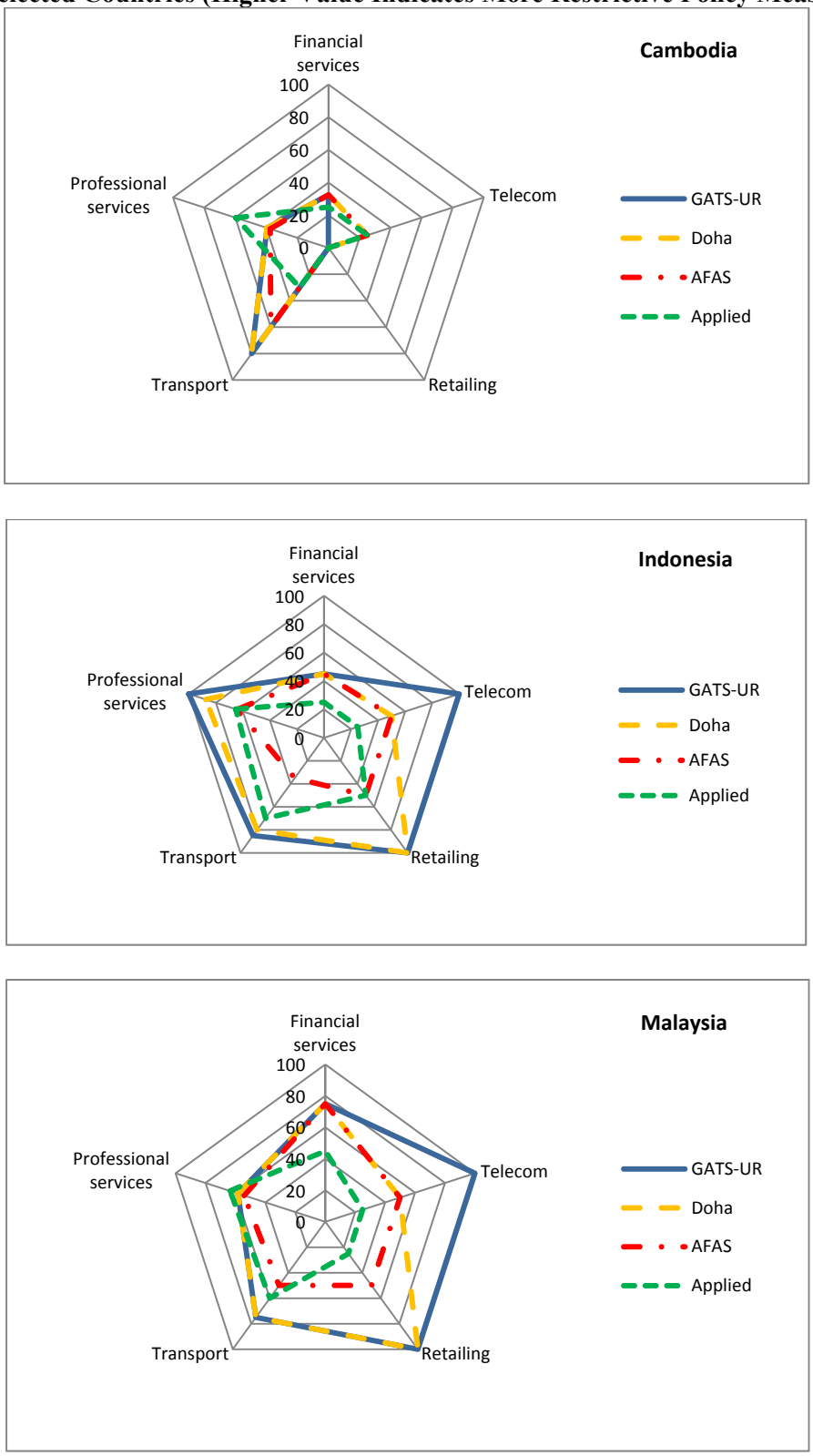
level for analytical purposes.[46] The resultant Services Trade Restrictiveness Index (STRI) takes values from zero for completely open trade and investment regimes to 100 for completely closed services sectors. This database is used for the subsequent analysis of liberalization commitments and the state of implementation.

23. **A comparison of AFAS commitments with similar reform schedules established in the context of GATS, or under discussion in the ongoing Doha Round of WTO negotiations, can provide a starting point for analysis on the extent to which AFAS has contributed to services sector reform in ASEAN countries**. Moreover, it is instructive to assess commitment levels of AFAS in relation to the status quo of in-country services sector regulation. As would be expected, the more recent Doha Round offers entail the same as or a higher degree of openness than the GATS-Uruguay commitments (Figure 3.1). In particular, further opening in telecommunications services has been offered by Indonesia, Malaysia, the Philippines, and Thailand to their WTO trading partners in the ongoing negotiations. For telecommunications, the AFAS commitments contain the same level of restrictiveness as the Doha offers, but in some other sectors they go beyond the state of discussion at the WTO level.

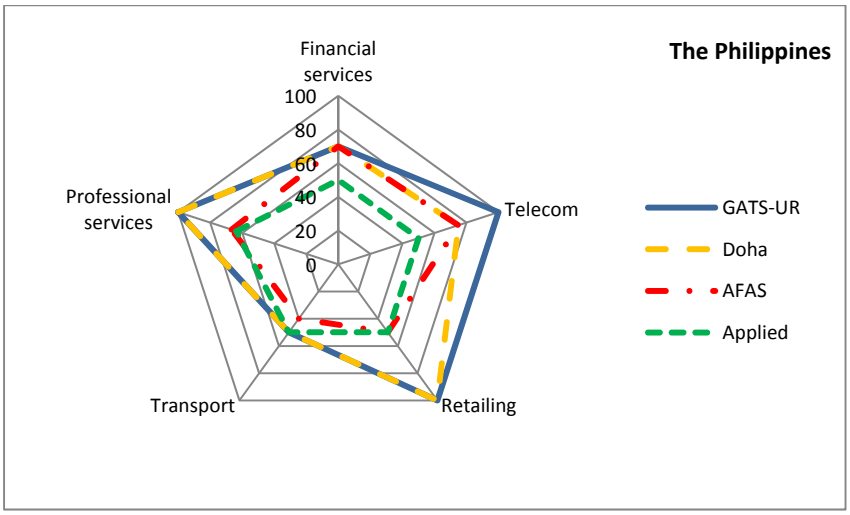
24. **In five of the six countries covered, that is, except for Viet Nam, AFAS calls for a more liberal policy in the retailing and transportation sectors than Doha**. Moreover, in some sectors and countries, AFAS commitments imply a more open services trade regime than the policies that were implemented in 2007/08. This is notably the case in transportation (except for Viet Nam) and for professional services in Cambodia, Malaysia, and Thailand. For most countries and sectors, however, the commitments contained in AFAS do imply a level of openness that actually falls short of the policies that were implemented in 2007/08 already. In other words, countries are ahead of AFAS and the main impact from implementation of the AFAS commitments will be to provide assurance to regional investors that any potential reversals in the trend towards greater services trade integration will be more limited than under the WTO provisions. Hence, the AFAS packages of liberalization commitments seem similar to the WTO's tariff bindings that provide a safeguard against policy reversals rather than representing the actual state of reforms.

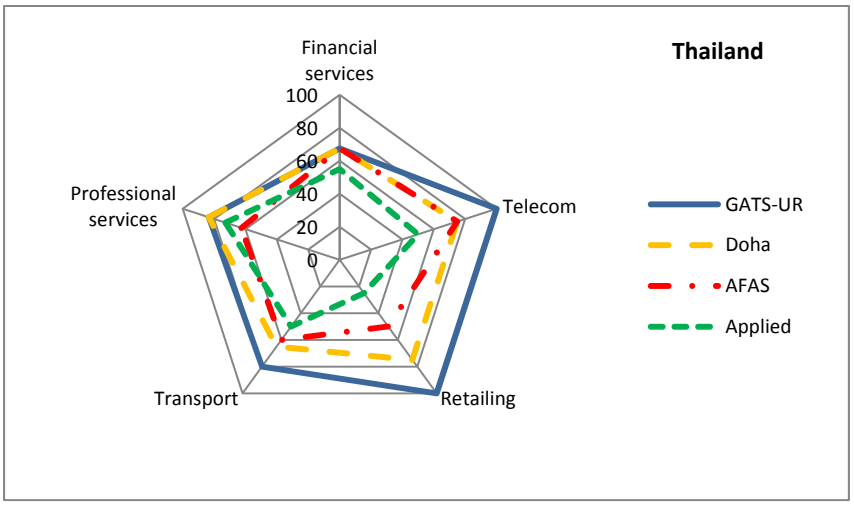
[46] For further details on the database and its contents, please see Ingo Borchert, Batshur Gootiiz, and Aaditya Mattoo, 2012, "Guide to the Services Trade Restrictions Database," Policy Research Working Paper 6108, The World Bank: Washington, DC.

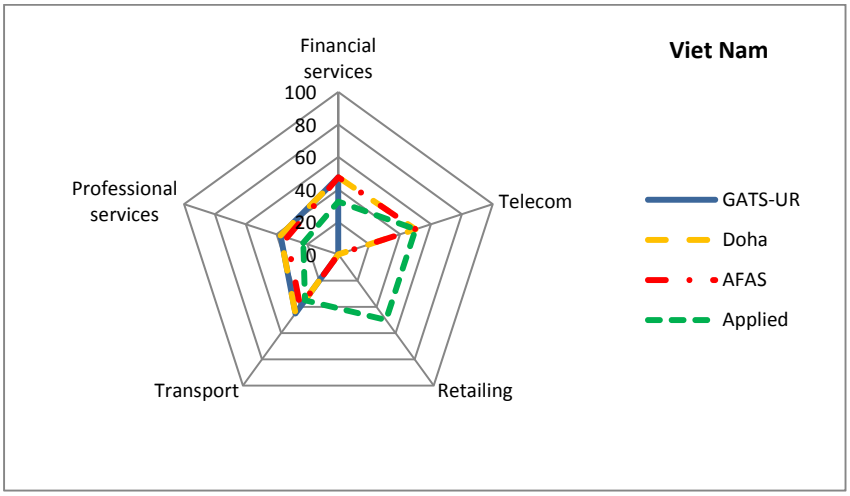
Figure 3. 1: Comparison of Services Trade Commitments and Policies for Selected Countries (Higher Value Indicates More Restrictive Policy Measures)



3.1 continued





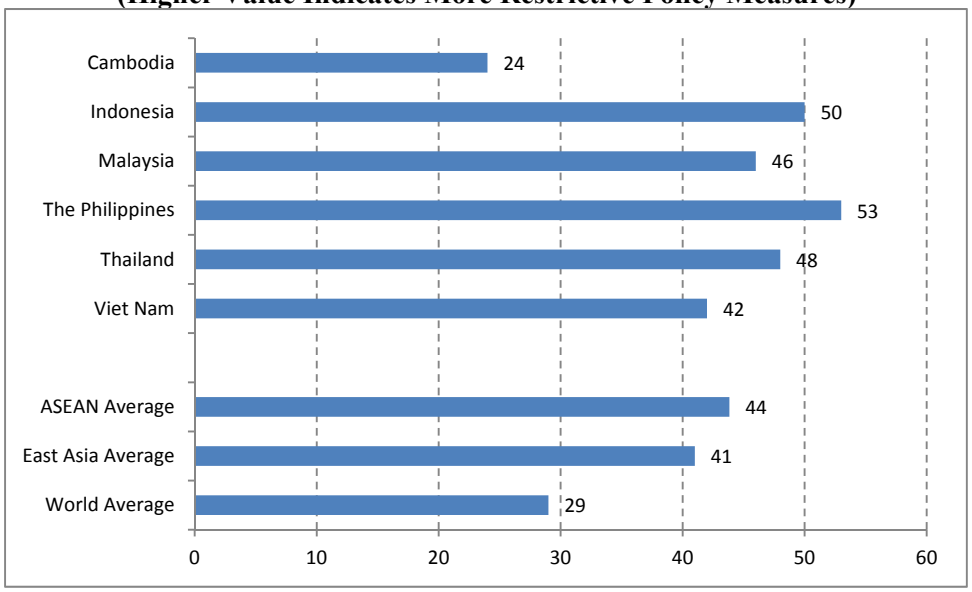


Note: AFAS commitments for Financial Services set equal to GATS commitments.
Source: Study Team Estimates.

C. International and Intra-Regional Comparison of Services Trade Policies

25. **The investigation of the database content also reveals that services trade in ASEAN countries is more severely restricted than in the broader East Asia and Pacific region or the world overall (Figure 3.2).** On average, the six ASEAN countries for which information is available have an STRI of 44, compared with an East Asia average of 41 and a global average of 29. The Philippines is showing the most restrictive policy regime with an STRI of 53, followed by Indonesia with an indicator value of 50. Hence, in general, the ASEAN region seems less advanced in the process of international integration of services than other regions. Moreover, it is worthwhile to note that the less developed countries, Cambodia and Viet Nam, feature the lowest STRI in the ASEAN group. This observation might reflect the nascent state of the countries' regulatory regimes and the possibility that not all existing policy measures and practices might have been fully codified, rather than these governments' proactive policies towards services trade.

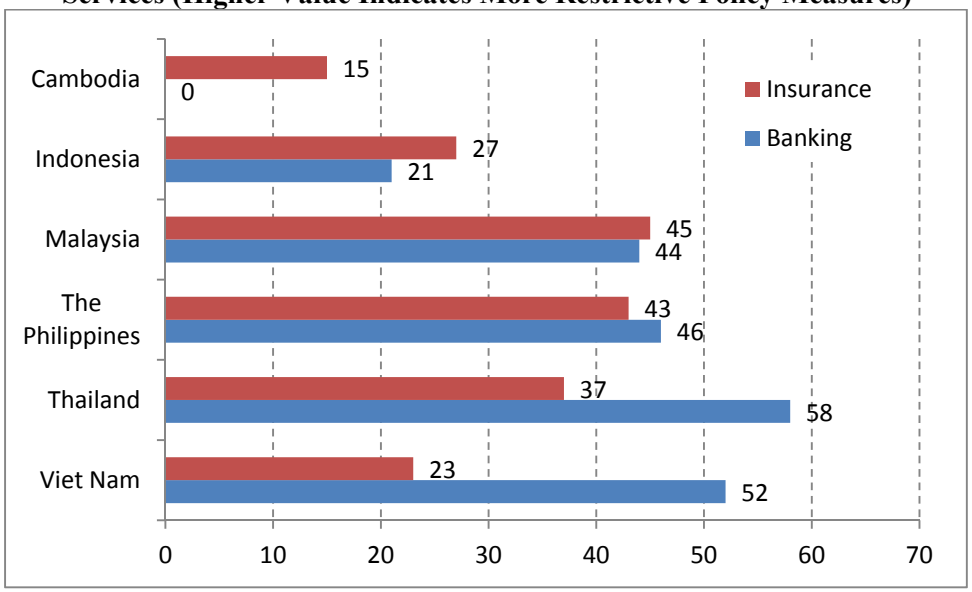
Figure 3.2: Overall Services Trade Restrictiveness Index
(Higher Value Indicates More Restrictive Policy Measures)



Source: "Policy Barriers to International Trade in Services: Evidence from a New Database," Ingo Borchert, Batshur Gootiiz, and Aadtiya Mattoo, Working Paper Series, (http://iresearch.worldbank.org/servicestrade).

26. **A closer look at the STRI information at the sectoral level reveals some additional insights.** In financial services, for example, Indonesia has a relatively open policy regime (Figure 3.3), with an STRI for banking of 21 and one for insurance of 27. This relative openness is a reflection of the absence of restrictions on the legal form of entry and the possibility for foreign investors to acquire up to 99 percent of a bank or 80 percent of an insurance firm, as long as the company is run as a joint venture with local partners and does not have more than 11 branches. In contrast, the financial sectors in Thailand, Philippines and Malaysia appear not as welcoming to trade in services. However, the situation in Malaysia is particular: while the regulatory regime in general limits financial company ownership to 49 percent of firm capital, the country has provisions to allow existing majority-foreign banks to operate under a grandfathering provision. Another observation from the STRI data concerns differences of restrictiveness within the financial sector where it is noteworthy, for example, that foreign trade in banking services in Thailand and Viet Nam is much more tightly restricted than trade in insurance services

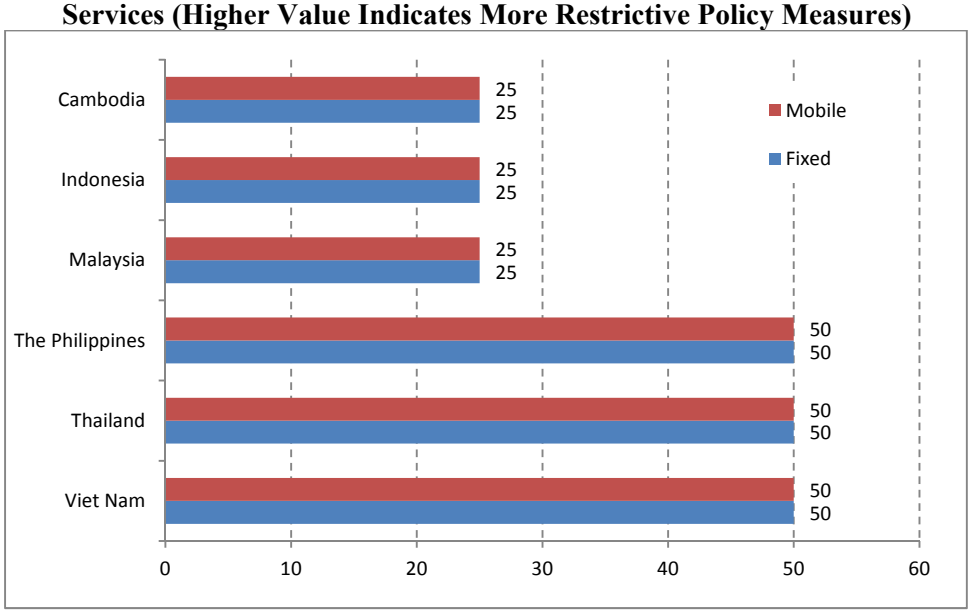
Figure 3. 3: Services Trade Restrictiveness Index for Financial Services (Higher Value Indicates More Restrictive Policy Measures)



Source: World Bank Services Trade Restrictions Database (http://iresearch.worldbank.org/servicestrade).

27. **In contrast, there are no significant intra-sectoral restrictiveness differences concerning mobile versus fixed line operators in the telecommunications sector of ASEAN countries (Figure 3.4).** The policy regime in Cambodia, Indonesia, and Malaysia is virtually open to international trade, with an STRI of 25, while in Philippines, Thailand and Viet Nam some major restrictions exist, which result in an STRI indicator value of 50 for these countries.

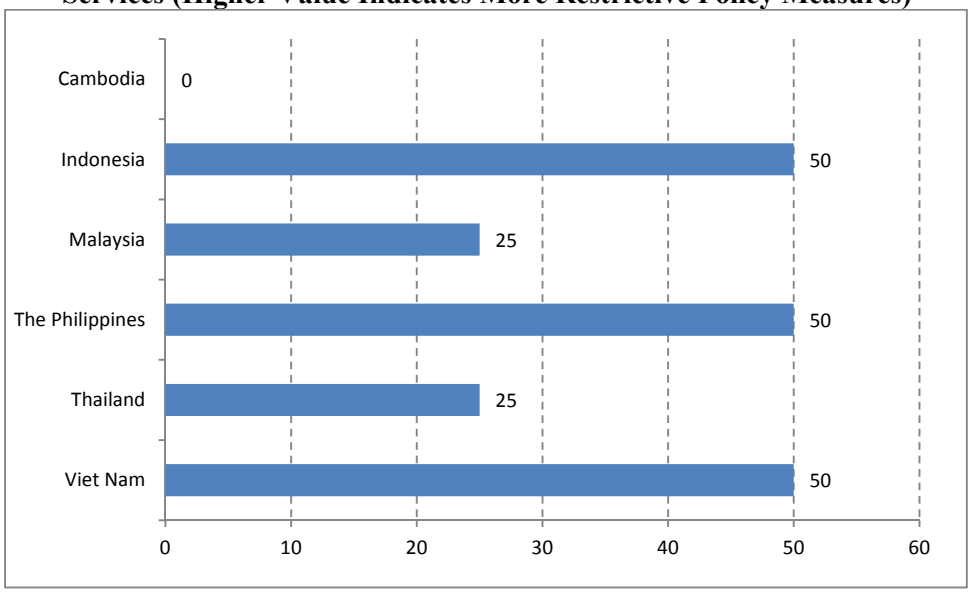
Figure 3. 4: Services Trade Restrictiveness Index for Telecommunications Services (Higher Value Indicates More Restrictive Policy Measures)



Source: World Bank Services Trade Restrictions Database (http://iresearch.worldbank.org/servicestrade).

28. **In retail, Cambodia operates a completely open services trade regime (Figure 3.5**). However, as noted earlier, the country might implement policies and practices that are not yet fully reflected in the body of sectoral regulations and are, hence, not captured in the STRI database. Malaysia and Thailand have virtually open trade regimes in the retail sector, while Indonesia, Philippines and Viet Nam have some major trade restrictions in place. For example, in Indonesia, while FDI up to 100 percent of equity is permitted, entry of foreign suppliers must occur on a large scale (minimum shop surface area of 2000 m^2) and is subject to cooperation arrangements with local small-scale businesses.

Figure 3. 5: Services Trade Restrictiveness Index for Retailing Services (Higher Value Indicates More Restrictive Policy Measures)

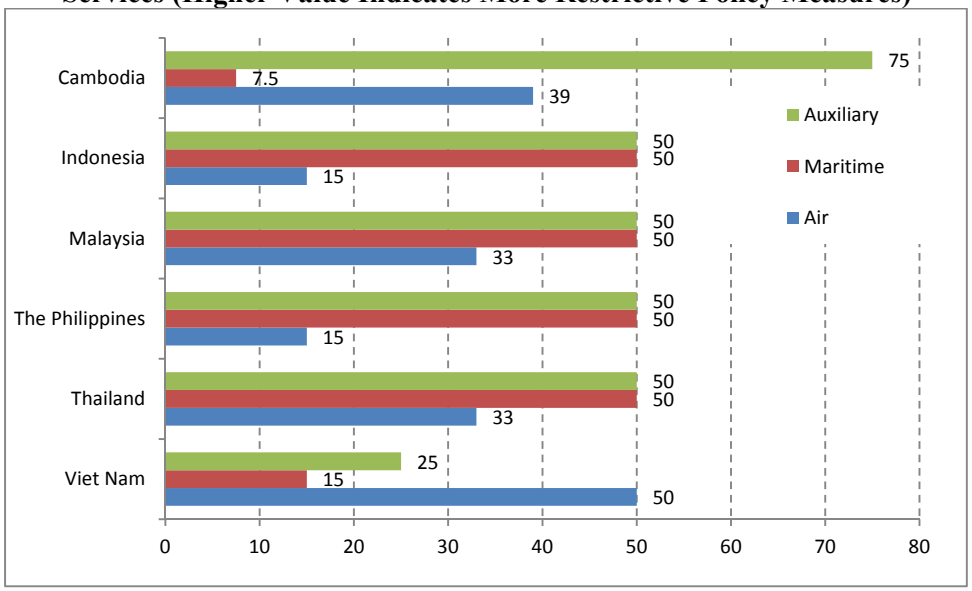


Source: World Bank Services Trade Restrictions Database (http://iresearch.worldbank.org/servicestrade).

29. **In transport, the restrictiveness of regulatory policies within the sector and across ASEAN countries shows some variability (Figure 3.6).** In the four more advanced ASEAN members, that is, Indonesia, Malaysia, Philippines, and Thailand, major restrictions to services trade exist in maritime transport, as well as in auxiliary maritime transport services. Air transport is more open. In Cambodia, maritime transport itself is almost completely open, while the provision of auxiliary maritime transport services is virtually closed. Also, in Cambodia as well as Viet Nam, air transport is more tightly restricted than in the four more advanced economies within the ASEAN group.

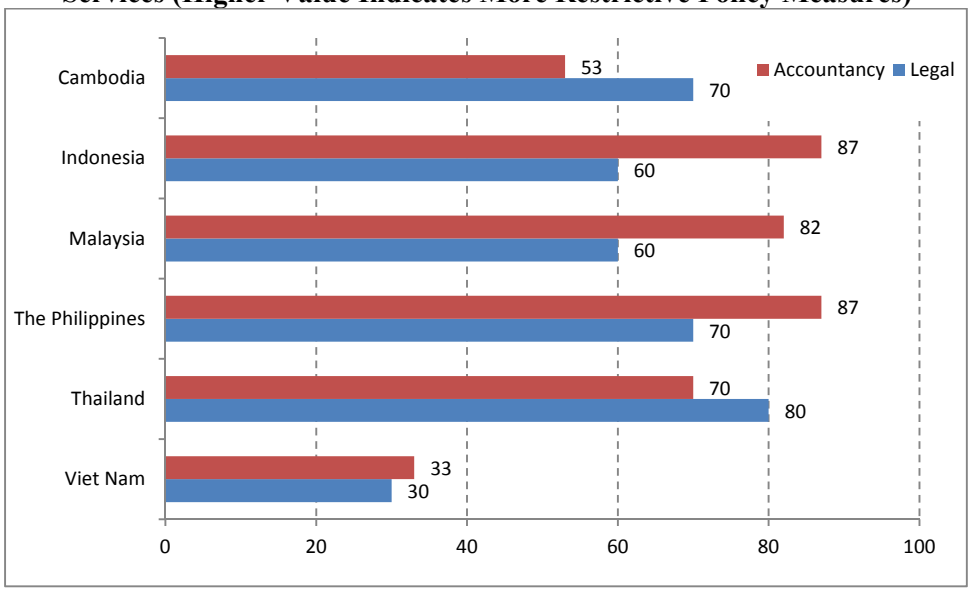
30. **Professional services are highly regulated and largely closed to international trade in most ASEAN countries.** All the countries in the group, except Viet Nam, have major restrictions for international trade in legal and accountancy services, as indicated by an STRI in excess of 50. In Cambodia and Thailand, the accountancy sector is somewhat more open than legal services, while in the four other countries the reverse is the case. Indeed, in Indonesia and the Philippines, the STRI for accountancy reaches 87, indicating a highly trade-restrictive policy regime. For example, in Indonesia, the accountancy sector is closed to foreign firms. For every foreign accountant hired, a national must be employed, and the ratio of foreigners to nationals must not exceed 1:3. Also, a foreign accountant must leave the country again after two years.

Figure 3. 6: Services Trade Restrictiveness Index for Transport Services (Higher Value Indicates More Restrictive Policy Measures)



Source: World Bank Services Trade Restrictions (STRI) Database (http://iresearch.worldbank.org/servicestrade).

Figure 3. 7: Services Trade Restrictiveness Index for Professional Services (Higher Value Indicates More Restrictive Policy Measures)

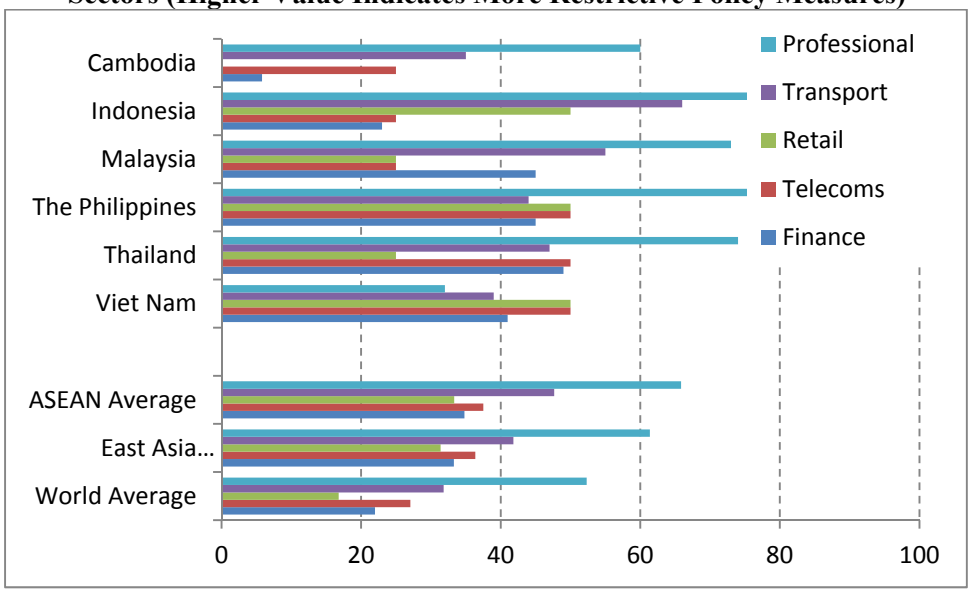


Source: World Bank Services Trade Restrictions (STRI) Database (http://iresearch.worldbank.org/servicestrade).

31. **In summary, the regulatory framework to enable international trade in services shows considerable variation across the six ASEAN countries and the five sectors covered in the STRI database** (Figure 3.8). Transport and professional services figure prominently in most

ASEAN countries as the sectors with the strictest regulations concerning foreign trade and investment. While a similar pattern can be observed in many other countries, as suggested by the respective global averages, the question for policy makers in this context is whether this pattern of restrictiveness across sectors is intended as such or whether ongoing and future reform programs will lead to a harmonization of services trade restrictiveness across sectors.

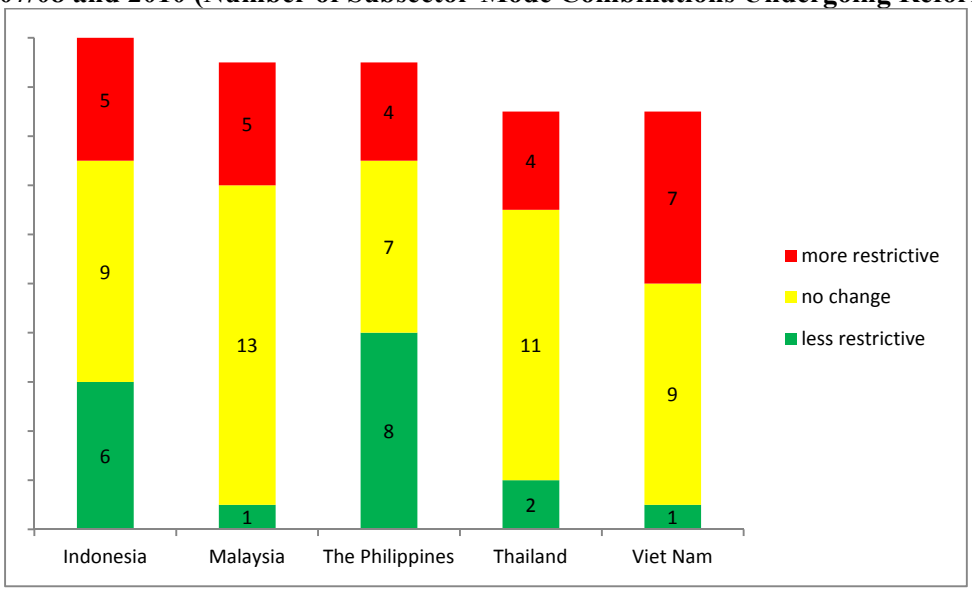
Figure 3. 8: Services Trade Restrictiveness Index Across Sectors (Higher Value Indicates More Restrictive Policy Measures)



Source: World Bank Services Trade Restrictions Database (http://iresearch.worldbank.org/servicestrade).

32. **Concerning developments since 2007/08, an update of the STRI database, this time covering all 10 ASEAN countries, is currently ongoing as a collaborative effort of the ASEAN Secretariat and the World Bank.** Yet, some limited information is already available on services policy reforms undertaken between 2007/08 and 2010, even though the sub-sectoral coverage of the information varies across countries and is, hence, not strictly comparable. With this caveat in mind, the preliminary and partial results for five ASEAN countries suggest that the track record of reform is mixed. In all countries, some subsector-mode combinations (for example, commercial presence in retailing) were reformed towards less trade restrictiveness, while in others more restrictive regulations were introduced. In the Philippines and Indonesia, more subsector-transaction mode combinations were opened up than further closed, while the reverse was observed for Malaysia, Thailand and Viet Nam. In the case of Viet Nam, the large number of more restrictive subsectoral regimes might reflect the development of sector-specific regulatory frameworks and the coding of previously informal policy practices. Nevertheless, overall the data does not suggest that ASEAN countries are very firmly on the road towards opening their services sectors to international integration, even though a more reliable assessment will have to wait until the full update of the STRI database is completed during 2013.

Figure 3. 9: Changes in Services Trade Restrictiveness Between 2007/08 and 2010 (Number of Subsector-Mode Combinations Undergoing Reform)



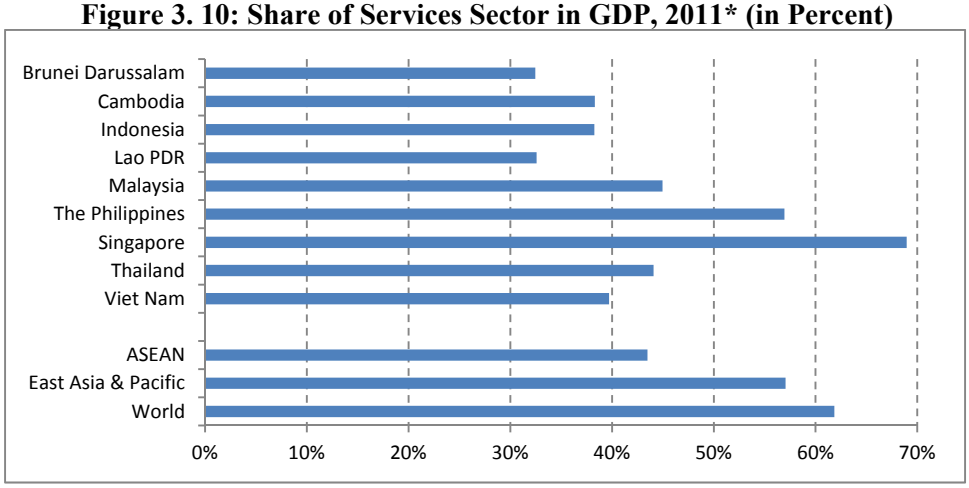
Source: World Bank.

D. Developments in Services Trade

33. **Services play an important role in the economy of AMS**. In 2011, the services sector accounted on average for about 43 percent of GDP, and for well above 50 percent in the Philippines and Singapore (Figure 3.10). The sector is similarly critical in terms of employment, and policymakers are well aware that demand for services will further increase as countries develop and income levels rise. Moreover, a well performing services sector is crucial for competitiveness. Many services activities, such as finance, telecommunications, and transport, provide essential inputs to other sectors of the economy, so that efficient services sectors are important to ensure the attractiveness of a location for investors and employers.

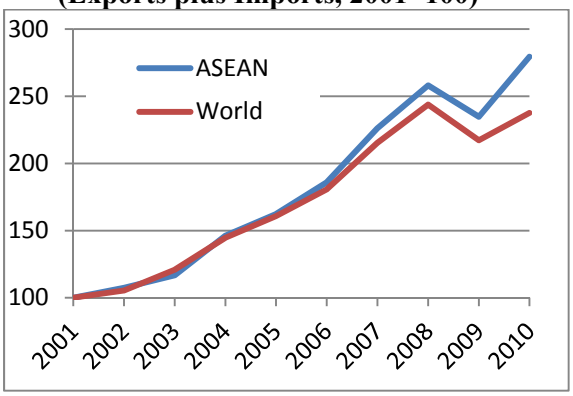
34. **One means of fostering efficiency gains is to integrate the domestic services sector internationally.** This opening towards regional or global markets gives countries access to a broader range of services suppliers, possibly including international best practice providers, while helping their own export-oriented services firms to expand and gain scale. Indeed, trade in services has risen significantly over time, both in ASEAN and in the world more broadly. Between 2001 and 2010, total services trade in ASEAN almost tripled and growth of services exports and imports outpaced global services trade growth since 2005 (Figure 3.11). However, since this growth was coming from a low base volume, the openness of AMS towards services trade, as measured by the share of services exports and imports in GDP, continued to drop in recent years and fell below 25 percent in 2010.

Figure 3. 10: Share of Services Sector in GDP, 2011* (in Percent)



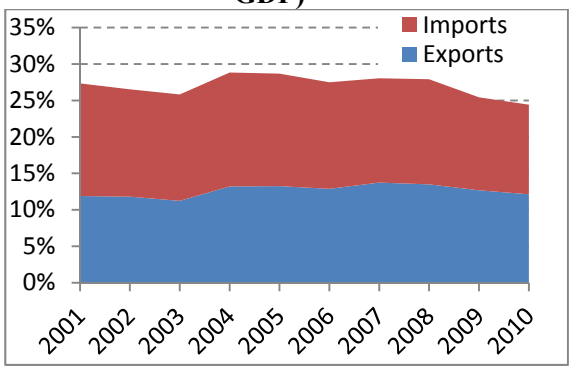
Notes: *or latest data available.
Source: World Development Indicators.

Figure 3. 11: Growth in Services Trade (Exports plus Imports, 2001=100)



Source: World Development Indicators.

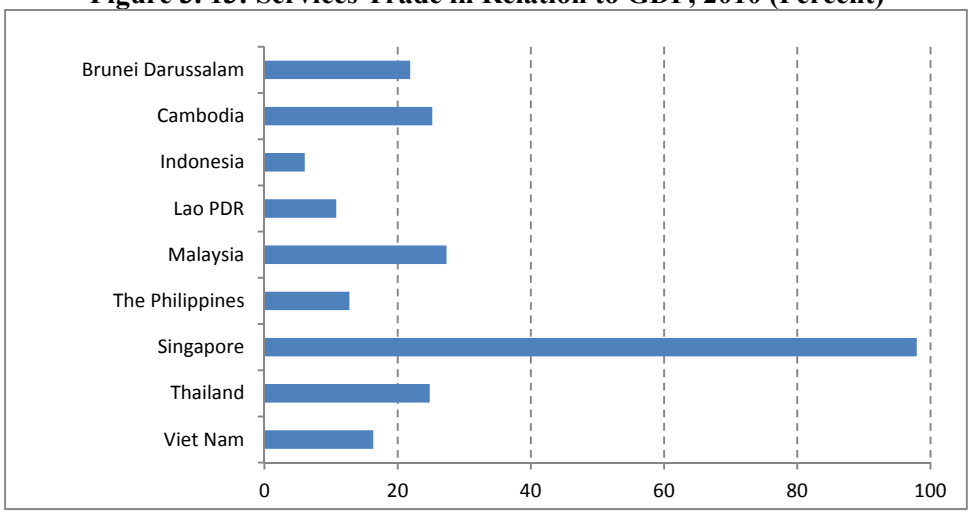
Figure 3. 12: Openness Towards Services Trade (Ratio of Exports plus Imports to GDP)



Source: World Development Indicators.

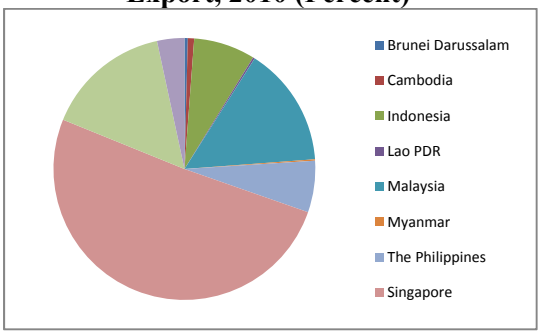
35. **However, the aggregate trend hides substantial structural differences across AMS**. Indeed, the share of services trade to GDP varies from six percent in Indonesia to 98 percent in Singapore (Figure 3.12). In 2010, Singapore alone accounted for more than half of ASEAN's services exports, and for more than 43 percent of its services imports. The country is, along with the Philippines, a major net exporter of services, while Indonesia, Thailand and Viet Nam are significant net-importers of services (Figure 3.13).

Figure 3. 13: Services Trade in Relation to GDP, 2010 (Percent)



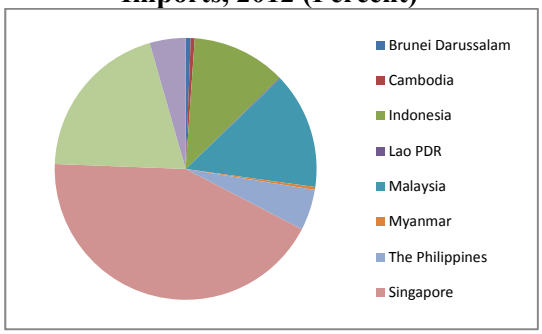
Source: World Development Indicators.

Figure 3. 14: Share in ASEAN Services Export, 2010 (Percent)



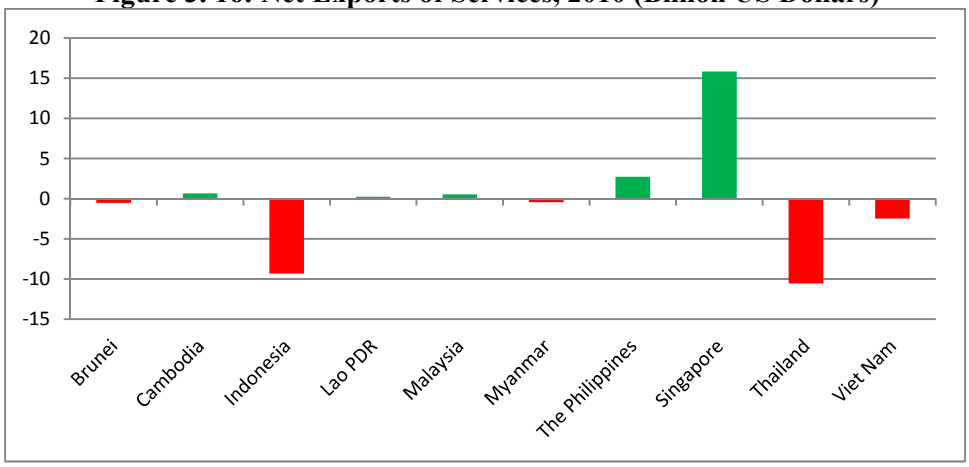
Source: World Development Indicators.

Figure 3. 15: Share in ASEAN Services Imports, 2012 (Percent)



Source: World Development Indicators.

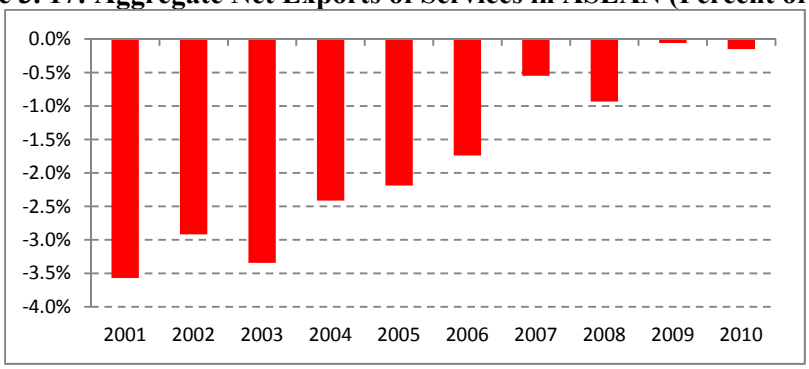
Figure 3. 16: Net Exports of Services, 2010 (Billion US Dollars)



Source: World Development Indicators.

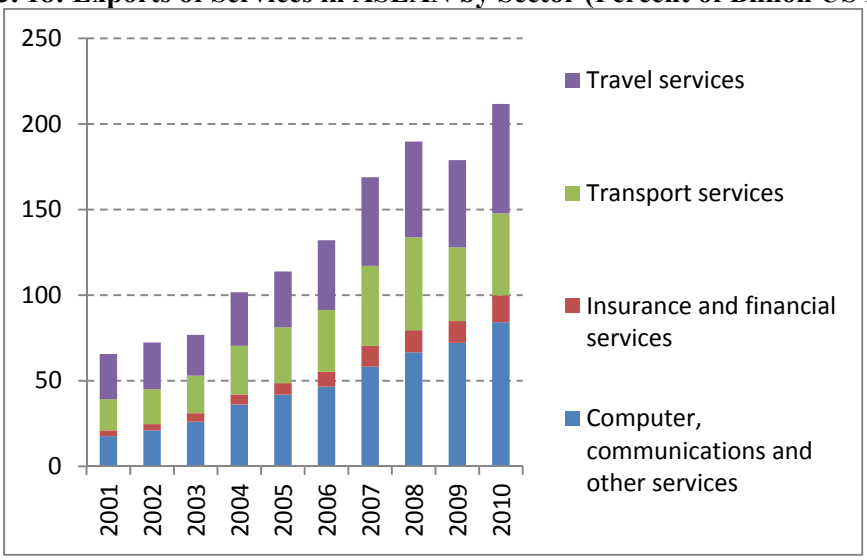
36. **Overall, ASEAN continues to be a net-importer of services, even though the region-wide services trade deficit has narrowed in recent years (Figure 3.17).** This reduction in net-imports was driven mainly by a strong expansion in exports of computer and telecommunications services (Figure 3.18). These expansions include, for example, the back-office processing and call-center services that countries such as the Philippines have successfully been providing.

Figure 3. 17: Aggregate Net Exports of Services in ASEAN (Percent of GDP)



Source: World Development Indicators.

Figure 3. 18: Exports of Services in ASEAN by Sector (Percent of Billion US Dollars)

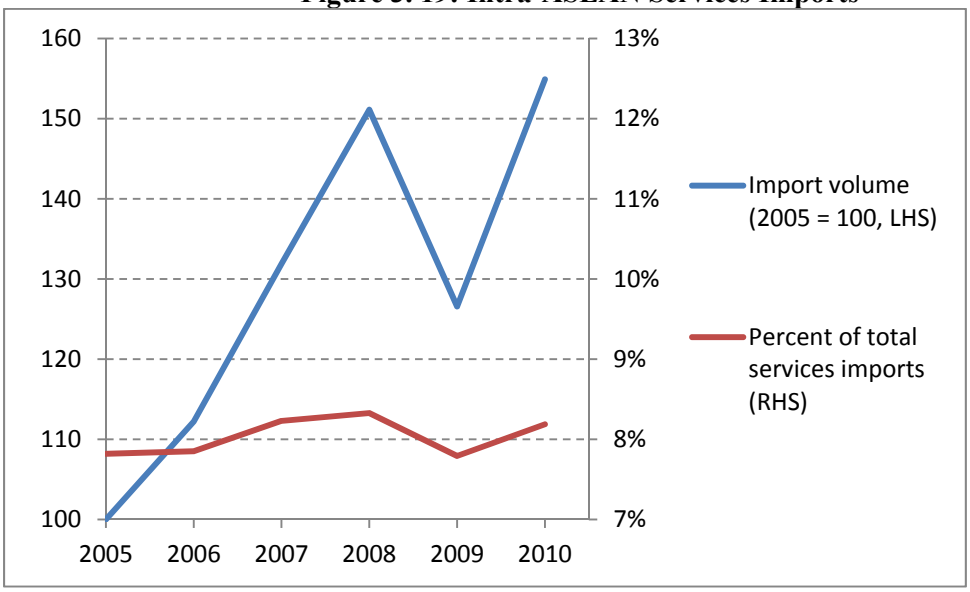


Note: Data does not include information for Viet Nam.
Source: World Development Indicators.

37. **With respect to intra-ASEAN services trade, few data are available.** However, the ASEAN Secretariat has worked with the statistical authorities of selected AMS to construct a new dataset of intra-regional services trade covering some of the AMS. While not fully comprehensive, these data make it possible to shed some light on general trends of intra-ASEAN trade in services. In particular, the data reveal that intra-regional services trade has been increasing strongly between 2005 and 2010 (Figure 3.19).

38. **The volume of intra-ASEAN services imports expanded by more than 50 percent during the period 2005-2010 (Figure 3.19).** Yet, the share of intra-ASEAN in total services trade remained largely unchanged at about eight percent, suggesting that intra and extra-regional trade have been growing in parallel and that intra-ASEAN transactions have not benefitted from any particular ASEAN Framework Agreement on Services (AFAS)-related integration boost.

Figure 3. 19: Intra-ASEAN Services Imports

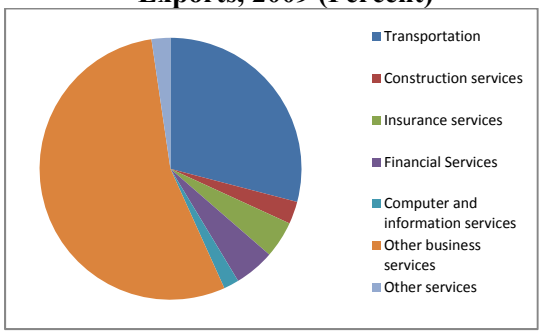


Note: Data does not cover Brunei Darussalam, Cambodia, Lao PDR, Malaysia, and Myanmar.
Source: ASEAN Secretariat.

39. **Singapore publishes detailed services transactions data that make it possible to analyze sub-sectoral trade patterns.** It turns out that transportation and 'other business services' are the dominant sub-sectors for Singapore's trade with its ASEAN partners (Figure 3.20). Moreover, the data reveal that the ASEAN market is relatively more important as an export destination than as a source of imports across all sub-sectors in Singapore (Figure 3.22). Construction features particularly prominently in regional services trade. Almost a third of Singapore's exports of construction services go to the regional market, while a fifth of all the construction services it imports originate in other ASEAN members. On the other hand, the Singaporean sub-sector for which the regional market is least important, both on the export and the import side, is finance (excluding insurance).

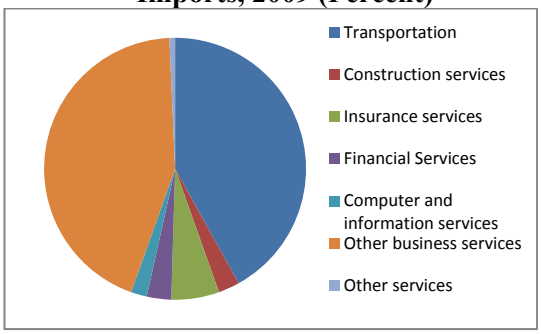
40. **However, in conclusion, it is clear that Singapore has made important progress in developing and integrating its services sectors with the global and regional economies.** This has been possible because Singapore and some other ASEAN countries have made important progress in implementing services reforms, of which a central aspect is domestic regulatory reforms. Unless domestic regulatory policies and institutions are aligned with international and regional integration goals, implementation of services integration agenda cannot proceed. Initial evidence from ASEAN economies suggests that the implementation and the reform of the services agenda is a key pending agenda. The next section discusses the conceptual issues concerning the domestic regulatory reform agenda. As noted in the introduction of this report, an in-depth study of the services sector integration agenda for ASEAN is planned for 2013. That study will provide the detailed sectoral information and data for a more in-depth discussion specifically focused on ASEAN economies. The discussion in the next section raises the critical issues concerning domestic regulatory reforms in a more general way.

Figure 3. 20: Singapore's Regional Services Exports, 2009 (Percent)



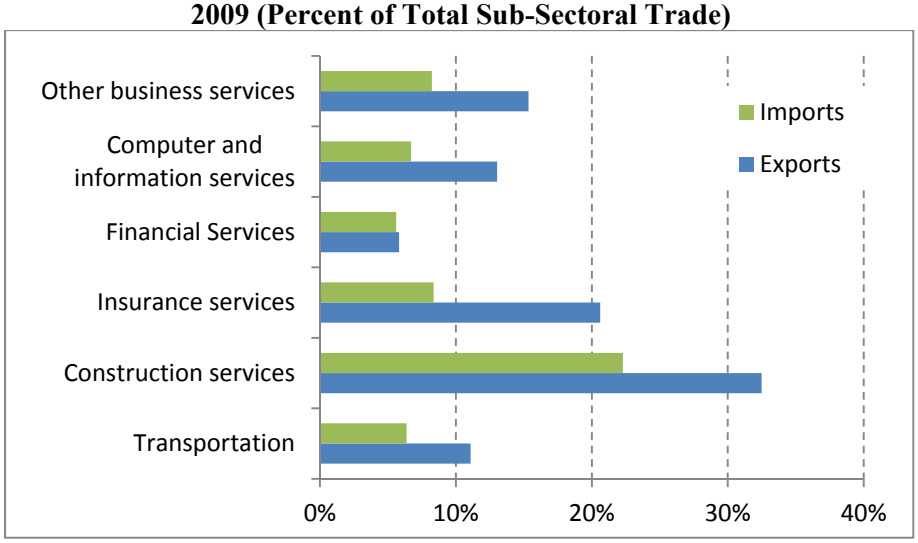
Source: ASEAN Secretariat.

Figure 3. 21: Singapore's Regional Services Imports, 2009 (Percent)



Source: ASEAN Secretariat.

Figure 3. 22: Singapore's Intra-Regional Services Trade, 2009 (Percent of Total Sub-Sectoral Trade)



Source: ASEAN Secretariat.

E. Skilled Labor Mobility

41. **ASEAN is an economically diverse region with substantial differences in skill and wage levels among AMS.** These differences suggest that there are large mutual benefits from the removal of restrictions to the temporary movement of natural persons. AMS are well aware of these potential benefits, and the ministers indeed signed the ASEAN Movement of Natural Persons (MNP) Agreement in November 2012 to facilitate the movement of skilled labor in the region. The Agreement is the first of its kind in the region and as such represents a major step forward towards the aims of completing AEC. In particular, it provides ASEAN business travelers with similar mobility opportunities to those enjoyed by some non-ASEAN citizens whose countries had signed plurilateral or bilateral agreements with AMS that contained provisions on the movement of natural persons. Examples include the ASEAN-Australia-New Zealand Free Trade Agreement, Japan's bilateral Economic Partnership Agreements with Indonesia, Philippines, Singapore, and Thailand, and Singapore's Free Trade Agreement with the United States.

42. **The MNP Agreement is intended to facilitate the movement of natural persons engaged in the conduct of trade in goods, trade in services, and investment between ASEAN Member States.** The provisions of the MNP Agreement govern the temporary entry and stay of skilled workers, professionals and executives in categories such as intra-corporate transferees, contractual services suppliers, and business visitors. The Agreement does not change any existing regulations on permanent entry and residence, nor does it cover the movement of unskilled workers.

43. **Moreover, AMS have concluded a number of Mutual Recognition Arrangements (MRAs) to facilitate the supply of services within the region.** In particular, eight MRAs for specific professions have been signed between 2005 and 2012:

- MRA on Engineering Services, signed on December 9, 2005.
- MRA on Nursing Services, signed on December 8, 2006.
- MRA on Architectural Services and Framework Arrangement in the mutual recognition of Surveying Qualifications, both signed on November 19, 2007.
- MRA on Tourism, signed on January 9, 2009, by nine AMS and on November 9, 2012, by Thailand.
- MRA on Medical Practitioners, MRA on Dental Practitioners, and MRA Framework on Accountancy Services, signed on February 26, 2009.

44. **Implementation mechanisms differ across MRAs.** The agreements on accountancy services and surveying qualification services are framework MRAs, so that another stage of negotiated accords is required to turn them into fully functional MRAs. For architectural and engineering services, registration is conducted at the country level, with the approval of professionals submitted by AMS being granted by the ASEAN-level institutions named the ASEAN Architecture Council and the ASEAN Chartered Professional Engineer Coordinating Committee. For nursing, dental and medical practitioners, the MRAs provide for an implementation mechanism that relies on country registration without an ASEAN-level approval procedure.

45. **Progress in implementing the ASEAN MRAs has varied across sectors**. For architecture and engineering services, a number of professionals in various AMS have been registered and certified under the MRA process. For other MRAs, the exchange of information of domestic policies and regulations of the MRAs remains ongoing. For the healthcare MRAs, it was recognized that patient safety remains the ultimate consideration, and therefore a different understanding of mobility in these MRAs (as compared to the engineering and architecture MRAs) is under discussion. An MRA on accountancy services (no longer a framework) is under consideration, which may exclude independent practice for auditors.

46. **While, to date, the MRAs have achieved little mobility of skilled human resources, Iredale and others (2010) point out that the process of negotiation itself might have been helpful for the least advanced members within ASEAN**.[47] Some AMS do not have guaranteed occupational standards, regulatory mechanisms, or professional bodies that register and accredit practitioners. In this context, the negotiations have been beneficial in raising the countries' awareness of deficits that need to be remedied.

47. **What can be done to accelerate the operationalization of the MRAs and increase their effectiveness, given the substantial diversity in educational standards and professional skills across**

[47] Robyn Iredale, Tim Turpin, Charles Stahl, and Tepin Getuadisorn (2010), "Free Flow of Skilled Labour Study," ASEAN-Australia Development Cooperation Program.

AMS? One approach that has been advocated by some analysts is to aim for common minimum standards in professional qualifications that are acceptable to all member states.[48] Setting such common standards would avoid the sometimes acrimonious discussions concerning the equivalence of qualifications and alleviate fears of a race to the bottom in terms of educational and professional standards. It would require, though, that partner countries come to an agreement on core competences and the harmonization of training schedules and programs.

F. Implementing the Services Integration Agenda: Domestic Regulatory Reform

48. **One of the key issues that trade policy makers in ASEAN countries face concerns the inherent tension between domestic regulation and market openness.** Regulatory autonomy makes it possible to tailor domestic rules to local conditions. Some of this autonomy might be lost when a country engages in an international trade agreement, as the provisions of services agreements frequently reach 'behind the border.' On the other hand, integrating with trade partners can provide a welcome opportunity to review and overhaul the domestic regulatory regime that might have become entrenched due to the influence of protectionist interests.

Rationale for Services Sector Regulation

49. **Even though there is considerable diversity across services sub-sectors, the underlying economic and social rationale for regulatory intervention rests on three pillars** (Mattoo and Sauvé, 2003): (a) monopolies in network-based services (for example, telecommunications, transportation and energy services); (b) externalities and asymmetric information in knowledge and intermediation-based services (for example, financial and professional services); and (c) the desire to ensure universal access in essential services (for example, health and education services).

50. **Many infrastructure services can be characterized as network services and as such provide natural monopolies or oligopolies for incumbent suppliers**. Such services require specialized distribution networks, such as roads and rails for land transport, transmission lines and satellites for telecommunications, and cables for energy distribution. The provision of this infrastructure is often subject to space constraints that make it impossible to develop several parallel networks. Moreover, the activities tend to be highly capital-intensive, with strong scale economies and assets that are long-lived and cannot be easily redeployed in other activities. While changing technologies have over time reduced both the optimal scale of operation and the importance of sunk costs in some services sectors, such as telecommunications and air transport, the issue of market power and anti-competitive behavior remains and the resultant market failure calls for regulatory intervention. The latter often takes the form of price controls that try to achieve a balance between investor and consumer interests, with the prices being set by a government agency or an independent regulator.

51. **In intermediation and knowledge-based services, asymmetric information is prevalent and can lead to market failures that motivate regulation.** Buyers are often not fully informed about the characteristics of service suppliers and their offers. For example, consumers cannot easily evaluate the competence of lawyers and medical doctors, the safety of air transport, or the soundness of insurance and banking companies. Since the dissemination of all the missing information to individual buyers would be very expensive, it has become general practice to regulate the suppliers. This regulation takes the form of minimum qualification and performance standards that ensure, for example, that professionals have the

[48] Aaditya Mattoo and Pierre Sauve (2008), "Regionalism in Services Trade," in *A Handbook of International Trade in Services*, Aaditya Mattoo, Robert M. Stern, Gianni Zanini (eds.), Oxford: Oxford University Press.

competence expected by consumers and that institutions, such as banks, are established in a sound and trustworthy manner.

52. **A third type of regulation arises from distributional objectives, such as to ensure universal access to services.** For example, regulations try to provide postal, health and education services across the entire population. In these situations, governments frequently regulate and enforce a uniform price, irrespective of the cost of service provision. The resulting, distorted price structure is then often sustained through cross-subsidization within public monopolies or through direct financial support from the government. There are alternatives to direct regulation that have frequently proven to be a more efficient means of reaching the distributional objective. These include competitive bidding for subsidized contracts to serve disadvantaged areas or groups of customers, and the distribution of vouchers to target groups who can then purchase the services from providers of their choice.

Trade and Regulatory Reform

53. **Trade integration can in some cases facilitate the task of services sector regulation by strengthening competition and thus helping consumers to obtain quality services at low prices.** Yet, the success of trade negotiations depends on the implementation of two principles: market access and national treatment. These principles require that regulations make it possible for foreign suppliers to enter the domestic market and that the regulatory framework does not discriminate against foreigners. In this context, it is important to note that trade can be inhibited even by regulations that do not discriminate, such as certain standards and licensing requirements, and by the absence of pro-competitive regulations. Hence, successful services trade integration will often require accompanying changes to the regulatory framework.

54. **In network services, existing monopolistic or oligopolistic market structures may undermine integration efforts if incumbents can impede access through their control of essential facilities.** Therefore, additional regulation might be required to ensure that monopolistic suppliers do not engage in anti-competitive behavior. In particular, appropriate regulation would stipulate that any major owner of essential facilities provides access to all service suppliers, national and foreign, at cost-based rates.

55. **Concerning intermediation and knowledge-based services, regulations like licensing and qualification requirements can often become obstacles to trade.** Market-opening commitments may thus need to be supported by a thorough review of the regulatory regime to identify and reform needlessly restrictive impediments to trade and investment integration. Also, creating the possibility to challenge trade-impeding or particularly burdensome regulation can provide government authorities with valuable input into the regulatory process.

56. **As may be expected given the overwhelming importance of the services sector in Singapore**, **regulatory reforms addressing these issues are most advanced in Singapore.** Box 3.2 provides the case study of how Singapore addresses these reforms in key sectors.

Box 3. 2: Services Trade Policy and Development in Singapore

The development of the services trade sector in Singapore is examined from the regulatory and liberalization policy perspectives (after the AFAS was launched in 1995). The areas of telecommunication, maritime transport and financial services are emphasized in this section.

Deregulation of the telecommunication industry was undertaken in 1989 in order to attract new competition, lower prices and charges, and to provide a larger range of services. Full competition in the telecommunications market was introduced in April 2000. The liberalization of services comprises facilities-based telecommunication services providers and services-based operators. It has been reported that the number of telecommunications service providers has increased significantly: 922 telecoms licenses were issued in 2008, of which 43 are facility-based operators and 879 are service-based operators. Former telecom services providers such as Sin-Tel and Temsack hold nearly half of StarHub's capacity.

In shipping, the main legislation constitutes the Merchant Shipping Act and the Carriage of Goods by Sea Act. The Marine and Port Authority of Singapore under the Ministry of Transport implements maritime policies. Singapore Ports are managed under licenses by the PSA Corporation Ltd and Jurong Port Pte Ltd. Singapore attracted 40 shipping companies' national headquarters in Singapore including COSCO, Odjfell Tankers, Shell Tankers, IMC Shipping, and K Line.

The liberalization in the financial sector was performed by conducting 'phased liberalization' in three phases. The Monetary Authority of Singapore (MAS) introduced the first phase—a five-year program in March 1999, a second phase in June 2001, and the third phase in 2004. In the first phase was a package on new banking privileges and licenses for foreign banks for three years (1999-2001). MAS introduced a new category of full banking license with Qualifying Full Bank (QFB) privileges or full service licenses. MAS issued these QFB licenses to ABN Amro Bank, Banque Nationale de Paris, Citibank, and Standard Chartered Bank by the end of 2000, and it awarded the last two of the planned six initial QFB licenses to Malaysia's Maybank and HSBC in December 2001. The government lifted the 40 percent limit on aggregate foreign shareholding of local banks in July 1999 and allowed local banks to merge the local and foreign share tranches.

Under the US-Singapore Free Trade Agreement, US banks with QFB privileges were permitted in 2005 and Wholesale Bank licenses were allowed in 2007. The wholesale banks and offshore banks were not allowed to make transactions using Singapore dollar domestic retail operations. As of the beginning of 2013, ten foreign banks operating in Singapore have been granted QFB privileges and may operate in 25 locations.

In capital markets, MAS identified measures for further liberalization in March 2002 to facilitate the development Singapore's capital markets. At the same time, new wholesale licenses were granted to banks from Switzerland, Japan, France, Australia, etc. To compete with incumbents' foreign banks, the local banks were consolidated—such as Development Bank of Singapore (DBS) with Post Office Saving Bank (POSB), United Overseas Bank Ltd. (UOB) with Overseas Union Bank Ltd. (OUB), and Overseas-Chinese Banking Corporation (OCBC) with Keppel-Tat Lee. With respect to investment banking, three main local banks were required to dispose of non-core assets by 2006, which would enable them to focus on core banking business.

In the Stock Exchange, the Stock Exchange of Singapore (SES) merged with the Singapore International Monetary Exchange (SIMEX) and formed the Singapore Exchange (SGX) in December 1999. The stock broking industry was liberalized in 1998 in the context of fees and opening up of market access. The brokerages have consolidated and upgraded capabilities, and widened services and products. New foreign brokerages were permitted to reach out to foreign investors. Since SGX was listed in November 2000, MAS administered statutory laws regulating the capital market, and oversaw SGX's regulatory functions while SGX retained the regulation of market participants.

The insurance sector is regulated by the Insurance Act of 2002, which is revised by replacing the audit-based inspection framework to a risk-based capital supervision Act of 2003. In 2004, MAS introduced a new system framework centered on a risk-based capital framework. In this framework, however, the minimum capital requirements on admission to the reinsurance market were unchanged at USD 25 million for direct insurers and re-insurers. It was reported that there were 153 insurance companies in Singapore.

Box 3. 3: Services Trade Policy and Development in Singapore (continued)

The MAS is the integrated regulator and supervisor of financial institutions in Singapore. MAS established rules for financial institutions, which are implemented through legislation, directions and notices. Guidelines have also been formulated to encourage best practices among financial institutions. As of 2012, there were over 600 operational financial institutions offering a variety of services across various asset classes in Singapore.

Thus, major unilateral financial reforms were launched in Singapore based on four main tasks: reforming regulatory environment; liberalizing financial sector; developing strategic and proactive approaches including encouraging capacity of local banks; and enhancing the financial sector.

Preparing for Trade-Induced Regulatory Reform

57. **Regulations of services sectors tend to be complex**. Typically, multiple regulatory and enforcement frameworks are involved that are managed by different agencies. Also, governments frequently impose restrictions on foreign ownership, market access, and the operation of services providers that might have been suitable at the time these regulations were introduced but might no longer represent efficient means of achieving the desired policy objective. Moreover, in addition to the laws and regulations themselves, the governance setting surrounding the decision-making and implementation process of services sector regulations plays a crucial role in determining the efficiency of the regulatory framework and the country's preparedness for international integration.

58. **In this context, the decision to further integrate with trading partners within ASEAN provides a useful opportunity to fundamentally review the state of services sector regulations and to bring it into line with international best practice and the objectives and commitments under the ASEAN Blueprint.** In particular, AMS might want to put in place (or revisit existing) mechanisms that are aimed at promoting the needed reforms. Examples exist in other countries or country groups on how, for example, services knowledge platforms that bring together regulators, trade policy makers, and private sector representatives can be organized to exchange information and generate evidence-based policy dialogue.[49] Moreover, a thorough regulatory stock-taking might be desirable. The latter would involve three major elements: (a) an inventory of regulations affecting the sectors covered in the Agreement, as well as an assessment of the regulatory process and institutional arrangements; (b) an impact evaluation that aims at collecting quantitative information on prices and costs, market structures, and prospective benefits and adjustment costs due to trade integration, and (c) the exploration of alternative regulatory means to achieve the domestic policy objectives while minimizing adverse impacts on trade.

59. **Such an assessment would provide the basis for the development and modernization of the regulatory framework for the services sector, with a view to fully support the ongoing trade integration process within ASEAN.** It could help to identify areas that require reform, both in the formal laws and in the administrative implementation procedures. Moreover, the assessment would make it possible to spot potential inconsistencies with international disciplines that may affect the negotiation process or compliance with the Agreement.

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[49] See, for example, Bernard Hoekman and Aaditya Mattoo (2011), "Services Trade Liberalization and Regulatory Reform: Reinvigorating International Cooperation," Policy Research Working Paper no. 5517, Washington DC; The World Bank; or Bernard Hoekman and Aaditya Mattoo (2012), "Liberalizing Trade in Services: Lessons from Regional and WTO Negotiations," paper prepared for the Global Trade and Financial Architecture project, Washington DC; The World Bank.

G. Conclusion and Policy Implications

60. **The preceding analysis of services trade and regulatory trends revealed some encouraging developments.** Services trade in ASEAN is growing fast, and the historically persistent services trade deficit is narrowing and might in the near-term turn into a surplus. On the other hand, the data also revealed some challenges that suggest policy implications.

61. **In particular, the commitment analysis based on the STRI data revealed that AFAS often goes beyond GATS commitments or Doha Round offers, but rarely leads to changes in the regulations that are applied in AMS.** Hence, the impact on trade and competitiveness of ASEAN services providers is limited to the potential effect on investment from strengthened assurances against a policy rollback. According to the analysis of services trade data, this effect has not been sufficiently strong to trigger a large expansion of intra-ASEAN services trade. A renewed focus on the implementation of pro-trade regulatory reforms thus seems desirable in order to move more quickly towards the objective of the AEC Blueprint of creating a unified services market in ASEAN. A first step in this direction could involve a more thorough monitoring of the implementation status of existing reform commitments, such that the available scorecard of commitment approval is supplemented by a scorecard of commitment implementation.

62. **One of ASEAN's relatively successful integration efforts concerns the mutual recognition arrangements for professional services that have been concluded among AMS.** Indeed, international experience suggests that the most pronounced benefits from regional integration in services come from the harmonization of the regulatory environment and the convergence of policy regimes through the creation of common standards and institutions. Yet, the conclusion of the MRAs can only generate the hoped for benefits in terms of market integration if the arrangements are properly implemented and not compromised by national regulations. In this context, a close monitoring of the movement of professionals under the MRAs and the compliance of AMS with the spirit of the arrangements seems desirable.

63. **More generally, the past focus of reform discussions in the Coordinating Community on Services (CCS) on improving market access could usefully be supplemented by discussions on deep integration through regulatory convergence and harmonization.** Measures to open markets towards regional partners are often rapidly multilateralized, and, while being welcome parts of the regulatory reform process, provide as such limited impetus for more intense regional services trade and investment. Hence, shifting the attention of regulators and policymakers towards creating a unified services market with common rules and procedures is often a more promising avenue to foster regional integration. Steps in this direction could range from the occasional organization of information exchanges among sectoral regulators to the delegation of negotiating authority from the CCS to new sectoral working groups. In fact, the Air Transport Working Group and the Working Committee on Financial Services Liberalization have arguably been advancing the implementation of the AEC Blueprint objectives in their areas faster than the CCS has been able to across its broad portfolio of sub-sectors that each are subject to very particular technical specificities and regulatory requirements.

64. **The establishment of new sub-sectoral working groups might also help to bridge the existing divide in regulatory capacity among AMS.** As the data analysis has demonstrated, there is considerable diversity within ASEAN with some strong services exporters, such as Singapore or the Philippines, and several less well-positioned countries, which are just starting to integrate their services sectors into international markets. Moreover, in the STRI analysis, CLMV appear as being relatively open to services trade. Yet, these AMS are still in the process of codifying their existing regulations, and creating transparent and consistent policy regimes in the different services sub-sectors is an important step in the

development process. On the other hand, many of the more advanced AMS have mature services sectors and well-established prudential and consumer protection measures in place and would benefit from a regulatory easing and its pro-competitive impacts. These diverging situations and needs might best be appreciated and dealt with in discussions of sectoral experts rather than trade policy all-rounders. Also, the regular meetings of sectoral officials from AMS might help to spread information on best practices and useful approaches to regulatory challenges in the individual sub-sectors.

65. **Last, the earlier discussion has revealed some marked gaps in the availability of information on intra-ASEAN services trade.** ASEANstats has recently started to compile a dataset on intra-regional trade in collaboration with national statistical authorities, but these data are not available for all AMS and the uncertain quality of the information at the sub-sectoral level does not make it possible to provide detailed assessments of the situation and prospects of intra-ASEAN services trade. Hence, further steps of regional integration should go hand-in-hand with efforts to strengthen the statistical apparatus in order to enable policymakers to properly monitor progress towards established integration goals with the help of quantitative indicators.

Where do AMS Stand with Respect to AEC Goals: Implementation and the Domestic Regulatory Reform Agenda

66. **The AMS established for themselves an ambitious set of objectives when they signed up for the AEC Blueprint targets on services sector integration.** By 2015, there should be substantially no restrictions to suppliers providing services and establishing companies across national borders.

67. **Subsequent rounds of negotiations have indeed resulted in good progress towards these goals**. In particular, the establishment of clear, quantifiable targets has provided useful guidance to negotiators and helped them advance towards the desired outcome. Naturally, some sectors and policy areas (such as relaxing restrictions on foreign ownership) are politically more sensitive than others and the negotiation mechanism has allowed for sufficient flexibility to accommodate related reform-reluctance while keeping the overall negotiating process on track. Yet, these flexibilities have also meant that many sensitive issues and difficult reforms have been back loaded, so that the remaining time till the 2015 target date risks becoming a rather charged period for negotiators and policy makers.

68. **Recent analysis by ERIA (2012) provided a detailed stocktaking on the extent to which AMS have fulfilled their AFAS commitments and concluded that the existing process of negotiations had proven its usefulness and could, with some modifications, also serve AMS well in the coming years.** These recommendations are welcome and should encourage AMS to reinforce their efforts towards fully meeting the AEC targets by 2015. Missing the objectives set out by political leaders or introducing new 'flexibilities' just before the deadline to formally meet the targets could seriously undermine the credibility of the integration process and, as a result, compromise progress in future negotiations.

69. **Given the urgency and sensitivity of the remaining tasks, it seems of fundamental importance that concerted efforts are launched in AMS involving all affected ministries to conclude the AEC reform agenda on time.** Sectoral ministries might usefully want to develop their own blueprints and reform schedules to meet the 2015 targets, rather than rely on the Trade Ministry (or other lead coordinating agency) to advance the reform agenda in their area of expertise and responsibility. Also, renewed efforts to reach out to business associations, local communities and civic society and inform

these stakeholders about upcoming regulatory changes and their rationale seems crucial in order to harness sufficient political support for reform.

70. **More generally, moving the services trade integration process forward will increasingly involve domestic policy reforms that entail regulatory adjustments.** The AFAS negotiating process has over time led to a convergence of openness commitments of AMS with the applied policy regime within countries. Further trade-enhancing reforms will, hence, increasingly trigger changes on the ground. In this context, it is important for policymakers to get the sequence of reforms right. Often, ownership restrictions in sectors such as financial services or health services are put in place because the institutional framework to regulate the behavior of financial institutions or the quality of medical services is insufficient. Lifting these ownership restrictions will, thus, first require that an appropriate regulatory framework be established in order to avoid adverse impacts on services quality. Also, international experience suggests that success in the opening of network industries, such as telecommunications or transport, depends on competition to be introduced into the sector before privatization, so that public monopolies are not simply replaced by private monopolies. These reforms are in the proper interest of each AMS unilaterally and their benefits do not depend on a reciprocal market opening by trading partners. However, undertaking the policy changes in the context of an international agreement increases their credibility and can help further illustrate the reforms' benefits to skeptical stakeholder groups.

71. **In order to deepen financial integration, among the important policies are the development of financial infrastructure, harmonization of regulations, market standards and rules, strengthening of member countries' capacity, as well as the promotion of greater macroeconomic and policy coordination.** These measures are important to enable ASEAN to further enhance financial linkages and implement new initiatives, including the integration of banking services. Moreover, a monitoring mechanism for regional financial integration is crucial to ensure the timelines and milestones in line with the AEC 2015 targets and beyond.

Chapter 4: Investments and the ASEAN Region

A. Key Findings

1. **The role of foreign investments in ASEAN global integration has grown noticeably over the past decade, even taking into account the financial crisis of 2008.** The perception that ASEAN countries are destination sources for foreign investments is very positive with several ASEAN members among the top world destinations. This positive trend can be expected to continue if the international environment remains favorable.

2. **Remarkably, intra-regional investments have taken a central role in this context**. The share of intra-regional foreign direct investment (FDI) is rising as a consequence of confidence in future opportunities in the region and the relative stability it offers in comparison with the rest of the world.

3. **However, the distribution of foreign investments in the region is very uneven: three-fourths of investments are concentrated in five countries, and half in one country, Singapore**. While this reflects the economic size and development disparities in the region, it also follows the level of regional and global integration of the various economies in the region. Therefore, if ASEAN is to keep attracting productive foreign investments, it must keep pushing not only investment reforms but also other trade and business environment reforms that are parts of the Blueprint package and beyond. Indeed, reduction of barriers to trade and facilitation of trade flows offer guarantees to investors of returns on their productive investments.

4. **The fact that foreign investment in ASEAN is geared towards investment in services industries and manufacturing, which are integrated into global and regional supply chains, suggests that there are still important barriers to regional trade integration (as mentioned in Chapters 2 and 3).** Once these barriers are removed the region will become even more attractive to foreign investors. Arguably, this applies more to Cambodia, Myanmar, and Laos, which are all in need of substantial reforms and increase in FDIs.

5. **In terms of investment policies, progress is needed almost at all levels, but especially in the case of restrictive foreign equity caps.** Good reforms have been made, but the region overall is still lagging behind East Asian and OECD countries. The ASEAN Comprehensive Investment Agreement of 2009 (ACIA 2009) does not cover all sectors, in particular services (some investment related aspects for services are, however, covered under AFAS). Restrictions in telecom, electricity and banking—important inputs into economic activities—are prevalent in a majority of AMS and still away from the 2015 objective of free and open investment. Overall, as noted in the previous chapter, progress in services areas is needed now that there is movement towards opening in trade in goods.

6. **The institutional approach of ACIA towards liberalization of investment would also benefit from improvements.** As it stands, there are numerous reservations to liberalization and the use of scheduling is not very transparent. This is because a positive list approach for sectors subject to liberalization is combined with a negative list approach for reservations.

7. **Less visible than restrictions on foreign equity are regulations such as performance requirements, restriction on capital movements, and movement of labor that can also severely restrict investments.** The prohibition of the use of performance requirements under ACIA is a very welcome progress, but restrictive regulations impeding investments are still relatively frequent in ASEAN countries and are contradictory to the principle of equal treatment of foreign and national investors affirmed in ACIA.

8. **Implementation or facilitation of investment is also very important.** Regulations that are indirectly related to investment—such as land access, visa policies, and screening policies for regulatory purposes and tax exemptions—may further limit foreign presence. In the case of land, for instance, while extended period leases are allowed, some ASEAN countries limit actual ownership. This restricts the ability of foreign investors to use land as collateral and also diminishes the value of investment. Surveys of businesses, reviewed below in Table 4.3, indicate that great importance is attached to such measures by foreign investors, which suggests that further joint efforts to streamline these policies will be welcome.

9. **The facilitation of the investment agenda is closely related to the need to improve monitoring and transparency of policies.** The Coordinating Committee on Investment provides a forum to exchange information and the decision to create a peer review mechanism will provide monitoring of the implementation of ACIA.

B. ASEAN Investment Integration: An Assessment

10. **The success of the ASEAN region in becoming a manufacturing hub is a testimony to the ability that AMS have demonstrated in hosting world-competitive intermediate manufacturing industries.** These industries are not only able to produce to world-class specifications but they have also become seamlessly integrated into regional and global value chains. It is also true, however, that investment rates (domestic plus foreign) in most ASEAN economies have still not recovered to their pre-Asian crisis rates. Raising investment rates will be a key part of the strategy for ASEAN middle-income countries to escape the 'middle income trap' through sustained growth. Attracting greater FDI will be an important part of raising overall investment rates. However, the role of FDI in ASEAN is also qualitatively important for the region's growth.

11. **The core of the region's overall competitiveness lies in its capacity to attract and retain foreign investment in manufacturing and services**. In addition to sound investment policies, attracting investment is determined by the sum of the many factors that enable entrepreneurs and businesses to thrive. These factors include a stable and predictable political and macroeconomic environment, appropriate exchange rates, input prices and endowments, and overall appropriate policies that address market and government failures.

12. **Recognizing its importance, facilitating regional FDI has been made a key goal of the AEC**. This chapter examines the key dimensions of the investment and business environment in the ASEAN region in the context of AEC's FDI goal: "A free and open investment regime." This goal is key to

enhancing ASEAN's competitiveness in attracting FDI and intra-ASEAN investment. Sustained inflows of new investments and reinvestments will promote and ensure dynamic development of ASEAN economies. The AEC Blueprint describes the various policy instruments in detail.

13. **This chapter focuses on the outcomes of AEC goals on regional foreign direct investment.** It first describes the outcomes of ASEAN's past and current policies (this section) and next, in section 2, provides an assessment of the broad policy factors that shape the environment for foreign investors in the ASEAN region. Section 3 looks into the direct impact of ASEAN investment integration on investment levels, and section 4 has the conclusion and policy implications.

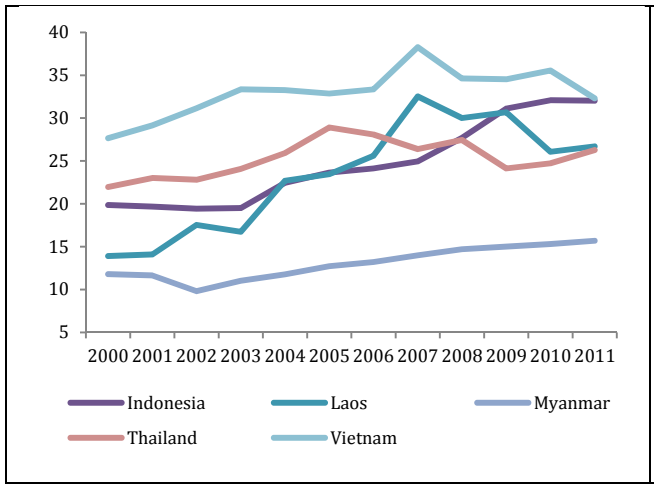
Foreign Investment Trends in ASEAN

14. **Investments have been an important component of the economic success of ASEAN countries**. Total investments in ASEAN countries have increased nearly four-fold in the last decade, from USD 266 billion in 2000 to USD 974 billion in 2010. Over this period, investments have also become relatively more important to ASEAN economies as the average ratio of total investments to GDP of ASEAN has increased from 20 percent in 2000 to 23 percent in 2010, though it is still below the pre-Asian crisis rate (Figures 4.1 and 4.2). Over the same period, FDI increased on average by 18 percent annually (Figure 4.3), outpacing GDP growth and highlighting the important contribution of foreign investments in overall rising investment levels.

15. **The role of FDI in feeding this overall trend has been particularly important in some ASEAN countries.** Over the last decade, Brunei, Cambodia, Indonesia, Singapore, and Thailand have experienced substantial increases in the ratio of FDI to GDP. However, the relative importance of FDI has declined in other ASEAN countries (Figures 4.2a and 4.2b), suggesting unrealized potential. Overall, the average ratio of FDI to GDP has been increasing in the region from 49 percent in 2000 to 58 percent in 2010, a figure that is driven mostly by Singapore's individual performance (see Box 4.1); excluding Singapore, the average ratio of FDI to GDP only slightly increased from 41 percent to 42 percent over the same period.

Figure 4. 1: Ratio of Total Investment to GDP (percent) ASEAN

Countries with Increasing Trends

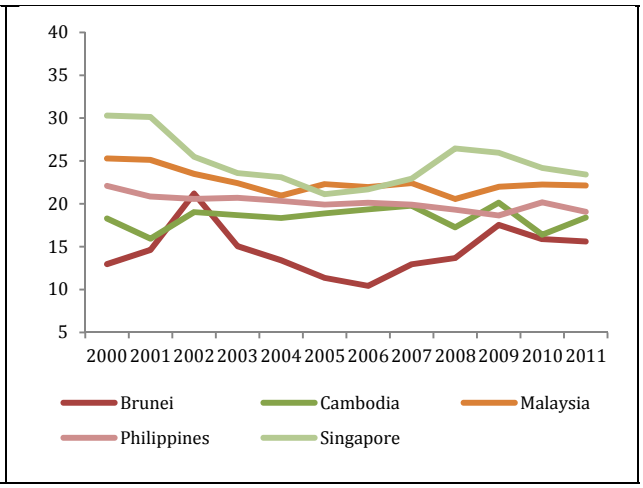


Note: Data of investment in 2011 are preliminary data

Source: Economist Intelligent Unit, 2012

Figure 4. 2: Ratio of Total Investment to GDP (percent) ASEAN

Countries with Decreasing or Stagnant Trends

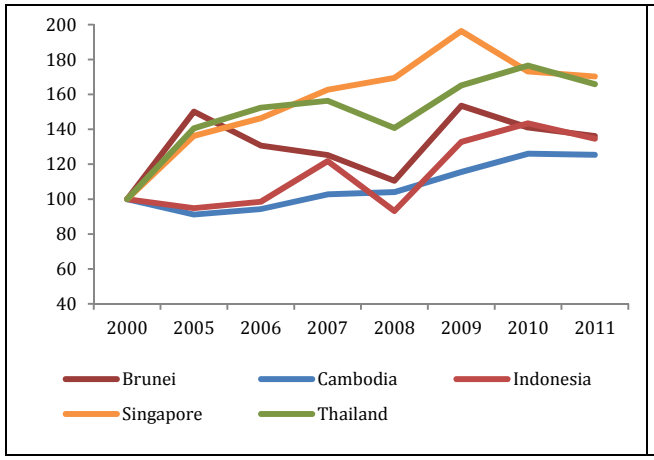


Note: Data of investment in 2011 are preliminary data

Source: Economist Intelligent Unit, 2012

Figure 4. 3: Ratio of Total FDI to GDP (Index, 2000=100) ASEAN

Countries with Increasing Trends of the Ratio of FDI to GDP

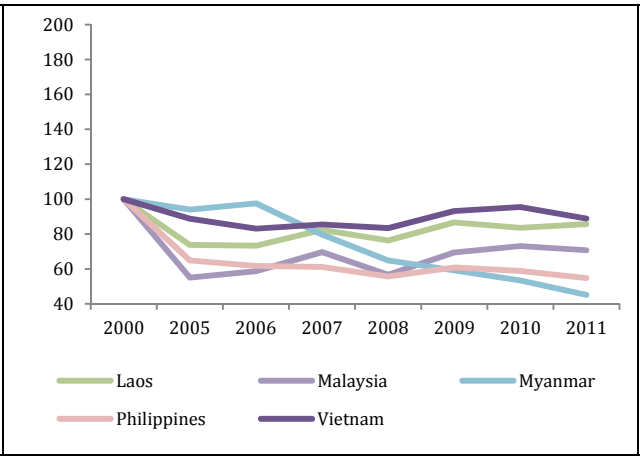


Note: Data of investment in 2011 are preliminary data

Source: Economist Intelligent Unit, 2012 and World Bank Staff calculations

Figure 4. 4: Ratio of Total FDI to GDP (Index 2000=100) ASEAN

Countries with Decreasing Trends of the Ratio of FDI to GDP



Note: Data of investment in 2011 are preliminary data

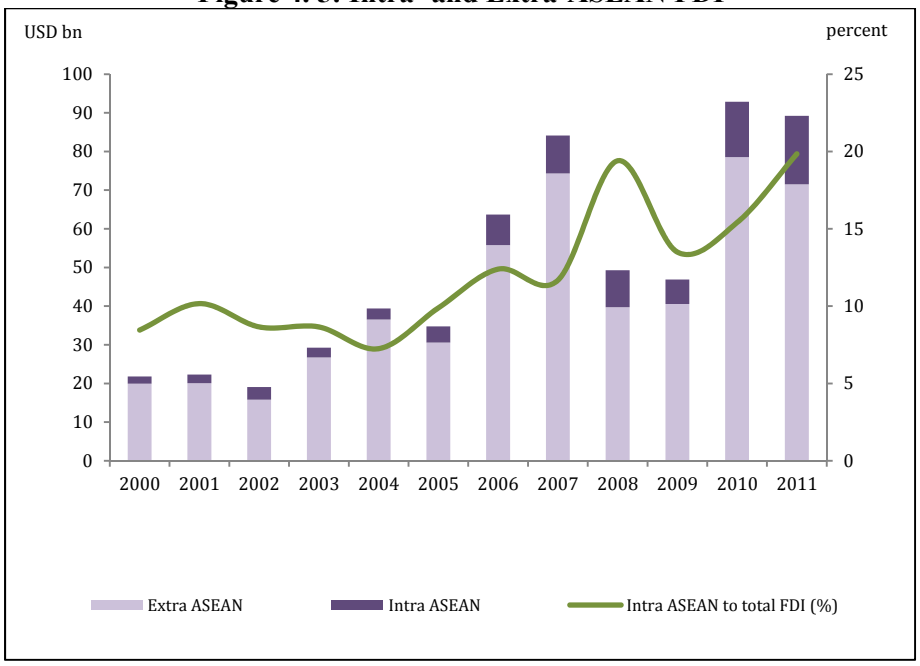
Source: Economist Intelligent Unit, 2012 and World Bank Staff calculations

16. **In some instances, this evolution can be linked with policies towards FDI**, which will be reviewed in the next section. Cambodia has, for instance, developed one of the most liberal policies in the region with respect to foreign presence. Likewise, Singapore is very open to the establishment of foreign

companies. Among the low performers, the Philippines have still a relatively restrictive regime in place, according to the various indicators reviewed below. However, this observation is not confirmed in all cases. Thailand, with the second highest level of FDI to GDP in the region, still maintains important limitations, and so does Brunei.

17. **In this overall context, the performance of intra-regional investments has been spectacular.**[50] The ratio of intra-ASEAN FDI to total FDI in ASEAN has been increasing from eight percent in 2000 to 20 percent in 2011. Initially, intra-regional FDI, as a share of total FDIs, experienced a slowing down from 10 percent of the total in 2001 to seven percent in 2004, but since then, it has increased significantly with a dip during the global financial crisis in 2009 (Figure 4.5). In 2011, intra-ASEAN FDI flows proved more robust than anticipated, expanding by 22.5 percent to USD 17.5 billion, above the pre-crisis levels.

Figure 4. 5: Intra- and Extra-ASEAN FDI



Source: ASEAN FDI Database, 2012 and World Bank staff calculations

18. **Among ASEAN countries, Singapore has received annually, from 2000 to 2011, an average of 52 percent of total FDI inflows to ASEAN.** Thailand, Malaysia, Viet Nam, and Indonesia have absorbed respectively about 15, 11, 8, and 6 percent. All other countries account for less than five percent of total FDI inflows to ASEAN (Figure 4.4). At the same time, Singapore has also been the main source of intra-ASEAN investment, contributing to the level of 60 percent of intra-ASEAN FDI annually over the same period (Box 4.1).

[50] Singapore accounts for about half of the intra-regional investment flows, but even without Singapore the increase in the FDI rate has been noteworthy.

Table 4. 1: Intra-ASEAN FDI 2011

FDI Outward by FDI Inward to	Brunei D	Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Singapore	Thailand	Viet Nam	Total		Intra-ASEAN share of tot FDI	Extra-ASEAN Share of tot FDI
											INTRA ASEAN	EXTRA ASEAN		
Brunei D		-	0.32	-	33.62	-	0.11	33.25	0.00	-	**67**	1,122	0.08	1.26
Cambodia	-		0.00	-	45.14	-	-	28.66	13.19	58.01	**145**	440	0.16	0.49
Indonesia	-	-		-	-32.87	-	12.16	8,102.15	123.36	1.87	**8,207**	10,699	9.23	12.03
Lao PDR	-	0.00	-		0.30	-	-	1.40	18.48	33.78	**54**	247	0.06	0.28
Malaysia	79.01	31.67	41.33	-0.06		-2.17	5.99	2,057.62	370.97	79.96	**2,664**	9,337	3.00	10.50
Myanmar	-	-	-	-	-		-	-	-	-	**-**	-	0.00	0.00
Philippines	0.00	-	-1.33	-	32.44	-		-115.46	-22.19	-0.43	**-107**	1,369	-0.12	1.54
Singapore	30.70	25.30	1,306.20	-	2,080.30	124.00	102.70		69.40	78.30	**3,817**	33,907	4.29	38.12
Thailand	1.13	2.66	1.99	-4.78	109.54	0.22	10.54	1,033.18		1.39	**1,156**	8,383	1.30	9.43
Viet Nam	40.19	0.62	14.66	0.38	229.26	-	1.26	1,116.44	96.58		**1,499**	5,931	1.69	6.67
ASEAN OUTWARD	151.04	60.25	1,363.17	-4.46	2,497.72	122.05	132.76	12,257.23	669.79	252.89	17,502	71,434	19.68	80.32

Data is compiled from submission of ASEAN Central Banks and National Statistical Offices through the ASEAN Working Group on Foreign Direct Investment Statistics.

Notes:

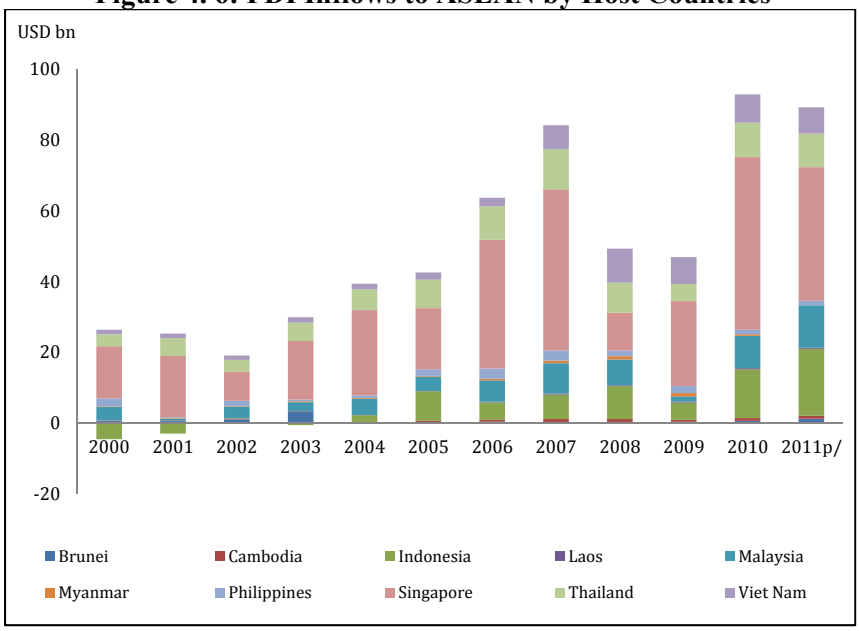
* Net FDI = Equity + Net Inter-company Loans + Reinvested Earnings.

Unless otherwise indicated, the figures include equity and inter-company loans.
(1) Myanmar's fiscal year starts on 1st April and ends on 31st March of the following calendar year. Data for 2011 is not available.
Source: ASEAN Secretariat - ASEAN FDI Database as of June 7, 2012

19. **Looking at sectoral composition of FDIs (Figure 4.7), manufacturing plays an important role, highlighting the role played by ASEAN countries in global manufacturing.** However, at 31 percent the share of manufacturing in total investment is actually lower than the share of the sector in global FDIs, which stands at 41 percent (UNCTAD, 2012). This lower share may partly reflect a composition effect as Singapore, a services-oriented economy, accounts for half of the investments in the region. It should also be noted that the share of investment in manufacturing over the period 2007-2011 dropped compared to before, when it was around 40 percent. This relative decline could be the result of the slowdown in global growth, but it could also reflect some factors internal to ASEAN that have to be identified. Investments in the services sector are growing, notably with investments in real estate and finance, which are also important. This is likely to be motivated by the robust growth of ASEAN countries, although the relative share of FDI in finance has decreased compared to pre-crisis levels, which is understandable given the uncertainty surrounding international financial markets.

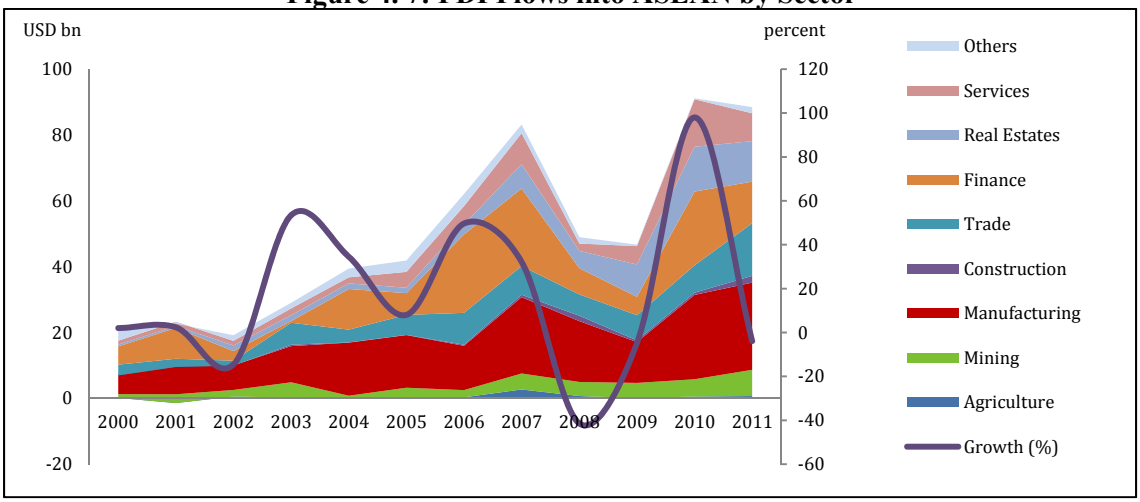
20. **Beyond ASEAN countries, large investors in the region are OECD countries, led by some European countries, Japan and the USA.** Korea and China (including Hong Kong) are also significant investors. It is likely for the latter that they are looking to delocalize production where costs are lower, a somewhat new phenomenon in the case of China. The geographic origin of investments reveals interestingly some degree of sectoral specialization, with Japan using ASEAN as a manufacturing base, US investment being focused in the financial sector, while the EU has a more significant presence than others in services and mining and a strong focus on real estate. For intra-ASEAN investments, the manufacturing sector is the most important, followed by real estate.

Figure 4. 6: FDI Inflows to ASEAN by Host Countries



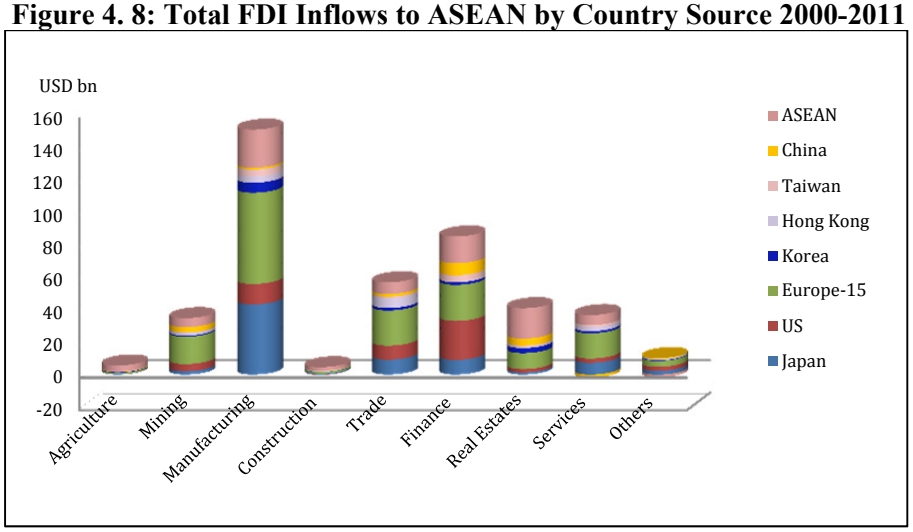
Note: Data on investment in 2011 are preliminary data
Source: ASEAN FDI Database, 2012 and World Bank staff calculations

Figure 4. 7: FDI Flows into ASEAN by Sector



Source: ASEAN FDI Database, 2012 and World Bank staff calculations

Figure 4. 8: Total FDI Inflows to ASEAN by Country Source 2000-2011



Note: (1) Agriculture includes agriculture, fisheries and forestry; Mining includes mining and quarrying; Finance includes financial intermediation and services (including insurance); (2) EU-15 covers Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom. *Source:* ASEAN FDI Database, 2012 and World Bank staff calculations.

Box 4. 1: Singapore: The Investment Hub of ASEAN

Singapore receives a little over half of the FDI of the ASEAN region even though it only accounted for a little less than 10 percent of the region's total GDP in 2011. The level of sophistication of the economy, and the quality of its business environment, are among the factors that make Singapore relatively more attractive than its ASEAN neighbors for FDI. Another reason why Singapore attracts so much FDI is because some of these investments are seeking access to the whole ASEAN market to benefit from the increased freedom of circulation within the ASEAN market. Plummer and Cheong (2009) noted that Singapore dominates as a source of intra-regional FDI, supplying 61 percent of total intra-regional FDI for the period 1995-2006. This share was 70 percent in 2011 (Table 4.1). They note that Singapore serves as both an "entrepot" center for intra-ASEAN trade and a hub for FDI and that without Singapore, intra-regional trade and investment would be much diminished. Singapore's excellent performance in attracting FDI is thus in many ways linked to the economic performance of the region.

ASEAN is, for instance, the first destination of Japanese investments, on par with investments towards China. Of these, investments in the services sector have been increasing and directed mostly towards Singapore, whose share was about 60 percent of total investment in 2009 and 2010. In the transport sector, Singapore's share of Japan's total investment in ASEAN has been over 80 percent in the five-year period 2006-2010. Among the companies that have established regional operating headquarters in Singapore in such sectors are: Nippon Express, Yamato Transport, and Mitsubishi Logistics.

These investments in the transport sector took place at a time when ASEAN members had decided to liberalize transport and logistics services, and in particular cross-border supply under AFAS. Singapore has also liberalized its logistics sector, allowing unrestricted foreign commercial presence, and has taken steps to liberalize parts of its transport sector.[51] Singapore has also extensive bilateral liberalization commitments in transport services under the 2002 Japan Singapore Economic Partnership Agreement.

Source: Hamanaka (2011)

21. **Since 2000, foreign investments in ASEAN have augmented slightly as a share of the region GDP and importantly in overall volumes, mirroring the growth of ASEAN countries**. In this overall positive context, the role of ASEAN as a region has been central. First, intra-regional investments have grown significantly in share, replacing to some extent investments coming from outside the region. This could reflect two developments. The first is that market access conditions for intra-ASEAN investors have become more favorable than for investors from outside the region; this also includes the possibility that over time, investments from outside ASEAN have generated profits that have been reinvested in other countries in the region by companies established in one ASEAN country.[52] The second development is the very important role played by Singapore at the regional level, as the country is both the host of a majority of FDIs in the ASEAN region and the majority source of intra-regional FDIs. This suggests that Singapore has a key role as an investment hub and probably also as a model of good practice. Also, investments have targeted, as would be expected, large and populated markets in the region, with the Philippines being an exception here.

[51] Note that in Table 4.5 Singapore's transport sector still appears relatively closed to foreign establishment. This reflects restrictions in the operations of airports and ports. The score on the transport sector in Table 4.5 does not include maritime transport.

[52] Early evidence from Tejima (1995) points to the importance of reinvested earnings by Japanese affiliates in ASEAN, amounting to 45 percent of total FDI in 1993.

22. **Finally, the good progress of investment integration in the region is worth noting**. Good macroeconomic management and sustained growth have clearly contributed to the increase in FDI. Beyond this, however, it is difficult to determine without further research to what extent policy factors have contributed to FDI growth. Developments in investment policies are examined later in the chapter.

23. **Looking forward, the ASEAN region is seen as a choice destination both for ASEAN and international investors**. Echoing the positive recent trend in FDI in the ASEAN region, multinational companies surveyed in the last UNCTAD investment report rank several AMS among the most desirable destinations, with Indonesia among the world's top five destinations. Further, of the four ASEAN countries ranked in the top 20, all have either increased or maintained their ranking over the past survey.

Table 4. 2: Transnational Corporations' Top Prospective Host Economies for 2012-2014 – Current and Last Year's Rank

Country	Rank in 2012	Rank in 2011
Indonesia	Fourth	Sixth
Thailand	Eight	Twelfth
Viet Nam	Eleventh	Eleventh
Malaysia	Nineteenth	Nineteenth

Source: UNCTAD World Investment Report 2012 based on a survey of 174 companies. Last year's ranking is in parenthesis.

24. **The favorable view of ASEAN as a region for investment is confirmed by views of companies from the region, as reported in the findings of the 2010 ASEAN Business Advisory Council (ABAC) Survey (Wong, 2011)**. Nearly half of the respondents from ASEAN countries consider another ASEAN country as the most attractive destination for investment in the world. The rankings of ASEAN businesses are different from those reported above in the UNCTAD survey, placing Viet Nam, Singapore, Indonesia, and Malaysia as the top four (in this order of merit).[53] Proximity is probably a factor explaining the preponderance of ASEAN investment markets for AMS firms, and confirms the general empirical finding that FDI tend to be more intense between countries that are close geographically and culturally. Moreover, future investment decisions are also likely to be predicated on existing ties among ASEAN firms, thus suggesting a virtuous cycle of intra-ASEAN FDIs.[54]

[53] One factor may be the timing of the BAC survey: Thailand is, for instance, quoted by only two percent as the top destination, which is likely to be related to the political crisis the country was undergoing through 2010.

[54] According to ASEAN's 2012 Investment Surveillance Report, there is an increasing trend of reinvested earnings apparent since a few years, implying that a significant portion of income by foreign companies in ASEAN is kept in the region. The evidence shows strong effects in Brunei Darussalam, Philippines, and Thailand.

Business Environment in ASEAN Region and Attractiveness of FDIs

25. **The ABAC survey suggests a positive outlook for investment in the ASEAN region.** This is likely a response to reform policies region-wide. However, several questions remain as the performance of individual AMS has been uneven and the regional trend appears to be largely led by the dynamism of Singapore. There is also the question of whether the positive trend of recent years can be sustained. This, in turn, raises the question of whether the overall environment for investment in ASEAN can be further improved. In particular, what are the areas where the region is performing well and what are the areas where it is performing not so well? Is ASEAN performing to its full potential? Also, can the large differences among members be closed?

26. **Pinpointing the policy determinants of FDI is notoriously complicated**. Economics suggests that the following factors are at play: the business environment and quality of infrastructure; the cost of factors of production (labor and access to finance and land); the overall macroeconomic state (exchange rate, macroeconomic stability); the institutional environment (corruption, political stability and quality of legal institutions); and the existence of international trade and investment agreements. However, some authors argue that the economic literature of empirical investigations has generally provided a partial view on what determinants matter for FDI (Blonigen and Piger, 2011).

27. **In fact, in the case of trade flows, bilateral investment flows are primarily determined by economic size and proximity of countries (measured by geographical or cultural closeness).** This explains why FDI in the region has been robust—fueled by economic growth averaging six percent from 2000 to 2011 and a rising middle-income class with GDP per capita of more than USD 3,000 in Malaysia, Thailand and Indonesia. Proximity explains also to some extent why intra-ASEAN investments should be relatively important. With respect to policy driven factors such as the business environment, infrastructure, and the quality of institutions, all are thought to be determinants of FDI, but the evidence is not conclusive. Therefore, while these policy dimensions are central for domestic activity to thrive, their direct role in promoting inward investment is not entirely proven. Among the possible factors driving foreign investment, only relative endowments in labor (especially important for vertical FDI) and, importantly for ASEAN, membership in a regional trading agreement are found to be significant factors (Blonigen and Piger, 2011).

28. **To better understand the determinants of investment, it is important to examine the broad constraints firms say they are facing in ASEAN countries in doing business that may deter prospective investors**. The World Bank's Enterprise Surveys data on businesses' perceptions of top business environment constraints is used to examine these constraints. The Enterprise Surveys show that in the six ASEAN countries surveyed, access to finance is the top constraint. This is followed by the practices of the informal sector, tax rates and administration, and concerns about workforce skills. These concerns about constraints are roughly similar to that of the rest of the world. ASEAN countries, however, perform better on access to electricity and instability of the political environment, which are globally identified as major constraints to doing business.

29. **Presumably access to finance and tax constraints are lower for foreign investors than domestic firms**, **because foreign investors have greater access to international finance from a foreign parent firm and are sometimes granted tax exemption. Perception of political instability does not appear to be an important deterrent to foreign investors in ASEAN with a few exceptions.**[55] The only dimension that may be a constraining factor is workforce skills.

30. **Additional information provided by the 2010 World Governance Indicators (WGI) suggests that there is also much progress to be made on governance.** The WGI reports aggregate and individual governance indicators for 213 economies over the period 1996-2010, for six dimensions of governance: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. The five latter dimensions are directly relevant to foreign investment decisions because they show a picture of vast contrasts in the region: ASEAN countries belong to both the top 10 and bottom 10 percent of countries as measured by these indicators.

31. **Given that half the ASEAN countries' governance indicators that matter to foreign investors (Figure 4.9) are ranked in the bottom half of the world, there is considerable room for improvement.** Government effectiveness and regulatory quality will ensure that appropriate policies are in place to enable business development and satisfactory rule of law and control of corruption will ensure that rights are properly enforced and business transactions can safely take place.

[55] These are Cambodia, Indonesia, and Philippines, and this finding is also reflected in the World Governance Indicators reviewed next.

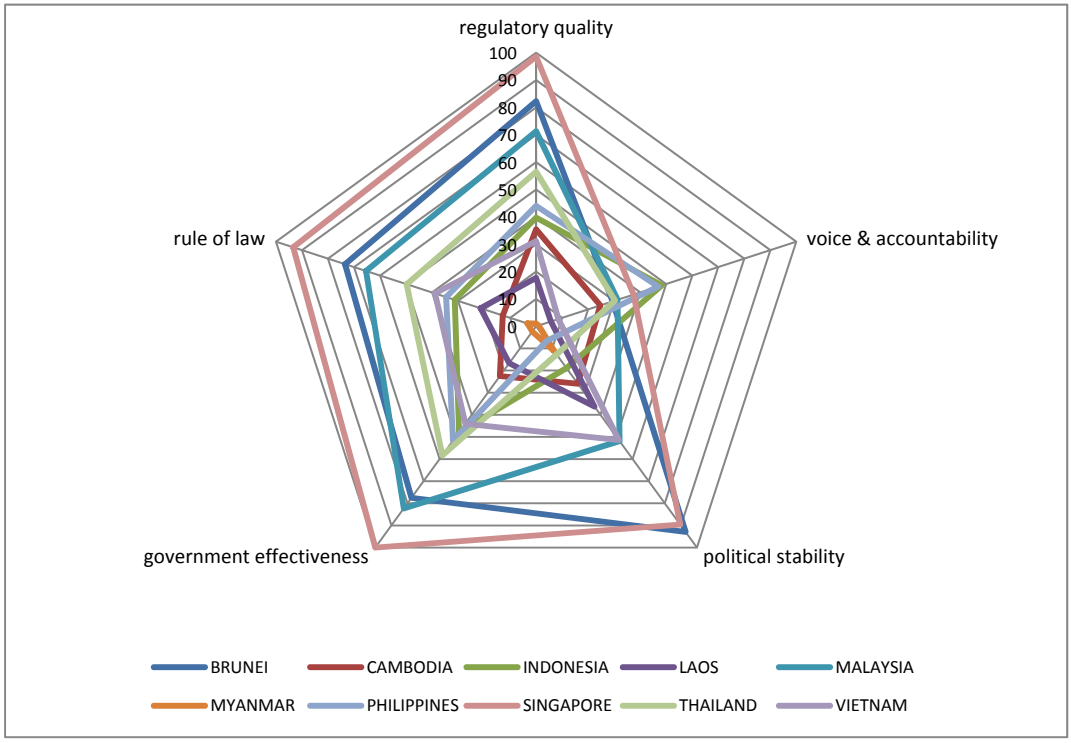
Table 4. 3: Enterprise Surveys: Top 10 Constraints to Doing Business

	Access to finance	Electricity	Practices of the informal sector	Tax rate	Political instability	Inadequately educated workforce	Corruption	Crime, theft and disorder	Customs and trade regulations	Access to land	Tran sport	Tax admin	Business licensing and permits	Labor regulation	Courts
World	16.4	14	11	10.6	8.4	7.8	6.7	5.3	3.4	3.3	3.2	3.2	3	2.6	1
High-income OECD	11.1	3.9	9.4	22.9	11.9	8.5	5.1	4	2	0.9	0.7	8.3	2.9	4.3	4.1
East Asia & Pacific	16.4	10.2	10.4	10	8.6	12.2	6.3	5.3	2.1	3.7	4.5	3.7	3.8	2.6	0.2
Cambodia	4.9	16.6	9.1	5.1	16.5	2.9	24.1	6.3	2	2.8	2.7	1.9	2.8	0.8	1.5
Indonesia	47.9	6.5	13.7	1.3	6.9	4.3	1.6	3	1.4	3.9	4.3	0.4	3.3	1.3	0.2
Lao PDR	21.2	8.9	4	36.8	0	16.5	0.2	0.1	1.5	6.8	2.8	0.6	0.5	0	0.3
Malaysia	7.2	0	0	0	0.7	33.6	11.1	2.2	5	2.3	0	17.9	15.2	4.8	0
Philippines	14.8	11.3	26.4	13	6.2	2.6	4.9	4.4	3.8	0.8	2.3	1.6	5.8	1.9	0.2
Viet Nam	24.7	4.3	19.3	3.5	0.4	10.2	3.3	1	4.2	6.9	13.3	6.3	1.4	0.9	0.3

Note: Percentage of manufacturing firms response to the question "Which of the following elements of the business environment, if any, currently represents the biggest obstacle faced by this establishment."
Years vary: Indonesia, Lao PDR, Philippines, & Viet Nam (2009); Indonesia and Malaysia (2007)
Source: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank

32. **The richer countries in the region—Brunei, Singapore and Malaysia—show scores consistently in the higher half, with Thailand at about the world's average.** However, the other ASEAN countries have below average scores, with the less developed countries—Laos, Cambodia and Myanmar—generally well below the last quartile performance.

Figure 4. 9: Governance Indicators in ASEAN Countries (Percentile Rankings)



Note: The percentile ranking indicates how individual countries rank relative to other countries in the world.
Source: World Governance Indicators, 2012.

33. **Despite relatively weaker governance indicators, ASEAN economies attract high rates of foreign investment because of their rapidly growing and large regional market and their linkages to global value chains.** However, good governance will be important to continue to attract and increase FDI for at least two reasons. First, foreign investors may be discouraged from investing some of their capital abroad if that place has poor governance and business environment.

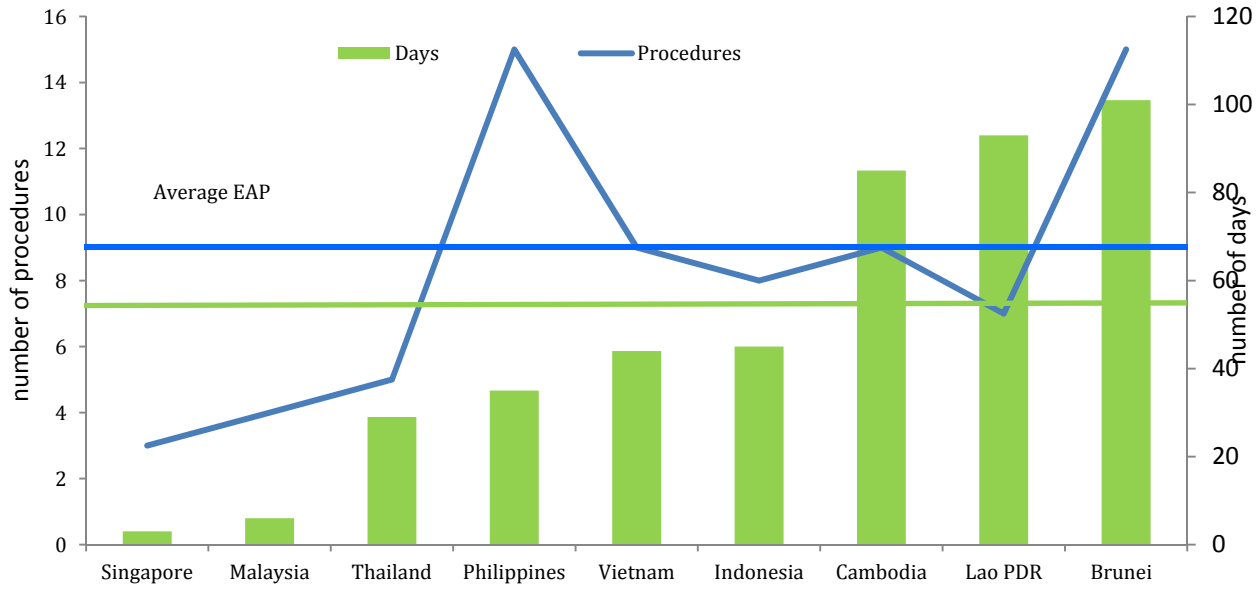
34. **A second important point is that from the perspective of the recipient country the objective is reaching maximum returns on these investments.** With poor conditions surrounding private enterprise, and resulting skewed private incentives, the welfare impact of foreign investment for the recipient country could be reduced significantly or even made negative (Teather, 2012). Taking for instance the issue of regulatory quality, inappropriate regulations combined with foreign entry can lead to

increased private capture (Copeland and Mattoo, 2008). Finally, it is also possible that in the near future, when current sources of comparative advantage of the region in attracting investments erode, these factors may become more important and thus require more attention.

Doing Business in ASEAN Countries

35. **Even though doing business in ASEAN costs less than it does in East Asia and Pacific (EAP) countries, it still requires more procedures and days in terms of starting a business, dealing with construction permits and paying tax (Figure 4.10 and Table 4.3).** A more detailed look at the business environment confirms the need for improvement of rules and procedures that businesses and investors face in most ASEAN countries. Starting a business in ASEAN still takes a higher number of procedures and days compared to the average in EAP. In ASEAN it takes 49 days and eight procedures on average to start a business; this is higher than the average EAP of 37 days for seven procedures. Among ASEAN countries, starting a business in Brunei Darussalam, Lao and Cambodia takes the longest time: 101, 93 and 85 days respectively (Figure 4.10 and Table 4.3).

Figure 4. 10: Starting a New Business in ASEAN



Source: Doing Business 2012.

36. **Because starting a foreign business is not strictly equivalent to setting up a domestic one, it is interesting to also look at the same measure, discussed above, in the context of foreign investment (Figure 4.11).** It becomes clear that where countries like Indonesia and Philippines performed relatively favorably in the context of domestic firms, there are more difficulties for foreign businesses. Other

countries are more consistent in their performance (good or bad) as measured by Doing Business.[56] Overall, this is a situation that is not unique to ASEAN, as EAP countries are not faring any better. A second point is the variance in terms of days it takes to start a foreign business among ASEAN countries is significantly higher than the variance for the number of procedures; this indicates that each additional administrative step has a compounding effect and lengthens the whole process. Finally, comparing the performance of most ASEAN countries with China, India and Korea shows that this latter countries perform better by this indicator.

Box 4. 2: Business Licensing Reforms in Singapore and Malaysia

Singapore

Singapore has been the world's top-ranked economy on the ease of Doing Business for the last five years running. Entrepreneurs starting a new business in Singapore enjoy an average of nominal or zero minimum capital, standardized forms, online registration, no court involvement, fixed registration fee, and simple or no publication requirements. It takes just three days to complete the necessary procedures with fees of about one percent of GNI per capita. Singapore has not only been the top-ranked of Doing Business, but also one of the top reformers to have conducted reforms in a short period.

Singapore started its business regulatory reform in 2003. Singapore's Accounting and Corporate Regulatory Authority (ACRA) is the first stop to start a business for entrepreneurs. The organization embarked on Bizfile, an Internet-based online registration, filing, and information retrieval system. With Bizfile up and running, information is now updated within half an hour of a successful filing—down from 14-21 days before reform. The time to register a new business has fallen from 24 hours to 15 minutes, and the time to incorporate a company has fallen from five days to just 15 minutes. Likewise, costs are down too. Businesses will benefit through faster business licenses and lower registration fees. Singapore has also developed an online business startup system, *enterpriseone.gov.sg,* which is a comprehensive network for business startups. A positive aspect about the system is that it is not only an online application system, but also provides a range of services in business starting from business guidelines to comprehensive information on government assistance programs, regulations and e-services for businesses.

Malaysia

The Malaysian government set up a regulatory reform committee, the Special Taskforce to Facilitate Business (Pemudah), in February 2007. Pemudah consists of highly respected members from the government and the private sector. This is a public private partnership that helped inform and monitor the implementation of the national business climate reform agenda. This task force reports directly to the Prime Minister. Every year, Pemudah has targets in improving business licensing. Many believe that Pemudah has played a significant role in improving Malaysia's ranking on ease of Doing Business, as its ranking improved from 23rd in 2010 to 18th in 2011. This was largely because there was significant improvement in the 'starting a business' ranking, from 111 to 50 over the same period (Doing Business, 2012). Malaysia has cut the number of procedures, length of time and costs of starting a business from 10 procedures, 37 days and 25 percent of income per capita in 2006, to four procedures, six days and 16 percent in 2011 respectively (Doing Business 2007-2012). Between 2007 and 2010, Pemudah initiated a series of improvements in business licensing. Some among them are:

- Time reduction for business registration. Companies Commission of Malaysia has actively engaged in reducing the time taken for approval of activities (for example, registering new business from three days

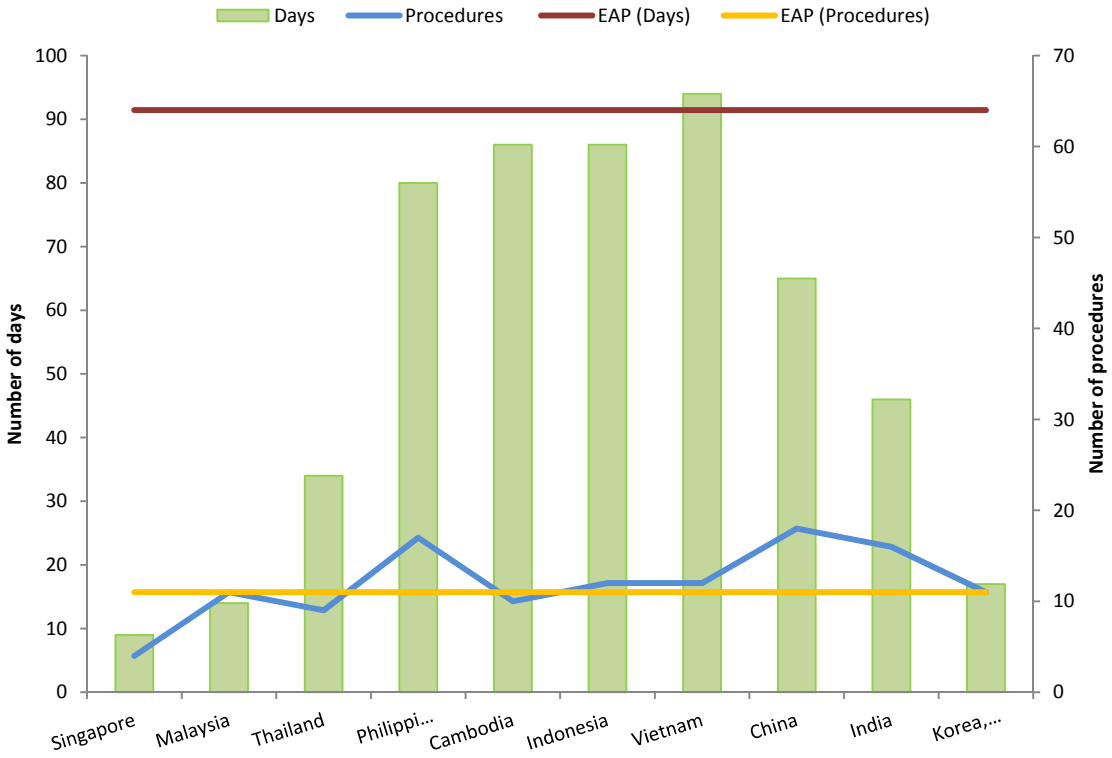
[56] The number of days reported by Doing Business and Investing Across Borders cannot be directly measured against each other as they are differently measured.

to an hour, renewal of registration from one day to 15 minutes, approval of company's name and incorporation from five days to one day, registration of charge from five days to two days and registration of Deeds of Trust and Prospectus from 14 days to five days).

- Establishment of One Stop Center (OSC) for business licensing. With the establishment of OSC for business licensing, all applications can be submitted concurrently. OSC will then circulate them simultaneously to all relevant technical agencies to get feedback within a stipulated time.
- Validation of Certificate of Completion and Compliance (CCC) issued by industry professionals within six months compared with the issuance of Certificate of Fitness for Occupation (CFO) by local authorities within two years. This is a regulatory reform implemented with the aim of changing from government-regulation to self-regulation. CCC will be issued by the Principal Submitting Person (PSP) consisting of registered engineers, architects or draftsmen whichever relevant, together with vacant possession. The initiative has reduced the number of procedures and time taken in registering property.
- Establishment of commercial courts to ensure speedy and efficient disposal of commercial cases. Beginning September 1, 2009, the New Commercial Courts will handle cases filed and lodged for all codes except cases involving Intellectual Property and Muamalat.
- Development of Business Licensing Electronic Support System (BLESS). BLESS has been developed to increase processing speed, enhance transparency, and maintain consistency in the application and approval of licenses. The system will show the time taken by the various departments to process the applications, thus ensuring government departments and agencies adhere to their respective clients' charters. It also enables on-line tracking and monitoring of applications and on-line payment of fees. BLESS will be in nationwide implementation by 2012.

Source: Ing, et.al., Business Licensing: Inclusive Investment Reforms in Indonesia (forthcoming)

Figure 4. 11: Starting a Foreign Business in ASEAN



Source: Investing Across Borders

37. **In terms of other components of ease of Doing Business, ASEAN has performed slightly better in enforcing contracts compared to the average East Asia and Pacific (EAP) country (Table 4.4).** Enforcing a contract requires 37 procedures in 461 days and costs about 46 percent of total claims in ASEAN. Meanwhile, on average, dealing with construction permits and paying tax requires more procedures and days in ASEAN compared to the EAP region. It requires 19 procedures and 201 days in dealing with construction permits and 30 procedures and 279 days in paying tax in ASEAN; it requires 17 procedures and 159 days in dealing with construction permits and 25 procedures and 215 days in paying tax in EAP.

Table 4. 4: Ease of Doing Business in ASEAN

Economy	Doing Business			Dealing with Construction Permits			Paying Tax			Enforcing Contracts		
	Procedures	Days	Cost (percent of income per capita)	Procedures	Days	Cost (percent of income per capita)	Payments	Hours	Tax rate (percent profit)	Procedures	Days	Cost (percent of claim)
East Asia & Pacific	7	37	23	17	159	99	25	215	35	37	519	48
ASEAN	8	49	22	19	201	51	30	279	32	37	461	46
Brunei Darussalam	15	101	12	31	163	4	27	96	17	47	540	37
Cambodia	9	85	110	21	652	41	39	173	23	44	401	103
Indonesia	8	45	18	13	158	105	51	266	35	40	570	123
Lao PDR	7	93	8	23	108	52	34	362	33	42	443	32
Malaysia	4	6	16	22	260	7	13	133	34	29	425	28
Myanmar												
Philippines	15	35	19	30	85	111	47	195	47	37	842	26
Singapore	3	3	1	11	26	18	5	84	27	21	150	26
Thailand	5	29	6	8	157	10	23	264	38	36	479	12
Viet Nam	9	44	11	10	200	109	32	941	40	34	295	29

Note: 1. ASEAN is the average of the value of ASEAN-10, World Bank staff calculations; 2. There are no data available for Myanmar
Source: Doing Business, 2012

The Role of Labor Costs for Vertical Investments

38. **ASEAN's relatively lower labor costs and the region's integration with the world economy make ASEAN an attractive destination for FDI.** The most important FDI flows to ASEAN are linked with 'vertical'-type FDIs, which are investments that are made to outsource whole or part of a production to a lower-cost country. Vertical FDIs are different in nature and motivation from 'horizontal' FDIs, which are made with market access in mind and the consumers of the destination country; vertical FDIs are motivated by access to cheap and competitive production and export conditions.

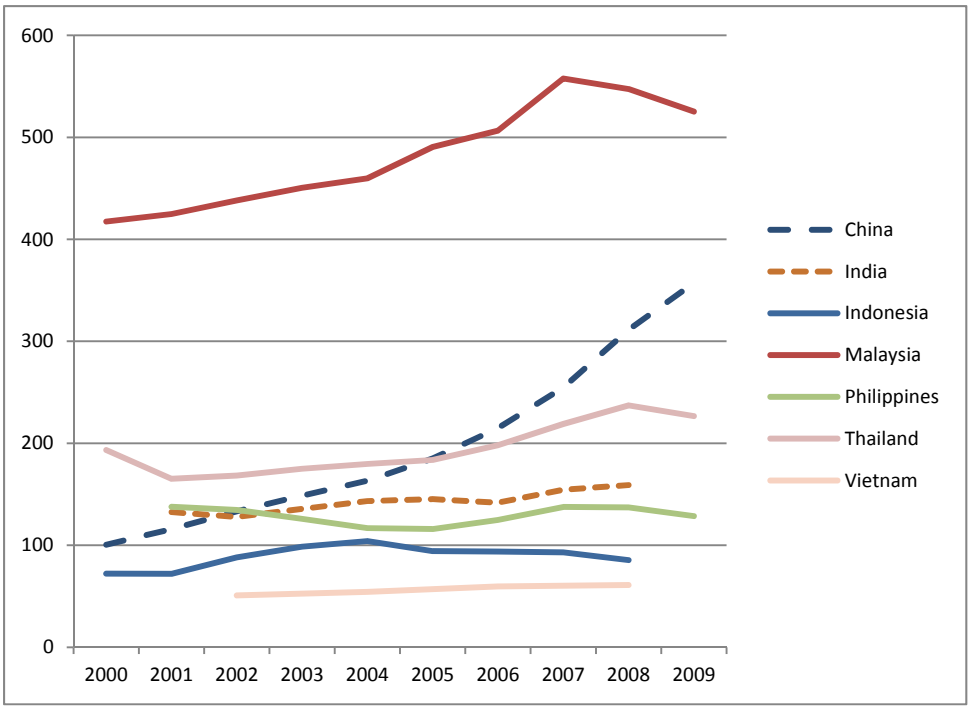
39. **For vertical-type FDIs, labor costs are an important motive**. Evidence from average wages in ASEAN countries collated by ILO suggest that ASEAN is at an advantage there and that the relative position of ASEAN countries has improved or at least maintained in recent years compared to large neighbors and potential competitors such as China (manufactured goods) and India (services). The ILO survey includes data for only five of the eight lower income countries of the region (Figure 4.6).[57]

40. **From 2006-2009, China's wages (in current dollars), in particular, rose by over 50 percent. Indonesian wages seem to have slightly declined, and wages in the Philippines and Viet Nam increased slightly (Figure 4.12).** This likely explains some of the attractiveness of ASEAN for FDIs[58] and corroborates an increase in the flow of investment to wage-competitive countries like Viet Nam.[59] At the same time, labor productivity in the region has been keeping pace with that of neighboring China (Figure 4.13).

41. **This attractiveness of the region for vertical-type investment is confirmed by looking at the good performance of ASEAN in terms of logistics performance.** On average, ASEAN is a strong performer in logistics and trade facilitation, and this has consistently been the case since the first Logistics Performance Index (LPI) survey in 2007 (see Box 2.4 in Chapter 2). A steady pattern of improvement is evident from 2007 to 2012. In all three LPI surveys, ASEAN's average score is much higher than the average for any developing region and the upper-middle income group average for the world. This result is striking given the range of per capita incomes in ASEAN (see Chapter 2 for a full discussion).

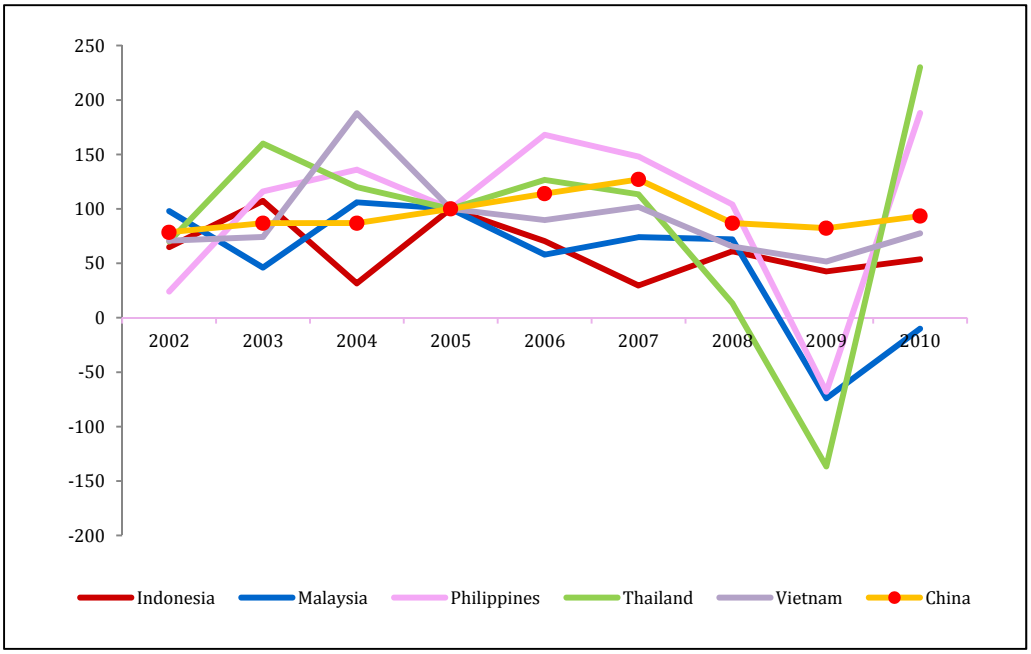
[57] Singapore and Brunei are high wages countries.
[58] For instance, Oclaro (United States) announced in March 2012 that it would relocate its production and testing businesses from Shenzhen, China to Malaysia within the next three years. (Source: UNCTAD, 2012).
[59] Source: ERIA Mid Term Review executive summary. It also mentions 'recent reports' that Viet Nam, Indonesia, Thailand and the Philippines would benefit from relocation of FDI away from China.

Figure 4. 12: Evolution of Real Wages of Employees (in Current US Dollars)



Source: Authors' calculations from ILO for average wages and WB WDI for exchange rate.

Figure 4. 13: Labor Productivity 2002-2010 (2005=100)



Source: Economist Intelligence Unit, 2012

42. **In conclusion, then, the environment for FDI in ASEAN countries looks attractive in growing economies**. Large potential markets (Indonesia, Philippines) which are in proximity to the huge economy of China, a favorable environment for ASEAN investors within ASEAN (to be discussed below), and have a favorable position regarding labor costs are particularly attractive. However, these factors are not all policy-related. Changing conditions in the external environment and the growth of ASEAN economies that drive wages upward may have an impact on ASEAN attractiveness for investment in the medium term.

43. **An issue of concern, at least for some AMS, is the quality of the overall environment in which international business is conducted.** While overall stability is not a major concern, the quality of governance and regulatory environment, and of the countries' infrastructure, may limit the development of private sector initiative and thus limit the ability of ASEAN countries to get the most benefits out of the investments made by foreign stakeholders. This is a problem that seems at least partly linked with capacity, as the less developed countries in the region are often the ones performing less well. However, as a region, ASEAN has the unique chance to count amongst its membership some of the world's best performers on each of these dimensions, thus raising the prospect for the good performers to share their expertise and policy approaches with those in need to improve their overall framework.

C. AEC's Role in Promoting and Liberalizing Investment Flows

44. **Having reviewed the relative merits of ASEAN markets for potential international investors, and the comparative advantages of the ASEAN region, this section now turns to ASEAN's policies regarding foreign investments in its markets.** Under AEC, the priority is to establish ASEAN as a single market and production base that will create a dynamic and competitive ASEAN. In this context, the free flow of investment is an integral element of the ASEAN single market. An open and non-discriminatory investment regime, leading to sustained investment flows complementing the free flow of goods and services, should become a key driver of ASEAN's global competitiveness, economic diversification and ultimately shared growth.

45. **Specifically, ASEAN seeks to achieve the four following objectives: i) investment liberalization; ii) investment protection; iii) investment facilitation and cooperation; and iv) investment promotion and awareness.** According to these objectives, beyond liberalizing investment establishment for foreigners to ASEAN markets, as well as ensuring national treatment, a comprehensive investment regime in ASEAN countries must also guarantee the protection of investment and thus enhance investors' confidence in investing in ASEAN. When the public interest is invoked, clear provisions on compensation are provided, based on fair market value. Transfer of funds, capital, profits, and dividends are done freely, and cooperation from ASEAN governments in terms of investment promotion and facilitation is reinforced.

46. **ASEAN members have also recognized that liberalization of FDI based on most favored nation and national treatment principles are complementary with the objective of increasing intra-ASEAN integration**. Free flows of investment shall encourage further development of intra-ASEAN investments, especially among MNCs based in ASEAN.

47. **The ASEAN approach towards regional foreign investment liberalization has been gradual, focusing on strategic sectors, and progressively adding building blocks to the investment regime.** Overall, the picture emerging from the review of policy reform towards investment is positive, with registered progress in all countries and most areas. Before reviewing comprehensively in the next section the progress achieved to date for each of the four pillars, an examination of the investment policy reforms compiled by two organizations—UNCTAD and Global Trade Alert (see Annex in section G to this Chapter)—offers a glimpse into the positive changes across the region in the past few years. It becomes clear that there is an overall pattern towards the easing of requirements towards foreign investors (with however some scattered exceptions such as in the mining sector in Indonesia). Improvements include the lifting of foreign equity requirements (for example, banking in Viet Nam, numerous services sectors in Malaysia and in Indonesia), and the removal of performance requirements.

48. **The private sector response to the ASEAN liberalization effort is positive**. The 2010 ASEAN-BAC survey (Wong, 2011) ranks investment protection and transparent and predictable investment rules as the two areas of the AEC Blueprint where satisfaction of the firms surveyed was the highest. However, this is tempered by lesser satisfaction in two important areas for investment (reflecting the need for further liberalization that is discussed in Chapter 3 and in this Chapter), which are those of restrictions on services and investment regime liberalization.

ASEAN Investment Integration Reform

49. **ASEAN has made significant efforts to achieve an ASEAN Investment Area (AIA)**. These efforts have been gradual and proceeded by constructing individual building blocks. It was not until 2009 that ASEAN's objectives were consolidated in an overarching framework, the ASEAN Comprehensive Investment Agreement (ACIA). Figure 4.14 illustrates the chronology of ASEAN investment integration reforms. Initially, ASEAN cooperation in promoting investment flows was implemented through separate agreements. The first was the ASEAN Agreement for the Promotion and Protection of Investment 1987, commonly known as the ASEAN Investment Guarantee Agreement (IGA). Under IGA, ASEAN's strategy to promote investment was solely through guaranteeing protection. After the Asian crisis, ASEAN members acknowledged a need to review and deepen the ASEAN investment framework for cooperation. In 1998, the Framework Agreement on the ASEAN Investment Area (AIA) was signed. AIA focused on three main pillars: liberalization, facilitation and promotion.[60] Regarding market access and national treatment, AIA covers six main sectors—manufacturing, agriculture, mining, fisheries, forestry and services incidental to these sectors, with exceptions listed in Exclusion and Sensitive Lists. According to AIA, ASEAN investors should benefit from national treatment by 2010 and all other ASEAN investors by 2020.[61]

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[60] In IGA the use of the term 'promotion' was set in general context: "encouraging and creating favorable conditions". AIA added more specific provisions about promotion: "begin the process of facilitation, promotion and liberalization," and "take appropriate measures to ensure the attractiveness of the investment environment."

[61] This commitment was later due to be fast-tracked under ACIA. See below.

Figure 4. 14: From IGA to ACIA

50. **In 2007, the 39th ASEAN Economic Ministers Meeting agreed to review the AIA Agreement and the ASEAN IGA, with the aim of consolidating these two agreements**. In February 2009, the ASEAN Comprehensive Investment Agreement (ACIA) was signed. Fundamentally, ACIA is a comprehensive agreement covering liberalization, protection, facilitation, and promotion.

51. **ACIA entered into force on March 29, 2012. Upon ACIA's entry into force, the ASEAN IGA and AIA Agreements were terminated.** A three-year transition period applies to investors who wish to keep existing investments (that is, all direct investment) within the ambit of the IGA and AIA Agreements.

52. **ACIA, while being similar in structure to AIA, covering the same four pillars—liberalization, protection, facilitation, and promotion—and the same six sectors, is actually more comprehensive than AIA and IGA put together.** ACIA has both incorporated new provisions and made improvements to existing provisions in AIA and IGA, including acceleration of ASEAN investment integration.

53. **ACIA is developed as a comprehensive investment agreement that provides a single framework for relevant investment provisions such as liberalization and protection.** ACIA is also conceived to provide clear and transparent procedures and definitions that are in line with international investment agreements (for example, US Model Investment Text, NAFTAS, OECD Guidelines for Multinational Enterprises, UNCTAD's assessment on international investment agreement).

54. **Among the notable improvements provided by ACIA, over IGA, are several liberalization provisions**. First, the agreement brings forward the objective to achieve an ASEAN open investment regime to all investors to 2015, instead of 2020 as previously under AIA. Second, ASEAN and foreign investors now enjoy the same benefits at the same time (AIA offered a 2020 timeline for foreign investors). Third, the coverage of the agreement is extended to include portfolio investment, which in doing so follows the practice of numerous bilateral investment treaties of strong proponents of comprehensive investment agreements such as the one modeled on the US NAFTA. Fourth, the agreement includes new articles on the prohibition of performance requirements under Trade-Related Investment Measures as defined by the WTO (Article 7),[62] and nationality requirements in the

[62] Article 7 of ACIA mentions that the provisions of the Agreement on Trade-Related Investment Measures in Annex 1A to the WTO Agreement (TRIMs) which are not specifically mentioned in or modified by this Agreement, shall apply, mutatis mutandis, to this Agreement.

appointment of managers (Article 8). Finally, ACIA provides detailed procedures on dispute settlement, including on consultation among the member states (Article 43).

55. **In an important step forward, ACIA has changed the liberalization scheduling approach, moving to a single negative list regime.** Exceptions to liberalization are listed in a single *negative* list replacing the prior lists: the Tentative Exclusion List (TEL) and Sensitive List (SL) under AIA. The ACIA consolidated Reservation List consists essentially of the remaining exceptions in TEL and SL, plus additional amendments and inclusions. The Reservation List for each country is intended to note only those sectors that are not subject to future elimination or improvement (that is, permanent exclusions) and those whose reservations are to be improved[63] or eliminated over time (that is, temporary exclusions). As of February 2010, ASEAN members had put forward a total of about 130 business sectors for inclusion in the Reservation List (Pratruangkrai, 2010). However, the Reservation List has not been finalized and is subject to further liberalization.

D. Policies towards FDI: Market Access and Equal Treatment of Foreign Investment

56. **Restrictions on foreign investments can occur prior to or after the establishment phase**. The protection of investment in the post establishment phase is generally more widely accepted and subject to better rules such as bilateral investment treaties (Golub, 2009). The history of investment agreements in ASEAN confirms this since protection of investment under IGA was the first element of investment integration.

57. **Guaranteeing market access to trade and investment from partner countries has recently become a central part of regional integration efforts (Miroudot, 2011).** Restrictions on foreign entry can take various forms (Golub, 2009). The most common are limitations to foreign ownership, specifying a maximum level of equity that can be owned by foreigners. Limitation on ownership can also target some asset classes, such as land. Another form of limitation is the use of screening conditions such as economics needs tests or various notification requirements. Finally, restrictions on operations or performance requirements can also be applied, such as specifying the use of local inputs or the employment of nationals. All these restrictions are present to some extent in ASEAN countries.

58. **The main World Bank database on investment access regulations (Investment Across Borders—IAB, 2010) suggests a mixed picture in ASEAN countries.** While ASEAN has relatively high openness to foreign equity compared to other developing regions it is on average, according to IAB, more restrictive than other EAP countries. Countries that are the most restrictive include Thailand, Philippines and Viet Nam (Table 4.5).[64] This is not however the case for all ASEAN countries: Cambodia and Singapore show fewer restrictions.

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[63] The possibility to improve on commitments is an innovation of ACIA since AIA considered only the option of elimination. This may be interpreted as a softening of the liberalization requirements (ERIA, 2011; ERIA, 2012), but possibly also, in the context of some limitations, the recognition of the regulatory necessity to maintain some government oversight.

[64] The foreign equity caps measured for the industries listed in the IAB database represent an average of foreign equity caps of subsectors in this industry. As there is a relatively limited number of subsectors, these averages represent an approximation of the degree of liberalization. Another method used is that of Intal and Panggabean (2012, as quoted in Chapter VIII of ERIA (2012)), who look at restrictions for all ISIC-3 subsectors and assess

Table 4. 5: Foreign Equity Caps by Sector, 2010

Region/Economy	Mining oil & gas	Agri & forestry	Light manf	Telecom	Electric -ity	Banking	Insurance	Transport	Media	Const, tour & retail	Healthc are & waste mgmt
ASEAN	72	78	87	62	67	75	83	61	32	92	82
Cambodia	100	100	100	100	86	100	100	70	100	100	100
Indonesia	98	72	69	57	95	99	80	49	5	85	83
Malaysia	70	85	100	40	30	49	49	100	65	90	65
Philippines	40	40	75	40	40*	60	100	40	0	100	100
Singapore	100	100	100	100	100	100	100	47	27	100	100
Thailand	49	49	87	49	49	49	49	49	28	66	49
Viet Nam	50	100	75	50	71	65	100	69	0	100	76
East Asia & Pacific	78	83	87	65	76	76	81	66	36	93	84
China	100	100	75	49	85	63	50	69	0	100	85
Korea, Rep.	100	100	100	49	85	100	100	80	40	100	100

Note: There are no available data on Brunei, Myanmar and Laos. Index of ASEAN shows an average of the indices of ASEAN country members. An index of 49 denotes that a foreign company can own up to 49 percent of shares in a business in a particular sector in a particular economy. The indexes take values from 0 to 100, where 100 denotes the absence of statutory ownership restrictions to FDI, and 0 means that foreign companies are not allowed to own equity in a sector or sector group by law or policy. The survey covers 33 sectors, which are aggregated into 11 sector group scores using equal weights. For example, in Indonesia, foreign equity cap for the agriculture and forestry sectors are 95 and 49 percent, respectively, so the foreign equity cap indexes is 72 which means the foreign equity cap in agriculture and forestry is 72 percent.

Source: Investment Across Border, 2012, except * for which the source is the Philippines Board of Investment.

59. **Restrictiveness also varies across sectors.** The difference ranges from zero percent in manufacturing to six percent in mining, oil and gas. In insurance, ASEAN is even more open for foreign equity, which allows 83 percent of foreign equity compared to 81 percent of foreign equity in EAP. Among ASEAN members, Cambodia and Singapore are very open on foreign equity. They allow 100 percent foreign equity in most of the sectors, excluding electricity (86 percent) and transportation (70 percent) in Cambodia, and transportation (47 percent) and media (27 percent) in Singapore. Among other ASEAN members, Indonesia is the most liberal.

60. **Turning next to equity requirements for ASEAN investors, there is little if any difference with the regime applied to non-ASEAN investors, suggesting that the ASEAN establishment regime is largely applied on a most favored nation (MFN) basis.**

whether the foreign equity cap is above or not a given threshold (they use 51 percent and 70 percent as threshold). While this data is reported later, IAB indicators are used as the principal source as they also cover services.

61. **Beyond the manufacturing (and associated services) sectors covered by ACIA, ASEAN also puts a lot of effort towards enhancing trade in services.** ASEAN has agreed on a number of steps towards liberalization in services: (i) remove substantially all restrictions on trade in services for four priority services sectors—air transport, e-ASEAN, healthcare and tourism—by 2010 and the fifth priority services sector, logistics sector, by 2013; (ii) remove substantially all restrictions on trade in services for all other services sectors by 2015; and (iii) allow for foreign (ASEAN) equity participation of not less than 51 percent by 2008, and 70 percent by 2010 for four priority services sectors; not less than 49 percent by 2008, 51 percent by 2010 and 70 percent by 2013 for logistics services, and not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2015 for other services sectors, and progressively remove other Mode 3 market access limitations by 2015.

Policies towards FDI: Regulations Affecting Investment

62. **Foreign equity requirements may represent the biggest barriers to foreign investment, but as noted earlier, other restrictive measures can also render difficult the establishment of foreign presence**. Generally, these additional market restrictions can make investment more complicated by discriminating against foreigners, such as, by imposing specific performance requirements for foreign companies or restricting foreigners' access to certain jobs or owning land. It is also possible that some rules that do not appear discriminatory (that is, offering national treatment as applying also to domestic firms) are *de facto* discriminatory because they are much more onerous for foreigners to comply with (for instance, adhering to particularly complex national standards).

63. **Under ACIA, some of these measures, such as performance requirements, are now explicitly prohibited.** This is a good start, but monitoring will be necessary to ensure that regulations that amount to performance requirements are indeed not used. On the other hand, other regulations that do not apply the national treatment principle, such as access to land rights, are not yet covered in the agreement. Additionally, because restrictions can take many forms or sometimes domestic regulations may have the unintended effect of restricting foreigners but not nationals, it is important to generate as much transparency as possible to all the measures that may affect foreign investment. The *ASEAN Investment Guidebook* (ASEAN, 2009) is an example of an effort to improve transparency on the regulatory environment surrounding investment. It is also important to provide a conduit for member states to discuss issues affecting investment; the existing peer review mechanism offers an interesting prospect in this respect.

64. **Under the ERIA project, Intal et al. (2012) examine in detail all the limitations to foreign investment beyond equity restrictions**. They compute an index indicating the percentage of sectors that have liberalized foreign equity restrictions (above a certain threshold) as well as other market restrictions.[65] Presented below is their index for the overall investment liberalization rate and what they call national treatment limitations, encompassing market access restrictions other than foreign equity listed in ACIA under this category.

[65] Their index covers only sectors covered by ACIA (excluding services).

Table 4.6: Investment Liberalization Rates in ASEAN

	Overall liberalization Score			NT Score
Country	**Agriculture**	**Mining**	**Manufacture**	**Goods**
Brunei	87.3	79.1	84.3	36.9
Cambodia	76.5	95.8	93.2	83.3
Indonesia	69.1	95.3	84.8	88.7
Lao PDR	68.5	87.7	80.1	50.0
Malaysia	57.2	70.7	83.2	78.7
Myanmar	83.3	82.7	86.5	61.0
Philippines	66.5	68.8	97.5	98.2
Singapore	88.0	86.5	89.0	66.0
Thailand	72.4	79.7	93.3	98.6
Viet Nam	76.2	85.9	76.8	57.1

Note: The overall liberalization score is calculated as a weighted average of 3 scores: foreign equity liberalization (0.6), national treatment (0.24), and other market access restrictions (0.16). The foreign equity threshold used is 51 percent; the restriction levels represent commitments under ACIA.

Source: Intal and Panggabean (2012) as quoted in ERIA (2012)

65. **The inclusion of restrictions other than foreign equity introduces some interesting nuances**. Brunei and Myanmar are among the most liberal members in terms of absence of restrictions to foreign equity, ranking above Singapore. However, these two countries (Brunei in particular) exhibit important restrictions beyond foreign equity, meaning derogations to national treatment that create preferential treatment for national investors. On the other hand, Cambodia has a liberal regime beyond the absence of foreign equity requirements and is thus overall the most liberal country in the region for foreign investment according to Intal et al. (2012) calculations. It is evident that countries like Thailand and the Philippines, which still restrict some access to FDI, use mostly foreign equity limits, whereas Viet Nam uses a variety of discriminatory restrictions other than foreign equity caps.

66. **Finally, research suggests that the signing of ACIA translates into significant liberalization in three countries: the Philippines, Thailand and Viet Nam (Intal et al. (2012))[66].** While for the Philippines (manufacturing) and Thailand (agriculture and manufacturing), the liberalization will be the result of relaxation of foreign equity requirement and various access restrictions, for Viet Nam the prohibition of performance requirements should add an important liberalization effect.

[66] As quoted in ERIA (2012).

67. **ERIA (2012) also reports significant improvements in CLMV and Malaysia in the facilitation of investment** according to a survey of the private sector, with more transparent and consistent rules in the two years preceding their survey (which took place in 2011). The survey, however, shows that much progress is needed, as respondents perceive the process of setting up a local presence in several ASEAN countries to be 'slow' or 'very slow,' in particular in Indonesia, Cambodia and Myanmar. Singapore, Malaysia, and to a lesser extent Lao PDR, offer better services on the whole.

68. **Turning now to the issue of land rights, the IAB database provides several indicators of ease of access to land for foreign investors.** The "strength of leasing right" index measures the security of legal rights to investors: for ASEAN this index (82.4 out of 100)[67] is relatively high, in par with the same number for EAP countries on average, and not significantly below that of OECD countries (92.2). Of the seven ASEAN countries covered in IAB, the Philippines exhibits the lowest index (below 70), followed by Malaysia, Indonesia and Viet Nam with indexes around 78. The access to land rights may both convey *de jure* legal discrimination against foreigners, as well as *de facto* differential treatment when they go to courts.

69. **Measuring the length of time taken to lease public land gives an insight on whether administrative procedures are onerous or not, and on that count the performance of ASEAN countries is much worse (152 days), though comparable to that of the East Asia and Pacific region, but much above high income countries (88 days).** This average is the result of the particularly bad performance of Malaysia (355 days). Viet Nam, Thailand and Cambodia take between 133 and 119 days. When one compares this with the time it takes to lease private land—only 56 days (which is only six days more than high income countries and 10 days less than EAP on average)—this seems to confirm that bureaucracy or capacity constraints are indeed adding costs.

Policies towards FDI: Investment Promotion and Protection

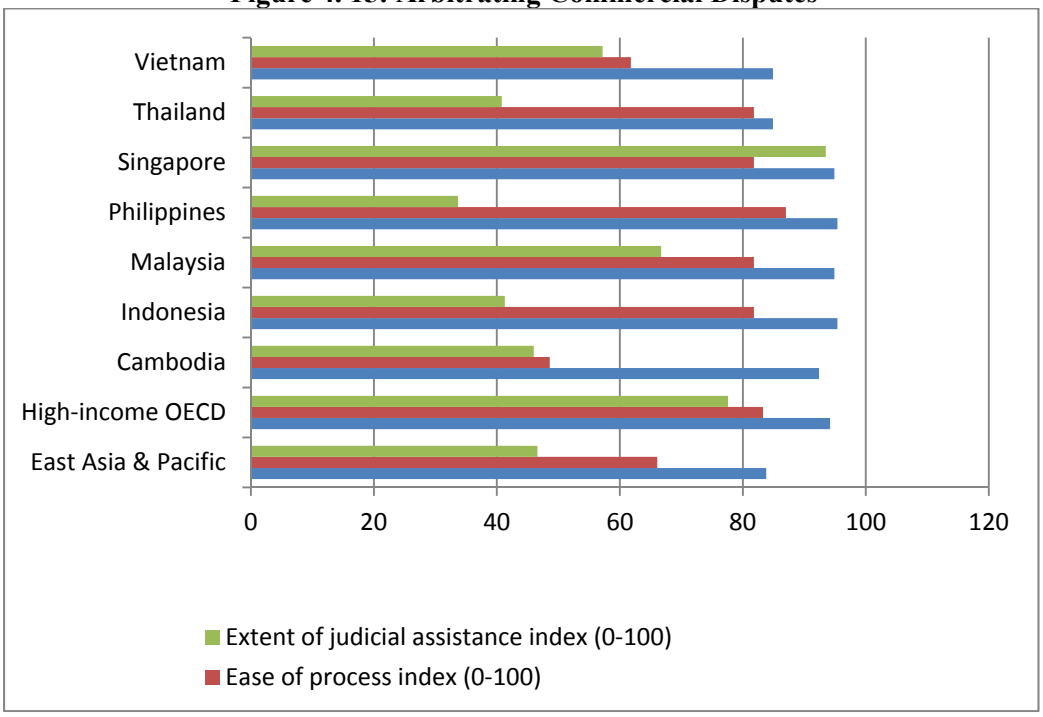
70. **This section investigates policies that take place before market access (investment promotion) and after market access (investment protection)**. Starting with protection of investments, ASEAN performs very well, very close to OECD levels and better than the average for EAP countries (Figure 4.15). Given the importance of FDI for the economies of ASEAN countries, and also given past evidence of steady inflows of FDI, one could indeed expect that ASEAN countries offer strong guarantees to investors.

71. **However, improvements could be made when one considers facilitating procedures, echoing again the burdensome processes of administrative procedures and the lack of capacity witnessed in other areas**. Measuring by the ease of the arbitrating process, ASEAN countries perform relatively well on average and better than the average EAP country, but significantly lower than OECD countries. The reason is the poor performance of Cambodia and Viet Nam, the two CLMV countries for which data is available. This could confirm that the issue is perhaps one of capacity. The extent of judicial assistance in ASEAN countries is also low, highlighting here not only a capacity issue but perhaps also the need for

[67] The strength of leasing index compares economies on the security of legal rights they offer to investors interested in leasing industrial land—whether or not foreign and domestic companies are treated differently and whether the land can be subleased, subdivided, mortgaged, or used as collateral.

countries in the region that have not yet done so (unlike Singapore, Malaysia) to pursue active policies to ensure that investment-related disputes are resolved in the fairest of manners. This latter aspect may also reflect what could be best practice policies that ASEAN countries may wish to emulate in the near future.

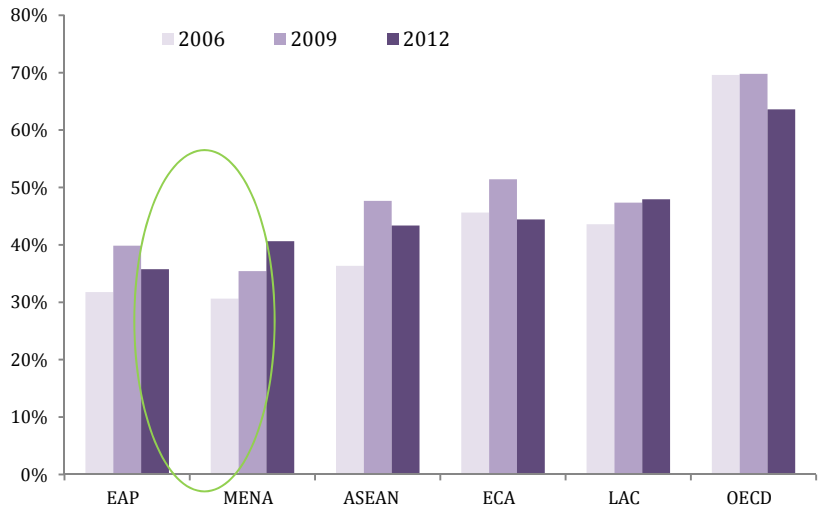
Figure 4. 15: Arbitrating Commercial Disputes



Source: Investing Across Borders, 2010

72. **ASEAN has been making good efforts towards promoting foreign investment.** ASEAN-5 economies, especially Malaysia, have put in place successful policies towards investment facilitation. At the same time, important efforts have been made by the CLMV economies too. Cambodia, Lao PDR, and Viet Nam stand out among AMS for their investment facilitation and overall investment climate policies. Comparing across regions, based on a measure of the availability of public information on investment, ASEAN fares relatively better compared to EAP and Middle East and North Africa countries, yet still lags behind Eastern Europe and Central Asia, Latin America and OECD countries (Figure 4.16).

Figure 4. 16: Global Investment Promotion Benchmarking



Note: ASEAN only covers nine ASEAN countries, as there are no data available on Myanmar. *Source:* GIBP Database and the World Bank staff calculations

73. **A recent scoring of efforts around investment facilitation[68] indicates that ASEAN has been more active than other countries in EAP with respect to investment promotion, regional information, and transparency initiatives, as well as the promotion of ASEAN regional networking and business linkages (see Box 4.3).** However, the regional implementation still lacks regional harmonization and needs to reach international best practice levels.

Box 4. 3: Handling Investment Inquiries in ASEAN Remains a Problem

ASEAN made good progress in promoting their investment through website and inquiry handling in 2009, which recorded a big jump from 36 percent in 2006 to 48 percent in 2009, yet slightly fell back to 43 percent in 2012 (these numbers represent the performance as a percentage of best practice: a 41 to 60 percent score being average practice). The large improvement in investment promotion was partly due to effective development of the website and business licensing online system in a number of ASEAN countries, notably Singapore and Malaysia.

ASEAN has been good at promoting investments through its websites, but on the other hand has been very poor at responding to inquiries. For instance, ASEAN scores 69 percent for investment promotion website quality (technical strength, design quality, promotional effectiveness, and supply of information needed by investors), but only 18 percent for inquiry handling in 2012. Countries like Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand recorded at least 70 percent for website, and Cambodia and Laos recorded between 50 percent and 60 percent, while Viet Nam recorded only 36 percent. For inquiry handling, however, only Singapore records an average score of 47 percent, while other ASEAN countries had weak to very weak performance with less than 30 percent; even Cambodia and Viet Nam had only less than 10 percent.

Source: World Bank, Global Investment Promotion Best Practices Database and authors' calculations

[68] Source: ERIA's Midterm Review (July 2012),

E. ASEAN Integration Impacts on FDI

74. **Having assessed the evolution of FDIs in the region, and the policies that are conducive to attract investment, and in particular those through ASEAN joint efforts, this final section seeks to ascertain whether reform policies have truly impacted investment levels.** A simultaneous movement of increasing FDIs, in particular intra-regional ones, and of policies and government actions to facilitate foreign investment in ASEAN countries is quite evident. However, to what extent have ASEAN efforts been the cause of the good performance of the region in attracting investment? Also, to what extent have ASEAN policies been shaping the type of investments received from abroad? This section offers a brief survey of the technical empirical literature.

75. **The empirical economic literature suggests that regional trade agreements have a positive influence on the flow of FDIs**. The facts suggest that this is indeed the case for ASEAN. Recent studies on FDI flows in the ASEAN region highlight the impact of ASEAN integration efforts in the volume of FDI and its nature. Investment decisions are indeed shaped by factors that are affected by regional integration efforts.

76. **Recent research (Plummer and Cheong, 2009) investigating the determinants of FDI after the 1998 financial crisis and the impact of the ASEAN Investment Area find that intra-ASEAN investment stocks are higher**, while investments coming from outside the region are lower than they would be without ASEAN. This result is confirmed by other research (Hattari and Rajan, 2009) that suggests that on average ASEAN countries invest more into each other because of regional integration. Ismail et al. (2009) also find that investments from outside ASEAN are negatively impacted by regional integration. This study further distinguishes between the 1967 founding members and members that later acceded to ASEAN to conclude that the increase in intra-ASEAN investment was more towards the new members, suggesting that the reforms that these countries had to implement to gain benefits from the ASEAN Investment Agreement (AIA) and ASEAN Industrial Cooperation (AICO) would have attracted this supplement of FDI. These studies look at the period after the financial crisis from 2003-2005; their results suggest that ASEAN helped its members weather the crisis by keeping on generating FDIs. Although one study posited that the decrease in outside-ASEAN investments could be a consequence of the crisis and diversion of investment towards other emerging economies, rather than investment displacement in favor of intra-ASEAN investments, further calculations made by Thangavelu (2012) for the period 2002-2009 using the same methodology confirm the negative impact of ASEAN integration on extra-ASEAN FDI flows. This study also confirms the importance of affordable human capital[69] in the region for attracting investment.

77. **Multinationals may seek to serve foreign markets through local subsidiaries rather than by exporting: this is the 'horizontal' FDI type model, motivated by market size and relative trade costs and cost of establishment**. Another motive may be to seek efficient host countries for fragments of an international production chain, because of local advantage in production costs: this is the 'vertical' FDI type model. In practice, FDI by MNCs may seek both objectives. In the context of regional integration, as suggested by Ismail (2009), liberalization of internal trade barriers would suggest that intra-regional FDI

[69] Proxied by skill differentials between host and source country.

would likely diminish if the motive of FDI is primarily horizontal FDI. Firms that would invest in a given ASEAN country to access its market may now be able to export at low cost to the market, thereby removing the FDI incentive. On the contrary, vertical type FDI may boost intra-regional FDI because the finished product may be easily exported to other markets in the region. The expected impact of a regional agreement on FDI originating from outside the region would be an increase of flows both for vertical and horizontal types of FDI.

78. **Evidence shows that FDI in the ASEAN region tends to be dominated by vertical-type investment.** This is what is suggested by the findings of Plummer and Cheong (2009). They show that motives for vertical investment tend to dominate in their analysis of FDI to ASEAN. More specifically, they find that investment seeks cheaper factors of production, which echoes the findings of Petri (2012) that Asian FDIs tends to be dominated by investments from high technology economies to mid-level technology economies (unlike FDI in the rest of the world).

79. **Analysis of the behavior of both US and Korean affiliates confirms these findings.** Antras and Foley (2009) look at how ASEAN integration efforts affect the investment decisions of American multinationals and the performance of their ASEAN affiliates. Their findings confirm theoretical predictions that regional liberalization increases the volume of FDI (originating from the US) in ASEAN. US affiliates also grow in size and become more active selling to markets outside ASEAN, thus suggesting that FDI towards ASEAN is to create export platforms (as for instance in the automobile sector, see Box 4.4). Based on these findings, the authors conclude that the increase in FDI triggered by regional integration is likely to generate benefits in the form of future productivity gains within ASEAN as multinationals and exporters typically exhibit high levels of productivity, pay high wages, and create positive spillovers for other firms. A similar study is conducted by Lee (2011) for Korean firms and also shows that FDI in ASEAN is not only to serve local ASEAN markets, but also to export outside of ASEAN.

80. **In summary, empirical analysis shows that intra-regional FDIs are by and large complementary of regional integration in ASEAN**. This is linked with an important motivation for FDI in the region, which is to take advantage of international differences in factor prices in fragmented supply chains. There is some suggestion that these intra-regional investment flows have benefited in particular the new ASEAN members. Besides, ASEAN integration seems to attract investment that is beneficial to the region as it contributes to higher level of exports and likely gains in competitiveness. One concern for the ASEAN region has been the prospect of a loss of competitiveness in attracting investment towards third countries, in particular China. Plummer and Cheong (2009) do not find supporting evidence that the rise of China has resulted in diversion of investments away from ASEAN.

Box 4. 4: The Central Role of Investment in the Rise of the ASEAN Automotive Sector

The automotive market has long been a focus of ASEAN regional integration. Efforts to integrate the ASEAN automotive market started with the Brand-to-Brand Complementation scheme, which was followed by the ASEAN Industrial Cooperation (AICO) system of 1996. Under AICO, producers using 40 percent of locally-made parts and demonstrating resource sharing between ASEAN companies enjoyed 0-5 percent preferential tariffs within ASEAN. In 2004, ASEAN initiated a "Roadmap for Integration of Automotive Product Sector"[1] aiming at the full integration of the automotive sector by 2010 and focusing on trade and investment liberalization, and improvement of technological and human resources capabilities.

Under AICO, producers were able to rationalize their production in the ASEAN region, concentrating their manufacturing in few production sites. For instance, the Japanese auto-part manufacturer Denso centered its production in Indonesia where before it had manufactured similar products in each ASEAN country.[1] In 2010, for ASEAN partner countries duties were eliminated in the ASEAN+6 countries, and significantly reduced in CLMV. By 2010, investment was opened to all ASEAN investors in the sector under AIA. Japanese investors have taken advantage of ASEAN integration and invested heavily in the region. For instance, Toyota's Innovative Multipurpose Vehicle initiative, started in 2002, opted to take advantage of the most competitive and efficient production bases for its production of multipurpose and pickup truck vehicles. Toyota centralized the production of individual parts in the most competitive countries, and concentrated assembly in four global locations, including two in ASEAN: Indonesia and the Philippines.

Toyota's Parts Manufacturing in ASEAN

Thailand	Philippines	Malaysia	Indonesia
Diesel engine	Transmission	Engine computers	Petrol engine
Steering column	Universal joints	Wiper arms	Door frame and lock
Body panels		Electronics	Small motors

Source: Frost & Sullivan, 2011[1]

Investments by Japanese automotive producers date back to the 1960s and were initially to develop a local production base. 'Horizontal-type investment' to serve the local market remains today a key consideration: the ASEAN domestic market is growing fast and with over 2.5 million vehicles sold in the region in 2011[1] represents now a market nearly as large as France and bigger than the UK. With still low ratios of vehicles per inhabitant there is further prospect for high growth.[1] In this market, Japanese cars are the top sellers, representing more than 95 percent of sales in Thailand and Indonesia, as well as of exports (90 percent of exports from Indonesia are realized by Toyota Astra).

As a whole, the ASEAN region is a net exporter of vehicles, with a production of three million vehicles in 2011.[1] Thailand represents nearly half of this total, followed by Indonesia and Malaysia. These three ASEAN countries have opted for different strategies to develop their automotive markets. Malaysia, unlike its two neighbors, has developed a national industry, starting from assembly of Japanese and European vehicles and having recourse to strict local content requirements enacted in 1979. In 1983, the Malaysian government launched the project Proton in partnership with Mitsubishi from Japan. Proton benefited from a range of exemptions of import tariffs and excise duties, which along subsidized loans conferred it a very significant cost advantage. A second national brand, Perodua was launched in 1992 in partnership with the Korean manufacturer Daihatsu. Today, both makers dominate the Malaysian market: Perodua is the leader with 35 percent of sales, followed by Proton with 29 percent. Thailand and Indonesia did not opt to develop a national manufacturer. Thailand, starting in the 1960s, provided incentives for multinationals such as Fiat, Ford UK and Nissan to set up operations in joint ventures with local companies. Investment became more difficult in the period from 1971-1982, when the government followed an import substitution policy, using local content requirements and high tariffs. After several years of struggle Thailand received a new surge of investment from Japan following the reevaluation of the Yen after 1985. This was followed by a liberalization of the sector starting in 1991, with the abolition of restriction on foreign car companies setting up factories in 1993 and new investment incentives in 1994. Investment continued to surge in the mid-1990s along with positive prospects for the Thai economy. Foreign investor pressure led to the abolition of local content requirements for assemblers in 1998.[1] After the financial crisis, Thailand further relaxed foreign investment requirements and joined the WTO in 2000, followed by further tariff reductions in 2003.

Source: Authors' compilation

81. **On the other hand, evidence suggests that ASEAN integration has not had any discernible impact on attracting extra-regional investments.** While in theory one should expect a positive impact, studies covering the post-Asian financial crisis show a negative impact on extra-ASEAN investment levels. Thus, there seems to be some degree of investment diversion at play: one potential explanation might be that investments originating in Singapore, the largest intra-ASEAN investor, might have replaced investments from outside the region.

F. Conclusion and Policy Recommendations

82. **Investment integration has been progressing quite well in ASEAN, which is driven concurrently by ASEAN growing economies and the ASEAN investment integration policy.** A free flow of investment regime should also be supported by business licensing, land, labor, and tax administration, which are all key to enhancing ASEAN attractiveness to FDI.

83. **Overall, the more open countries in ASEAN have tended to show that they have had more success generating FDI flows.** Further, the opening of sectors to foreign investors is the main goal of ACIA and what the ASEAN membership should seek to advance. However, the region still restricts access much more than countries with which ASEAN competes on a global scale. The level of opening in the manufacturing sector is high in most countries, and there is progress in the agricultural sector. In this respect, most countries already have liberal policies, with a few ASEAN members still pursuing more restrictive agendas. Where the region lags overall is regarding openness to foreign investors in the services sector. Quick interventions to remedy this could focus on the following areas:

i. Liberalization of investment in services sectors is as important as in the manufacturing sector if not more, since many services are essential inputs into most economic activities. AMS commitments to liberalizing foreign investments in all sectors need to become more commercially meaningful.

ii. Improving the clarity of the negative list used for investment market access liberalization in ASEAN will be important. By consolidating various pieces related to the investment regime, ACIA is a good step forward. However, the existence of both negative list (exception lists in sectors covered in ACIA) and positive list (limitation of coverage to certain services sectors) results in a lack of transparency.

iii. Providing clarity on measures affecting investments seems desirable. The language of ACIA is general about the measures that should be covered by the national treatment provision. Transparency would be improved by listing these measures, and also by monitoring in detail their use. Additionally, ACIA only provides for national treatment, but this does not guarantee that regulations affecting investment reflect best international practice or are implemented in the most efficient way. Defining what is best international practice is however complicated and not an exact science: it would be useful to consider a mechanism, for instance through the Coordination Committee on Investment, for member states to interact to exchange views on regulatory matters.

iv. Continuing business license simplification will be useful. Simplifying licensing is not only about cutting licenses, but it is more about how to limit licenses that serve their objectives best. The first thing is to compile all licenses and cut unnecessary licenses. It could be started by setting technical standards to ensure that licenses should fulfill legitimate regulatory purposes—such as safeguard public health and safety, protect the environment, ensure national security, or manage limited natural resources. ASEAN

should also foster the full implementation of an integrated One Stop Shop where there is an authority delegation to a particular agency to issue licenses and allow reductions of overlapping licenses (as one agency could take a control in issuing licenses). This should also be accompanied by fostering the implementation of an online system—not only electronic business licensing system but also electronic payment system. In addition, there should be full implementation of electronic filling and payment system of business licenses nationwide as well as ASEAN-wide.

v. Improving the service quality of the website[70] and the help desk at investment offices will facilitate investment. Website and help desk services should act as a front line in dealing with investment regulations and policies for investors. The improvement should cover both hard and soft infrastructure, including personal skills of officials. It could be started with, first, providing detailed information on business startup requirements online or making them publicly available along with the costs of obtaining licenses, and identifying government departments that are responsible to issue licenses as well as persons in charge and their contacts. Second, the focus should be on empowering the help desks and/or investment relation units with enough knowledge to respond to basic questions related to investment, investment policies and regulations of each member country and ASEAN, and providing information on standard operating procedures on how to start up a business.

[70] The ASEAN investment website is under development.

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