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*Assessing Connectivity: Advancing Economic
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Assessing ASEAN Economic Integration and Initiatives for ASEAN Connectivity

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Abstract: ASEAN country leaders have agreed to promote and implement the concept of ASEAN Connectivity as a way forward toward for the process of ASEAN Community building. ASEAN Connectivity envisages a deeper and wider connectivity between ASEAN countries as well as between ASEAN and its partner countries in broader East Asian framework. Realizing the importance and necessity of ASEAN connectivity, successful implementation of the concept however faces some challenges. This paper provides some contribution in this context. In particular, it reviews the current extent of regional economic integration in ASEAN and the relevant ASEAN initiatives for the connectivity concept. The paper, based on its reviews, underlines the need to further develop the potential that exist for a deeper economic integration, particularly by intensifying and expanding the participation of ASEAN countries in the East Asian production networks and distribution. The paper also emphasizes the urgency for ASEAN to expedite the implementation of AEC Blueprint initiatives, in order to achieve a stronger institutional connectivity which is critical to achieve the overall ASEAN connectivity. The acceleration should move beyond tariff reduction, by addressing non-tariff barriers, making more credible commitments in services liberalization, and put a framework to guide the process of investment liberalization.

1. Introduction

In their meeting at the 15th ASEAN Summit in Cha-am Hua Hin, October 2009, ASEAN Leaders discussed the concept of ASEAN Connectivity as one of the way forward to intensify and strengthen ASEAN Community building efforts. ASEAN Connectivity envisages a deeper and wider connectivity between ASEAN countries as well as between ASEAN and its partner countries in broader East Asian framework. The concept does not only consider the connectivity in terms of economic activities and physical infrastructure, but also people-to-people connectivity. ASEAN Connectivity is a concept that presents strengths and potentiality. It builds on the ongoing initiatives, the current extent of regional integration within ASEAN and with other partner countries, and the idea of ASEAN centrality.

While appealing and necessary, realizing well connected ASEAN member countries is challenging. Given all achievements to date, there still exists a development gap between the ASEAN countries. In global context, particularly as a destination of foreign investment and one of the global production centers, all ASEAN countries as a group constantly faces credible competition pressure from rapidly growing China and India. Some challenges may also come from differences in social and cultural system.

This paper explores the subject of ASEAN Connectivity. It focuses on exploring the Connectivity from the perspective of economic integration, in the light of the wide coverage sub topics covered by the concept. This paper reviews the current situation of economic integration in ASEAN and the ASEAN initiatives that are highly relevant to achieve ASEAN Connectivity. Addressing these topics is critical for a success implementation of ASEAN Connectivity, particularly for the reason that a connected physical infrastructure within ASEAN may not optimally utilized without a robust institutional basis.

The rest of this paper addresses these reviews, with a prelude of a proposal of a framework for the concept of ASEAN Connectivity. The last section discusses some potential broad strategy on how ASEAN could improve the institutional connectivity.

2. ASEAN Connectivity framework: a proposal

Achieving the goal of ASEAN Connectivity as envisaged by the leaders therefore is not instantaneous. A clear framework is critical to facilitate the process toward well connected

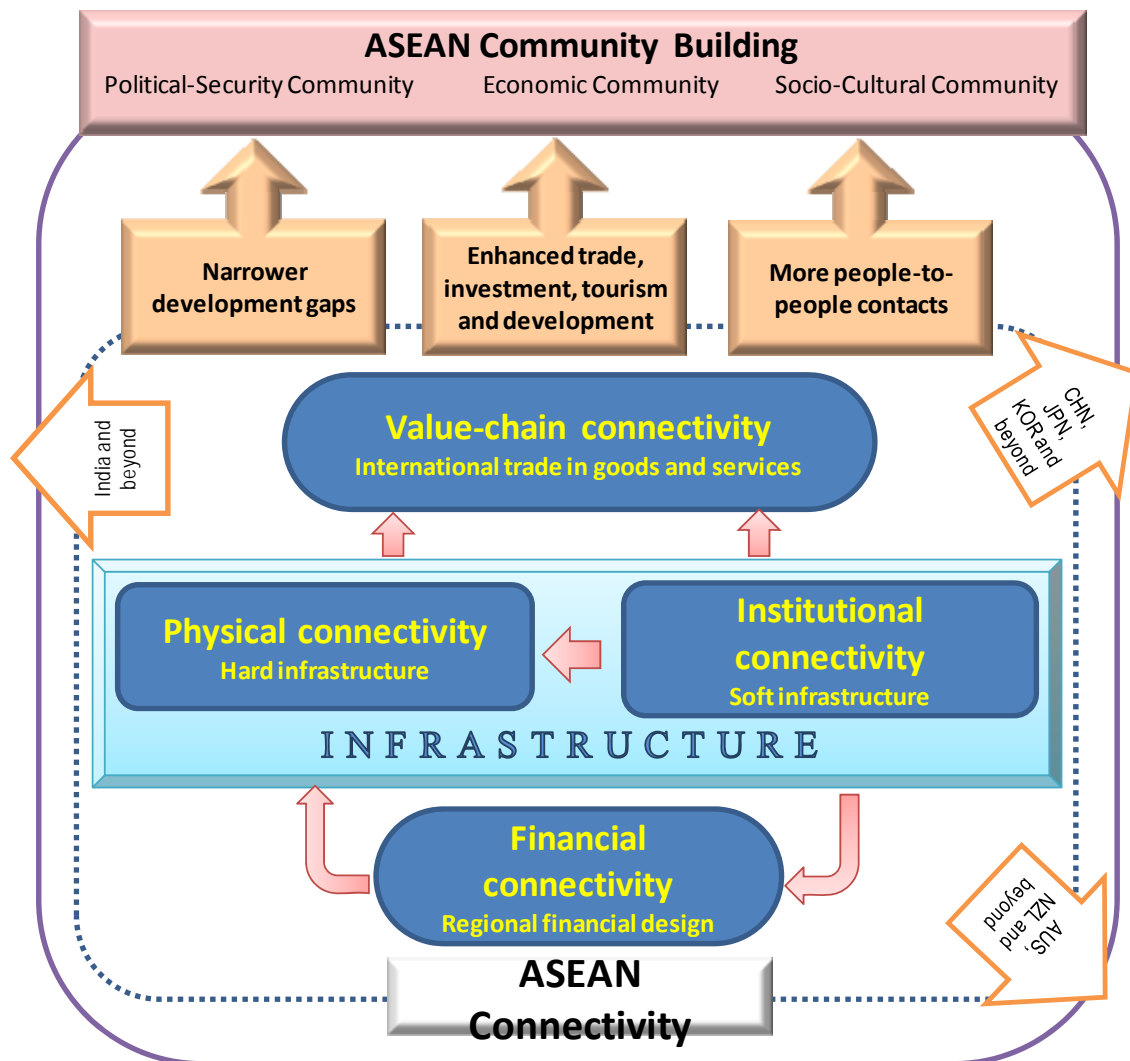
ASEAN countries. The framework should govern a smooth coordination between all of the relevant ASEAN initiatives and physical infrastructure development, including the strategizing the funding mechanisms and/or options that are needed to have such coordination. Figure 1 describes this, which defines ASEAN Connectivity as consisting of four connectivity modes that interact one to the other. The four connectivity modes are (i) value-chain connectivity, (ii) institutional connectivity, (iii) physical connectivity, and (iv) financial connectivity.

Value-chain connectivity represents private economic activities and reflects the degree of interconnectivity between the activities through international production and distribution networks, covering all value chains from production to markets. Value-chain connectivity therefore includes virtually all sectors of an economy in the globalizing world. Stronger value-chain connectivity refers to a deeper, wider sectoral coverage and inclusive economic integration. Social and cultural interactions play their important part here; they are thought to provide a strong basis for value-chain connectivity, by deepening the intensity and widening the coverage of value-chain activities.

Institutional capacity refers to various international or regional agreements to facilitate international transactions of goods and services as well as the movement of natural persons across borders. The core part of institution connectivity is essentially represented by ASEAN Economic Community (AEC) Blueprint. The Blueprint consists of initiatives that pave the way toward the achievement of fundamental AEC goals, which is a single regional market and production base that is highly competitive and fully integrated with the global economy, and at the same time, developing vigorously and more equitably economic development. These are: (i) free flow of goods, (ii) free flow of services, (iii) free flow of direct investment, (iv) freer flow of capital, and (v) free flow of skilled labor. Because AEC Blueprint is a huge single-undertaking, it is imperative that strong connectivity is met to facilitate the other connectivity modes.

Physical connectivity refers to hard infrastructure. The critical hard infrastructures that facilitate ASEAN Connectivity are those in transport, ICT, and energy sector. Physical connectivity is pursued to enhance value-chain connectivity, by lowering transportation and other transaction costs that occur from fragmentation of production and industrial agglomeration (or commonly known as ‘service link’ and network set-up costs).

Figure 1. ASEAN Community Framework



Financial connectivity aims to achieve connectivity in various financial arrangements to support the development of physical infrastructure. In order to have an effective financial connectivity for infrastructure development, flows of available financial resources need to be synchronized. Financial connectivity also requires robust mechanisms to ensure efficiency and effective utilization of our own financial resources. All these are also crucial to achieve the development of infrastructure in a timely manner, given the scheduled steps in the ASEAN Community building process.

Finally, it is important that the flow of logical connection exists among the four connectivity modes. Institutional and physical connectivity are the key modes. Physical connectivity, as noted, facilitates value-chain connectivity through its ability to reduce the cost for both

establishing and expanding production networks and industrial agglomerations. Institutional connectivity offers a robust institutional framework in ASEAN region that supports the other connectivity modes. Institutional connectivity directly contributes to value-chain connectivity by ensuring openness and competitiveness in the markets for goods, services, and in the movement of skilled labor. Institutional connectivity helps to achieve financial connectivity by ensuring freer flow of capital. Lastly, institutional connectivity contributes to physical connectivity by providing a coherent institutional set-up and guidance for a strategic infrastructure development plan.

3. Economic integration in ASEAN

This section briefly describes the degree of economic integration that ASEAN countries have achieved so far. This reflects much of the value-chain connectivity within the framework we proposed in the previous section.

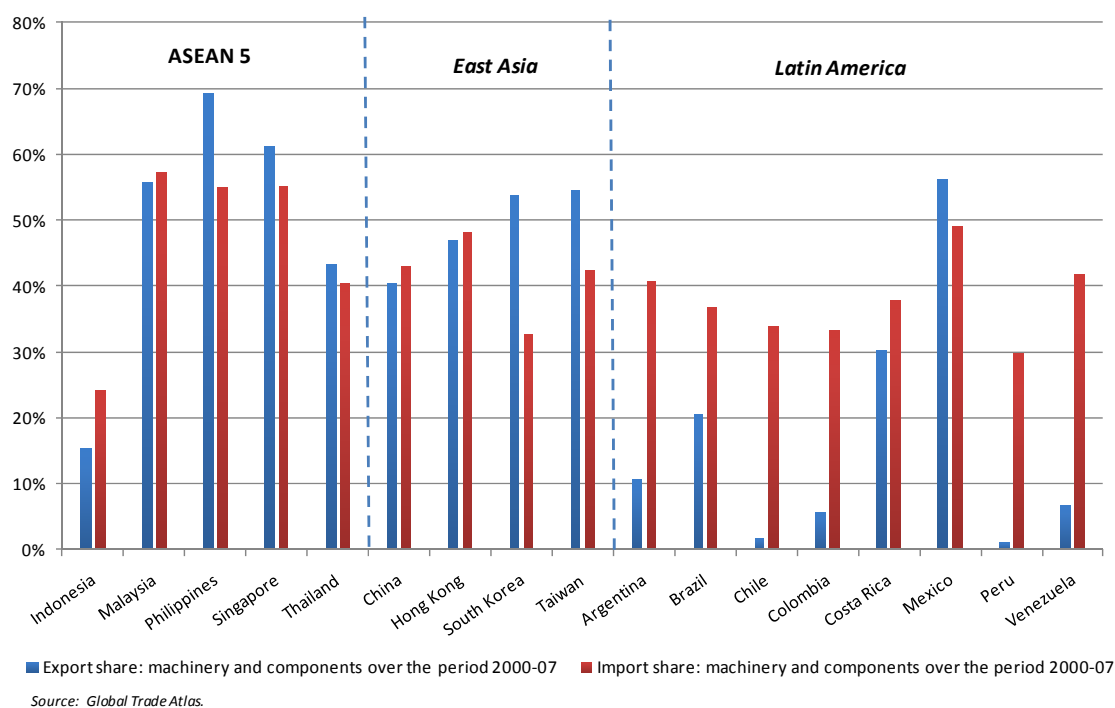
Integration in trade in goods and services

ASEAN member states have intensified their trade among themselves during the past two decades while at the same very much engaged with the rest of East Asia and the world. Intra-ASEAN trade as a share of total ASEAN trade increased from 19.4 percent during 1990-1991 to about 24 percent in 1995-1996 and 2000-2001 to 27 percent during 2007-2008 (UNCTAD 2010). The intensification of intra-ASEAN trade relationships is reflected by the increase in the intra-regional trade intensity index of the ASEAN from 3.65 during 1995-1996 to 4.55 during 2007-2008. ASEAN has the highest share of intra-regional trade to total trade (at 26.3 percent in 2008) among the regional economic groupings in the developing world, with the second (Black Sea Economic Cooperation) with 18.8 percent. As argued by many, the intensified trade can be attributed by the reduction in intra-ASEAN trade (e.g. Mikic 2009).

One factor that explains the intensive ASEAN intra-trade is the participation of many of the ASEAN countries in the East Asian production networks. Figure 2 highlights this, which shows that the extent active reciprocal transactions in machinery and components occurring in the ASEAN-5 countries were larger than that those in other countries, particularly those within Latin America.¹

¹ See, for example, Kimura and Ando (2005) and Athukorala and Yamashita (2006) for more evidence on the extent on the existence of East Asian production networks.

Figure 2. Import and export share of machinery and components in ASEAN-5 and other countries in the world



Notwithstanding the performance of ASEAN countries in the ASEAN intra-trade, it is important to highlight that ASEAN member states have largely hewed to outward-oriented “open regionalism.” This explains in part the substantially lower intra-ASEAN trade share as compared to the very high dependence of Mexico on its trade with US under NAFTA. As a result, ASEAN has been able to deepen its trade relationships with two, large and fast growing economies in East Asia, China and India. ASEAN’s total trade with China expanded 10 times from 1995 to 2008; ASEAN’s total trade with India expanded 8 times during the same period. In contrast, intra-ASEAN trade expanded 3.3 times during 1995-2008. ASEAN-China trade and ASEAN-India trade have risen to 42 percent and 11 percent of intra-ASEAN trade respectively by 2008.

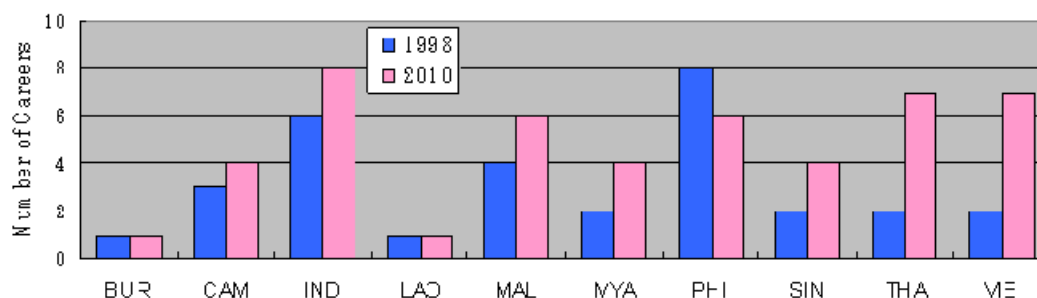
Service plays an increasing role in ASEAN member countries. In the ASEAN economy, service sector has the biggest share in GDP compared to agriculture and manufacture for almost ASEAN countries except for Thailand and Vietnam. In 2008, the service sector makes up around 40% of ASEAN countries GDP, while industry, manufacture and agriculture only comprise 26%, 22% and 11% of ASEAN GDP, respectively. In terms of employment growth,

performance of services is encouraging. Services grew by about 12 percent per annum over the past decade. However, the growth is still below the growth in goods, in particular manufacturing and agriculture that grew by about 20 percent and 13 percent per annum, respectively, over the decade. The slow growth in the services may reflect the rather slow progress of liberalization in the sector.

The total ASEAN trade in services to the world has more than doubled from US\$ 154 billion in 2000 to US\$ 329 billion in 2007 (5.2% of the global service trade). There is, however, large variation in the trade size across the ASEAN countries. At this moment, only several countries that make up the bulk of ASEAN trade in services. In fact, some ASEAN countries has also been the top world service exporter such as Singapore for transport, telecommunication, insurance, finance and construction, Malaysia for tourism, communication and telecommunication, Thailand for tourism and construction, Philippines for communication (WTO, 2007a, pp. 117-152 through Mikic, 2009).

It is worth mentioning here that air transport services in ASEAN countries have expanded rapidly in the past decade, most notably with the establishment and expansion of private Low Cost Carriers (LCCs) that serve the routes within ASEAN countries. This expansion is the result of the implementation of the ASEAN's Open Sky policy since the early 2000s, with which allows regional air carriers to take unlimited flights to all ten ASEAN member countries. Airlines registered at, and operate from, ASEAN member states, except the Philippines, increased significantly in 2010 compared to those in 1998 (see Figure 3).

Figure 3. Comparison for Number of Airlines 1998 and 2010 in ASEAN Member States



Source: *The ASEAN Strategic Transport Plan (ASTP) 2011-2015: Midterm Report*

In terms of movement of natural persons, as one of the elements of trade in services, one can relate this to some basic facts of international labor migration occurring in ASEAN countries. One of the important features is movement of people seeking temporary employment in ASEAN region that has been happening since 1980s. The deficit of labor in some ASEAN member states, notably Singapore, Malaysia, Thailand, and Brunei Darrusalam, draws manpower from neighboring labor-surplus countries. The Philippines and Indonesia send large numbers of migrant workers to these countries. Thailand, meanwhile, is major destination for migrant workers from Myanmar, Lao PDR, and Cambodia. While many of these intra-ASEAN migrations concentrate in low-skilled workers, the flow of workers between Singapore and Malaysia is dominated by high-skilled workers/professionals. Many of workers from the Philippines are also categorized in this group of workers.

Development gap between Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV) and the ASEAN-6 countries

One of major concerns about ASEAN economic integration is large variation in per capita income between CLMV and the ASEAN-6 countries. Table 1 illustrates a wide development gap in the perspective of income per capita. In particular, the table shows that average ASEAN-6 countries income per capita is ten times that of CLV. This large difference is mainly caused by Singapore and Brunei that rank at the top. Variation among ASEAN-6 also happened, where Indonesia and the Philippines are ranked below of other ASEAN-6 countries.

Furthermore, there are also differences in the development stage between CLMV countries and ASEAN-6. In the ASEAN-6 countries, their economic structures have transformed and the value added of industry contributes, averagely, around 47 % to their economies in 2006. Indeed Singapore has moved forward to service-based economy with its contribution reaching more than 65 percent of GDP. In contrast, most of CLMV countries still rely on agricultural sector as a driver of economic growth. Agriculture contributed to around 30 % and 42 % to Cambodia and Lao PDR economies respectively. Meanwhile, manufacturing has developed as Viet Nam's important economic sector.

Table 1. Some development indicators for ASEAN countries

Country	Gross National Income per capita (US \$ PPP)	Share of Agriculture (% of GDP)	Share of industry (% of GDP)	Share of services (% of GDP)
Brunei Darussalam	49,900	0.7	73.4	25.9
Indonesia	3,310	12.9	47.0	40.1
Malaysia	12,160	8.7	49.9	41.3
Philippines	3,430	14.2	31.6	54.2
Singapore	43,300	0.1	34.7	65.2
Thailand	7,440	10.7	44.6	44.7
Cambodia	1,550	30.1	26.2	43.7
Lao PDR	1,740	42.0	32.5	25.5
Vietnam	2,310	20.4	41.6	38.1

Source: World Development Indicators, World Bank 2007

Table 2. ASEAN Human Development Indicators

Country	Life expectancy at birth	Net Enrollment, Secondary	Gini	Prevalence of undernourishment (% of population)
	2005	2005	1990-2004	2004
Brunei Darussalam	77.0	87.3		4
Indonesia	67.8	58.3	34.3	6
Malaysia	73.7		49.2	3
Philippines	71.0	60.5	46.1	18
Singapore	79.7		42.5	
Thailand	70.9		42.0	22
Cambodia	57.0	24.5	40.4	33
Lao PDR		37.7	34.6	19
Myanmar	61.1	37.2		5
Vietnam	70.7	69.3	37.0	16

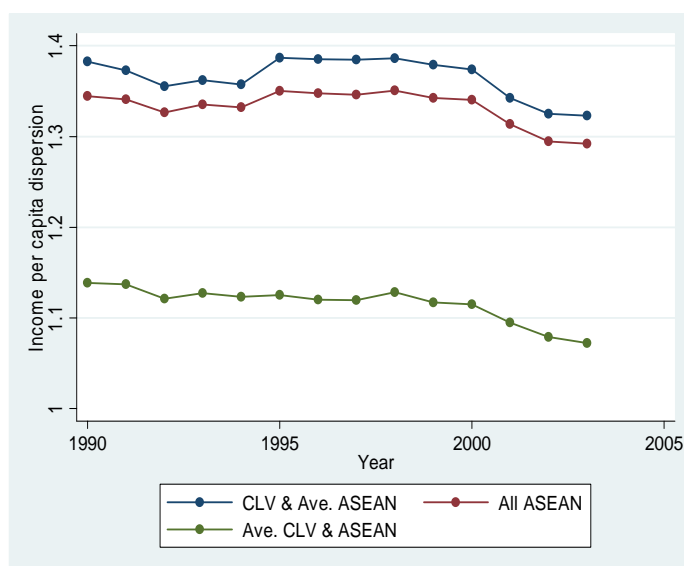
Source: Asia-Pacific Human Development Report 2008, UNDP

Table 2 illustrates further disparities between ASEAN-6 countries and CLMV. Life expectancy at birth in ASEAN-6, averagely reached more than 70 year, while in CLMV, was averagely about 63 year. Interestingly, life expectancy of Viet Nam was higher than that of Indonesia. Viet Nam war bringing modern medicine in the country seems to have contributed to this. Even though secondary education is far from universal among most ASEAN countries, Cambodia, Lao, and Myanmar far lagged behind: only a third of secondary-school age population staying at the secondary level. Meanwhile, in regard to income inequality, CLMV perform better than ASEAN-6 countries, which is observable by the low Gini index. However, it could well be because the countries are still in the beginning of development

stages (i.e. Kuznet hypotheses). Among ASEAN-6, Indonesia seems to have lower income inequality than other countries.

Even so, PPP-adjusted income per capita among ASEAN countries suggests that convergence is on the way in recent years. Figure 1 exhibits a dramatic convergence between the average per capita income of CLV region and ASEAN, though Viet Nam contributes largely to lessen income dispersion of CLV countries with old ASEAN countries. Large variation among CLV can be predicted since Viet Nam grows faster than other, which is consistent with Figure 4. This is in comparison with per capita income of CLV and the average ASEAN that show high dispersion, given the observed tendency of convergence.

Figure 4. Income per capita dispersion (σ -convergence)



Source: Penn-World Table, adapted from Narjoko et al. (2009)

4. Review of ASEAN initiatives for ASEAN Connectivity

This section briefly reviews some of the key ASEAN initiatives which are relevant to support ASEAN Connectivity. As explained in the proposed ASEAN Connectivity framework outlined in Section 2, all of these initiatives contribute to form what so-called institutional connectivity. As further explained, much of the institutional connectivity consist of the initiatives set out by the AEC Blueprint.

Initiatives for free flow of trade in goods

The building of an ASEAN economic community starts with tariff liberalization. ASEAN, through the Common Effective Preferential Tariffs (CEPT) and now embodied in the ASEAN Trade in Goods Agreement (ATIGA), is well on the way to the elimination of tariffs within the ASEAN region, with deadlines of 2010 for the original ASEAN 6 and 2015 (with flexibility to 2018) for the new ASEAN members CLMV. ATIGA specifies the schedules of tariff liberalization in the region under Schedules A to H in the Agreement. ATIGA also specifies the elimination of tariff rate quotas in intra-ASEAN trade.

As of 2009, at least 98.8 percent of all tariff lines in the ASEAN 6 countries are in the CEPT Inclusion List and of which at least almost 80 percent are zero tariffs. Among CLMV, at least 97.6 percent of all tariff lines are in the ASEAN Inclusion List and at least 60.6 percent of them are zero tariffs except for Cambodia where only about 7 percent are zero tariffs. Thus, overall, ASEAN member states have been on track with respect to tariff liberalization within the region.

One significant feature of ASEAN tariff liberalization is that for a number of the ASEAN member states, the reduction in intra-ASEAN tariffs has been largely in tandem with the reduction in MFN tariffs. Although this reduces the margin of preference of the intra-ASEAN tariff liberalization, it preserves the de facto “open regionalism” of countries in the region inasmuch as their markets are East Asia wide and global in part due to the regional and global production networks that drive a significant portion of their international trade. For CLMV, reducing intra-ASEAN tariffs may mean reducing MNF tariffs also in order to deepen their linkages in the regional and global production networks.

ASEAN rules of origin have evolved over time, from the early emphasis on the 40 percent regional value content (RVC) rule to a more flexible and user-friendly menu offered to the region’s firms in order for them to benefit from the margin of preference in the region. Apart from RVC and wholly originating (WO) rules, ASEAN ROOs provide for change of tariff classification (tariff heading or tariff sub-heading) and product specific rules as alternatives to the RVC rule. The cumulation rules for the RVC have also been relaxed under the ATIGA. The main objective of the changes in the ASEAN ROOs over time is to make the ROOs trade facilitating rather than primarily as instrument to prevent trade deflection. Thus, overall ASEAN ROOs are largely liberal.

Despite the relatively liberal ASEAN ROOs, the utilization rate of the AFTA/CEPT is relatively low among the region's firms (Manchin and Pelkmans-Balaoing 2007). A key reason for this is that in the most important traded commodity group in the region, electronics and electrical machinery parts and components, there is an extensive use of ITA and export processing zones where tariffs are virtually zero or near zero; hence, there is no need for the resort to AFTA/CEPT. Exporters also complain of lack of information on the ROOs, delays and administrative costs, arbitrary classification of origin, as well as the small margin of preference.² The above list brings out the importance of improving ROO administration, especially the process for the granting of the Certificate of Origin.

Elimination of Non-tariff Measures (NTMs) is another initiative to ensure free flow of goods. NTMs essentially lower the extent of trade openness across the ASEAN member states. To illustrate, and except for apparel where the impact was negative, NTMs in five ASEAN member states (Indonesia, Malaysia, Philippines, Singapore, and Thailand) push prices upward significantly in some agricultural products and processed food. The percentage premia on products restricted by NTMs in Southeast Asia relative to the price of those products in countries without NTMs has been very high, ranging from about 50 percent to 70 percent.³

Initiatives for free flow of trade in services

AFAS is an initiative of ASEAN to liberalize services in the region. AFAS was initially signed on 15 December 1995 by AEM during the 5th ASEAN Summit in Bangkok. AFAS has just completed its 7th round of negotiations. The schedule commitment in AFAS is based on GATS, and that is, comprising country commitments in the four modes of services with commitments on market access and national treatment. AFAS also includes commitments on mutual recognition arrangement, dispute settlement, and institutional mechanism.

The commitments made in AFAS by each ASEAN member states exceed those made in GATS, with 50 percent greater sectoral coverage. However, there is substantial variation across the member states. While Cambodia, Indonesia, Malaysia, Singapore, and Thailand did not add much in AFAS, Myanmar and the Philippines seem to have benefited greatly from regional liberalization. All these suggest that there are only small additional gains from AFAS. In terms of the depth of commitment, both AFAS and GATS use the same approach,

² See Medalla and Balboa (2009) for an example of problems that exporters face on ROOs.

³ See de Dios (2007) for a description on the extent of NTMs in ASEAN countries.

which is the bottom-up approach or the positive list. It is however not clear on how deep or detailed the restrictions are not included in the list. Since GATS and AFAS have the similar approach, it could be the case that both AFAS and GATS have similarities in term of the depth of the commitment. GATS only differ with AFAS in terms of its transparency clause.

Generally, experts view the progress of service trade liberalization of the ASEAN member countries as being pessimistic (e.g. Stephenson and Nikomborirak 2002; Vo and Bartlett 2006; Fink and Molinuevo 2007). There has been limited progress on the schedule of commitment in AFAS by each country. The ‘GATS plus’ feature in AFAS, where regulations in AFAS go beyond those in GATS, has not been bold, and there is only little difference in AFAS relatively to GATS. This is supported by a finding that AFAS commitment only marginally better than those in GATS. Even for a particular sector, commitments made in AFAS are lesser than those in GATS, which indirectly shows that ASEAN member states reluctantly open up their services sector.

ICT sector provides support to achieve free flow of services in ASEAN region via facilitation of e-commerce growth, facilitation of trade liberalization in ICT services, and promotion of ICT applications to support the delivery of government services (e-Government). At this moment, ICT-ASEAN cooperation is governed by e-ASEAN Framework Agreement, the ICT components under AEC Blueprint, and later the ASEAN ICT Master Plan 2015 (to be concluded November 2010). E-commerce in ASEAN remains to face challenges from the extent of digital divide and issues with implementation of e-ASEAN agreements at national level. In addition, and particularly in terms of connectivity, the current development of e-ASEAN has highlighted some key challenges for the sector. These particularly are connecting ICT development with the implementation of ASEAN trade facilitation initiatives, including ASEAN Single Window, and providing clear and further participation in activities to promote education.

As for the ASEAN initiative in tourism sector, it has multiple objectives that aim at promoting ASEAN member states and/or region as an attractive tourist destination, by upgrading the quality of tourism facilities and human resources to meet international standards, promoting

tourism in the region, liberalizing restrictions tourism and travel services, and encouraging the participation of private sector in the ASEAN tourism sector development.⁴

Achievements of the initiatives have been made, such as the adoption of mutual recognition arrangement (MRA) for tourism human resources to ensure the quality of tourism service delivery and facilitate mobility of tourism professionals within ASEAN. Actions to promote tourism in the ASEAN region and member states were also taken. Notwithstanding the achievements, challenges remain for ASEAN to enhance tourism integration. In terms of the connectivity, there is a challenge to enhance policies and programs that deal with various transport sectors. In addition, there is a need to ensure prompt development of ASEAN Tourism Investment Corridor Development and the need to resolve issues of port handling and immigration procedures in some member states, and this is to ensure a larger and freer movement of tourists.

In addition to the above initiatives on services, there exist a group of initiatives that aimed at facilitating movement of goods, as well as services. Large components of these initiatives are part of transport facilitation initiatives, which has an objective to create an efficient logistics and multimodal transport system that connects land, maritime, and land transport.⁵

While agreements and roadmaps are in place, implementation of all these institutional initiatives has been very slow or ineffective, as well as facing many constraints. To illustrate, many protocols of the agreements are yet to be ratified. Therefore, it is unlikely to witness an immediate operationalization of these agreements. While it is sensible to expect the delay, a prolonged delay potentially restrains the regional ASEAN economy from growing, given much of the agreements' objectives are critical to facilitate connectivity of private business transactions and movement of people across the member states. Moreover, ratification process may well take longer time because of institutional constraint. Some of the member countries, such as Indonesia, have not yet ready to establish national regulations on multimodal transport.

⁴ These are achieved through the implementation of the Roadmap for Integration of Tourism Sector (RITS) 2004-2010 and ASEAN Tourism Strategic Plan 2011-2015, which was scheduled for completion by the end of 2010 and for endorsement by January 2011.

⁵ These initiatives are: ASEAN Transport Action Plan (AFAFGIT), ASEAN Framework Agreement on Multimodal Transport (AFAMT), ASEAN Framework Agreement on the Facilitation on Inter-State Transport (AFAFIST), Roadmaps for Integration of Air Travel Sector (RIATS), Roadmaps Towards an Integrated and Competitive Maritime Transport in ASEAN, and Roadmap for Integration on Logistics Services.

Another example is related to the objective of Roadmaps Towards an Integrated and Competitive Maritime Transport in ASEAN. A critical element of the Roadmap, which is all measures toward an implementation of the Single Shipping Market, is challenging, owing to the adoption of cabotage principle commonly adopted by archipelago countries, which in ASEAN are Indonesia and the Philippines. As noted, the implementation of the measures shall accord national laws and regulation; as a result, the initiative toward the single shipping market needs to find some options to answer this challenge effectively.

Initiatives for free flow of investment

Towards the realization of free flow of investment in the ASEAN region, the ASEAN Economic Community blueprint calls for the ratification of the ASEAN Comprehensive Investment Agreement (ACIA) and the phased reduction and elimination of investment restrictions and impediments during 2010-2015 in three major phases. The ACIA covers the 4 pillars of liberalization, investment protection, facilitation, and promotion. It is more comprehensive in scope compared to the earlier ASEAN Investment Agreement (AIA) and ASEAN IGA. The ACIA covers mainly manufacturing, agriculture, fishery, forestry and mining and quarrying, as well as services incidental to the above mentioned industries. Foreign equity liberalization in the services sector is governed by the AFAS, with its own modality of services sector liberalization including commercial presence.

The AEC initiatives on investment facilitation are less encompassing, focusing on knowing the global best practices and have them implemented in the region, information dissemination on the FDI situation/climate in the region, and joint investment promotion through fairs, etc. and, for CLMV, infrastructure investment promotion.

Investment liberalization will test the resolve of the ASEAN member states in their drive towards an integrated regional economy. A number of the member countries have significant national treatment deviations as well as foreign equity restrictions, especially in agriculture, fishery, and forestry. One underpinning of this bias for differential treatment of domestic and foreign investors is the view that natural resources are part of national patrimony. Nonetheless, as the mining sector indicates, there can be institutional mechanisms (e.g., production service contracts) wherein foreign investors can fruitfully engage in the sectors.

In addition, global competitiveness ratings and rankings indicate that a country's investment climate is more than just investment liberalization and facilitation. There are many more

factors affecting investment decisions. The top four ASEAN member states in terms of per capita FDI flows during 1995-2008 are also the top four ASEAN member states in the global competitiveness rankings. Thus, in order to reduce the skewness of FDI flows within the ASEAN region, the challenge is the one where the investment laggard countries improve substantially their investment climate and attractiveness. This involves not only foreign equity liberalization and improved investment facilitation but also the betterment of other factors such as infrastructure, quality of people and institutions, and the like.

Initiatives for free flow of skilled labor

The key initiative for a deeper integration in services trade and sector are mutual recognition agreements (MRAs), which enables the qualifications of professional services suppliers to be mutually recognized by the rules and regulation of the member states. To date, there are seven MRAs that have been concluded in ASEAN, which are:

- Engineering Services (signed in December 2005);
- Nursing Services (signed in December 2006);
- Architectural Services and Framework Arrangement for the Mutual Recognition of Surveying Qualifications (both signed in November 2007);
- Medical Practitioners, MRA on Dental Practitioners (signed in February 2009);
- MRA Framework on Accountancy Services (signed in February 2009).

MRAs should in theory facilitate an easier movement of skilled labor. There are, however, several domestic barriers that tend to negate the positive impact of MRAs. Two of the most binding are, first, many ASEAN member states still impose nationality condition before issuing license. This is clear, for example, for the MRAs on accountancy services. The traditional form of regulation is based on the notion that nationals are more familiar with local rules than foreign suppliers. However, this regulation has gone out of synch as countries align their standards of practice with international standards.

The second barrier is licensing. Certain ASEAN member states require professionals to have a compulsory membership in professional association in domestic countries. This, however, might not be critical. The more important trade restrictiveness that come from licensing does not emanate from the requirements themselves, but it comes from the divergence of these requirements across countries. In accountancy services, such divergence is pronounced. Reconciling differences in education and experience requirements has been proven difficult, which explains the lengthy negotiations before a mutual recognition agreement can be forged. Moreover, among ASEAN member states, only the Philippines has instituted reciprocity

arrangements to allow foreign professionals to practice in the country provided they have “equivalent” licensing requirements as the Philippines’ and their home countries accord reciprocal privilege to Filipino accountants.

5. Conclusion and recommendations

This paper addresses the topic of recent ASEAN leaders’ initiative of ASEAN Connectivity. It acknowledges the importance of the initiative and attempts to make some contribution by proposing a coherent framework to move further the concept for practical implementation. Following this framework, the paper further reviews the current situation of economic integration that underlines the idea of value-chain connectivity and some key ASEAN initiatives that support the other modes or elements of the ASEAN connectivity.

The reviews in the previous two sections bring a message that although many has been achieved, both in terms of economic integration in ASEAN region and the initiatives put forward by ASEAN in the past decade or so, there are outcomes and effective implementation of the initiatives that need to be realized. The following outlines some recommendations on the broad strategy towards improving the extent of economic integration – or value-chain connectivity – and institutional connectivity.

First, it is important to promote an innovative industrial agglomeration. Countries or regions that have already participated in international production networks and have started forming industrial agglomerations inevitably confront issues and challenges on how to upgrade industrial agglomerations and make them innovative. Although these countries have successfully attracted a number of production blocks of multinationals, thick vertical links of production with supporting industry may not be well established. Manufacturing activities may still be conducted mainly by multinationals, and local firms and local entrepreneurs are not yet successful in penetrating into production networks. Congestion effects in industrial agglomerations such as wage hikes, land price surge, and traffic jam may weaken international competitiveness of labor-intensive industries, and the adjustment of industrial structure may be necessary. Local firms, local universities and laboratories, and multinationals together with human resource development in middle class may not yet complete a virtuous cycle of innovation.

Countries or regions at such a development stage must make industrial agglomerations more innovative, expand the scope of industries, establish more sophisticated value-chain

connectivity, and step up a ladder from middle-income to fully developed countries. Deeper institutional connectivity and advanced physical connectivity are required for upgrading value-chain connectivity.

Second, related to the first recommendation, it is also important, at the same time, to promote an upgrading in the quality of production networks that currently being in operation in ASEAN region. Countries or regions that have not yet incorporated in quick, high-frequency-type production networks such as in machinery industries should remove bottlenecks and participated in them for accelerating economic development. Tighter value-chain connectivity provides chances to take advantage of Asian dynamism based on globalizing corporate activities.

In order to participate in such production networks, a reduction in the cost of service link that connects remotely located production blocks is essential, in addition to the enhancement of location advantages. The improvement of physical connectivity backed up by institutional connectivity and financial connectivity lowers service link costs. The expansion of the frontier of production networks will achieve both deepening economic integration and narrowing development gaps.

The two previous recommendations bring forward an implied proposition that ASEAN countries should shift to the perspective of new industrial development with better physical connectivity. Some regions in ASEAN are far from growth centers with large population and have some delay in utilizing globalizing forces. These regions tend to depend on primary resources and other traditional industries and may not have high expectation for participating in quick, high-frequency-type production networks at least in the short run. However, once physical connectivity supported by institutional connectivity is improved, new perspectives for industrial development may be visualized. For example, some resource-based industries such as mining and fishery can be modern and vibrant industries with tight physical connectivity. Tourism can also be a sophisticated environment-friendly industry with proper logistics link. Even labor-intensive manufacturing may move to these regions.

The next recommendation addresses the strategy to move forward with the current ASEAN initiatives in order to strengthen the institutional connectivity. The review in this paper suggests a general recommendation that ASEAN needs to expedite the implementation of AEC Blueprint initiative. This has some more detailed elements. Regarding the initiatives on

trade, stronger efforts are clearly needed to expedite liberalization process in this area. In particular, credible actions are needed to remove trade restriction beyond tariff reduction, for the trade in goods. This should cover further reducing non-tariff measures, streamlining and consolidating rules of origin within ASEAN and with free trade partner countries, harmonizing standards and strengthening conformity assessment capabilities, and strengthening trade facilitation mechanisms and institutions.

As for trade in services, the strategy should be focused on making more credible commitments in AFAS. AFAS negotiations have not so far created substantial liberalization outcome. In a coherent way, progress in the implementation of transport facilitation needs to be expedited; currently, the progress is rather slow. Among others, efforts to accelerate implementation of measures shall be taken, including promoting consultation with stakeholders in the member states. Some studies suggest that one factor contributing to the slow pace of the implementation is the lack of understanding from domestic stakeholder, at national level, on the benefit and cost assessment on such measures.

Finally, regarding the initiatives to achieve free flow of investment, a framework firstly needs to be adopted to develop a strategic plan to reduce investment barriers, and subsequently, actions coming from the plan needs to be accelerated and monitored at the same time. As commonly understood, measures to liberalize investment regime could be a very difficult obligations faced by the member countries, and therefore, a constant monitoring system should be in place to guard a timely investment liberalization process.

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