



# ASEAN

## Perspective on Economic Integration

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# ASEAN In Perspective

By **Dr. Munir Majid**

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## BACKGROUND

**The regional grouping ASEAN (Association of Southeast Asian Nations<sup>1</sup>) is often not sufficiently recognised for its accomplishments. When ASEAN was formed in Bangkok in 1967 by the five founding states, Indonesian confrontation against Malaysia of 1962-66 had only just ended, the Philippines still had an outstanding claim for the Malaysian state of Sabah, and Malaysia and Singapore had just gone through an acrimonious separation in 1965. The fact these countries could meet, move on and cooperate is reflective of great statesmanship. If it is remembered, further, that apart from these then-recent problems, there was also a sticking point in the discussions over the existence of foreign bases in the region, which almost led to a walkout from the talks in Bangkok by the Singapore delegation<sup>2</sup>, it will be better appreciated how in its very establishment ASEAN signalled a major regional achievement.**

The ASEAN Declaration of 8 August 1967 was brief, citing growth, social progress and cultural development, regional peace and stability, and collaboration on matters of common concern as the purposes for ASEAN's establishment. Yet it was entered in the last paragraph of the Preamble: "Affirming that all foreign bases are temporary and remain only with the expressed concurrence of the countries concerned and are not intended to be used directly or indirectly to subvert the national independence and freedom on states in the area or prejudice the orderly processes of their national development." Security then was the primary concern, even if cooperation over it quite deliberately not specifically mentioned.

At this time the Vietnam War was raging, with the TET Offensive to come in 1968 and peace talks to take place afterwards between 1968 and 1973 before the fall of Saigon in 1975. ASEAN was seeking to insulate itself from what was happening in Indo-China, although there was involvement of individual states in the failed American war effort that underpinned the desire to distance ASEAN from any appearance of group involvement in what was taking place.

On 27 November 1971, ASEAN issued the ZOPFAN Declaration in Kuala Lumpur "to secure the recognition of, and respect for, Southeast Asia as a Zone of Peace, Freedom and Neutrality, free from any form or manner of interference by outside powers." ASEAN was now seeking the neutralisation of Southeast Asia. Again, regional security was the paramount concern.

That concern was not to be assuaged, as peace did not come to all of Southeast Asia with the end of the Vietnam War. There was a struggle for power and control in Indo-China, with Vietnam and outside powers, notably China, involved. The main theatre was Cambodia, where the internal struggle for power established the bloody rule of the Khmer Rouge and engaged Pol Pot, with the support of the Chinese, in a proxy battle for control with Vietnam. The antagonism between the Khmer Rouge regime and Vietnam led to the Vietnamese invasion of Cambodia on Christmas day 1978, which ended the prospect of non-communist ASEAN engaging in peaceful cooperation with the unified Vietnam. ASEAN countries swiftly condemned the Vietnamese action, since non-violation of territorial integrity was a central principle of the regional grouping, as did China, which invaded Vietnam in 1979 in an abortive attempt "to teach it a lesson." It was to be ten years after the fall of Phnom Penh in January 1979 that Vietnam withdrew from Cambodia.

According to Thanat Khoman, one of the founding fathers of ASEAN, because of the Vietnamese invasion of Cambodia, economic matters were "almost entirely neglected and set aside."<sup>3</sup> Indeed from 1967 to the 1990s ASEAN's main role was to ensure that, even if there was not peace and stability throughout Southeast Asia, the non-communist part was not destabilised and deflected from national growth and economic development.

<sup>1</sup> Presently comprising Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam

<sup>2</sup> As related to the writer on 27 February 2009 by S.R. Nathan, President of the Republic of Singapore, then a member of the Singapore delegation

<sup>3</sup> Thanat Khoman, "ASEAN Conception and Evolution," 1 September 1992, [www.aseansec.org/thanat.htm](http://www.aseansec.org/thanat.htm)

## ECONOMIC COOPERATION

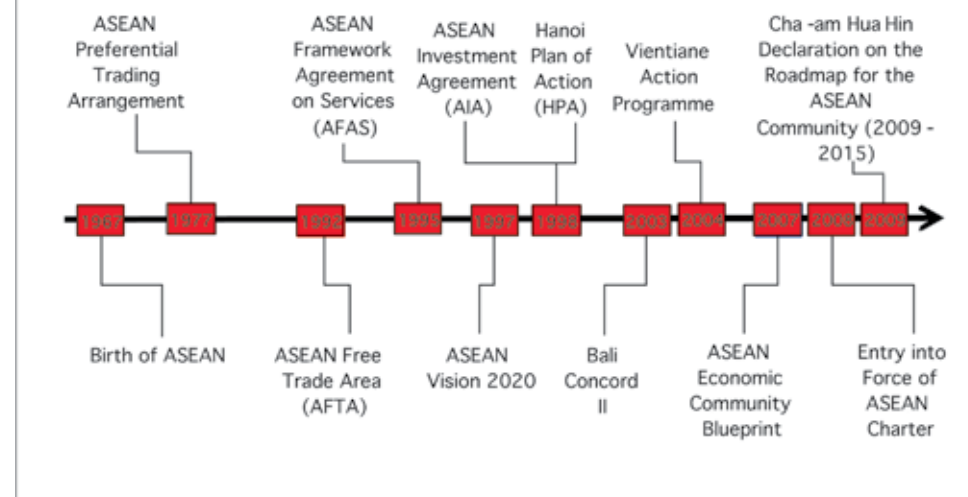
From the end of the Pacific War through to the setting up of ASEAN and into the 1990s, the five founding members of the regional grouping plus Brunei, which had joined from 1984, experienced creditable economic development. Their respective growth was based first on commodities and primary resources, and import substitution strategies, which then progressed to export-led expansion. By the 1990s Singapore had joined the ranks of the Asian economic tigers (Hong Kong, South Korea and Taiwan) and the other ASEAN member countries had become fast-growing emerging economies. With China and India also breaking economic growth records as they opened up their economies to the rewards of the free market, some proclaimed that the Asian Century was at hand.

Even though Indo-China was going through turmoil of one kind or another during this time and Myanmar was to get into a dark age of military dictatorship following the coup led by General Ne Win in 1962, the line of security was held, the more so as ASEAN gained confidence in its diplomatic ability as a regional grouping to establish, effectively, a cordon sanitaire between the ASEAN and the non-ASEAN regions of Southeast Asia. While security concerns over the situation in Indo-China may have caused ASEAN to neglect matters of regional economic cooperation, there is no refuting the level of peace and stability achieved within the grouping, stability which was the basis of the economic development attained. With peace and stability largely in place across the whole of the Southeast Asia by the 1990s, ASEAN grew to incorporate those Indo-Chinese countries that had been in turmoil for so long. At the same time, ASEAN paid greater attention to pursuing its other purposes (although the concern with Myanmar's human rights record continues to be a thorn in the flesh within and without the region). The Asian financial crisis of 1997-98, which hit a number of ASEAN countries badly and even resulted in regime change in Indonesia, was also to concentrate minds on the need to protect their economies, both individually and cooperatively.

Under the ASEAN Charter, adopted at the regional grouping's summit in Singapore on its 40th anniversary in December 2007, all three pillars of regional cooperation have been explicitly identified – the political-security, the socio-cultural and the economic. The push towards greater economic integration has been accelerated, with the aim of realising ASEAN Economic Community (AEC) by 2015. The AEC has four objectives: a single market and production base; a highly competitive region; a region of equitable economic development; and a region fully integrated into the world economy. The process of economic integration has assumed greater urgency after slow initial progress due to the increased competitive challenge from China and India following the opening up of their economies in the 1990s, a challenge that by the year 2000 saw 87 per cent of FDIs – foreign direct investments – into Asia going to China. As mentioned, the Asian financial crisis of 1997-98 and now the global economic crisis have made ASEAN's need to establish a meaningful geo-economic space between China and India even more urgent. The question is whether ASEAN, in this next cooperative phase, will be as successful in achieving economic benefit as it was in attaining regional peace and stability in its first generation of existence. What might be the impediments and what could be the solutions? Could ASEAN play an effective role in economic diplomacy as it did previously in political diplomacy?

It was in this context that a LSE IDEAS South East Asia International Affairs Programme (SEAP) workshop on "The Path to ASEAN Economic Integration" was held in Kuala Lumpur on 28-29 April 2009.

Chart 1: The Path towards ASEAN Economic Community (AEC)



Source: Overview of ASEAN Economic Community by Manasvi Srisodapol, Deputy Director-General of the Department of ASEAN Affairs, Ministry of Foreign Affairs, Thailand, LSE IDEAS workshop, Kuala Lumpur, 28-29 April 2009.

There is, evidently, a clear, charted path towards greater ASEAN economic integration. The questions raised at the workshop were with regard to its speed, quality, institutional and leadership support. Since the ASEAN Charter came into force in December 2008 there has been greater confidence, at least at the official level, in the process's progress towards its objectives. Those less confident in the process, however, point to a patchy past record, continued institutional deficiencies, divergent views and interests, and the greater challenges of the times which may leave ASEAN lagging behind in the emerging global economic balance of power.

The notion of an ASEAN Free Trade Area (AFTA), one of the earliest of the ideas of economic cooperation that was introduced in 1992, has successfully bought tariffs down but it has not led to as much intra-ASEAN trade as had been hoped. The average tariff rates for the ASEAN-6 have indeed come down from 12.76 per cent in 1993 to 0.79 per cent in 2008, but for ASEAN as a whole they are at 1.95 per cent and, if Cambodia, Laos, Myanmar and Vietnam (CLMV) are taken apart, they are at 3.69 per cent. It is expected that zero tariff rate will be achieved among the ASEAN-6 by 2010 and, including the CLMV, by 2015. There are, however, exceptions with strategic products including rice and sugar exempted. Under the AEC, apart from the elimination of tariffs, the non-tariff barriers (NTBs) will also be addressed. There is, for example, to be increased transparency with on-line database for public access, a kind of shaming process. Members can also reach agreed timelines for the elimination of the NTBs separately, as has happened between Malaysia and Thailand. There has also been movement on trade in services, with packages covering 12 service sub-sectors. On movement of skilled labour, agreement has been reached for seven professional services

(engineering, nursing, architectural, surveying, accounting, medical and dental). There are also clearly time-lined commitments for comprehensive investment liberalisation and protection, with benefits also extended to foreign-owned ASEAN-based investors.

Both senior ASEAN government officials at the workshop bemoaned the fact that intra-ASEAN trade remained low at 25 per cent. In comparison, intra-European Union (EU) trade stood at 60 per cent. Only when trade among the ASEAN+3 states (China, Japan and South Korea) is taken into account does the figure reach a more satisfactory 50 per cent. This is a point of strategic significance as it poses the question of whether ASEAN alone can constitute a meaningful trading bloc. Wider regional integration, even as ASEAN plays catch-up with its own economic integration process, has not been sufficiently thought and worked through by the regional grouping. It is not an issue that can wait upon two summits a year, either for ASEAN or the wider East Asian region, a matter to which we shall return.

Abdul Rahman Mamat, the top official at the Malaysian Ministry of International Trade and Industry, was particularly scathing of the many shortfalls in the ASEAN economic integration effort. Apart from the relatively limited intra-ASEAN trade, he pointed out that intra-ASEAN investment was also small. There are work plans to encourage such investment, but the numbers are still puny. In 2007 ASEAN investment into ASEAN was only 15 per cent of total inflow of FDIs into the region. The SMEs (small and medium enterprises) in the individual countries have also hardly been brought into the regional supply chain, as they still feed into their national economies. He concluded that the priority areas should be the following: SMEs should be given the push to invest across ASEAN borders and become pivotal to intra-ASEAN trade; targets should be set to increase intra-ASEAN trade; the harmonisation of standards and conformance should be accelerated; the services sector should be the main driver of the AEC. He was quite clear in his mind as to the impediments to implementing these policies – national interests and conflicting objectives

– but this is not a peculiar or exceptional problem in any cooperative effort among any grouping of sovereign states (although more newly-independent states, as in Southeast Asia, which have many more recent experiences of real and threatened domination from near and afar, may be less inclined to let the national guard down).

The point is, having acceded to the regional grouping it has to be presupposed there is intention to cooperate. The Treaty of Amity and Cooperation in Southeast Asia of 1976, which ASEAN has succeeded in making the umbrella convention for regional cooperation within and without; the strictly members-only ASEAN Charter which came into force in December 2008; not to mention the various ASEAN summits and commitments (for example, the Bali Concord II in October 2003 when all member states agreed to pursue closer economic integration by 2020, fast-tracked to 2015 by the Charter); together these constitute overwhelming evidence of this cooperative will. The problem arises in actualised situations when commitments are watered and interpreted down, and exclusions are sought. This has been the main problem with ASEAN, particularly in respect of economic integration. Different members are at different stages of political and economic development and have to be accommodated;<sup>4</sup> and ambitious targets give rise to expectations only available from an organisation which is institutionally-driven and rules-based.

There seems to have been a realisation of the latter point with the promulgation of the ASEAN Charter, on which much hope is placed,<sup>5</sup> but the former remains an outstanding issue in the overall ASEAN integration process.

At the workshop, the senior government officials also bemoaned the lack of the feeling of “ASEAN-ness” in the grouping, most of the integrative process being the work of officials with incessant and interminable meetings which may or may not arrive at conclusions often overridden at higher ministerial level. There was a lack of private sector participation, it was alleged, which was true. There was insufficient people-involvement, which it was claimed will be addressed now that the ASEAN Charter was in place. To take the first point, it should be noted businessmen prefer to take advantage of opportunities rather than to attend meetings, particularly if their outcome is uncertain of implementation. They appreciate the scale ASEAN offers (population: over 580 million, over 60 per cent under 60 years old; GDP:\$1.3 trillion; total trade:\$1.4 trillion; rich natural resources, large talent pool), but see and experience the many obstacles and challenges, such as the border rules, the barriers, the differing standards and fragmented markets, the diverse cultures and languages, and the greater attractiveness of China and India. Therefore, they will move their business expansion and activities along the key success factors, such as market size, growth, pricing and flexibility, availability of talent, technology, specialisations and capital; and not be driven necessarily by any ASEAN regional imperative. This does not mean, as was evident from the presentation at the workshop by Azman Mokhtar, Managing Director of Khazanah Malaysia Berhad (Malaysia’s national investment arm), that there are no ASEAN cross-border investments and activities; indeed there are successful ones in telecommunication, aviation, real estate, plantations, with other sectors like healthcare, energy, leisure and tourism, and regional hubs based on specialisation (Mekong Basin, Greater Jakarta, Singapore-Iskandar, in Malaysia) offering great potential. However, as Azman Mokhtar noted, rather wryly, there are good big moves in ASEAN to integrate economically, but “it will take time”, meaning business will respond as opportunities are available but is unprepared to hang on the big plans for the big bang. Businessmen will not get involved in planning within a broad framework of no immediate benefit to them although, no doubt, when they have identified an immediate great opportunity they will lobby their governments. They are, in other words, not conceptual but practical. Perhaps the ASEAN integration process should also support specific major business initiatives not necessarily involving all member states. There was a clear message from the workshop that, instead of the other way around, business should be more effectively supported in the ASEAN integration process, with specific strengthening of the ASEAN secretariat to do so.

<sup>4</sup> See Analysis by Dr Narjoko: An Indonesian concern on equitable economic development, even though the AEC identifies narrowing the development gap through inter-ASEAN investment and SME development as one of its objectives, was expressed at the workshop by Dionisius Narjoko of the Economic Research Institute for ASEAN and East Asia, Jakarta in his paper, An Indonesian perspective on ASEAN economic integration.

<sup>5</sup> See Keynote Address by Surin Pitsuwan, Secretary-General of ASEAN, LSE IDEAS Workshop, Kuala Lumpur, 28-29 April

A highly significant presentation was made at the workshop on a detailed effort at ASEAN capital market integration by Ranjit Ajit Singh, Managing Director of Malaysia's Securities Commission. There is a cogent case for the integration of the ASEAN financial market, of which the capital market project is one area of activity. There is also the factor of scale of the pooled market capitalisation of the regional grouping's major stock exchanges which would catapult it to 12th in the world, ahead of India and Korea in Asia. This work is well advanced and involves detailed and complex issues. It has progressed in the most professional manner since it began in 2004 after the Bali Concord II of 2003 which sought the roadmap on monetary and financial integration of ASEAN. The AEC 2015 Blueprint seeks to achieve significant progress in building a regionally integrated market where capital can move freely, issuers are free to raise capital anywhere and investors can invest everywhere. The work, as well as its outcome, has a significance in the ASEAN economic integration effort in excess of its capital market implication, as it would signal the ability to address hugely complex issues of great national importance to achieve a greater regional good within the governance framework now formed by the ASEAN Charter. After focusing on three dimensions of integration (regulatory alignment and harmonisation, integrated market infrastructure to facilitate connectivity, and regional financial products base), the process has now reached the implementation plan stage, and the plan was endorsed by the ASEAN Finance Ministers Meeting on 9th April 2009. The ASEAN working committees are to review and incorporate appropriate recommendations of the plan, and the ASEAN Secretariat will monitor the integration process through a consolidated action plan and provide technical assistance.

There are still a number of fundamental issues to be thrashed out which could lead to impediments and delays in implementation of the plan. It is an acid test for ASEAN in this much vaunted age of the Charter. Will the ASEAN Secretariat have the determination, capacity and expertise to push through that consolidated action plan? Will there be the political will to implement a plan based on professional and highly technical preparation following an endorsed process? There are significant differences in the levels of development of the capital markets, with some jurisdictions also taking the view that integration should be with the rest of the world rather than just within ASEAN. Furthermore, capital controls and exchange restrictions exist in a number of member countries, as well as differences in withholding tax regimes. The different exchanges use different systems and trading platforms, and there will be resistance to using a common gateway for the intra-ASEAN network. If this capital market integration process makes meaningful progress, it would be a most encouraging development; if it does not, there will be a conclusion that there is really no change in the ASEAN process, even under the new regime of its Charter.

## BECOMING MORE EFFECTIVE

As noted, much hope is invested in the ASEAN Charter, which formally came into force on 15 December 2008, to make the regional grouping more effective. Its purpose is to provide a legal and institutional framework for an ASEAN community, with the objectives of making the regional grouping more consequential, more rules-based and more people-oriented. It has been acclaimed by ASEAN leaders as introducing a regime that will make a difference in the process of integration and of setting up political-security, socio-cultural and economic communities. Decision-making and implementation are to become more flexible, with a relaxation of the principle of non-interference and giving an enhanced role to the ASEAN Chair. New organs were set up – the ASEAN Coordinating Council, the ASEAN Community Councils and the Committee of Permanent Representatives. The summit is to be held twice a year.



Source: Manasvi Srisodapol

Dispute settlement mechanisms are in place for all three pillars of the community, and the role of the secretary-General of ASEAN has been enhanced in monitoring compliance. In case of serious breach of undertakings, the leaders will decide on the measures to be undertaken. The regional grouping is also to become more people-oriented by opening up a channel for consultation between ASEAN organs and civil society organisations. The terms of reference of the ASEAN human rights body is to be completed within one year of the Charter coming into force.

The Charter is undoubtedly a positive step that ASEAN has taken to make itself more effective and relevant. But it is still too early to see whether it will make ASEAN more successful in achieving its objectives fully and in a timely manner. Many new targets have been set, even if past ones have not been wholly achieved. At the same time greater challenges are being faced, particularly with respect to the global economy.

The early signs, unfortunately, have not been too encouraging. Even as Thailand has worked hard as the ASEAN Chair in the first year of the Charter coming into force, the postponement of the summit meetings in Pattaya in April because of Bangkok's internal political troubles was more than an embarrassment. Singapore Foreign Minister George Yeo described it as a "great humiliation for the grouping" in a speech to the US-ASEAN Business Council in Washington on 28th April. The more general point must be that regional and extra-regional engagement cannot rely entirely on summits without mechanisms for off-summit consultation and provisions for alternative arrangements short of the formality of a summit. Lack of flexibility, and the appearance of being stymied at a time of financial and economic crisis, are not a good advertisement of a functioning regional association. At the same time, the jury is still out about the meaningfulness of setting up a human rights body when ASEAN is reticent about criticizing Myanmar for human rights abuses.<sup>6</sup>

What ASEAN cannot avoid, Charter or no Charter, is strong leadership of the kind that distinguished it at the time of its establishment. This is absent today. With ten leaders across a wide spectrum of governance systems who do not know one another especially well, there has been a loss of the esprit de corps found among leaders of the original ASEAN-5 – even if they were robust in their disagreements – which made it more alive and consensus-seeking. Although times change, camaraderie and leadership are always needed. At the workshop, there was a discussion centred on the kind of factors of leadership and institutional support that have made the EU achieve many of its objectives, even if it was conceded the regional context of ASEAN was not that of the EU, and the EU itself has had its own failures and continues to face many challenges.<sup>7</sup>

## GLOBAL CRISIS AND CHALLENGE

The ASEAN Chair was invited to attend the G-20 Summit in London on 2 April, 2009. This is a major breakthrough, especially at a time of crisis and challenge. What must also be done however is to establish a systemic link from ASEAN to a larger process of critical global importance. ASEAN must weigh in to be active in the establishment of the new world order.

The global financial and economic crisis has raised major issues of international macro-economic and financial management. ASEAN must have detailed and well-articulated positions on these issues which must be presented orally and in writing. From observation, there is a penchant for generalities, with the leaders often uttering platitudinous motherhood points against protectionism, for economic stimulus, for better regulation and for reform of international financial institutions. It is not clear how many technical position papers were prepared on the ASEAN side, and how these became engaged with those of the others represented on the G-20, including after the summit meeting and going into the next one. For example, there was no clear and detailed ASEAN position at the London

Summit on the Chinese proposal for an enhanced role for SDRs (Special Drawing Rights) in the international financial and payments system. Being there is not enough. ASEAN has to be sufficiently organised to engage counterparts both diplomatically and technically. This can only happen when there is strong and competent support, which can only come from an empowered and technically resourced secretariat, and when the ASEAN Chair is given sufficient space to articulate the grouping's position and engage with counterparts. Once the broad policy decision has been made, ASEAN governments must not continue to want to dot the "i's" and cross the "t's". A more evidently effective ASEAN puts greater belief among its members in the association. It will have positive knock-on effects on other ASEAN efforts, including those at closer economic integration. This is the simple thesis of functional integration.

At the workshop in Kuala Lumpur, Professor Kang Shaobang of the Central Party School in Beijing, made two essential points.<sup>8</sup> First, that ASEAN is the only successful regional organisation in all of Asia and should be the platform for greater Asian integration. And second, that ASEAN, along with other Asian countries, should address the problem of the US dollar as a reserve currency and come up with an Asian currency unit for settlement in their international trade. Both these proposals take us back to the need for ASEAN to be technically competent and fleet-footed, and to dock into firm extra-ASEAN arrangements to make its views effectively heard on the major global economic and financial challenges of the day. ASEAN, rightly, prides itself on having been able to draw so many parties into its Treaty of Amity and Cooperation of 1976, after the amendment made in 1987 to allow accession by those outside the region (with the US being the latest party considering accession, as announced by Secretary of State Hillary Clinton in Jakarta in February this year, which contests the point made by Douglas Paal at the workshop that ASEAN has not gained

traction in Washington). ASEAN has also been able to engage in dialogue, not to mention concluding FTAs (Free Trade Agreements) in numerous cases, with many extra-regional states, and has become the focal point for those relationships. The time has come, not least because of the global financial and economic crisis, for ASEAN to hard-wire the more important of these relationships to address the more important of the global challenges. Inevitably, there will be those within the grouping who will express the fear of dilution; that would be argument enough that ASEAN's own effort at integration should get stronger support if individual members are not to hang separately.

The Chinese have been coming out more evidently to engage those in Asia undermined by the global financial and economic crisis, paying particular attention to threatened dollar reserves. There have been major proposals on expanding the role of SDRs, for example by Zhou Xiaochuan, Governor of the People's Bank of China, and interesting suggestions on conversion of US Treasury dollar debt to US industrial equity.<sup>9</sup> Meanwhile, China has also been actively supporting the now committed \$120 billion Chiang Mai swap scheme set up by ASEAN+3 after the 1997-98 Asian financial crisis, making the running with a contribution of \$38.4 billion, swiftly matched by Japan, with \$19.2 billion from South Korea. On 18 April, 2009 Prime Minister Wen Jiabao announced that China planned to establish a \$10 billion fund to promote infrastructure that connects it to ASEAN nations. All these initiatives reflect and presage more active Chinese economic diplomacy which requires structured and detailed response from ASEAN which must not be found slow and wanting. On the other hand, the largest economy in ASEAN, Indonesia, has found new confidence with its direct membership of the G-20, with the expectation of achieving good GDP growth while others are struggling, under a democratic and stable government. Goldman Sachs

<sup>6</sup> In a rare rebuke, the Prime Minister of Thailand as the ASEAN Chair issued a statement on 19 May 2009 expressing "grave concern" over the arrest and trial that had begun the previous day of Aung San Suu Kyi who, in her sixth year of detention due to end on 27 May, is accused of breaking the terms of her house arrest after an uninvited American swam to the house where she was being held. ASEAN repeated previous calls for her immediate release, and for her to be given adequate medical care and to be treated with dignity. The issuing of the statement followed a meeting of ASEAN senior officials, including from Myanmar, in Phuket, Thailand, signaling perhaps an active ASEAN on human rights issues under the regime of the Charter. The military junta in Myanmar responded on 25 May by lashing out at ASEAN and Thailand.

<sup>7</sup> See Analysis by Colin Budd: The EU experience of the process of economic integration: successes, failures and challenges, LSE IDEAS workshop, Kuala Lumpur, 28-29 April 2009

<sup>8</sup> See Analysis by Professor Shaobang Kang, ASEAN in Asia Economic Integration, LSE IDEAS workshop, Kuala Lumpur, 28-29 April 2009. The Central Party School was instrumental for the conceptual policy plank of "peaceful rise" and then "peaceful development" (Discussion with Kang in Beijing, 5 December 2008)

<sup>9</sup> See article by Professor Yu Qiao, Tsinghua University, Beijing in the Financial Times, 1 April, 2009. Also Zhou Xiaochuan, Reform of the International Monetary System, www.pbc.gov.cn/english

has recently reported that Indonesia will be among the ten largest economies in the world by 2050.

Although not directly from the government, Indonesia has been asking questions of whether ASEAN can measure up in the new and dynamic developments in the global political economy.<sup>10</sup> Indonesia, sometimes identified as a laggard in ASEAN economic integration efforts, has some clear views on how the regional grouping should progress – across all three fronts of the pillars of the community.<sup>11</sup>

All these developments and moves by significant actors on the international stage at a time of turmoil and change call for a positive response from ASEAN, both in terms of engagement and organisational linkage, as well as by investment of intellectual capital in the ideas to form the management of the global political economy. In his closing speech at the workshop, Kishore Mahbubani expressed his full confidence that ASEAN would find the sweet spot in the new, what I would term, Asia-centric world. But that does not come without trying to get that best possible place.

From the papers that were presented, speeches and interventions that were made, and the extensive discussions that took place at the workshop, it was clear there are different perspectives on the rate of progress, challenges and prospects. The greater weight of opinion was on the side of disappointment and pessimism, although there was a strong view among the more influential that the pessimism was overdone and that there was sufficient political will and an overwhelming shift in the strategic economic balance towards the Asia-Pacific from which the ASEAN economic entity may benefit. ■

<sup>10</sup> See Jusuf Wanandi, Remodelling regional architecture, PacNet Newsletter, February 19, 2009

<sup>11</sup> Interview with Hassan Wirayuda, Foreign Minister of the Republic of Indonesia, 26 March 2008, Jakarta

# Enhancing **Competitiveness** through Regional Integration

By **Dr. Surin Pitsuwan** ASEAN Secretary-General



It is an honour to be with you today at this “High-Level London School of Economics and Political Science (LSE) ASEAN Integration Workshop,” and to share my views on regional economic integration amid the crisis. Before I begin, let me take this opportunity to thank LSE IDEAS (Centre for International Affairs, Diplomacy and Grand Strategy) for organising this workshop, and for giving high importance to ASEAN economic integration.

Since the ASEAN Charter came into force in December 2008, our efforts toward community building have never been the same again. The Charter has strengthened our resolve to put our act together toward deeper integration and to bring into reality the goals of a single market and free movement of goods and labour, and freer flow of capital. Along with that are the real benefits to be had from the internal and intra-regional aspects of our integration – that is, greater efficiency in consumption, and more competition and improved scale of economies in production.

Yet, the events over the past year – the global financial crisis and synchronised global downturn – have also reminded us how the current conditions can pose serious challenge to global integration. Some evidence suggests that since the start of the crisis, tariffs have increased in several countries around the world, while financial protectionism has also started to emerge in some countries. At a regional level, there is a perception that these risks might increase as well, thus undermining the drivers of integration that are behind our region in recent years. This is the reason why the ASEAN Leaders at their meeting in February in Hua Hin have reaffirmed their commitment to ASEAN economic integration and community building as part of our response to the crisis.

Taking this challenging context as a starting point let me emphasise at the outset that regional integration can be an important strategy to help the region overcome the crisis.

One important lesson of the current crisis and that of the Asian crisis ten years ago is that any recovery can be achieved quickly through strategies that harness synergies within the region. I see those synergies in terms of shifting our demand away from exports to advanced countries in favour of intra-regional trade. Evidence suggests how intra-regional trade has facilitated the quick recovery of the region during that time. In fact, Asia is becoming more important as a recipient region for ASEAN+3 exports from 34% in 1987 to 50% in 2007. The share of exports of ASEAN economies from China, Japan and Korea also increased over the years, from 7.8% in 1987 to 13% in 2007.

I always see economic integration as a way of boosting competitiveness within ASEAN, especially now that we are being challenged by the crisis. Integration will not only increase the efficiency of production and consumption, but will also expand the economies of scale and accelerate investments in physical capital, technology, and people – key elements that we need to get our economies out of the doldrums.

In the case of ASEAN, some large strides have also been made over the years to preserve our competitive advantage, since the ASEAN Free Trade Agreement in 1992 and the adoption of ASEAN Economic Community Blueprint in 2007. In addition to liberalisation of trade in goods, trade in services and investment have been further liberalised. For example, our current commitments to services liberalisation are now based on increasing removal of restrictions on cross-border trade and greater purchases of services from abroad. A comprehensive investment agreement is also now in place, with benefits extended to foreign-owned but ASEAN-based investors, not to mention the creation of a more liberal and facilitative environment in the region for doing business and investing capital.

To ensure that ASEAN builds the “right market”, product and regulatory standards, financing systems, logistics and transport facilitation, and a wide range of business procedures have been constantly improved. The establishment of ASEAN Single Window, which increases the efficiency of customs procedures and promotion of trade facilitation in the region, is already being tested in a number of countries. Significant improvements in standards to harmonise them with the region’s trade partners are being implemented as well, such as the ASEAN Guideline on Good Regulatory Practice. In the area of finance, efforts are underway to liberalise financial services and capital account and develop capital markets in order to ensure that financial flows remain supportive of increased trade flows under a single market.

Engagement with other countries is also a key element of ASEAN’s competitive strength. Recognising that the integrated production network and market that

ASEAN develops will need to be closely linked to the region’s trading markets, the region has engaged actively with other countries through the free trade agreements. By leveraging on other countries’ strengths and open markets, ASEAN believes that such productive engagement will lead to a strong competitive position for ASEAN economies. For example, new regional agreements with China (on investment) and India (on goods) will soon to be signed, indicating ASEAN’s continued strategy of maximizing its presence in other markets in the world.

Let me now focus on what I think are the key challenges going forward as the region continues to navigate the financial storms. As I mentioned at the outset, the economic and financial turmoil engulfing the world today marks the first crisis of the current era of globalization. To be sure, the crisis will reshape the global economy and the economic forces at play – and it is for this reason that ASEAN should stand ready to remain competitive amid these challenges.

So what exactly should ASEAN and the individual countries do?

First, it is critical that ASEAN continues to adhere to trade integration. Actions that can make the crisis and the contagion worse should be avoided, including any barriers that support protectionism such as tariffs and subsidies. In this regard, ASEAN Member States must remain committed to implement rescue and support measures that are acceptable and which will not directly or indirectly undermine trade and financial flows in the region.

Thus, enlarging the US\$400 billion intra-trade in ASEAN must be further pursued through comprehensive trade facilitation measures, including access to much needed trade financing in the region. ASEAN economies with their burgeoning middle class must begin to see each other as end-markets rather than only primarily as links in the global supply chains. It’s about time that a strong middle class is created to enable the region to strengthen domestic demand that is crucial to sustaining ASEAN’s economic

growth and increasing the region’s resilience against external shocks.

Second, given the importance of stimulus programmes to stimulate recovery in the region, it is important that those programmes be designed in such a way that they support integration rather than undermine it. Stimulus packages by themselves are not just mere increasing spending but need to be targeted at increasing competitiveness of ASEAN economies. This crisis represents an opportunity to boost efficiency and competitiveness when the will to do so is at its highest. For example, ASEAN must focus on infrastructure financing in the region as a way forward to boost domestic spending which is critical to gradual recovery. The region’s huge infrastructure needs and growing consumer market of US\$330 billion offer ample investment opportunities for ASEAN capital. In fact, three weeks ago in Pattaya, the World Bank and ASEAN have announced their partnership that will increase infrastructure financing in the region starting this year.

Finally, given the global nature of the crisis, what ASEAN needs is a collective response to ensure that the impact of the crisis in the region will be broadly contained and adjustments are well coordinated to facilitate gradual recovery.

Perhaps of particular relevance to preserving the region’s integration efforts is the avoidance of exchange rate policies that trigger external instability. For example, “beggar-thy-neighbour” exchange rate policies must be avoided. Beyond the crisis and once the global financial stability is restored, it is possible that ASEAN countries will begin to attract large capital inflows once again. In this regard, greater exchange rate flexibility must continuously be encouraged to avoid distortions in trade and capital flows that are critical in our market integration. This is in addition to other financial measures currently being discussed such as the Multilateral Chiang Mai Initiative (CMIM) to restore financial stability in ASEAN.

With these remarks, let me thank you again for your attention and I wish your Workshop a great success. ■

# Achieving the **ASEAN Economic Community** Agenda: an Indonesian Perspective

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## INTRODUCTION

**Regional integration is a major agenda that ASEAN currently pursues for its ten members. It is the ASEAN Vision 2020 that envisages an integrated Southeast Asian region with equitable economic development and reduced socio-economic disparities. In respect to economic integration, the Hanoi Action Plan in 1998 stated the Vision more clearly by declaring an intention to create a prosperous and highly competitive ASEAN region in which there is free flow of goods, services, and capital.** This was further

expanded in the 2003 Declaration of ASEAN Concord II, by establishment of the ASEAN Economic Community into “a single market and production base, turning the diversity that characterises the region into opportunities for business complementation making the ASEAN a more dynamic and stronger segment of the global supply chain”. The original target for the AEC was 2020, but it has been revised to 2015.

The literature suggests a number of important factors for the process towards an integrated ASEAN economy. According to Soesastro (2005), one of these is the state of development of the ASEAN member countries, which applies not only for the dichotomy between the ASEAN-6 and CLMV (i.e., the newer ASEAN member countries), but also within the ASEAN-6 members. This paper addresses this subject from the perspective of Indonesia. Here, we put a proposition that the AEC agenda, furthering economic integration in the Southeast Asia region – as well as in the wider regional perspective of East Asia – is important not only for the region, but also for any ASEAN member country.

This paper tests this proposition by discussing two economic-development topics that are pertinent to Indonesia, namely industrialisation and income inequality. It also attempts to derive some stylised facts which enable one to – at least – determine the likely answer for the test of the proposition. In doing so, we elaborate on the extent of the gap of development in respect of the two topics mentioned earlier.<sup>1</sup> Thus, the next two sections discuss the challenge faced by Indonesia in terms of industrialisation and income inequality, respectively.

<sup>1</sup> This forms the major part of this paper

## CHALLENGES FACED BY INDUSTRIALISATION IN INDONESIA

Indonesia has enjoyed rapid industrialisation in the past two decades or so. As noted in Table 1, this is reflected by the rapid increase in the share of the country's manufacturing sector over the period 1985-2004. In the early phases of industrialisation, much of the rapid growth came from the labor-intensive and resource-intensive sectors, such as textiles-garments and wood sector. Over time, however, the importance of this sector declined, and the technology- and capital-intensive sectors started to contribute more to overall manufacturing growth. All these are illustrated in Table 2 where, on the one hand, the share of the wood sector had declined in the past two decades but, on the other hand, the share of heavy processing and metal goods industry increased.

**Table 1. Output share of Indonesia and the other ASEAN countries (in%) 1985 - 2004**

Country	Sector	1985	1990	1995	2000	2004
Indonesia	Agriculture	23.2	19.4	17.1	15.6	14.6
	Manufacturing	35.8	39.1	41.8	45.9	44.0
	Services	40.9	41.5	41.1	38.5	41.4
Brunei Darussalam	Agriculture	2.2	2.4	2.5	2.7	3.6
	Manufacturing	52.3	54.8	43.9	47.8	49.2
	Services	45.5	42.8	53.5	49.5	47.2
Malaysia	Agriculture	20.0	15.0	12.7	8.4	9.1
	Manufacturing	38.5	41.5	40.5	48.4	48.5
	Services	42.7	43.5	46.8	43.1	42.4
Philippines	Agriculture	24.6	21.9	21.6	15.8	15.2
	Manufacturing	35.1	34.5	32.1	32.3	31.9
	Services	40.4	43.6	46.3	52.0	52.9
Singapore	Agriculture	1.0	0.4	0.2	0.1	0.1
	Manufacturing	34.5	32.5	32.9	33.5	32.4
	Services	68.8	67.2	66.9	66.4	67.5
Thailand	Agriculture	15.8	12.5	9.5	9.0	10.1
	Manufacturing	31.8	37.2	40.8	42.0	43.5
	Services	52.3	50.3	49.8	49.0	46.4
Cambodia	Agriculture	44.7	55.6	49.6	37.9	32.9
	Manufacturing	20.3	11.2	14.8	23.0	29.2
	Services	35.0	33.2	35.5	39.1	37.9
Lao PDR	Agriculture	53.9	61.2	55.2	52.6	47.0
	Manufacturing	17.7	14.5	19.1	22.9	27.3
	Services	28.4	24.3	25.7	24.6	25.7
Myanmar	Agriculture	48.2	57.3	60.0	57.2	50.6
	Manufacturing	13.1	10.5	9.9	9.7	14.3
	Services	38.7	32.2	30.1	33.1	35.1
Brunei Darussalam	Agriculture	40.2	38.7	27.2	24.5	21.8
	Manufacturing	27.4	22.7	28.8	36.7	40.2
	Services	32.5	38.6	44.4	38.7	38.0

Source: Compiled from ADB Statistics and CEIC Data base

**Table 2. Output share of manufacturing sector by broad industry groups, Indonesia and the other ASEAN countries (in %), 1985-2004**

Country	Industry	ISIC*	1990	1995	2000	2004
Indonesia	Food processing	31	27.5	22.3	20.1	na
	Footloose labour intensive	(32+39)	15.1	18.6	18.1	na
	Wood & paper products	(33+34)	15.6	13.0	13.3	na
	Heavy processing	(35+36)	18.1	16.7	20.0	na
	Metal goods	(37+38)	23.8	29.4	28.5	na
Thailand	Food processing	31	21.7	17.1	17.0	19.9
	Footloose labour intensive	(32+39)	27.9	19.6	17.9	16.4
	Wood & paper products	(33+34)	4.5	11.7	10.5	10.9
	Heavy processing	(35+36)	17.5	14.8	17.4	19.5
	Metal goods	(37+38)	28.4	36.9	37.1	33.3
Singapore	Food processing	31	3.7	3.1	2.5	3.1
	Footloose labour intensive	(32+39)	5.1	2.3	1.9	4.2
	Wood & paper products	(33+34)	6.2	6.5	4.9	4.2
	Heavy processing	(35+36)	23.1	19.1	22.6	22.5
	Metal goods	(37+38)	61.9	69.0	68.1	68.2
Malaysia	Food processing	31	13.4	11.3	6.3	8.1
	Footloose labour intensive	(32+39)	7.9	6.4	4.8	3.6
	Wood & paper products	(33+34)	10.2	10.1	7.4	5.5
	Heavy processing	(35+36)	25.3	25.6	26.2	29.8
	Metal goods	(37+38)	43.3	46.7	55.3	53.0
Philippines	Food processing	31	49.4	47.3	49.1	51.6
	Footloose labour intensive	(32+39)	11.7	11.7	10.0	9.1
	Wood & paper products	(33+34)	6.1	5.0	4.2	3.7
	Heavy processing	(35+36)	21.5	21.5	19.4	16.9
	Metal goods	(37+38)	11.3	14.5	17.2	18.7
Cambodia	Food processing	31	na	44.8	19.9	13.6
	Footloose labour intensive	(32+39)	na	30.8	67.3	77.4
	Wood & paper products	(33+34)	na	14.1	5.9	2.9
	Heavy processing	(35+36)	na	8.7	5.8	5.0
	Metal goods	(37+38)	na	1.6	1.1	1.1
Philippines	Food processing	31	na	35.9	33.5	25.8
	Footloose labour intensive	(32+39)	na	16.3	15.7	14.7
	Wood & paper products	(33+34)	na	11.3	9.0	10.7
	Heavy processing	(35+36)	na	19.2	18.9	18.9
	Metal goods	(37+38)	na	17.3	22.9	29.9

Note: n.a = not available \* Based on ISIC Revision 2  
Source: CEIC Database

According to Hill (1996), the pattern shown by Table 2 reflects both changes in industrial policy in Indonesia over the period and the natural stages of industrialisation. In the early export-promotion phase, countries tend to promote manufacturing products that they have some comparative advantage in,<sup>2</sup> but as these countries acquired more advanced technology, production activities move towards a higher level of product sophistication. Meanwhile, the rapid industrialisation in Indonesia was triggered by bold trade and industrial policy reforms put in place from the mid-1980s through to the first half of the 1990s.

The rapid industrialisation that occurred in Indonesia, however, does not seem so exceptional if one compares the Indonesian experience with the experience of other ASEAN countries. Examining Table 1 more carefully, there seems to have been some ‘catching-up’ of industrialisation in Vietnam, Cambodia, and Lao PDR. In addition to this, and perhaps more importantly, Indonesia seems to have lagged behind the other older ASEAN member countries, particularly Thailand and Malaysia, in developing technology intensive industries. The share of output of metal goods industries in the total manufacturing output is much lower for Indonesia, compared to Malaysia and Thailand. The gap is particularly large between Indonesia and Malaysia where the share of the industry in Malaysian manufacturing was almost twice that of Indonesian manufacturing.

<sup>2</sup> See, for example, Ng and Yeats (2003), Kimura and Ando (2005a; 2005b), Ando (2006), and Athukorala and Yamashita (2006) for empirical studies highlighting the increasingly importance of IPNs in East Asia. All these studies employed international-trade data or firm-level data to derive some findings of the occurrence of IPN.

One possible reason for the lag experienced by Indonesian manufacturing is the inability of the country's manufacturing sector to adjust to the increased importance of international production networks in the East Asian region. It is a stylised fact that production of final-products of some technology and capital-intensive products has been facilitated by cross-border production networks.

Tables 3 and 4 provide some support for the reasoning. Table 3 produces a key point that the industrialisation in Indonesia still relies much on labour- and resource-intensive sectors, despite their declining importance within the country's manufacturing output, and this is compared to the general situation in the other ASEAN countries. The table, which reports the share of manufacturing exports by factor intensity in Indonesia and some other ASEAN countries, shows the share of unskilled labour intensive (ULI) group in Indonesia's export is still rather large compared to its share in the other ASEAN countries. Although this has been declining, the share of ULI group for Indonesian exports was only slightly below 50 per cent of the total Indonesian manufacturing exports in 2005. Meanwhile, the share for the other ASEAN countries was much less than 50 per cent, although it varies from country to country (i.e. about 20 per cent or below). The data also supports the proposition by showing the slow rate of the reduction in the share of ULI group. This is clearly illustrated when one compares the trend of the ULI share of Indonesia with the Philippines or Thailand. The share of exports in the ULI group in these countries declined substantially from about 50 per cent in 1990 to slightly above 20 per cent in 2005.

**Table 3. Share of manufacturing exports of Indonesia and the other ASEAN countries (in%), 1990 - 2005**

Product Group and Country	Description	1990	1995	2000	2005
<b>Indonesia</b>					
ARI	Agriculture Resource Intensive	34.3	22.1	11.0	8.1
MRI	Mineral Resource Intensive	1.9	0.8	1.5	1.4
ULI	Unskilled Labour Intensive	49.7	54.1	50.8	47.5
HCI	Human Capital Intensive	9.1	14.1	20.5	22.4
TI	Technology Intensive	5.1	8.6	16.1	20.7
TOTAL		100	100	100	100
<b>Malaysia</b>					
ARI	Agriculture Resource Intensive	4.0	5.2	3.3	2.9
MRI	Mineral Resource Intensive	2.4	1.5	0.7	0.6
ULI	Unskilled Labour Intensive	25.6	21.0	19.8	18.2
HCI	Human Capital Intensive	20.6	19.8	20.6	22.2
TI	Technology Intensive	47.5	52.5	55.5	56.0
TOTAL		100	100	100	100
<b>Philippines</b>					
ARI	Agriculture Resource Intensive	6.5	2.4	0.8	0.6
MRI	Mineral Resource Intensive	1.6	0.6	0.3	0.4
ULI	Unskilled Labour Intensive	52.8	42.1	18.2	23.5
HCI	Human Capital Intensive	12.9	16.7	8.5	11.8
TI	Technology Intensive	26.2	38.2	72.2	63.7
TOTAL		100	100	100	100
<b>Singapore</b>					
ARI	Agriculture Resource Intensive	1.4	0.6	0.3	0.2
MRI	Mineral Resource Intensive	0.8	0.6	0.3	1.3
ULI	Unskilled Labour Intensive	24.6	16.6	13.8	11.4
HCI	Human Capital Intensive	26.7	25.3	16.4	19.0
TI	Technology Intensive	46.5	57.0	69.2	68.2
TOTAL		100	100	100	100
<b>Thailand</b>					
ARI	Agriculture Resource Intensive	3.3	2.4	2.1	1.4
MRI	Mineral Resource Intensive	7.9	4.6	3.0	3.0
ULI	Unskilled Labour Intensive	54.3	47.4	31.7	25.8
HCI	Human Capital Intensive	20.0	21.4	26.3	34.7
TI	Technology Intensive	14.4	24.2	36.9	35.2
TOTAL		100	100	100	100

Source: UN Comtrade data base

**Table 4. Trade in parts and components of some ASEAN countries, 1992-2003**

EXPORT									
Country	Value of parts & components exports (US\$ billion)			Share of parts and components exports in total manufacturing exports (%)			Growth of parts and components exports (%)	Growth of manufacturing exports (%)	Contribution of parts and components in growth of manufacturing exports (%)
	1992	1996	2003	1992	1996	2003	1992-2003	1992-2003	1992-2003
Indonesia	0.6	1.7	4.3	3.7	7.4	13.9	8.3	2.7	24.5
Malaysia	10.0	23.5	33.9	38.7	42.6	42.7	4.9	4.5	44.6
Philippines	0.8	8.8	20.7	19.8	52.5	63.8	13.7	8.6	70.0
Singapore	13.0	39.4	56.5	27.0	39.7	46.7	6.0	3.7	59.8
Thailand	4.1	9.5	15.8	19.1	23.4	26.7	5.4	4.1	31.0

IMPORT									
Country	Value of parts & components imports (US\$ billion)			Share of parts and components imports in total manufacturing imports (%)			Growth of parts and components imports (%)	Growth of manufacturing imports (%)	Contribution of parts and components in growth of manufacturing imports (%)
	1992	1996	2003	1992	1996	2003	1992-2003	1992-2003	1992-2003
Indonesia	3.6	6.7	3.1	18.5	23.8	18.5	-0.5	-0.5	18.5
Malaysia	11.0	27.1	36.5	35.2	47.5	55.7	4.9	3.0	74.4
Philippines	1.9	10.9	19.1	24.8	43.6	63.1	9.4	5.5	76.5
Singapore	16.0	50.3	49.6	30.0	42.8	49.2	4.6	2.6	70.8
Thailand	6.8	20.9	17.2	24.7	32.9	32.5	3.7	2.6	41.0

Source: UN Comtrade Database, taken from Athukorala and Yamashita (2005)

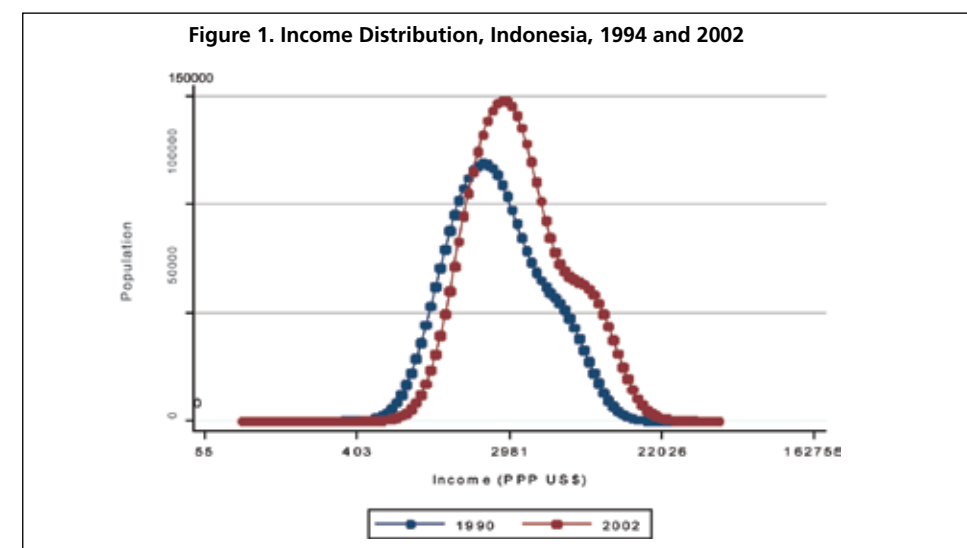
Another set of evidence is provided by Table 4, which shows a wide gap in the importance of parts and components trade between Indonesia and the other ASEAN countries. The table shows that the share of the parts and components trade is substantially lower for Indonesia compared to that of the other ASEAN countries. Here, the growth of imports, for example, was negative for Indonesia over the period 1992-2003, and a similar picture can also be drawn for the export side. These statistics indicate that compared to the other ASEAN countries Indonesia has not been developing its parts and components industry.

## INCOME INEQUALITY IN INDONESIA

There is a consensus among economists that poverty reduction is strongly associated with economic growth. However, several studies on poverty in East Asia or Southeast Asia show rather mixed conclusions – although some key points remain regarding the link between significant poverty reduction and sustained economic growth (e.g. Warr 2006; Jomo 2006). One of the key issues in this subject is the trade-off between inequality and economic development. Rapid economic development, although it improves country-level development in general, does not always go hand-in-hand with improvement in income equality.

As for Indonesia, however, the trade-off between inequality and economic development does not seem to be a major one. This is illustrated in Figure 1, which compares the income distribution in Indonesia between 1994 and 2002. A striking feature of the figure is that income growth which occurred between 1994 and 2002 was not marked by significant inequality. Nonetheless by 2002, the income of the rich group grew faster than other income groups and it led to rather unequal income distribution in 2002. This may be caused by the impact of the 1998 economic crisis whose consequence ran into the 2000s. The message of this figure is straightforward: while the economy experienced stagnation in 2000-2002, only the rich

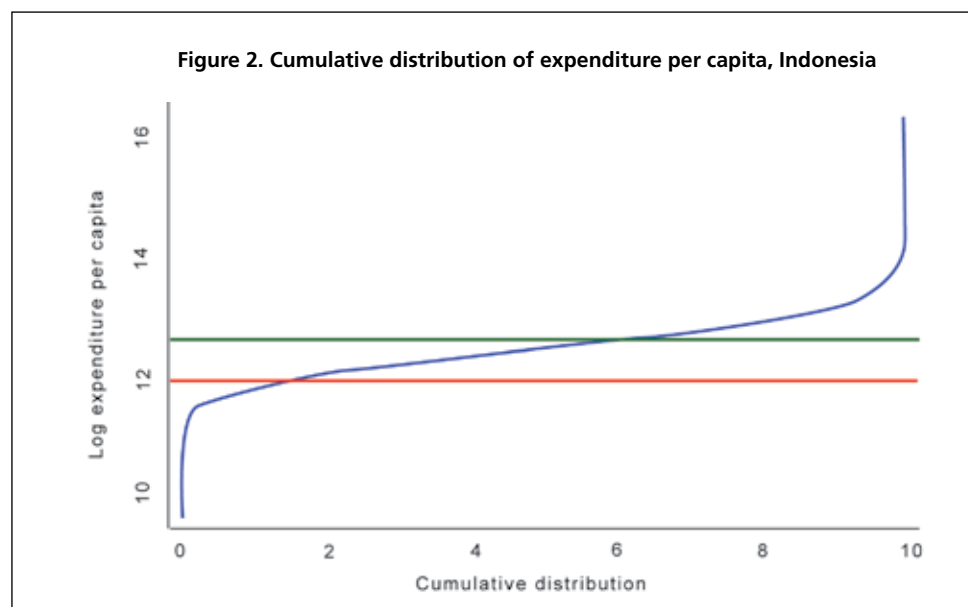
reaped the benefit of economic development. Cameron found that the 1998 economic crisis resulted in less inequality as urban people were hard hit by economic crisis and this narrowed the income gap between urban and rural. However, Cameron concluded that the evolution of income distribution in Indonesia has marked the success of equitable economic development. One reason is that industrial centres happened to be close to rural Java where many poorest families live (Cameron 2002) and industrialisation grew rapidly due to strong policy of openness.



According to a recent estimate, the poverty rate in 2007 was 16.6 percent, down from around 17.5 percent in 1996.<sup>3</sup> In 2007 the level of absolute poverty, measured by those living below PPP \$1 a day was 10.4 percent, or around 23.4 million.

However, when measured by those living under \$2 a day, the number jumps significantly to 133.6 million or around 59.3 percent of the total population (Figure 2 is drawn from Susenas data in 2007, a period of robust economic growth after sluggish growth between 2000 and 2004). We witness that a doubling in the poverty line results in an almost five-fold increase in the proportion of poor people. These figures suggest that a large number of Indonesians are living at or near the poverty line and are highly susceptible to adverse economic shocks.

Most of the poor in Indonesia live in the rural area where one in every two households is poor. They are likely to be peasants, i.e., those who engage in low-paid agricultural sector jobs or small land holders. In addition, there are the urban poor whose number is smaller than the rural poor but, because of migration, is rapidly increasing. They are likely to be working in the informal sector or doing low-paid, menial jobs in the formal sector. An adverse economic shock is likely to affect different economic sectors differently. The 1997/98 economic crisis, for example, had a greater adverse impact on the manufacturing, construction and financial sectors than on the agricultural sector. As a result, poverty incidence tended to increase more in the urban area than in the rural area. Nevertheless, the crisis might also have caused reverse migration from the urban area to the rural area. PPP US\$ 1/day PPP US\$ 2/day 59.3% below PPP US\$ 2/day 10.4% below PPP US\$ 1/day.



Source: Atje, Soesastro and Wicaksono 2009

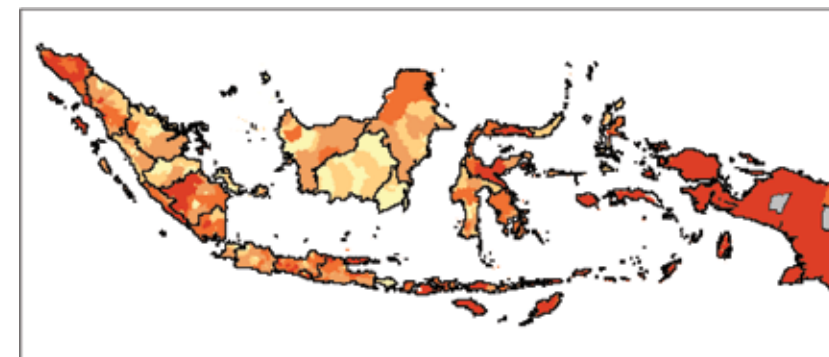
## GEOGRAPHIC DISTRIBUTION OF THE POOR

Poverty in Indonesia has a very strong geographical characteristic. Some of the remote regions such as Papua, Maluku, East Nusa Tenggara, Gorontalo and Aceh have higher poverty rates than the rest of the country. In these regions the poor households ranged between 20 and 41 percent of total households. The fact that these are remote regions suggests that their problem may be associated with the lack of access to markets, resources and various services.

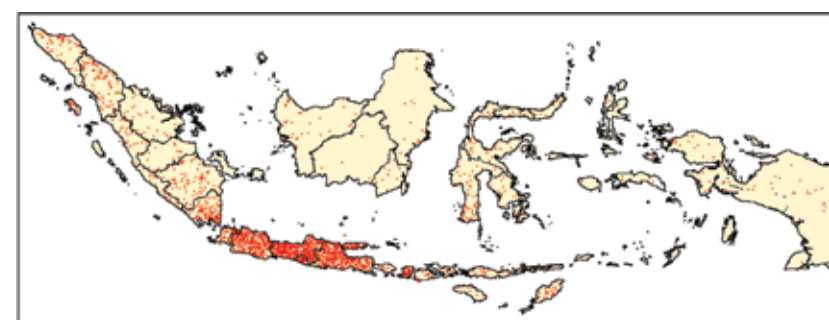
Yet, the concentration of poor people in Java and Madura, where most of the Indonesians live, is much higher. The majority of poor people live on these two islands. A closer look at the concentration of poor people in Java and Madura shows that some of the districts in these two islands have average numbers of poor people similar to those of the remote areas mentioned above. It should be noted that the geographical characteristic of poverty in Indonesia has not changed significantly over the decades. That is, while the number of poor people has dropped significantly, their geographical dispersion remains the same.

Map 1 illustrates that poverty rates are high in lagging areas, (i.e. Eastern part of Indonesia and Aceh) which are sparsely populated, particularly in Papua. However, from Map 2, one can clearly visualize that the poor are mainly concentrated in Java and Madura - two islands with high population density. These geographical and demographic differences, moreover, suggest that different poverty reduction strategies may be necessary to cope with the challenges. The overall policy should be to connect lagging areas in the Eastern part of Indonesia to the Western part of Indonesia. This can be achieved through improving hubs and transportation modes that allow people and goods to move freely between these regions.

Map 1. Poverty rate is high in Eastern Part of Indonesia and Aceh



Map 2. But the poor is concentrated in Java and Sumatera



Source: Atje, Soesastro and Wicaksono 2009 - 12

## WHAT HAS BEEN INDONESIA'S RESPONSE SO FAR?

This brief description of two development topics highlights the point that Indonesia, despite its rapid economic development in the past two or three decades, still lags behind other neighbouring countries in its economic development. This creates a credible justification of having an integrated relationship of the Indonesian economy with the regional economy that surrounds it, and this can arguably be achieved by fulfilling the AEC agenda. In terms of industrialisation, it is clear that through meeting the AEC objective, Indonesia would likely benefit substantially by integrating its industrial sectors with the existing international production networks in the region.

Meanwhile, in terms of reducing poverty, the AEC agenda could help make income distribution more equally distributed in Indonesia. As for this, the reasoning is also clear that economic integration and openness policies should help the poor to more effectively utilise the fruits of economic development. This is because most of the poor were born into poverty from which they have difficulty escaping, and they remain poor because they are unable to participate in productive economic activities. There are a number of factors that may prevent them from engaging in such activities. First, they lack access to markets and basic infrastructure, such as roads, which is one reason why remote regions have a high percentage of poor households. Second, they lack

access to resources, including financial resources. This prevents them from starting their own business. Third, they lack necessary education to enable them to participate in relatively high paid jobs in the formal sector.

What has been the response of Indonesia, so far, in its attempt to reach the objective of AEC? While it is clear that more needs to be done, there are some credible signals of a seriousness of the Indonesian government to meet the AEC objective. This is illustrated, for example, by the inclusion of some AEC commitments in a formal government policy (i.e., one of the most recent presidential instructions – the Indonesian Presidential Instruction No. 5/2008). The Presidential Instruction outlines, for example, many detailed plans of domestic policy objectives for removing trade barriers, both in terms of tariff and non-tariff barriers, and simplifying the AFTA's CEPT Rule of Origins. In addition to these, the Indonesian government launched, at the end of 2008, the National Logistics Blueprint, which aims to improve the logistics sector in the country. It is well noted that the country's logistics infrastructure and services also lag behind the other ASEAN countries, and this constrains Indonesian economic development and poverty alleviation. The Blueprint is consistent with the AEC agenda because, among other things, it plans to improve the services of the Indonesian logistics services providers (LSPs) industries. ■

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# ASEAN Capital Market Integration Issues and Challenges

By **Datuk Ranjit Ajit Singh** Managing Director, Securities Commission of Malaysia

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## INTRODUCTION

In early April 2008, the ASEAN Finance Ministers (AFM) at a meeting in Danang, Vietnam endorsed several proposals made by the region's capital market regulators through the ASEAN Capital Market Forum (ACMF) towards integration of ASEAN capital markets. Among the key proposals was an agreement to develop an "Implementation Plan to promote the Development of an Integrated Capital Market to achieve the objectives of the ASEAN Economic Community Blueprint 2015" ("Implementation Plan 2015"). It was agreed that a Group of Experts would be established to assist in drafting the implementation plan together with the assistance of the Asian Development Bank (ADB). With the following year's ASEAN Finance Ministers' Meeting set as the timeframe to present the Plan to the Finance Ministers for their consideration, the demands for an all encompassing implementation plan was indeed a challenge – particularly given that such aspirations had been in the pipeline since the last financial crisis over a decade ago.

This objective of developing a plan became a reality when the Implementation Plan 2015 was presented to, and endorsed by the ASEAN Finance Ministers at the 13<sup>th</sup> AFM held in Pattaya, Thailand on 9<sup>th</sup> April 2009.

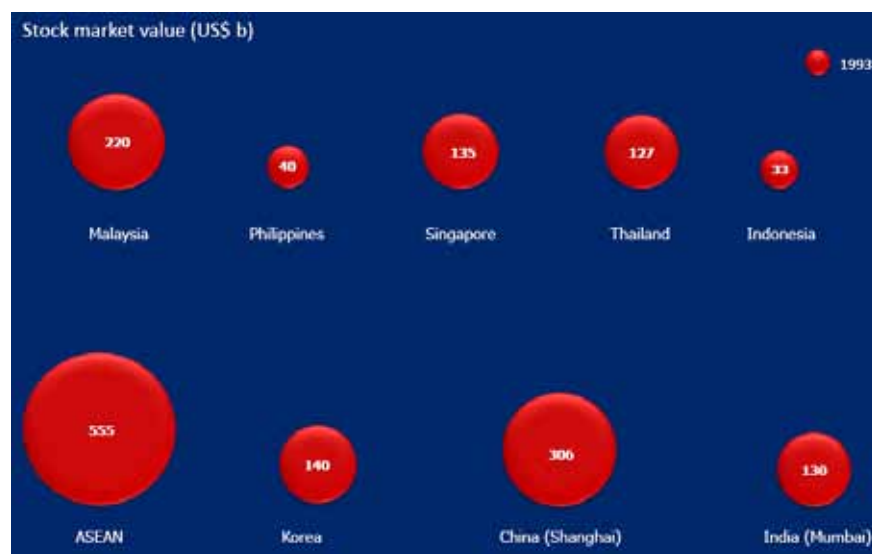
The AEC Blueprint 2015 pertaining to capital markets is intended to achieve significant progress in building a regionally integrated market, where it will enable capital to move freely within the ASEAN region, with issuers free to raise capital in different ASEAN markets and investors able to invest freely across markets. It was hoped that through the integration efforts, anyone would be able to trade in ASEAN capital market products freely in any ASEAN market at a competitive fee from a single access point, with capital market intermediaries providing services throughout ASEAN based on home country approval.

This paper provides some perspectives on the formulation and contents of the Implementation Plan 2015 and the core strategies. The paper also attempts to provide some of the background and rationale that drove the efforts and the catalytic role played by events post Asian Financial Crisis in driving efforts towards the development of the region's capital markets and consequently the integration agenda. Finally the paper concludes with an outline of the some the issues and challenges that need to be addressed in the implementation efforts.

## THE ASIAN ECONOMY - FROM MIRACLE TO CRISIS...AND BACK

In the early 1990s, Asia was undergoing a period of gradual liberalisation and transformation. Riding on a wave of strong economic growth and increasing investment flows, many countries in Asia were seen as the hotspots for trade and investments. The increasing consumer base, large infrastructure-financing needs and the massive savings pools within Asia provided the perfect confluence of factors that characterized what was being described as the Asian miracle. Within Asia, ASEAN countries, such as Singapore, Thailand, Malaysia and to some extent Indonesia, whose economies were export driven, recorded GDP growth rates well above 7% joining the likes of Taiwan, Hong Kong and Korea as the new emerging tigers. Capital markets and in particular stock markets were a direct beneficiary. Markets rallied on the back of massive capital inflows and domestic investments and the market capitalisation of the ASEAN exchanges grew to a level of USD 555 billion (see Figure 1).

**Figure 1. Market capitalisation (stock market value) of selected Asian countries in 1993**



Source: World Federation of Exchanges

Unfortunately, around early 1997 cracks began to appear and the miracle gradually seemed to turn into a mirage. Distortions in the way in which the economies were operating, under-developed financial systems and a corporate sector with weak balance sheets in an environment of excessive capital flows led to the inevitable bursting of the asset price bubbles, falls in currency values and a severe economic downturn. The Asian Financial Crisis as the events of 1997 and 1998 came to be known was underway and it took a devastating toll on many of the countries that were severely affected, including several within the ASEAN region.

There have been numerous studies on the Asian Financial Crisis including its causes and effects and this paper does not intend to go into these areas. However, there are several key points related to the subject matter of this analysis worth noting, in relation to identifying core weaknesses and areas for strengthening the region's capital markets.

Firstly, many of the countries in the region had serious corporate governance issues, which required comprehensive reforms at many levels. Support from the government, corporate sector, industry and regulators were crucial in developing a comprehensive framework to enhance corporate governance standards.

These corporate governance reforms were wide-ranging and enhancements were made by introducing codes of corporate governance, increasing levels of transparency and disclosures and addressing gaps in financial reporting. Improvements in data dissemination and steps to increase transparency of policies could help markets address risk pricing, inhibit the build-up of imbalances and allow policymakers to take timely action to address vulnerabilities. There were also weaknesses in oversight and regulatory arrangements that needed to be addressed, which resulted in the relevant regulatory bodies being further equipped with the requisite powers and resources to effectively regulate the markets. Several major legislative amendments were promulgated to strengthen enforcement powers.

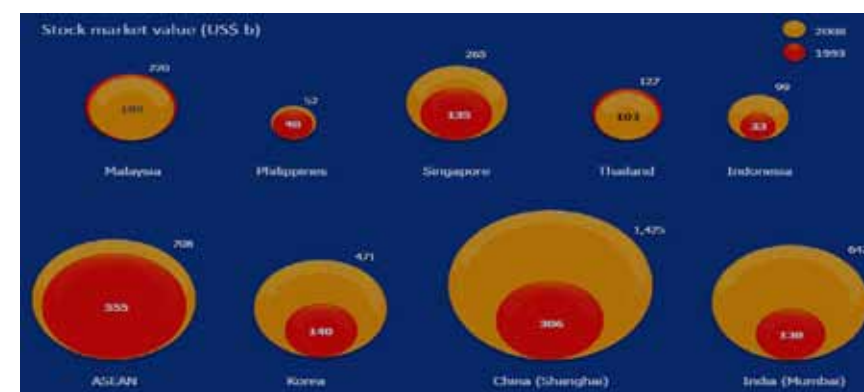
There was also a need to focus on effective diversification of sources of financing and reduce dependency on the banking system, principally by addressing maturity mis-match issues between the sources of financing and the tenure of the projects being financed, particularly for infrastructure projects. This drove efforts towards developing domestic bond markets and led to strong growth in bond markets among some of the Asian countries. There was also substantial consolidation and strengthening of domestic capital market intermediaries to better withstand challenges and shocks as well as initiatives to strengthen market institutions and also address

risk management and prudential standards. To enhance the resilience of the financial system the supervisory framework over banks and non-bank financial intermediaries was strengthened.

There was also significant debate around the issue of capital account liberalisation with contrasting views ranging from concern about the liberalisation to the adoption of still freer policies. This issue still dominates discussions on integration. Overall strategy as far as market development is concerned has been to create a stronger and more stable macroeconomic environment, strengthen oversight arrangements and adopt a more pragmatic and sequenced approach to deregulation and liberalisation. At the same time, structural reforms have been pursued with a long term view encompassing financial and corporate reforms as well as social and macroeconomic reforms.

In many ways, these enhancements and addressing the weaknesses noted from the Asian Financial Crisis provided a certain degree of resilience for the ASEAN countries when the Global Financial Crisis of 2008 hit the developed markets. The impact on the financial system of the countries within the region was fairly contained. The markets did not witness the same degree of displacements that had occurred in other global markets. But clearly the economic consequence of the global slowdown was felt in these markets.

**Figure 2: Over the years, Asian countries have shown tremendous growth as reflected by their market capitalisation.**



Source: World Federation of Exchanges

## THE CASE FOR INTEGRATION

In the case of ASEAN, although significant efforts were made towards addressing weaknesses in several areas within the economy and financial markets, the phenomenal growth rates of China and India completely changed the competitive landscape for these countries. As shown in Figure 2, the increase in the market capitalisations of other markets simply dwarfed many of the markets in ASEAN, leading to a complete change in the investment flows. There was a clear recognition among policy makers that something had to be done to ensure that ASEAN remained relevant and important in attracting investment flows. This led to greater urgency towards economic integration, giving birth to a range of initiatives announced by the ASEAN leaders, economic ministers as well as finance ministers.

In a sense, the value proposition offered by ASEAN is obvious. It's a region with a strategic geographical footprint within the Asia-Pacific, diverse membership of developed countries, emerging markets and less developed countries. Its large population base offers a large consumer market accounting for almost 6% of global exports and 2% of global GDP. This is also boosted by its sustainable growth, posting GDP amounts of US\$ 1.2 trillion and doubling per capita income from US\$1 thousand to US\$2 thousand over the past decade. And underpinning this is a large pool of domestic savings in many of the countries in the region and a growing wealth base.

The lessons from the Asian Financial Crisis and even the current global financial crisis further reinforce the need to channel some of the region's savings towards productive investments within the region. ASEAN capital markets, for instance, are still individually small for the main part, and the range of products and openness within ASEAN remains low. Further, the markets remain relatively illiquid with high transactions costs and large equity premiums due to sub-scale trading volumes and largely closed markets through the capital account restrictions.

Unless ASEAN markets work together to collaborate and achieve parity with developed markets in terms of cost, liquidity, product range and technology investments, investors and issuers in the region will rely on the larger and more liquid markets outside ASEAN, thus making ASEAN less relevant. This threat of marginalisation has acted as a catalyst for greater capital market integration in ASEAN.

At present, cross-border holding of portfolio capital and other indicators, is still relatively low (see Table 1).

**Table 1: Table on indicators of openness and integration in ASEAN (2005/6)**

Indicator	Spore	Msia	Indon	Thai	Phil	HK	Korea
Non-resident holdings of equity as % of market cap	44	17	73	34	61	36	40
No of domestic companies listed abroad	0	26*	5	2	0	na	na
No. of foreign listing	267	4	0	0	2	na	na
Equity holdings in ASEAN as % of total equity assets held abroad	19	43	65	24	3	2	1
Equity holdings of ASEAN investors as % of total non-resident bookings	1.5	19	24	13	6	9	2

Source: Data provided by authorities and Centennial estimates\* Data as at Mar 2009

Therefore, regional integration that allows for greater cross-border access to investors and issuers regionally and globally can help broaden the investor base and range of products, thereby strengthening domestic capital markets and provides the liquidity, scale and capacity to compete globally.

Further, regional integration can, by facilitating access to a larger pool of issuers, investors and financial services providers, build awareness of ASEAN as an asset class and enhance the attractiveness of the region for global capital flows.

### Integration will have holistic benefits to all stakeholders, in that:

- There will be overall benefit to the country in terms of promoting and facilitating economic growth, enhancing the breadth and depth of the capital market and diversifying sources of financing, investment channels and investor base.
- For investors, capital market integration will lead to enhanced product and service innovation, and lower prices for financial services as competition lowers transactions costs and allows larger regional firms to exploit economies of scale and scope. Investors can also now diversify their investments to a greater extent than before.
- The integration of markets will allow the intermediaries to benefit from economies of scale and scope, leading to improved and more innovative services at lower prices, as well as from the opportunity to tap the larger pool of investors in ASEAN.
- For companies/issuers, harmonisation of standards can considerably reduce the administrative burden and costs by replacing many different sets of diverging rules with a single set. For e.g. the release of the ASEAN and Plus Standards on disclosure in October 2008 aims to promote the integration of the region's capital markets, facilitate greater efficiency in cross-border capital-raising and provide cost savings

to issuers making multi-jurisdiction offerings within ASEAN. Under the Scheme, issuers seeking to issue equity or debt securities in more than one ASEAN country will be required to prepare only one set of disclosure documents, with additional limited wrap-around for multi-jurisdiction offers.

- For governments and regulators, capital market integration will lead to a more efficient allocation of capital, arising from the fact that savings can flow more easily and at lower cost to investment and because barriers will have been dismantled. Through sequenced liberalisation and integration process, regulation of cross-border trades and investment will be strengthened and regulators are able to offer greater protection for investors. In addition, through harmonisation and mutual recognition agreements, ASEAN markets will be able to improve their regulatory standards by benchmarking with international standards and adopting best practices.
- Integration will also hasten the development of the less developed capital markets in the region as they are able to benefit from the experiences of the more developed ASEAN markets and accelerate their adoption of international standards.

There is therefore a strong case for ASEAN to step up its integration initiatives. Care has to be taken that regional integration is not an obstacle to the efforts of each individual market to develop themselves, and it must be done in a systematic and complimentary fashion so as to ensure that domestic and regional efforts progress efficiently and in tandem. Policy coordination efforts need to be enhanced and clear goal setting is required for the short, medium and long-term.

Having a clear roadmap was seen to be critical with established milestones and action parties providing a systematic approach to ensure efficient financial integration.

## INTEGRATION EFFORTS

Integration for ASEAN, as articulated in the ACMF Implementation Plan, is facilitating more cross-border flows, opening markets to players from other ASEAN countries, and extending reach to a broader investor base. Unlike the European Union, where their approach to integration is focused on full harmonisation of domestic laws, regulations and operations in order to facilitate cross border access – the ASEAN approach is through a process of creating enabling-conditions for cross-border access.

ASEAN capital market regulators have tried to achieve this objective by focusing on mutual recognition and harmonisation as mechanisms to foster regional integration. Mutual recognition is pragmatic as it recognises and accommodates the differences in the regulatory framework of the respective countries, and allows access to another jurisdiction without having to also comply with another set of what is normally equivalent regulatory requirements and processes. This reduces regulatory burden and makes cross border participation more efficient.

Given that ASEAN capital markets are at different stages of development, rendering large differences in market practices, institutional development and regulatory standards, laws and process, an opt-in approach is proposed. This means that ASEAN countries which are ready will proceed first through bilateral arrangements based on an established set of guidelines or framework, while the other jurisdictions will undertake a more gradual approach and pursue integration initiatives as and when they are ready.

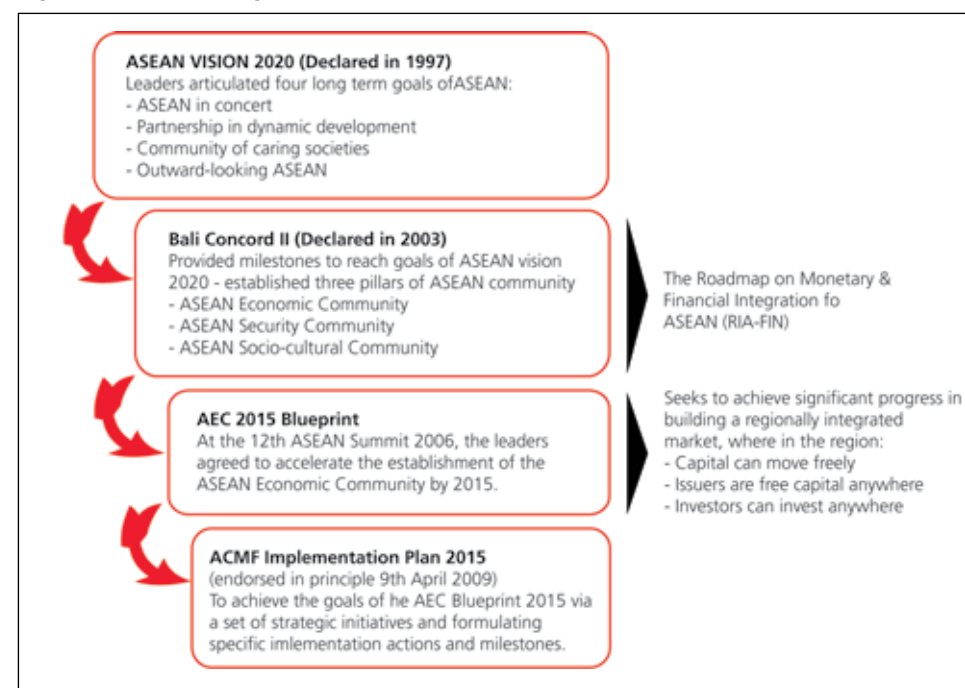
Another initiative to facilitate cross-border access is the establishment of ASEAN exchange linkages. The ASEAN exchanges are working towards creating an electronic trading link through a single access point (known as ASEAN Common Exchange (ACE) gateway) to facilitate cross-border trading of stocks listed on ASEAN exchanges. This will allow regional reach

without dis-intermediating local brokers. The key principle to the exchange linkages is to enhance ability to trade across markets and enhance overall trading liquidity in the respective markets. This is done with application of home rules and without disenfranchising domestic players. Therefore, the mutual recognition arrangements are expected to achieve some of the direct benefits of integration and provide investors a wider choice of products and services.

ASEAN's integration efforts commenced with the declaration of the ASEAN VISION 2020 in 1997. At that time, the vision focused on improving regional co-operation and socio-economic development. However, six years later in 2003, this vision was expanded through the Bali Concord II to establish the three pillars of ASEAN Communities; namely the ASEAN Economic Community, the ASEAN Security Community and the ASEAN Socio-cultural Community. In tandem with this, the goals for financial and capital market integration were established through the Roadmap on Monetary & Financial Integration of ASEAN (RIA-FIN), covering capital market development, financial services liberalisation, capital account liberalisation and currency cooperation.

This was followed by a decision at the 2006 Leaders' summit to bring forward the establishment of an ASEAN Economic Community to 2015 from 2020 and to transform ASEAN into a region with free movement of goods, services, investment, skilled labor and freer flow of capital. Accordingly the timelines for achieving the goals of the ASEAN roadmap on monetary and financial integration of ASEAN was also accelerated by five years (see Figure 3).

Figure 3: ASEAN Integration Efforts



At the Leaders' Summit in Singapore in November 2007, the leaders signed the declaration of the AEC Blueprint. The Blueprint calls for a single market and production base comprising: free flow of goods and services, free flow of investments, freer flow of capital and free flow of skilled labour. Working towards integration by 2015, the Blueprint provides principles and action areas for further liberalization of trade in financial services, for strengthening ASEAN Capital Market Development and Integration, and for promoting greater capital mobility. The Asean Capital Market Forum (ACMF) which was formed about four years ago in recognition of the increasing role of capital markets in ASEAN has played a key role in driving the capital market integration efforts. The ACMF also began work towards formulating an Integration Plan for Capital Markets within the auspices of the AEC blueprint.

The Asian Finance Ministers Meeting endorsed the ACMF's proposal to develop an "Implementation Plan to promote the development of an integrated capital market to achieve the objectives of the AEC Blueprint" in April 2008 and then subsequently endorsed the actual plan in April 2009.

## AEC 2015 BLUEPRINT

The AEC Blueprint 2015 seeks to achieve significant progress in building a regionally integrated market, enabling licensed persons to move freely within the ASEAN region, issuers being able to raise capital in other markets and investors investing anywhere

**The AEC Blueprint adopts two strategic approaches:-**

- **Strengthening ASEAN capital markets through development and integration.** This is achieved through greater harmonisation in offering standards, facilitating mutual recognition, allowing greater flexibility in language and laws in securities issuance, enhancing tax structures and facilitating market linkages
- **Allowing greater capital mobility.** This is achieved through liberalisation of capital movements, subject to having in place necessary safeguard mechanisms

These strategic approaches are centered on three dimensions, namely regulatory alignment and harmonization, integrated market infrastructure to facilitate connectivity and a regional financial products base.

### REGULATORY ALIGNMENT AND HARMONISATION

Based on the observation of the Linkages Task Force, areas requiring further deliberation include regulation of special purpose vehicles, allowing the use of omnibus accounts for custody of exchange linked trades, prevention of cross-border market misconduct, disclosure of material information in a timely manner to investors of both exchanges, and non-discriminatory investor protection schemes and standards.

The Task Force has set out a few midterm targets to achieve the ASEAN interlinked market by 2010:

- **Alignment of environments** – regulatory and legal (trading, clearing, settlement and custody, market conduct, enforcement and disclosure), and market practices (settlement deadlines and periods, operational hours, corporate action processing rules)
- **Address impediments and barriers** such as capital controls
- **Address cooperation and partnership issues** such as technical assistance, technology and infrastructure

### MARKET INFRASTRUCTURE TO FACILITATE CONNECTIVITY

The Task Force has initiated efforts to look into the following trading models:-

- **Dual / cross listing of securities**

**Issue:** Regulatory cost of listing due to disclosure and listing requirements of both exchanges

- **Depository receipt instrument**

**Issue:** When a company depository receipt is traded on a foreign exchange, the listed company needs to satisfy the disclosure and listing requirements of both exchanges – again, this could add to the regulatory cost

- **Offshore trading**

**Issues:** Issuers not subject to listing requirements of the foreign exchange and not therefore required to disclose information. Only need to comply with domestic requirements. Arrangements needed to allow dissemination, ease of access to information from corporate disclosures of the foreign issuers

In establishing cross border market access, factors for consideration include political climate, business factors, risks, legal and regulatory environment, and technology.

## A REGIONAL PRODUCT BASE

Initiatives for promoting the integration and development of the regional markets have already been undertaken by promoting ASEAN as an asset class. The Asian Bond Fund (ABF)<sup>1</sup> initiative that was championed by the Executive Meeting of East Asia and Pacific Central Banks (EMEAP), was the starting point in enhancing the development of the bond market in the region and ultimately creating an integrated regional bond market. To date, Asia has played host to the successful launching of the exchange traded bond index funds and also establishing the Renminbi inter-bank bond markets which is open to foreign investors.

The other product worked was an ASEAN index launched in 2006 with FTSE and also subsequently an ASEAN exchange traded fund based on this index. The FTSE / ASEAN indices are a joint collaboration between FTSE and exchanges of ASEAN 5 countries. This initiative is the first collaborative effort amongst the exchanges under the ASEAN umbrella using FTSE's internationally recognised index design methodology. The FTSE / ASEAN indices are designed to represent the performance of the ASEAN markets. The series contains a benchmark and tradable index that is suitable for Exchange Traded Funds, derivatives and other tradable products. These indices are designed to give investors access to the ASEAN markets major emerging players in the global market place and present new opportunities. The FTSE ASEAN 40 index was subsequently used, in an effort to market ASEAN as an asset-class, in developing a USD-denominated Exchange Traded Fund (ETF) tracking the securities of the index. This ETF is currently listed on the Singapore Exchange (SGX).

Nevertheless, the existing product base is still wanting, with expansion in product diversity crucial. The ASEAN region needs to increase its efforts in terms of developing regional equity and derivative products, providing sophisticated hedging instruments within the region, growing collective investment schemes at regional level and developing the region as a destination / conduit for shariah compliant instruments and services.

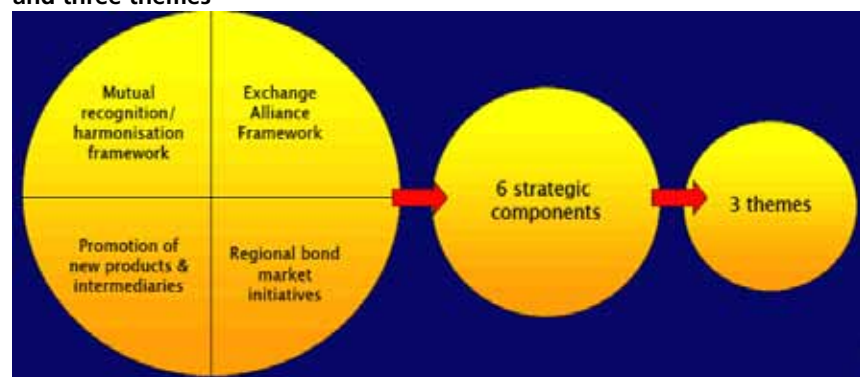
<sup>1</sup> ABF1 – the ABF1 is a closed-end fund launched in June 2003. US\$ 1 billion has been contributed by EMEAP central banks. The fund is managed by BIS. ABF2 – Launched in 2004. An open-ended fund which allows participation from private sector. US\$ 2 billion was contributed by EMEAP central banks.

## Development of Implementation Plan

The endorsement of the Implementation Plan on April 2009 is viewed as a significant milestone in terms of promoting the development of an integrated capital market to achieve the objectives of the AEC Blueprint. The implementation plan comprises six strategic components, sub-categorised into three themes (see Figure 4).

**The six strategic components in the Implementation Plan are:-**

**Figure 4: The Implementation Plan 2015 comprises six strategic components and three themes**



### i. Mutual Recognition framework to facilitate:-

- Cross border fund raising
- Product distribution
- Cross border investments within ASEAN
- Market access by intermediaries

### ii. ASEAN exchange alliance and governance framework encompassing:-

- Building trading linkages and setting up ASEAN Board
- Enhance governance, trading efficiency and cost reduction
- Clearing, depository and settlement linkage
- Marketing and investor education

### iii. Promote new product and build ASEAN as an asset class via:-

- Private sector led regional products development
- ASEAN star companies under the ASEAN board

### iv. Strengthen bond markets by:-

- Accelerating reform initiatives in bond issuance, listing and distribution
- Designing a regional strategy for ratings comparability
- Improving market liquidity and clearing & settlement of linkages

### v. Aligning domestic capital market development plans to support regional integration through:-

- National development initiatives to support cross border integration
- Adopting a phased approach to liberalisation to ensure domestic market readiness

### vi. Reinforcing ASEAN working process through:-

- Establishing ASEAN Coordinating team, comprising dedicated resources from ASEAN Secretariat and dedicated point persons from ASEAN Capital Markets Forum members to monitor, coordinate, report and raise issues on the Implementation Plan

**The aforementioned strategic components are expected to flow into the following three themes:-**

### i. Creating an enabling environment for regional integration:-

- Design and implement a mutual recognition/harmonisation framework of gradually expanding scope and country coverage

### ii. Creating the market infrastructure and regionally focused products and intermediaries:-

- Implement an exchange alliance framework to facilitate cross-border trades with local brokers initially
- Strengthen and harmonise exchange governance, listing rules and corporate governance framework
- Promote new products and regionally active intermediaries to build awareness of ASEAN as an asset class
- Reinforce and expedite implementation of ongoing strategies and initiatives to strengthen and integrate bond markets

### iii. Strengthening the Implementation Processes:-

- Refine the strategies for domestic capital market development in each ASEAN country and incorporate measures and milestones that support regional integration initiatives
- Strengthen the ASEAN level working mechanisms in order to better coordinate regional integration initiatives and monitor and support its implementation at the country level

## ISSUES AND CHALLENGES TO INTEGRATION

The endorsement of the Implementation Plan formalises the first step towards capital market integration. However, there are still considerable challenges in the “how-to” part of the process to integrate ASEAN capital markets. For instance, further progress towards integration will require a convergence of national objectives with regional aspirations. The vast disparity in development, socio-economic and financial stability requirements suggests that policy objectives are likely to vary and that there is a need to accommodate economic diversity. On this note, some market players are of the view that domestic markets should be integrating with the rest of the world rather than within ASEAN.

As highlighted by Dr Surin Pitsuwan (ASEAN Secretary General):

*“A new landscape is (ASEAN+3) is being developed with multi-centres - no longer dependent on the US or Western Europe. A healthy economic landscape post-crisis will need to be multi-polar and East Asia is on such candidate.”... “ASEAN is about open and inclusive regionalism. We cannot close and create a fortress around ASEAN and turn it into our own cocoon of comfort.”*

The value of regional integration and promoting ASEAN as an asset class remains unclear to some participants. This requires an effective communication plan to articulate the objectives and benefits of ASEAN capital market integration. Perceived costs and benefits differ significantly from country to country, in the extent of their national development plans include the measures to enable and benefit from greater integration. As such it is essential that regional initiatives be translated into country policies.

On the surface, the disparity within ASEAN is clear, as evident by the presence of capital controls and exchange restrictions, differences in tax regimes, uneven development and portfolio restrictions on institutional investors. Compounding matters further are the differences in product range, particularly the lack of derivatives markets or of regionally focused products in many jurisdictions. Notwithstanding that there are already large differences in regulatory regimes and market infrastructure – as reflected in the degree of observance of global supervisory and market standards. With such challenges ahead, integration efforts will require strong political will in order for desired outcomes to materialise.

The integration of capital markets also requires a high level of readiness in the form of institutions, sound regulatory frameworks and efficient market infrastructure. The diverse levels of development in the individual member countries therefore suggest that a “one-size-fits-all” or “big bang” approach may not be appropriate or feasible as the objectives may vary significantly from country to country. As such, integration in the ASEAN context does not mean a single financial market such as the European Union, but a process of creating enabling conditions for cross-border access whereby capital can move freely within the region, issuers are free to raise capital anywhere in region and investors can invest anywhere in the region.

There will be concerns and lobbying by domestic players that their domestic businesses will be displaced by integration. A timely reminder came from Sri Mulyani Indrawati (Indonesia’s Finance Minister), when he said that “In addition to overseas investors, a wide range of domestic players would also need to be given access to the integrated market.” There will therefore be a need for ASEAN policy makers to manage pressure from domestic lobbying, and the impact of displacement of domestic businesses as activity shifts towards centers of comparative advantage. In this regard, ASEAN capital market players must adopt a change in mindset and embrace integration as an opportunity to enhance and expand their businesses, compelling them to be more creative and innovative in their provision of services and creation of products.

There will certainly be trade-offs that each country will face in the short-term. However, for the longer-term future, integration will result in a bigger and more diversified market and pool of investors. There will also be differences in perceived cost and benefits towards integration. Some markets may take the view that they may be sizeable enough to not pursue integration, and to instead focus their efforts on building their own domestic capital markets. This may be true, especially for large countries like Indonesia. For countries like Malaysia, however, the market would benefit from greater liberalisation and to meet the challenges of international competition and globalisation.

To reiterate, it is crucial to have in place a sequential and phased approach to integration. This should be complemented by collective efforts from the government/regulators as well as the private sector. For instance, governments must ensure national economic policies that facilitate as well as deregulation and liberalisation. This must be complemented by private sector commitment for cross-border regional activities. Finally, there must be a transparent process of building consensus towards commonality of objectives. ■

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# The **EU Experience** of the Process of Economic Integration: Successes, Failures and Challenges

By **Sir Colin Budd** LSE IDEAS Advisory Board



**I must start with a caveat. Though I represent the LSE at this conference, I am myself no academic! As a diplomat turned politician my natural style, which I hope you will find stimulating, is nearer that of political journalism than it is to the drier groves of academe. Secondly, let me emphasise that, though the EU can always – as you can for us – provide ideas, and though you are naturally free to take out of what I say whatever you want, I realise full well that for all sorts of reasons it is by no means always appropriate to think of the EU as a model for the future of ASEAN. It must be for you to decide what in the European way of doing things is attractive, and what is not.**

I say that with all the more clarity because we in Europe, though still decently proud of what the EU is achieving, know very well that overlapping with the speeding up of globalisation has been the declining validity of the assumption that what happens to the economies of the West matters much more than what happens to those of others. Whether one thinks in terms of pendulums swinging back or tectonic plates shifting, there are plainly in this century huge changes afoot in the world economy, adding importance all the time to your part of the world. Thirty years ago, emerging Asia was one eighth of the world economy, of which it is now around a third, with the fraction increasing by the day. Not least because of changes in the distribution of the world's population – of which Europe in 1957 had 21%, today has 11%, and by 2050 is likely to have only 7%. Many people in Europe are rereading Paul Kennedy's "The Rise and Fall of the Great Powers".

Among Kennedy's arguments, mind you, was the assertion that the strength of a Great Power – and much the same surely applies to a regional association of states – can only be properly measured relative to that of other such powers or associations. For that reason among others, study of the EU's strengths – and they are on any analysis impressive – no doubt has a proper place somewhere on ASEAN's agenda. The EU has made very substantial progress towards the creation of a single market, creating millions of jobs and generating much extra wealth. It has a huge trade surplus, is the world's leading exporter of services, accounts – excluding energy – for around 20% of global trade, and has just celebrated the tenth anniversary of its single currency, a reality already for 329 million Europeans.

When the Secretary General of ASEAN visited Europe in July 2007 he stressed that though ASEAN was certainly not planning to take the EU model lock stock and barrel, it was always on the look out for good ideas and best practice, as it pursued the ambitious task of Community building. Especially in connection with its drive to become a more rules-based organisation, with the task of narrowing the development gap between older and newer members of the group, and with the problems involved in cultivating a stronger sense of group identity.

The EU, I can assure you, has wrestled for decades with all those problems, and a myriad more. We have of course been in existence much longer than you, and have in certain respects chosen to go much further than you.

Many of you will know the dramatic story of how France and Germany emerged in 1945 from their third cataclysmic war against each other in three generations, causing some of their leading figures to be utterly convinced of the need to found a new type of organisation, which would eliminate for ever the threat of nationalism. As Helmut Kohl always says, it was Winston Churchill's Zurich speech of 1946 which first publicly stressed the importance of a new friendship between France and Germany, to transform the old enmity into a new cooperation. Although Churchill himself did not envisage the UK joining the new grouping, he nonetheless argued the case for "a European group which could give a sense of enlarged patriotism and common citizenship to the distracted peoples of this turbulent and mighty continent".

It took time to build the membership, which started with six member states in 1957, increased to nine in 1973, then 12, then 15, and now 27. Already from the start there was a common trade policy and a common agricultural policy – plus a plan for a single market, though that was not achieved till 1992. It took time to build the consensus that was needed for successive further steps towards integration, and to build the balance between the institutions which we have today. The European Commission was there from the start, with the sole right of initiative. So was the Council, representing the member states. And so was the European Court of Justice. But the European Parliament has taken a long time to evolve, and the whole idea of "co-decision" – the practice whereby decisions in many areas are now taken jointly by the Council and the European Parliament, is still today advancing into new areas (or will do if the Treaty of Lisbon is ever agreed).

We have the makings of a European polity, with political parties taking increasingly seriously the Europe-wide political groups to which they belong, but public opinion for the most part is still totally focussed on the national rather than the European level.

Many of you will know, and the rest will not be surprised to hear, that there has in Europe been endless controversy about advancing integration. As is no doubt true in Asia, too, states with long histories do not easily give up sovereignty. The reference in the original treaty to "ever increasing union" has been taken by the integrationists as a licence to drive onwards towards a vision of a single, omniscient

body – and by the nationalists as proof positive of the evil of the whole enterprise.

The truth, I think it is fair to say, lies somewhere in the middle. There is no reason why the EU should be regarded, much though Murdoch-owned newspapers love to see it that way, as some kind of inevitably hostile leviathan, forever devouring new fields of competence. The European Commission is no tyrant, the Court of Justice no enemy of the European peoples, and the European Parliament not the illegitimate cuckoo in the parliamentary nest some would make it out to be. If the checks and balances in the system are properly used, and if those at the helm exercise proper self-restraint, then the value of the Union's institutions is that they can play a key role as the guarantors of fair play and even dealing: the architects, groundsmen and referees who between them ensure both that the European playing field is made and kept level, and that those who play on it stick to the democratically agreed rules. Rules which dictate, *inter alia*, that action should only be taken at the EU level where the member states cannot by themselves sufficiently achieve the objectives of the proposed action, and where that action, by reason of its scale and effects, can be better achieved by the Union. A doctrine often referred to as the subsidiarity rule.

I can return, if it helps, in discussion later to the more political aspects of integration, but my main focus will, as advertised, be on the EU's movement towards further economic integration. And rather than recite a long list of successes, I will concentrate, since they are usually the more instructive cases, on the goals not achieved, the agenda still not realised – not least in the context we all now have in common: survival of and the fastest possible recovery from the current global economic crisis. I would therefore like to focus on the closely connected topics of the challenges – and where appropriate, the failures – confronting the EU in relation to the future of the Single Market, the Lisbon Agenda, and the euro.

The Single Market we have today represents a huge achievement. Business benefits enormously from the level playing field for the free movement of

goods and services and – between 22 (double check: 27?) EU member states – people. Phone calls in the EU cost a fraction of what they did ten years ago. Air fares have fallen significantly. Consumers have much greater choice when buying electricity and gas. Business has benefited from major economies and efficiencies of scale.

Much, however, still remains to be done. Partly because the original design has still not been completed; partly because enlargement has brought in new member states which have further to go than the older ones; and partly because the nature of any single market is that it can never be “completed”: it needs constant adaptation, constant change, constant modernisation.

The facts, for instance, show that the services sector has opened up to full integration more slowly than markets for goods – though a major new law was adopted in 2006, enabling companies to offer a range of cross-border services from their home base. Delays have also affected financial services. Most were liberalised by 2005; and in March 2007 it was agreed to unify national payments regimes, which has made it easier to use credit and debit cards abroad and to transfer money from one member state to another. But bank charges for cross-border payments are still higher than they should be, and the fragmented nature of national tax systems continues to put a brake on market integration and efficiency. Whether one looks at financial services or telecommunications, postal services or energy, the reform enthusiasts in Europe know how much further there still is to go before full liberalisation is achieved.

They also know, as the Treaty of Lisbon makes clear, that in future the focus will need to be not so much on the progressive establishment of the internal market and more on establishing and ensuring its functioning. The member states must move, faster and more efficiently than before, to translate EU rules into their national legal systems, and where necessary to enforce them. They need to set up administrative structures – such as points of single contact for businesses. And they need to make sure that consumers both know and can use their rights

– so that maximum choice and the best quality at the lowest prices become a reality.

All this is the more important because securing the implementation of the EU's Single Market rules and standards has long since ceased to be important solely for the EU. In recent years the EU has as you know increasingly been emerging as a global rule maker, shaping and influencing rules and standards worldwide. In many areas such as product safety, environmental protection, public procurement, financial regulation and accounting the EU has in effect become the global standard-setter. The GSM standard, for example, was created in Europe in 1982 but is now used by over three billion mobile phone customers in 212 countries, worldwide.

The Single Market, however, is only part of creating an effective modern economy. Another vitally important campaign is that known in Europe as the Lisbon Agenda. Nothing to do with the Lisbon Treaty – but the programme agreed at the Lisbon summit of March 2000 with the aim of modernising the European economy, the aim being to turn the EU by 2010 into the “most dynamic knowledge-based economy in the world”.

Progress towards that aim has, to say the least, been patchy! As already noted, the internal market in goods is well integrated, but that in services is still fragmented. Competition in the network industries, such as telecoms and energy, is uneven, with national champions continuing to dominate their home markets. Youth unemployment remains far too high. Far too many children do not complete secondary education. Some member states have made far less progress than others. And so on.

The goals of the Lisbon Agenda remain sound enough: the perfection of the information society, a European area of research and innovation, help for SMEs (small and medium enterprises), the completion of the internal market, coordinated macroeconomic policy, better education and training, and an active employment policy. But the EU remains only partially integrated, with a lot of variable geometry, and is still of course in some key respects less well integrated

than the United States, having after all no common language, an only partially common currency, and very rigid labour markets.

The simplest and best guide to the EU's Lisbon Agenda progress is produced every year in February by the London-based Centre for European Reform. Its latest report – “Scorecard IX” – is entitled “How to emerge from the wreckage”. As it points out, a good number of Europeans have long regarded the Lisbon agenda as an attempt to import into Europe the dreaded “Anglo-Saxon neo-liberalism”. Not surprisingly, they are now trying to argue that the financial crisis discredits the Anglo-Saxon model, and hence Lisbon. To which one can of course respond that though some assumptions about the financial sector certainly need to be rethought, the baby should not be thrown out with the bath water: we need more regulation, but should clearly not go so far that we end up with a financial system so safe that it stifles long term growth. Lisbon's broad conceptual thrust has not been invalidated by the crisis. Put simply, countries which fail to lift their educational performance will condemn themselves to lower living standards, and be all the more exposed to rising income inequalities flowing from globalisation and technological change.

The immediate danger for the EU, as for others round the world, is that in the face of the rising social unrest often engendered by recession it becomes even more difficult to push through much of the reform regarded as essential by the architects of the Lisbon agenda. There is indeed a risk that some European governments will be tempted to row back, undermining the single market in the process, and putting strain on some of the disciplines associated with the single currency. For the health of the EU economy it is most important that they should not. Europe badly needs more innovation, faster liberalisation, a keener spirit of enterprise, and a more flexible approach to employment. And it needs these qualities on a more uniform basis. The best Europeans – for instance as regards E-readiness, or the quality of a country's ICT infrastructure and the ability of its people to use ICT well – the best Europeans are among the best in the world, six

being in the global top ten. The level of broadband internet access in France, Germany and the UK is comparable to that of the US, while the latter is well behind the Nordic world and the Netherlands. But a clutch of other Europeans have records which are much less impressive.

The EU will certainly not meet its original 2010 Lisbon agenda objective – but the agenda's aims remain valid. Its methods – often benchmarking and peer pressure rather than central direction – are likely to survive, since the EU treaties leave such areas as labour markets, social security and education in the hands of the member states. Its targets remain an indispensable guide to the desirable direction of reform, and an essential contribution to the task of meeting the great challenges we face: those of ageing populations, increasingly rapid technological change, and globalisation. There is no magic bullet, but an unrelenting drive to improve education and skills must on any analysis remain high on the agenda.

And what, finally, of the euro? As I mentioned already, last January it reached its tenth anniversary. For those interested in the detail, there is a 300 page European Commission assessment of the progress made so far, and the goals that still remain to be achieved. The euro's contribution as a factor of dynamism for the EU economy needs little emphasis. It has done much to promote price stability: average annual inflation in the euro area in its first decade was 2.2%, the same as in Germany in the 1990s, despite the nearly 600% rise in the price of oil between 2002 and 2008. It helps to bring down the costs of borrowing. It has enhanced price transparency and convergence, increased trade, and promoted economic and financial integration, both within the euro area and with the rest of the world. It has greatly facilitated the completion of the Single Market, being one of the reasons why cross-border trade in the euro area since it was introduced has increased by about ten percentage points in relation to GDP.

Yet all too obviously, as the President of the ECB said last January, this is no time for complacency: there are challenges aplenty ahead.

First, the financial crisis, which is imposing much strain on the euro area as a whole, and even more on some EU member states – both inside and outside the euro zone. Precisely because of its relatively advanced state of integration, the zone has to absorb a number of country-specific shocks which in the absence of internal exchange rates and with fiscal policies constrained by the SGP (Stability and Growth Pact) are in some ways less easy to deal with than they used to be: the onus of internal adjustment now falls on relative wages and prices, along with the need to ensure labour market flexibility.

Second, Economic Union. The solidity of the single currency rests on two pillars: an effective monetary policy, and a set of sound economic policies – including the firm implementation of the SGP and constant efforts to make the EU economy more productive, innovative and dynamic (You see there the connection to the Lisbon agenda). The ECB lays much stress on the importance of structural reforms, both of the markets for goods and services and of the labour market (especially to promote labour mobility).

Third, making a success of enlargement, both of the EU and of the euro area. It is inspiring to have a single market of 500 million people, but its newest segments still need much nurturing to make them a decently homogeneous part of the whole.

Fourth, all the other Lisbon agenda objectives I have already mentioned – especially the need to improve education and thus develop an increasingly skilled work force, to maintain Europe's competitiveness in the global market place.

Fifth, the rapid ageing of the EU's population, due to change from the current situation of four people of working age for every elderly person to a new ratio of two to one, with potentially far-reaching economic ramifications. This will call for a variety of counter measures, at a time when public indebtedness is already high.

And sixth, the ever clearer requirement – as well as opportunity – for a stronger EU foreign economic policy. As Commissioner Almunia argued earlier

this month, Europe should play an international role commensurate with its economic weight. It has the world's second most important currency, plus shares in world GDP and trade flows surpassing those of the United States, and is the world's largest aid donor. It arguably needs a stronger voice in the international financial institutions – though needless to say there is much dispute about what form that could or should take. One clear insight emerging from the wreckage of the world's financial system is surely that global economic integration demands stronger global governance – which inevitably for any regional association of states begs some sensitive questions about how it organises its governance.

That in turn connects to the underlying wider philosophical challenge that confronts and has to be kept under review by every new EU generation – namely the question of how far further economic integration will require more political integration. That same supranational element in the EU which creates some asymmetry between the EU and ASEAN also continues to give rise, as it always has done, to debate inside the EU. The integrationist purists believe that the greater the role of the union in the economic sphere, the greater the need for political integration, while there is also no shortage of Europeans who think, to put it mildly, that political integration has gone far enough.

This is of course a very old debate. Over sixty years ago, in 1947, the League of Nations Secretariat produced an analysis of customs unions which included this passage:

"For a customs union to exist, it is necessary to allow free movement of goods within a union. For a customs union to be a reality, it is necessary to allow free movement of persons. For a customs union to be stable, it is necessary to maintain free exchangeability of currency and stable exchange rates within the union. This implies, inter alia, free movement of capital within the union. When there is free movement of goods, persons and capital in any area, diverse economic policies concerned with maintaining economic activity cannot be pursued. To

assure uniformity of policy, some political mechanism is required. The greater the interference of the state in economic life, the greater must be the political integration within a customs union".

That sequence of lapidary statements can only prompt a wry smile, since logical though it undoubtedly is, on one plane, it fails to take account of the complexity of human nature and the force of historical experience. Immanuel Kant, the 18th century German philosopher, used to warn that using reason without applying it to experience would only lead to illusions. "Out of the crooked timber of humanity", he said, "no straight thing was ever made".

European statesmen have learned over time since 1957 that they need to work with the grain of the people of Europe, not against it – which some of them have found an easier lesson than others. They need, to switch metaphors, to chart a way forward which is both navigable and inspiring. Integration, as European history since 1957 very clearly shows, can be hugely advantageous, and there is a strong case for taking it further, but it is an undeniably complex and sensitive process, which requires careful planning and good advertising, if it is not to run straight into pavlovian nationalist opposition.

The United Kingdom's experience of this story is perhaps especially instructive. It was a Briton – Lord Cockfield – who designed the European Single Market, in which the large majority of the British have always believed, while resenting what many have seen as excessive standardisation. But we have had our difficulties, to say the least, both with freedom of movement of people and with the idea of a single currency. These and any other issues which interest you I would be very happy to explore further in discussion. ■

# ASEAN in Asia Economic Integration

By **Professor Shaobang Kang** Central Party School, China



## ABSTRACT

Asia is one continent which has the most dynamic and the fastest developing economies in the world. But Asia's economic integration is developing too slowly and stands at the lowest level in the world. Many factors have affected Asia's economic integration but, in the current global financial and economic crisis, it is necessary to strengthen Asian countries' cooperation in finance, investment and trade to promote Asia's economic integration. As the healthiest and most integrated regional organisation in Asia, ASEAN should be the centre and platform to promote Asia's economic integration. So we should enlarge financial cooperation among ASEAN, China, Japan, and South Korea. We could firstly discuss creating the Eastern Asia super-sovereign reserve currency so that we create an official currency of East Asian nations, the "Asian Dollar" or "Asi". The purpose of creating "Asi" is to keep its value stable in the long term, and to improve Asia's economic integration.

## THE ASIAN ECONOMIC DEVELOPMENT AND DELAYED ECONOMIC INTEGRATION

Asia is one continent which has the most dynamic and the fastest developing economies in the world. After World War II, Asia's economic growth chain has been built up chronologically through the development of different Asian countries and regions including Japan, South Korea, some countries of ASEAN, China, and India. In the world economic structure, Asia's place has been continuously improving and Asia is one of the world's economic centres, along with Europe and North America.

After World War II, the economic growth of most Asian countries and regions was much faster than European and North American developed countries. Asia's economic scale was enlarged, and its proportion in the world economy increased greatly. From 1953 to 2008, Asian economies' (including Japan) share of the global GDP increased from 5% to 19%.

Most Asian countries and regions generally adopt the export-oriented strategy, resulting in sharp expansion of foreign trade. From 1953 to 2006, Asia's (including Japan) share of global foreign trade increased from 6% to 28%.

Asia's foreign exchange reserves are the largest in the world. In 2006, eight of the top ten foreign exchange reserves were held by Asian countries or regions: 1) Peoples Republic of China (not including Hong Kong or Taiwan), 2) Japan, 4) Taiwan, 5) South Korea, 6) India, 7) Singapore, 8) Hong Kong, 10) Malaysia.

Regional integration and economic globalisation are essential characteristics of the world economy. However, Asia's economic integration is developing too slowly, and is at the lowest level in the world. For example, the EU has completed economic and financial integration, and is carrying out political and judicial integration; North America has set up NAFTA; South America has set up the South

American Common Market (MERCOSUR); and Africa has set up the African Union; but there is not any organization for the whole of Asia to this day. The situation is not fitting given Asia's leading position in the world economy.

## DIFFICULTIES OF ASIA'S ECONOMIC INTEGRATION

There are many reasons for the delay in Asia's economic integration. First, Asia's economic growth is unbalanced. According to World Bank data, some countries, such as Japan, Singapore, South Korea, Kuwait, Qatar, United Arab Emirates, and Saudi Arabia are high income countries. Some countries, such as Malaysia, Lebanon, and Kazakhstan are medium-high income countries. Some countries, such as China, Indonesia, Philippine, and Thailand are medium-low income countries. Some countries, such as India, Pakistan, Bangladesh, Cambodia, Laos, and Vietnam, are low income countries. For example, the GDP per Capita of Qatar was \$70,754 in 2008, third in the world; but Myanmar's \$239, No.173 in the world. Unbalanced economic growth is one of main difficulties for Asia's economic integration.

Second, Asia has diversified cultures, religions, and customs. Asia is one of the cradles of human civilisation. Three of the four great ancient civilisations originated from Asia - China, Babylon, and ancient India. The world's three major religions, Buddhism, Islam, and Christianity, also originated from Asia. A long history and brilliant ancient civilisation are an Asian treasure but they are also reasons causing Asia's diversification - so they influence the progress of Asia's economic integration.

Third, there are still some issues and problems of security in Asia. After the Cold War, Asia's security situation looked like being moderated and stable, but there are still some historical and new security issues and problems. For example, the Korean Peninsula issues, the Japanese history issue, the war

on terror in Afghanistan, and the Iran nuclear issue. Those issues and problems have also brought some negative consequences to the progress of Asia's economic integration.

## GLOBAL FINANCIAL CRISIS AND ASIA'S ECONOMIC INTEGRATION

Generally speaking, the level of development of most Asian countries is lower than European and American developed countries. A lot more needs to be done for the development of the Asian economy.

Most Asian countries take the export-oriented strategy, so that they depend on foreign market too much. Due to economic globalisation and the old irrational international economic order, Asian developing countries face more and more financial and economic risks. In the 1997- 1998 financial crisis, the attack on Southeast Asian countries was very severe. In 2008, Wall Street's financial tsunami led to global financial and economic crisis which has hit the Asian economy even more seriously. Japan has fallen into recession, and in the new economies of China and India economic growth slowed for the first time in many years.

Therefore, Asia faces the challenge to perfect the financial system, to change the growth model, to restructure industry, and to execute standing development. In order to solve the global financial crisis, global cooperation has to strengthen.

In Chinese, the word "crisis" has two meanings, danger and chance. Recently, at the London summit, the leaders agreed on steps to strengthen financial supervision and regulation, and to reform the international financial system. The recent global financial crisis provides a chance to promote Asia's economic integration. Under this situation, it is necessary to strengthen Asian countries' cooperation in finance, investment and trade to promote Asia's economic integration.

## USING ASEAN AS THE CENTRE TO PROMOTE ASIA'S ECONOMIC INTEGRATION

Asian economic integration has a paradox: one is that it has the difficulties described above; another is that both Asia's economic status and need to fight the financial crisis require the integration. Therefore, using ASEAN as the centre to promote Asia's economic integration is a reasonable and feasible path.

ASEAN is the healthiest and most integrated regional organisation in Asia. After Cold War, its integration was speeded up and it now includes ten Southeast Asian countries. In addition, it has also promoted cooperation and integration for its members, built the ASEAN Free Trade Area and Investment Area. ASEAN has promoted multilateral dialogues within Asia as well as globally, and funded some cooperation regimes including the ARF (Asean Regional Forum), the 10+3, the 10+1, and ASEM (Asean-Europe Meeting).

Therefore, ASEAN has already played an important role to help Asia's integration and has done some fundamental work for Asia's integration. Using ASEAN, the 10+3 and the 10+1 as the centre and platform would be a good way to avoid or confront the above difficulties.

## SUGGESTIONS AND STEPS FOR ASIA'S ECONOMIC INTEGRATION WITH ASEAN AT THE CENTRE

### 1) Enlarge financial and monetary cooperation between China and ASEAN.

Since China became a full dialogue partner of ASEAN in 1998, their relationship has been running well, and much dialogue and cooperation regimes between China and ASEAN have already been set up. Particularly, in 2001 the both sides decided to set up China-ASEAN Free Trade Area within 10 years and this programme is being carried out.

Therefore, there is great foundation and arrangement system for economic integration of China and ASEAN. Based on this, both sides should strengthen financial and monetary cooperation. For example, they could set up some leader meetings for their central banks and big commercial banks. China's government decided to open 5 cities for RMB clearing pilot cross-border trade in Shanghai, Guangzhou, Zhuhai, Shengzheng, Dongguan. ASEAN could discuss the RMB clearing issue with China, to decide how to operate RMB clearing for trading purposes between China and ASEAN in some Chinese cities such as Nanning and Kunming.

### 2) Improve financial and monetary cooperation among ASEAN, China, Japan and South Korea, and create the "Asian Dollar" or "Asi" in East Asia.

Asia is getting more and more important in the current financial world. Today, current international foreign exchanges reserves are up to \$7 trillion, and Asia holds more than 70% of the amount of international foreign reserves. On the other hand, the international financial is still dominated by the US and Europe, and the international monetary system still goes by the

US dollar standard. Those two factors threaten Asia's foreign exchange reserve security, so it is necessary to reform the international financial, monetary and currency system. In addition, the financial crisis provides Asia opportunities to improve their cooperation and to lead international financial system reformation.

With ASEAN at the centre, Asia's financial and monetary cooperation has already made some basic progress. On May 2000, ASEAN, China, Japan and South Korea (10+3) agreed to sign "Chiang Mai Agreement". On June 2005, the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) announced that Asian Bond Fund was formally activated by the central banks of 11 governments. On April 18th 2009, China's Premier Wen Jiabao at Boao Asia Forum announced that China plans to establish a \$10 billion China-ASEAN investment cooperation fund to promote infrastructure that connects it to ASEAN nations.

Recently, China's central bank governor, Mr. Zhou Xiaochuan suggested the creation of a new international reserve currency to take place of US dollar. The new international reserve currency is a super-sovereign reserve currency and keeps stable valuation in the long term. His suggestion was supported by many leaders from developing countries and international organizations. The issue will be also discussed on the G20 New York summit on September 2009.

In my opinion, regarding the above system, ASEAN, China, Japan, and South Korea could firstly discuss the creating of an Eastern Asia super-sovereign reserve currency so that we could make realisation of an official currency of East Asian nations, the "Asian Dollar" or "Asi" possible. The purpose of "Asi" is to keep its value stable in the long term.

The path to the creation of "Asi" could also benefit from the experience of creating the Euro. As a first step, it could be used in the trade clearing among

the ten members of ASEAN, China, Japan, and South Korea. Second, it could be expanded into the trade clearing among the other Asian nations. The third step would be for it to become an international currency with stable value in the long term.

Collectively, these measure would improve Asia's economic integration through Asia's financial cooperation and the creation of Asian super-sovereign reserve currency "Asi". ■

## SPEAKERS

01	HE Surin Pitsuwan	02	Mr Manasvi Srisodapol
03	Sir Colin Budd	04	Mr Douglas H. Paal
05	Dr Dionisius Narjoko	06	Prof Kang Shaobang
07	Prof Kishore Mahbubani	08	Tan Sri Dr Munir Majid
09	Tan Sri Azman Hj. Mokhtar	10	Tan Sri Abdul Rahman
11	Dato Ranjit Ajit Singh		

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01	Mr Omar Merican	Bursa Malaysia
02	Mr Attila Emam	Securities Commission
03	Prof Dr Mahani Zainal Abidin	Inst of Strategic and International Studies (ISIS)
04	Ms Elina Nor	ISIS
05	Mr Chua Teong Ban	ISIS
06	Dato' Zainuddin Yahya	Ministry of Foreign Affairs Malaysia
07	Prof Chandran Jeshurun	Institute of Diplomacy and Foreign Relations (IDFR)
08	Mr Supark Prongthura	Thai Embassy
09	Ms Boosara Kanchanalai	Thai Embassy

## EMBASSIES

<b>Indonesia</b>	HE Tan Sri Prof Drs Da'I Bachtiar
<b>Philippines</b>	HE Mr. Victoriano M Lecaros
<b>Thailand</b>	HE Piyawat Niyomrerks
<b>Brunei</b>	Ms Hadijah Bt Haji Md. Idrus
<b>Singapore</b>	Mr Kevin Cheok
<b>Cambodia</b>	Ms Rath Many

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## High Level Workshop "The Path to Asean Economic Integration" Ritz Carlton Conference Centre, Kuala Lumpur, 28-29 April 2009





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