

ASEAN Economic Community 2015 : Opportunities or Threats?

By Dr. Prasarn Trairatvorakul

Governor of the Bank of Thailand

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Good afternoon, ladies and gentlemen.

Let me first thank Professor Toemsakdi Krishnamra for inviting me to deliver the keynote speech at today's Sasin Update Reunion. We are here today to talk about the ASEAN Economic Community in 2015, and its potential opportunities and threats. The success of the AEC, and how it will affect us, will depend ultimately on the support it receives from ASEAN's citizens, businesses and governments. I am therefore glad to see the future of ASEAN here today, taking a great interest in ASEAN's future.

If we ask any one of the 580 million or so ASEAN citizens what they think ASEAN will become in 2015, we are likely to get 580 million different answers. Some see an ASEAN Economic Community that resembles early versions of the European Economic Community. Others envisage a Euro area in the making. Plenty more view the AEC with cynicism; that life will go on, with few changes to the status quo. These divergent perceptions of what the AEC will bring, and the uncertainty surrounding it, leads to responses ranging from enthusiasm, to indifference, to apprehension.

There are dangers in allowing such an important issue to remain vague. Overblowing potential threats tends to lead to over-conservatism. In Europe, the term "Euro skeptic" was coined to represent the movement which surfaced to cast doubt on the process of European integration. While I reckon that the number of ASEAN-skeptics may rise as we approach 2015, this is unlikely to be too much of a concern, given that doubts about the AEC are not about the dangers of integration, but are based upon cynicism that little will change come 2015. But this in itself can lead to a more dangerous threat – that of complacency and the danger that we will wake up and find that we are already too late to catch the rising wave of ASEAN.

Let me divide the rest of my address today as follows. To separate the fact from the myth, I will lay out what we can realistically expect from the AEC. I will touch upon its five main pillars, namely free trade in goods, free trade in services, free flow of skilled labor, free flow of investment, and a freer flow of capital. I will lay out how each pillar supports the goal of a single market and production base, and the

benefits that we can expect. I will discuss financial integration under the AEC, an area in which central banks, Ministries of Finance, and securities regulators around the region have collaborated closely. Finally, I will raise some of the threats which we need to be aware of as we prepare for 2015.

Ladies and gentlemen,

One of the important questions that need to be answered is “*what can we realistically expect from the AEC*”? First of all we must remember that the AEC is part of a larger plan for the ASEAN Community which involves security, economic, and socio-cultural cooperation. While the vision is that strengthening all three pillars will eventually make ASEAN stronger as a region, we must be realistic about what it is not.

The AEC *is not*, and *has no intention of* transforming ASEAN into a European style union. We should refrain from perpetuating any grand, Euro area-type visions. ASEAN lacks supranational policy-making bodies like the European Central Bank or the European Commission which are required to make such an entity function properly. Furthermore, as the European experience has shown, jumping into a highly integrated model without the necessary infrastructure is risky, as demonstrated in recent banking, financial, and fiscal difficulties.

What the AEC *does* aim to do, however, is to “*transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy*”¹. The AEC blueprint crystallizes this in its goal of a single market and production base by achieving free flow of goods, services, investment, and skilled labor, and freer flows of capital, while continuing to reach out to the rest of the world; the so-called “open regionalism”. Such a single market and production base would help minimize transaction costs and maximize trade gains.

The first pillar of integration rests upon trade liberalization. Trade liberalization under the AEC builds upon achievements over the past decades which began with trade integration under the ASEAN Free Trade Area (AFTA), signed in 1992. Under AFTA, a substantial reduction of tariffs has already been achieved. And as of 1 January 2010, ASEAN-6 applied zero tariffs to 99 percent of goods, while the CLMV countries plan to achieve the same goal by 2015.

The AEC takes this a step further and provides a blueprint for liberalization beyond AFTA, because despite considerable progress, the region falls short of being a

¹ Taken from the “Declaration on the ASEAN Economic Community Blueprint”, 20 November 2007.

complete free trade area. Under the AEC, not only will all tariffs will be reduced to zero, but non tariff barriers, including subsidies, restrictions, and sensitive industry classification will also be eliminated.

A unified trading region will facilitate development of production networks, bridge fragmented trade opportunities, and allow ASEAN to become central to global supply chains. This model is supportive of Asia's new growth model of a regional production hub and increasing intraregional trade.

Specific measures to further facilitate trade have been undertaken, such as liberalization and simplification of rules of origin, with the aim of promoting regional trade and competitiveness by lowering compliance costs. Reforms to reduce administrative burden, particularly with regards to trade and customs procedures, have also taken place. Furthermore, simplified, harmonized, and standardized trade and customs processes and procedures² should reduce transaction costs, and enhance competitiveness.

In addition to liberalization of trade in goods, the AEC also aims to achieve free flow of services³ as a second pillar for integration. This is in recognition that the services sector in ASEAN countries must respond rapidly and flexibly to demands for competitiveness, efficiency, and productivity. They must aim to meet the goals set out in the AEC blueprint in providing substantial freedom to ASEAN service suppliers and to facilitate cross-border interaction in ASEAN, subject to domestic regulations. This is in recognition that a country's institutional and regulatory environment needs to be strengthened before and during liberalization in order to reap those benefits.

Liberalization in services spurs competition, which should lead to lower prices and increased quality of services. Competition should also lead to a better transfer of know-how from outside and within the region, in areas such as business organization and management, or better risk management capacity through foreign participation in financial services, for example. And while services liberalization can involve short-term adjustment costs, the increased competition and economies of scale can also lead to enlarged services export markets, and improved service competitiveness and efficiency.

² Such as the ASEAN Harmonized Tariff Nomenclature, which allows a uniform and consistent classification of goods via an 8-digit commodity nomenclature.

³ Services in most ASEAN member countries typically include final services for consumption, such as hotels and restaurants, wholesale and retail trade, intermediate services such as business and professional services, transport and communications, finance, insurance, information technology and computer services.

Since its signing in 1995, the ASEAN Framework Agreement on Services (or AFAS) has aimed to eliminate intraregional trade restrictions and expand liberalization in services (GATS plus). It has focused on financial services, transport, tourism, telecommunications, and professional business services.

Ladies and gentlemen,

Let me spend a moment on the finance side, whose liberalization falls under the purview of the Ministries of Finance and Central Banks of member countries. Given that financial services liberalization can have a substantial impact on the orderly development of the financial sector and maintaining financial and socioeconomic stability, financial services liberalization has been accorded a greater amount of flexibility in the AEC than other service sectors. Countries are allowed room to progressively liberalize restrictions in financial subsectors or modes as identified by each member country by 2015, with room for remaining subsectors or modes to be progressively liberalized by 2020. In the case of Thailand, for example, while the capital market is identified for liberalization by 2015, the banking sector has been granted greater flexibility, with the timeframe for liberalization extended to 2020.

Financial services liberalization has followed two main principles, which include (1) liberalization through the ASEAN minus X formula, where countries that are ready to liberalize can proceed first and be joined by others later, and (2) placing due respect for national policy objectives and the level of economic and financial sector development of individual members in any liberalization plans.

Accordingly, each country's financial services liberalization is guided by the country's own circumstances and financial sector master plan. In Thailand development of the banking sector is guided by our second Financial Sector Master Plan, which covers the period from 2010-2014, and was developed with the involvement of relevant stakeholders in the financial sector. This is consistent with the ASEAN minus X principle, and respects national policy agendas and objectives, given the importance of financial services to overall economic and financial stability.

Distinguished audience,

A single market and production base cannot be complete without the free movement of factors of production, which includes the free movement of labor. The free flow of skilled labor is complementary to other freedoms, such as freedom of capital flows (particularly FDI) and services, and together they have important implications for productivity growth and investment. But the issue of free movement of labor always raises emotional concerns, as it triggers fears relating to immigration and cultural impacts.

But how much of this fear is in fact founded in reality? Freedom of labor in the ASEAN context pertains only to skilled labor, through “*managed mobility or facilitated entry for the movement of natural persons engaged in trade in goods, services, and investments, in accordance with prevailing regulations of the receiving country*”⁴.

The phrase “*in accordance with prevailing regulations of the receiving country*” means that in practice, country specific regulations still prevent completely free labor mobility. In Thailand, for instance, the Alien Employment Act continues to prohibit foreigners from being employed in certain professions, such as civil engineering or legal services, while other professions are regulated by professional associations. Going forward, moves need to be taken to *further* enhance the free flow of labor by 2015, such as through increased use of mutual recognition of professional qualifications.

Skeptics and opponents of labor mobility tend to place emphasis on the short term potential threats. An often cited short-term effect is the “brain-drain” away from migrant’s home countries. However, the flip side is a short-term “brain gain” in receiving countries, and a consequent gain in labor productivity, which could be beneficial for ASEAN as a whole. It provides greater competition for local professionals, usually through the introduction of international standards and practices. And in the medium and longer term, the “brain drain” is usually offset by remittances and a “reverse brain drain” as returnees bring wealth, skills, experience, and their business and social networks back home.

Ladies and gentlemen,

I have mentioned three crucial pillars for economic integration: free trade in goods, free trade in services, and mobility of skilled labor. As important, but perhaps less visible, are two remaining areas of liberalization which are also crucial to supporting economic integration, namely free flows of investment and freer flows of capital.

Liberalization of investment in ASEAN, as well as investment cooperation and protection is currently implemented through the 1998 Framework Agreement on the ASEAN Investment Area (AIA) and the 1987 ASEAN Agreement for the Promotion and Protection of Investment. This was enhanced, under the AEC Blueprint, by the ASEAN Comprehensive Investment Agreement (ACIA) which was signed in February 2009.

⁴ Taken from the ASEAN Economic Community Blueprint

The ACIA takes into account international best practices and is based on four pillars: namely liberalization, protection, facilitation, and promotion. Under the AEC Blueprint, ASEAN countries remain committed to investment liberalization based on principles of open regionalism, national treatment, and MFN treatment of investors.

Finally, the AEC is designed to facilitate a freer flow of capital into and within the region, and its availability for use. This freer flow of capital is achieved both through the strengthening of domestic capital markets to better channel capital to efficient use, and progressive capital account liberalization to allow both capital inflows and outflows. Capital market development, through better market access and increased market liquidity, should increase the availability while lowering the cost of capital in each country. The linkage of ASEAN's individual capital markets onto a common platform, allowing ease of investment across countries, and efforts to harmonize rules and regulations should also help lower costs of financing, as a larger market capitalization creates more room for economies of scale.

At the same time, progressive capital account liberalization is important to promoting growth and supporting regional economic integration. Given that capital account liberalization is a sensitive issue, and has implications for economic and financial stability, it needs to be undertaken at a pace that will ensure a maximization of benefits, while providing adequate safeguards against macroeconomic instability. Furthermore, we must keep in mind that capital account liberalization is not an end in itself; it should support balanced growth and be consistent with needs and level of development.

Ladies and gentlemen,

The mere fact that 10 economically diverse countries have managed to get together and hammer out a common Blueprint for an economic community is no small feat. What this means is that the foundations for the ASEAN Economic Community are in place. The AEC Blueprint provides a roadmap outlining the necessary economic measures and a timeline for implementation. It lays out the main components which are required to achieve a final goal of single market, free flow of goods, services and investment, and a much more significant market for capital, talents, and skills.

Furthermore, it provides a mechanism for monitoring progress, through an agreed upon scorecard, followed-up upon by the highest levels of government. And just last year, ASEAN Finance Ministers collectively decided to strengthen monitoring to achieve economic integration by setting up the ASEAN Integration Monitoring Office,

reflecting commitment in implementing the AEC Blueprint in accordance to the deadlines that have been set.

I have so far highlighted only some of the possible benefits that can potentially arise from the AEC, and touched upon a few potential concerns. But as I mentioned early on, one of the greatest risks that may arise is not from the AEC itself, but from ensuring that businesses and stakeholders understand what exactly is at stake. The greatest threat is remaining complacent and not preparing for these changes. What we can do is, to the best of our ability, paint a picture of what can we realistically expect, in order to prepare to reap the benefits and face the challenges that lie ahead.

Thank you.