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มุ่งสู่การรวมตัวทางเศรษฐกิจและการเงินที่เหนียวแน่นขึ้นของประชาคมเศรษฐกิจอาเซียนปี 2015

AEC 2015: Ambitions, Expectations and Challenges ASEAN's Path towards Greater Economic and Financial Integration

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AEC 2015: Ambitions, Expectations and Challenges
ASEAN's Path towards Greater Economic and Financial Integration

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บทคัดย่อ

ข้อคิดเห็นที่ปรากฏในบทความนี้เป็นความคิดเห็นของผู้เขียน
ซึ่งไม่จำเป็นต้องสอดคล้องกับความเห็นของธนาคารแห่งประเทศไทย

การก้าวเข้าสู่ประชาคมเศรษฐกิจอาเซียน (AEC) ในปี 2015 ถือเป็นก้าวสำคัญในกระบวนการการรวมตัวของอาเซียน อย่างไรก็ดี ความท้าทายต่อประเทศสมาชิกคือ ความพร้อมของภาคเศรษฐกิจที่จะเก็บเกี่ยวประโยชน์และความสามารถในการปรับตัวเพื่อรองรับการเปลี่ยนแปลงที่จะเกิดขึ้น โดยเฉพาะในภาคการเงิน จึงจำเป็นต้องรับเอาแนวคิดของการสร้างวงจรเกื้อกูลให้เกิดขึ้น กล่าวคือ กล้าที่เปิดเสรีทางการเงินให้มากขึ้น เพื่อให้เกิดการแข่งขัน ซึ่งจะมีส่วนช่วยพัฒนาและเสริมศักยภาพภาคการเงิน และคุณภาพสถาบันการเงินให้แข็งแกร่งยิ่งขึ้น

งานวิจัยนี้ได้วัดระดับของเปิดเสรีทางเศรษฐกิจตาม AEC Blueprint ซึ่งพบว่า AEC ไม่ได้ตั้งใจที่จะเปิดเสรีเต็มที่ในทุกด้าน นอกจากนี้ ยังพบว่าระดับการเปิดเสรีของประเทศสมาชิกยังห่างจากเป้าหมายของ Blueprint และที่สำคัญ การเปิดเสรีของไทยในภาคบริการทางการเงินและเงินทุนเคลื่อนย้ายยังอยู่ในระดับที่ห่างจากประเทศสมาชิกหลักของอาเซียนอื่น ทั้งๆ ที่ ในความเป็นจริงแล้วไทยมีความพร้อมใกล้เคียงกับประเทศหลักในอาเซียน โดยประเมินจากเครื่องชี้ทางเศรษฐกิจและการเงินที่สำคัญ จึงนำไปสู่นัยเชิงนโยบายว่าไทยน่าจะเร่งแนวทางปฏิบัติตาม Blueprint โดยเฉพาะในส่วนของภาคการเงิน โดยทุกภาคส่วนที่เกี่ยวข้องต้องมี integration mindset โดยการบรรจุเรื่องการรวมตัวทางเศรษฐกิจของอาเซียนเข้าไปในกฎหมาย ระเบียบ และแผนแม่บทต่างๆ ของประเทศ เพื่อให้เกิดวงจรเกื้อกูลดังที่ได้กล่าวข้างต้น

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* ผู้วิจัยขอขอบคุณคุณอัจนา ไวความดี คุณสุชาดา กิระกุล คุณไพบูลย์ กิตติศรีกังวาน สำหรับข้อชี้แนะที่เป็นประโยชน์ยิ่ง ขอขอบคุณคุณจิรเทพ เสนีวงศ์ ณ อยุธยา และคุณสมศจี ศิกษมัต ที่ได้ให้คำแนะนำและความช่วยเหลืออย่างไม่เหน็ดเหนื่อย นอกจากนี้ ขอขอบคุณคุณจันทวรรณ สุจริตกุล คุณรุ่ง มัลลิกะมาส คุณปฤษันต์ จันทน์หอม คุณสมชาย เลิศลาภวศิน คุณอุบลรัตน์ จันทรังษ์ คุณเก่งใจ วัจนะพุกกะ คุณบัณณรี ปัณณราช และคุณสุโชติ เปี่ยมชล สำหรับคำแนะนำและความช่วยเหลือในหลายส่วนตลอดช่วงการทำวิจัย

บทสรุปผู้บริหาร

ประชาคมเศรษฐกิจอาเซียน หรือ AEC จะเกิดขึ้นในปี 2015 AEC ไม่ใช่การรวมกลุ่มทางเศรษฐกิจที่เกิดขึ้นใหม่ แต่เป็นการสานต่อกระบวนการรวมกลุ่มของอาเซียนที่เริ่มจากการเปิดเสรีด้านการค้าที่มีมานานเกือบ 20 ปี เป้าหมายตามแผน หรือ AEC Blueprint คือการสร้างตลาดและฐานการผลิตร่วมกันของภูมิภาคผ่านการเร่งกระบวนการเปิดเสรีด้านสินค้า บริการ และการลงทุนที่มีอยู่แล้ว และเสริมด้วยการเคลื่อนย้ายปัจจัยการผลิต คือ แรงงานฝีมือ และเงินทุน ทั้งนี้ การรวมกลุ่มของอาเซียนที่เหนียวแน่นขึ้นจะมีส่วนช่วยเสริมสร้างประสิทธิภาพในการผลิตจากการแบ่งงานกันทำ รวมถึงได้รับประโยชน์จากขนาดที่ใหญ่ขึ้น เพิ่มอำนาจต่อรองของภูมิภาคในเวทีโลก ซึ่งหากจะพิจารณาภูมิภาคอาเซียนเป็นกลุ่มเดียว ก็จะมีประชากรนับเป็นอันดับที่ 3 มีรายได้เป็นอันดับที่ 6 และมีมูลค่าการส่งออกเป็นอันดับที่ 5 เมื่อเปรียบเทียบกับประเทศต่างๆ ในโลก

การรวมกลุ่มทางเศรษฐกิจในขั้นแรกมักจะเริ่มจากการเปิดเสรีทางการค้า ซึ่งเป็นที่ยอมรับโดยทั่วไปว่าประเทศสมาชิกจะได้รับประโยชน์ค่อนข้างชัดเจน อย่างไรก็ดี จากทฤษฎีและข้อมูลเชิงประจักษ์พบว่า ยังไม่มีผลสรุปแน่ชัดในประเด็นเกี่ยวกับประโยชน์ที่จะเกิดขึ้นจากการรวมกลุ่มทางการเงิน ซึ่งการจะได้รับประโยชน์หรือไม่นั้น ขึ้นอยู่กับสองปัจจัยหลัก ได้แก่ ความพร้อมของภาคการเงินและปัจจัยแวดล้อมด้านสถาบันของประเทศ และความกล้าที่จะเปิดเสรี ทั้งนี้ อาจจะพิจารณาได้ในลักษณะ “วงจรเกื้อกูล” (Virtuous circle) กล่าวคือ การเปิดเสรีจะนำมาซึ่งการแข่งขันและการเรียนรู้จากภายนอก ส่งผลให้ประเทศมีระดับการพัฒนาของภาคการเงินและปัจจัยแวดล้อมด้านสถาบันที่ดีขึ้น อันเป็นการสร้างความมั่นใจที่จะเปิดเสรีมากขึ้นในที่สุด จากทั้งหมดที่กล่าวมานำไปสู่คำถามสำคัญของงานวิจัยนี้ที่ว่า ระดับการเปิดเสรีของไทยสอดคล้องกับระดับการพัฒนาของภาคการเงินและปัจจัยแวดล้อมด้านสถาบันหรือไม่

ดังนั้น เป้าหมายหลักของวิจัยครั้งนี้ จึงเป็นการวัดระดับการเปิดเสรีของประเทศไทย และในอีกด้านหนึ่งคือการวัดระดับความพร้อมของไทยในด้านการพัฒนาภาคการเงินและปัจจัยแวดล้อมด้านสถาบัน

ในด้านการเปิดเสรีนั้น งานวิจัยนี้ได้วัด Liberalization gap ซึ่งเป็นความแตกต่างระหว่างระดับการเปิดเสรีสูงสุด และการเปิดเสรีที่ระบุไว้ในเป้าหมายตามแผนของ AEC และ Implementation gap ที่วัดระดับการเปิดเสรีของประเทศสมาชิกหลักของอาเซียน (ASEAN-5) เทียบกับระดับการเปิดเสรีที่ระบุไว้ในเป้าหมายตามแผนของ AEC สำหรับในด้านความพร้อมนั้น ได้มีการคัดเลือกเครื่องชี้วัดที่สะท้อนถึงระดับการพัฒนาภาคการเงินและปัจจัยแวดล้อมด้านสถาบันของไทย และเปรียบเทียบกับประเทศสมาชิกหลักของอาเซียน ทั้งนี้เพื่อพิจารณาระดับการเปิดเสรีและระดับความพร้อมว่ามีความสอดคล้องกันหรือไม่

งานวิจัยได้ข้อสรุปหลัก ดังนี้

ประการแรก: AEC ไม่ได้มีเป้าประสงค์ที่จะเปิดเสรีระดับสูงสุดในทุกด้าน โดยเมื่อพิจารณาเป้าหมายตามแผนของ AEC พบว่า ภาคบริการมีเป้าหมายการเปิดเสรีในระดับที่น้อยกว่าภาคสินค้าหรือการลงทุน ส่วนภาคแรงงานฝีมือนั้นยังอยู่เพียงขั้นเตรียมพร้อมเพื่อการเปิดเสรี ในขณะที่กรอบการเปิดเสรีของภาคการเงินนั้นมีความยืดหยุ่นมาก คืออนุญาตให้แต่ละประเทศพิจารณาได้เองโดยขึ้นอยู่กับสภาวการณ์และความพร้อม และได้ขยายกรอบเวลาไปจนถึงปี 2020 ดังนั้น อาจกล่าวได้ว่ารูปแบบการรวมกลุ่มของอาเซียนเป็นการพัฒนารูปแบบจากการเปิดเสรีทางการค้า โดยมิได้มีความมุ่งหวังไปถึงระดับตลาดร่วมดังที่เกิดขึ้นในการรวมกลุ่มของยุโรป

ประการที่สอง: แม้ AEC จะไม่ได้กำหนดเป้าหมายการเปิดเสรีไว้ในระดับสูง แต่ในปัจจุบันประเทศสมาชิกหลักของอาเซียน ก็ยังเปิดเสรีไม่ถึงเป้าหมายตามแผนของ AEC ที่กำหนดไว้ โดยในกรณีของไทยได้เปิดเสรีด้านสินค้าไปในระดับที่ใกล้เคียงกับเป้าหมายของ AEC แล้ว แต่ที่สำคัญคือ ระดับการเปิดเสรีของไทยยังตามหลังสมาชิกหลักของอาเซียนในภาคบริการทางการเงินและเงินทุนเคลื่อนย้าย ซึ่งส่วนหนึ่งมาจากความระมัดระวังในการเปิดเสรีของไทย อันสะท้อนได้จากกฎหมายและระเบียบต่างๆ ในปัจจุบัน ที่ยังไม่สอดคล้องกับเป้าหมายการเปิดเสรี อย่างไรก็ดี ในอีกด้านหนึ่งของวงจรเกื้อกูลนั้น จากการพิจารณาเครื่องชี้วัดด้านการพัฒนาภาคการเงินและปัจจัยแวดล้อมด้านสถาบัน สรุปได้ว่า ประเทศไทยอยู่ในระดับปานกลาง เมื่อเทียบกับกลุ่มประเทศอาเซียนหลัก

ประการที่สาม: ทุกภาคส่วนที่เกี่ยวข้องจำเป็นจะต้องมี integration mindset โดยบรรจุเรื่องการรวมตัวของอาเซียนเข้าไปในกฎหมาย ระเบียบ และแผนแม่บทต่างๆ ของแต่ละประเทศ เพื่อให้สามารถขับเคลื่อนแนวปฏิบัติได้ตามกรอบของเป้าหมายตามแผนของ AEC ซึ่งสำหรับประเทศไทยเองนั้น ควรพิจารณาให้มีการเปิดเสรีทางด้านการเงินเพิ่มมากขึ้นจากปัจจุบันที่อยู่ในลำดับรั้งท้ายของกลุ่มประเทศสมาชิกหลักของอาเซียน อันจะเป็นการช่วยพัฒนาให้ไทยมีความพร้อมด้านภาคการเงินและปัจจัยแวดล้อมด้านสถาบันเพิ่มมากขึ้น ทำให้สามารถเก็บเกี่ยวประโยชน์ที่เกิดขึ้นจากการรวมกลุ่มทางเศรษฐกิจในภูมิภาคได้อย่างเต็มที่

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AEC 2015: Ambitions, Expectations and Challenges

ASEAN's Path towards Greater Economic and Financial Integration

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Bank of Thailand

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Abstract

The views expressed in this paper are those of the authors and do not necessarily represent those of the Bank of Thailand

The formation of the AEAN Economic Community (AEC) in 2015 is an important milestone in the process of ASEAN integration. The challenge for members is to tap on the gains of integration while staying prepared for changes. As financial integration is part of this process, it is important to reap benefits by creating a mutually reinforcing "virtuous circle" of financial integration: having more willingness in financial liberalization would—through increased competition and technology transfer—support the development of the financial sector, which, in turn, will support further liberalization.

We aim to quantify the extent of liberalization under the AEC Blueprint and the current state of implementation, and come to the conclusion that it does not aim towards full liberalization in all areas, with implementation currently lagging behind in some areas. Importantly, Thailand's present willingness to liberalize the financial sector trails other ASEAN peers. However, relevant indicators of financial development and institutional environment reveal that Thailand's readiness is relatively on par with its peers. We therefore come to the policy recommendation that Thailand has room to accelerate its liberalization process under the Blueprint, particularly in the area of financial liberalization. Key to this is the adoption of an "integration mindset" by incorporating regional integration issues into domestic laws, regulations and master plans, which will ultimately give thrust to the aforementioned "virtuous circle".

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Executive Summary

2015 will see the establishment of the ASEAN Economic Community (AEC). It is not to be regarded as one-off phenomenon in the ASEAN integration process, but rather as another key milestone in the ASEAN integration process that began almost two decades ago with the region-wide trade liberalization. The main objective of the AEC, according to its "Blueprint", is to create a "single market and production base" by accelerating current liberalization process of goods, services and investment and complement it with greater flows of skilled labor and capital. A stronger regional integration will enhance efficiencies through greater specialization in production, greater economies of scope and scale, not to mention that it will also raise the collective bargaining power. If seen as an economic entity, the AEC will have the world's third largest population earning the sixth largest income with the fifth largest exports.

Regional integration efforts generally start with the liberalization of trade flows, where benefits are most evident. While the benefits of trade integration are widely acknowledged, a review of the empirical evidence indicates that gains from financial integration are not as clear-cut. This is because there are two key mutually reinforcing conditions in securing benefits from financial integration: One is the readiness of financial and institutional development in supporting liberalization, while the other is the willingness to engage in financial liberalization itself. This may be seen as a virtuous cycle: gradual liberalization, with new competition and technological transfer, would contribute to financial development and, in turn, provide support for further liberalization. This leads to the main theme question of this study—whether in the specific case of Thailand, the relative extent of its financial liberalization corresponds to its financial and institutional development or not.

It is therefore the primary aim of this study to quantify the extent of Thailand's current willingness in financial liberalization on one hand and the readiness financial development and institutional environment on the other.

In measuring the extent of liberalization, we come up with two gaps: the "liberalization gap" to see the difference between the AEC Blueprint and full liberalization, and the "implementation gap" to measure how much the key five ASEAN countries have liberalized compared to the AEC Blueprint.

For the financial development and institutional environment part, we extract indicators that best represent both aspects. Using these indicators, we will explore Thailand's case and see whether the relative position of Thailand's financial development is consistent with its current financial liberalization.

Three main conclusions can be drawn:

First, we find that the AEC does not aim for full liberalization in all dimensions: According to the Blueprint, liberalization of trade in goods and investment is expected to be larger than that in services, whereas that for skilled labor is still in its initial stages. Liberalization of financial services and capital flows is subjected to flexibility, i.e. it is dependent on the situation and readiness of members and is extended to 2020. In short, the AEC will be an enhanced form of a free trade area, but is not aiming to be in the common market that the European Community once was.

Second, even though the AEC is not aiming for full liberalization, there are still implementation gaps among five key members of ASEAN. In the case of Thailand, while goods have made progress, Thailand still lags behind other ASEAN peers in the liberalization of financial sector and capital flows. This is because elements of integration are not adequately reflected in current laws and regulations. Nevertheless, an assessment of the relevant indices which represent financial development and institutional environment, reveals that Thailand's relative position is in the middle among the five ASEAN countries.

Third, drawing from the findings, it is recommended that an integration mindset should be instilled to current domestic laws, regulations and master plans. This is particularly important for Thailand's financial liberalization, which currently trails other ASEAN peers. There is therefore room to engage in further financial liberalization for Thailand, which would not only aid the development of the financial sector and institutions, but, more importantly, bring about the benefits of financial liberalization itself.

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Introduction

The ten members of the Association of Southeast Asian Nations will establish the ASEAN Economic Community in 2015, which is considered to be a major event in the history of the most successful regional integration in the developing world. However, the formation of the AEC is not to be seen as a one-off phenomenon, but rather as one of the key milestones in ASEAN's process of economic integration that began with the liberalization of trade almost two decades ago.

With a goal of achieving a "single market and production base", the AEC aims to achieve efficiencies in markets and also tap on gains from economies of scope and scale, reduce current development disparities, and ultimately raise the welfare of its citizens. Instead of ten very diverse economies, the AEC will be among the top five economies of the world. The rankings speak for themselves: If taken as economic entity, the AEC will have the world's third largest population earning the sixth largest income as the world's fifth largest exporter.

The AEC, according to its work plan or the "AEC Blueprint", intends to accelerate the ongoing process of liberalization of movements of goods, services and investment and to complement it with greater flows of production factors of labor, and more prominently, capital. Hence an important aspect of the AEC will be financial integration, which covers both the liberalization of financial services as well as capital flows.

This paper aims to join in the current prevalent discussion rounds and seminars brought about by an atmosphere of anticipation of the AEC. The authors intend to provide insights into three key areas, which will be covered in the three chapters of this paper, each conveniently titled as "Ambitions", "Expectations" and "Challenges".

The first Chapter, "Ambitions of ASEAN Integration", begins with theoretical underpinnings of regional integration and will determine the position of the AEC along the many different routes of integration. Because the AEC is a trade-led, finance-supported model of integration, this part will also explore in detail the complexities associated with financial integration. While the benefits of trade integration are practically undisputed, the gains from financial integration are not as clear-cut, especially when one considers the empirical evidence. The reason for this is that there are key mutually supportive factors necessary for securing these gains and minimizing risks: first, the willingness in liberalizing the financial sector; and second, the readiness of financial development and institutional environment in supporting liberalization. This may be seen as a virtuous cycle: gradual liberalization, with new competition and technological transfer, would contribute to financial development and, in turn, provide support for further liberalization. This leads to the main theme question of the paper—whether in the specific case of Thailand the relative extent of its financial liberalization matches its financial and institutional development or not.

The second Chapter, "Expectations of the AEC in 2015", carries on the theme and will primarily aim to measure extent of liberalization expected by the Blueprint and implemented by key member countries. We will explore of how much the AEC intends to liberalize and how much Thailand and its ASEAN-5 peers (Indonesia, Malaysia, Philippines and Singapore) have currently achieved in their liberalization endeavors. In measuring the extent of liberalization, we will come up with two gaps: the "liberalization gap" to see the difference between the AEC Blueprint and full liberalization, and the "implementation gap" to gauge how much the key five ASEAN countries have liberalized compared to the AEC Blueprint. While the absolute values are important in determining Thailand's current implementation status, it is the relative scores which really matter, as they show the relative positioning of Thailand vis-à-vis its peers. This is particularly important in the case of the financial liberalization—both in terms of financial sector and capital account—to see how much Thailand has done in these aspects.

The third Chapter, "Challenges for Thailand's financial integration" completes the arc began in the first Chapter by further looking into the financial and institutional development conditions necessary to reap benefits from financial liberalization. Before that, we will provide an overview of the current work on ASEAN financial integration and the specific role of Thailand in its financial integration effort. In the key part of the Chapter, we extract indicators that best represent both development aspects. For financial development these include proxies for both breadth and depth of the financial system. Using these indicators, we will explore Thailand's case and see whether the relative position of Thailand's financial development is consistent with its current financial liberalization.

The paper concludes with policy recommendations as how to move forward on the financial integration aspect of the AEC. While the plans of financial integration under the AEC is not as large-scale as, for instance, anticipating a common currency, there is no reason for members to be complacent, given that any gaps in implementing the AEC Blueprint relative to other peers may lead to losses in competitiveness due to foregone first-mover advantages, and possibly to marginalization. It is therefore important for individual countries to change the "**integration mindset**". By this we mean that there should be political will to incorporate the idea of ASEAN integration into domestic laws, regulations and master plans.

Chapter 1: Ambitions for ASEAN: Regional Economic and Financial Integration in Theory and Evidence

1.1 Benefits of Regional Integration

ASEAN has long been touted as the most successful regional integration undertaking in the developing world. With the imminent establishment of the ASEAN Economic Community (AEC) in 2015, it will thus strengthen the role of ASEAN as a key global economic player. Instead of looking at ten very diverse member countries, the AEC as a much more coherent economic entity would stand out in terms of global rankings. If treated as such an economic entity, the global rankings of ASEAN tell a powerful message of the importance of ASEAN within the world community (see Figure 1.1):

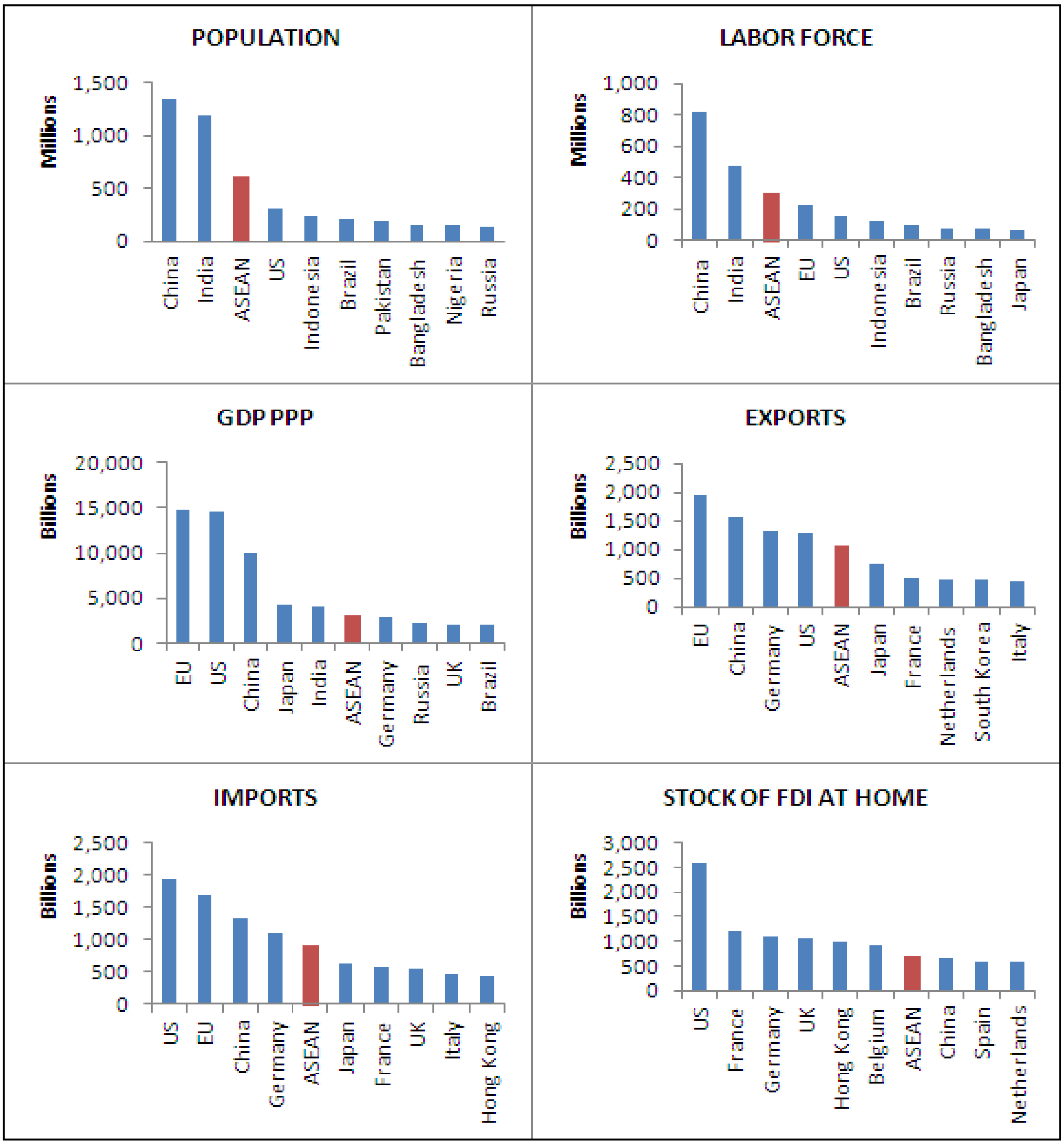
- ASEAN ranks **third** in terms of **population size** which exceeds twice of that in the United States.
- ASEAN is also **labor-abundant** and ranks **third**, after only the two Asian powerhouses, of China and India.
- The region is the **sixth** largest **economy** (GDP PPP) and the **fifth** largest **exporter** and **importer**.
- Thanks to strong economic fundamentals, ASEAN is the **seventh** most attractive economic territory for **foreign direct investment**.

These rankings demonstrate that ASEAN as an economic region is one of the major players in the global economy, which cannot be said for each of the individual member countries. ASEAN thus represents a working example of why countries integrate regionally.

First, the economic benefits are substantial. The large cross-border aggregation of economic agents induces both economies of scope and scale to improve production efficiency. Intra-regional division of labor, brought about by disparate levels of economic development and comparative advantages, combined with increased competition further enhances production efficiency within the region. Production efficiency, in turn, delivers consumption benefits to the more integrated population. With increased production efficiency and better resource allocations, more goods can be produced at a greater variety, and these goods can be produced at lower costs. This ultimately improves the welfare of members' citizens.

Second, an integrated region enhances the political gains from increased collective bargaining power of the individual members. Indeed, the increase may be particularly large for the small members. ASEAN members, for instance, tend to negotiate trade agreements as a single bloc with other partners. This is especially beneficial for smaller members which do not normally engage in bilateral trade agreements. However, political gains from regional cooperation do not merely confine to greater bargaining power. The stronger the regional economic cooperation becomes, the more the region is insulated from internal conflicts. Moreover, engaging in regional agreements can help lock in necessary domestic reforms and signal commitments to sound macroeconomic policies.

Figure 1.1: ASEAN in Global Rankings



Source: World Factbook, CIA
Note: data for population are as of 2011, data for exports and imports for EU are of 2007, and others are of 2011.

1.2 Forms and Sequential Process of Regional Integration

The advantages of regional integration might explain why it is tempting for countries to engage in regional integration. In modern times, starting with the establishment of the European Economic Community (EEC) in 1957, there have been quite a number of regional integration projects on every continent, each taking various forms. Concurrent with the genesis of the EEC, a new economic theory of regional integration has been developed to explain this development. In a seminal work by Balassa (1961 and 1996), regional integration takes one of the following forms.

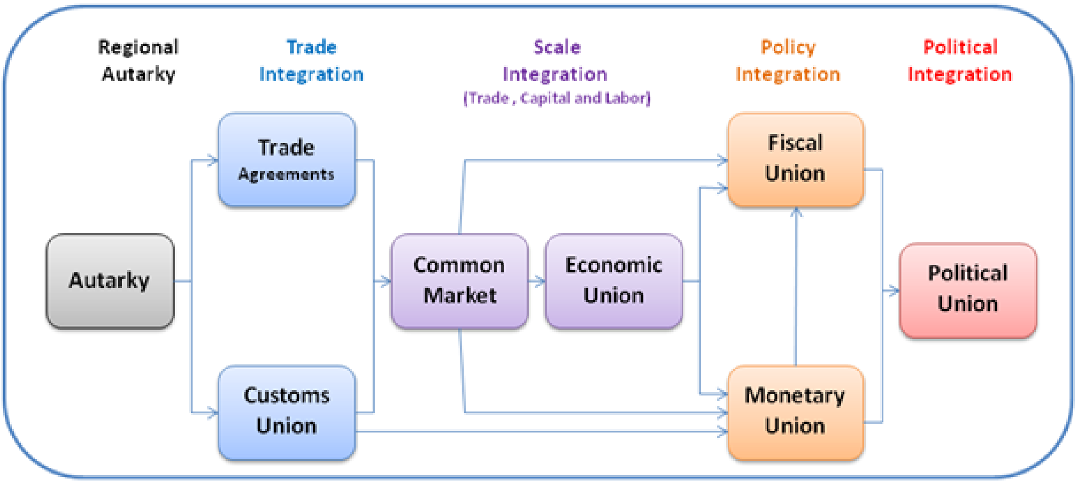
Departing from a state of regional autarky, a **free trade area** involves liberalizing trade in goods and services mainly through the elimination of intra-regional tariffs. If external tariffs on non-participating countries are equalized, a free-trade area is said to progress to a **customs union**.

A **common market** differs from the first two in that it requires member states to liberalize not only on the trade dimension, but also key factors of production—labor and capital. A common market may then further evolve into an **economic union** through harmonization of and cooperation on economic policies. Finally, the unification of fiscal and monetary policies supported by various supranational bodies ultimately establishes **complete economic integration**.

More recently and in line with developments in the European Union, the five Balassa stages have been expanded by Crowley (2001) by including three advanced stages: a **monetary union** requires a member to share monetary policy as a result of having a common currency, while a **fiscal union** necessitates deep and extensive fiscal cooperation, and a **political union** demands members to delegate significant national sovereignty to supranational authority. Hence, the more extensive regional integration becomes, the more sovereignty in economic (and political) decision-making powers has to be transferred to the region itself or an authority representing the region.

These forms of integration may not capture real regional integration perfectly, since the actual approach may have many facets that may not adequately explained by the Balassa model. Against this backdrop, Crowley (2001) proposes a new taxonomy to define levels of integration in a broader sense, as shown in Figure 1.2. A free-trade area (or trade agreements, which include goods, services and investment) and a customs union are subsumed in the **trade integration** phase. A common market and an economic union are under the same umbrella of **scale integration**, which incorporates flows of factors of production in addition to flows of goods and services. **Policy integration** includes both a fiscal and a monetary union, while **political integration** implies a political union.

Figure 1.2: Forms of regional integration



Source: adapted from Crowley (2001) [3]

[3] The arrows in the figure capture a spillover effect from Crowley's forward-looking analysis.

Crowley also views regional integration as a sequential process, using a backward- and a forward-looking analysis. On the one hand, the **backward-looking approach** indicates that some forms of integration require some other preceding forms as a precondition. To illustrate, a common market expects that either a free-trade area or a customs union be already created, while a political union presupposes the formation of a fiscal union. On the other hand, the **forward-looking analysis** demonstrates that each stage of integration tends to have a spillover effect that advances towards deeper levels once the benefits become more desirable and evident. For example, the success of an economic union may call for stronger policy coordination—either in terms of monetary or fiscal policy coordination—to facilitate flows of trade and factors of production.

However, a progress of regional integration initiatives might not entirely be portrayed by this sequential process. Several economic and political influences actually play a central role in explaining the pathway of each regional integration project. Yet even though this sequential analysis is not an ultimate determinant for a real regional integration approach, it proves to be very useful in explaining current developments.

So far, ASEAN's route toward regional integration appears to conform to this sequential concept. Economic integration in ASEAN began with the process of integrating trade through tariff reductions and, with more apparent benefits, has moved to encompass services and investment as well. The establishment of the AEC would mean that ASEAN is now transcending Crowley's trade integration phase towards the scale integration phase, taking some forms of a common market, but not becoming a common market *per se*. The extent of how much the AEC is expected to move towards a common market will be discussed and measured in detail in the next Chapter. Hence it should be emphasized that, contrary to popular (mis-) perceptions, the AEC in 2015 will not be a common market that the European Union was in 1992. This also renders any discussion on a single currency for ASEAN as too ambitious for the time being.

In sum, the AEC will rather be an intermediate form of integration between trade agreements and a common market, driven by trade integration and facilitated by increased labor mobility and regional financial integration. Within the context of the AEC, financial integration implies both the liberalization of financial services (banking, insurance, capital markets) and capital flows.

1.3 Reaping Benefits of Financial Integration

While the benefits of trade integration are generally undisputed with compelling evidence, the gains to be had from financial integration are not as clear-cut. This section therefore reviews recent literature on theory and empirical evidence on international financial integration.

Financial integration can be defined as a state in which one financial market becomes part of another, with saving and investment activities as well as interest rate movements of integrated areas being increasingly synchronized. Financial integration can be achieved through financial openness which involves capital account liberalization or removals of capital control (see Le (2004)), and may also take institutional form, such as through the integration of the banking sector and capital markets. The concept of both financial integration and financial openness is interrelated and hence the terms are used interchangeably in this paper[4].

[4] See also Bonfiglioli (2008) and Kose, Prasad, Rogoff, and Wei (2003).

The two key potential benefits of financial integration concern **growth** and **volatility**:

In terms of growth, financial integration allows capital to flow into a country and thus helps expand domestic savings and deepen domestic financial markets. Efficient cross-border capital allocation also results in lower cost of capital and an associated increase in investment. These channels directly contribute to improved economic performance in terms of higher economic growth (See also Kose, Prasad, Rogoff, and Wei (2003) and Agenor (2003)).

In case of volatility, international financial integration should help reduce consumption volatility through more efficient capital allocation and international risk-sharing, as suggested by Kose, Prasad, and Terrones (2003). Given that fluctuations are not perfectly correlated across countries, trade in financial assets allows national consumption levels to detach from idiosyncratic components of output fluctuations (See also Obstfeld and Rogoff, 1998). Thus, consumption volatility relative to output volatility is expected to decrease from increased financial integration.

The growth-enhancing and consumption-smoothing benefits of financial integration are argued to operate through several **transmission channels**:

Firstly, financial integration should **promote domestic financial development**. Levine (1996) and Caprio and Honohan (1999) argue that foreign bank penetration results in improved financial services quality and availability. In addition, an increase in the depth and breadth of domestic financial market should enhance efficiency in the financial sector (See also Agenor, 2003; Levine, 2000; and Klein and Olivei, 2005).

Secondly, MacDougall (1960), Berthelemy and Demurger (2000), Borensztein, De Gregorio and Lee (1998) find that foreign direct investment helps **facilitate transfer of technology** and managerial know-how to a recipient country.

Thirdly, Obstfeld (1998) observes that financial integration **enhances macroeconomic policy discipline** and reduces frequency of policy mistakes. For instance, Bartoloni and Drazen (1997) suggest that financial openness signals a commitment to sound macroeconomic policies by reducing budget deficits and forgoing the use of inflation tax.

1.3.1 Empirical evidence of financial integration on growth

Even though these channels explain how financial integration can promote higher economic growth, a review of the available empirical evidence provides rather mixed results for a broad set of countries. However, a closer scrutiny reveals that there are certain conditions to be fulfilled before the growth benefits could be realized.

Some studies, such as Quinn (1997) and Bekaert, Harvey, and Lundblad (2001), find a robust and positive association between financial liberalization and better economic performance. However, others including Grilli and Milesi-Ferretti (1995), Rodrik (1998), and Kraay (1998) find that there is no, or merely a weak, link between financial integration and economic growth. Moreover, Carkovic and Levine (2002) and Edison, Levine, Ricci, and Slok (2002) do not find a robust and independent effect of various measures of international financial integration on economic growth, after taking into account bi-directional relationship between financial openness and growth.

However, various studies argue that the effect of financial integration on growth is **conditional** on a number of key domestic considerations. Edwards (2001) finds that capital account openness is positively associated with higher economic growth if a country achieves a certain degree of economic development. Klein and Olivei (2005) report that capital account liberalization has a positive growth effect only in industrial countries, therefore implying that adequate institutions and sound macroeconomic policies are required. Arteta, Eichengreen, and Wyplosz (2001) suggest that the degree of macroeconomic stability explains differences in the effect of capital account liberalization across countries. Eichengreen and Leblang (2003) argue that the effect of capital account liberalization is context specific. It tends to be favorable when domestic financial system is robust and the international financial system is not prone to disruptive crises.

More recently, Coricelli, Masten, and Masten (2007) suggest that the positive effects of financial integration depend on the development of domestic financial markets, macroeconomic stability and quality of institutions. Similarly, Osada and Saito (2010) find that countries with good institutions and developed financial markets benefit more from financial integration.

1.3.2 Empirical evidence of financial integration on volatility

With regard to the effect of financial integration on macroeconomic volatility, empirical evidence still fails to establish a strong conclusion that financial integration can unconditionally lead to greater economic stability.

Easterly, Islam, and Stiglitz (2001) do not find strong evidence that increased financial integration is associated with lower volatility. More importantly, Bekaert, Harvey, and Lundblad (2002) even observe that capital account openness in emerging market economies even results in *higher* volatility.

O'Donnell (2001) came up with a similar conclusion that financial integration is associated with higher volatility in developing countries. However, he also reports that the volatility declines with increased financial integration in developed countries and that developed financial sectors might be important in mitigating output volatility coming from increased financial integration.

Interestingly, Kose, Prasad, and Terrones (2008a) explain that the composition of financial flows matters in determining successful financial integration. They find that FDI and portfolio equity stocks seem to promote risk sharing but debt stocks produces the opposite effect. However, capital flowing into developing countries appears to be pro-cyclical and might be predominantly concentrated in bad type of flows. This explains why financial integration in developing countries is often associated with increased volatility.

1.3.3 Thresholds for Reaping Benefits of Financial Integration

As discussed above, numerous studies observe that there appears to be a threshold for financial integration to promote economic growth. In particular, Kose, Prasad, and Taylor (2009) suggest that key conditions required to maximize gains from international financial integration include financial sector development, institutional quality, trade integration, and sound macroeconomic policy. They, however, report only the result for financial development and institutional quality, not least because the indicators for financial development and institutional quality are most robust and statistically significant.

With regard to the threshold of financial development, even though many studies rely on the same ratio of private credit to GDP (as a proxy for financial depth) their estimated threshold levels vary considerably. Hermes and Lensink (2003), Alfaro, Chanda, Kalemli-Ozcan, and Sayek (2004), and Carkovic and Levine (2005) report that the ratio should be at least 13 to 48 percent for benefits to be seen from financial integration.

Meanwhile, Kose, Prasad, and Taylor (2009) find that the threshold of financial development appears to be non-linear. They suggest that the growth effect of financial integration will be positive only if the ratio of private credit to GDP crosses a lower threshold, but later turns negative after it goes beyond an upper threshold level. Using generalized method of moments, they find that the figure has to surpass 50 percent, but not exceeding 126 percent, for financial integration to pay off[5].

In terms of institutional environment, these authors use World Bank Governance Indicators as a proxy[6]. Similar to the result of financial development indicator, they find non-linear institutional quality effect for financial integration to promote economic growth. However, they observe that although all developed countries pass the estimated threshold, only 29 percent of emerging market economies and 20 percent of developing countries meet this precondition.

A threshold also exists for financial integration to smooth consumption. Kose, Prasad, and Terrones (2008b) observe that financial openness is initially associated with rising consumption volatility relative to that of the output. But when a country liberalizes more financially until it reaches a certain degree, consumption volatility relative to output volatility begins to decline[7] (see also Evans and Hnatkovska, 2007). Bai and Zhang (2009) support this by arguing that developing countries have not witnessed much decline in volatility following financial liberalization because capital flows that increase after removal of capital controls are quantitatively insignificant to improve risk sharing.

1.3.4 The Virtuous Circle of Financial Integration

The message in the preceding sections is a key theme of this paper: **For financial integration to generate benefits**, i.e. to promote growth and reduce volatility, **domestic financial markets and the institutional environment need to be developed** and **the degree of financial liberalization to be sufficiently high**.

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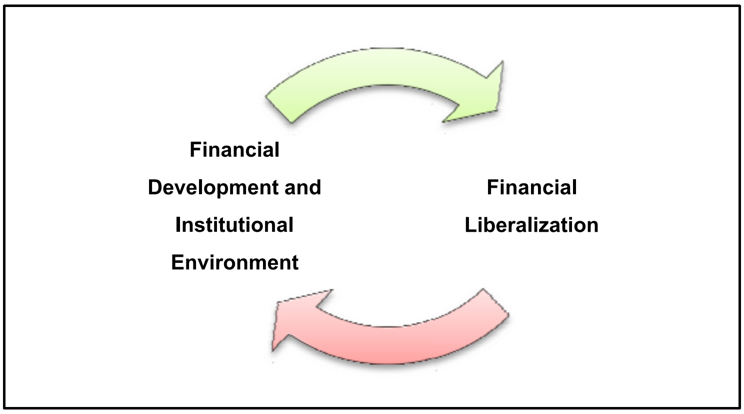
[5] Based on their fixed effect estimates, they find that the lower and the upper level of the threshold lie at 71 and 137 percent, respectively. They report that estimates from both fixed effect and generalized method of moments are statistically significant.

[6] World Bank Governance Indicators (WBGI) contains six institutional quality dimensions which include voice and accountability, political instability and violence, government effectiveness, regulatory quality, rule of law, and control of corruption to represent institutional quality.

[7] Kose, Prasad, and Terrones (2003) indicate that in order for financial integration to reduce relative consumption to income volatility, gross financial flows have to exceed 49 percent of GDP.

Remarkably, these thresholds are interrelated and mutually reinforcing, and resemble a virtuous circle (see Figure 1.3). Financial sector development and strong institutional quality/ environment are required to integrate more financially. But the process of financial liberalization itself can also encourage stronger institutional quality (e.g. impose a discipline on macroeconomic policy) and promote domestic financial development (e.g. increase depth and breadth of financial markets).

Figure 1.3: The virtuous circle of financial integration



Conversely, many countries believe that their financial and institutional development will not support financial liberalization, and will not take the first step of financial liberalization. This stalls further financial and institutional development, thus creating a vicious instead of virtuous circle. Most developing countries do not seem to significantly benefit from financial openness because they have not passed these thresholds. However, this hardly implies that they need to be less financially open. In fact, a sufficiently high degree of financial integration is one of the thresholds. Therefore, going forward an appropriate route to financial integration is to develop financial markets and institutional quality and concurrently welcome international financial linkages.

The next two chapters will, among others, touch on this theme by first measuring how much Thailand has progressed in its financial liberalization efforts compared to its main ASEAN peers; and compare them with Thailand's relative rankings on financial development and institutional environment.

Chapter 2: Expectations of the AEC in 2015

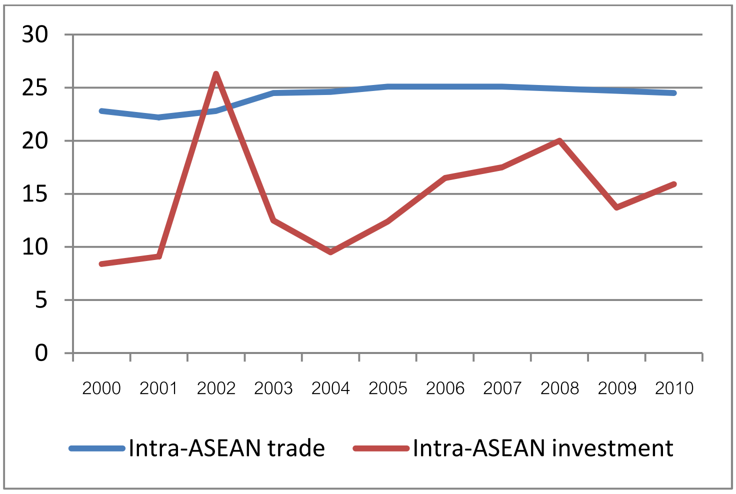
Following an overview of the theory and empirical evidence on integration in the previous chapter, the thrust of this chapter will be on the ASEAN Economic Community (AEC) itself, in particular on the extent of integration the AEC is aiming for and how the major ASEAN members are currently progressing in liberalizing the various dimension called for by the Blueprint. The extent of liberalization is quantified and two gaps are revealed—integration and implementation gaps. More importantly, chapter will also address one of the key aspects of the "virtuous circle", that is, to see Thailand's degree financial liberalization relative to its peers.

2.1 The AEC within the framework of ASEAN Economic Integration

2.1.1 The ASEAN Economic Community

What exactly is the AEC? It is the economic pillar of the triad "ASEAN Community" which aims to be realized by 2015 as agreed by ASEAN leaders in 2007, with the other two pillars being the ASEAN Political-Security Community and the ASEAN Socio-Cultural Community. The AEC itself comprises four key elements (see Table 2.1), at the core of which is the first one, namely to create a "**single market and production base**". Unlike the more inward-looking single market of the European Union, the ASEAN model is more outward-looking, as its intra-regional trade and investment, though on an increasing trend, are more geared towards the rest of the world (Figure 2.1). This is why one of the parts of the AEC calls for stronger integration with the rest of the world, mainly through the vehicles of FTAs with its key dialogue partners.

Figure 2.1: Intra-ASEAN trade and investment



Source: WTO, ASEAN Secretariat

The AEC should not be seen as a one-time phenomenon of regional integration in ASEAN, but it should rather be regarded as a key milestone of several successive building blocks that began almost 20 years ago with the founding of the ASEAN Free Trade Area (AFTA) in 1992 and then proceeded to the ASEAN Framework Agreement on Services in 1995 for trade in services and the ASEAN Investment Area in 1998 for investment.

In the context of these original agreements, the "single market and production base" part of the AEC aims to achieve two important goals. First, to improve on and accelerate previous liberalization efforts: AFTA, for instance, focused on tariff reductions but paid less importance on non-tariff barriers, which have gained importance as tariffs are reduced. AFAS was initially slow in liberalizing services, with members liberalizing only marginally beyond their commitments under the WTO. Second, the AEC aims to augment these integration elements by including production factors of labor and capital, which shows the importance of financial integration within the AEC.

The first five goals of the AEC outlined in Table 2.1 may seem *prima facie* akin to the "common market" stage of the Balassa integration stages. However, this may not be the case for all dimensions, and hence there is a need for assessing the extent of liberalization called for by the AEC Blueprint. Furthermore, it is also important to assess where member countries currently are in the implementation of the Blueprint. A distinction is made in Table 2.1 into two objectives: (1) "liberalization" goals, i.e. those that involve lifting current barriers to movements of goods, services or production factors, be it through the removal of tariffs and non-tariff barriers, the reduction of foreign equity participation and the removal of barriers of capital flows; and (2) goals that involve the facilitation and protection of investment, harmonization of laws and regulations, capacity building, and the like.

Table 2.1: Overview of the AEC Blueprint

Core Elements	Liberalization	Facilitation/Protection/Harmonization
A. Single Market and Production Base		
1. Goods	Eliminate tariffs: 2010 for ASEAN-6 and 2015 for CLMV Eliminate non-tariff barriers: 2010 for ASEAN-5, 2012 for the Philippines and 2015 for CLMV	Simplify rules of origins, customs integration ASEAN Single Window, trade facilitation, standards of commerce
2. Services	Allow 70% foreign equity in priority sectors (health, tourism, IT, transport by 2012), logistics by 2013 and all other services by 2015 Financial services: liberalization according to readiness	
3. Investment	Liberalization according to the ASEAN Comprehensive Investment Agreement	Investment protection and promotion
4. Capital	Progressive liberalization depending on members readiness	Harmonize regulations
5. Skilled Labor		Facilitate movements of professional labor through Mutual Recognition Agreements

6. Priority Sectors	Projects in 12 Priority sectors
7. Food, agriculture, forestry	Harmonize best practices, such as safety and quality standards
B. Competitive Economic Region	
1. Competition policy	Introduce competition policies and develop regional networks and guidelines
2. Consumer protection	Develop regional networks and guidelines
3. Intellectual property rights	Implement IPR action plan, promote regional cooperation
4. Infrastructure	Facilitate multimodal transport and implement key infrastructure projects
5. Taxation	Complete bilateral agreements
6. E-commerce	Harmonize legal infrastructure
C. Equitable Economic Development	
1. SMEs	ASEAN Blueprint of best practices
2. Initiative for integration	Capacity building for CLMV countries
D. Integration into the Global Economy	
1. Coherent Approach	Enhance coordination and common approaches for trade agreements with dialogue partners
2. Supply networks	Adopt international best practices and standards, technical assistance

Source: based on Petri et al. (2010) and ASEAN (2007)

This Chapter attempts to focus only on the liberalization dimension of the AEC Blueprint in the five core areas: goods, services, investment, labor and capital using a comparable index to gauge the extent of liberalization. More importantly, the status of implementation of members is assessed through the use of various indices.[8] This would allow for comparison of across dimensions and countries.

2.1.2 Liberalization and Integration Gaps

As ambitious as the AEC Blueprint may be, it is evident from Table 1 that not all dimensions are expected to be fully liberalized. For instance, the liberalization of services calls for a minimum investment threshold of a minimum of 70% in service sectors by 2015 (instead of full foreign ASEAN ownership as would be the case in a fully liberalized regime). There are two questions that arise from this observation: (1) how much liberalization does the Blueprint really call for; and (2) how much progress has the major countries made in achieving the objectives of the Blueprint.

[8] The ASEAN Secretariat has come up with a scoring for the implementation of the Blueprint. Called the "Scorecard", it is a comprehensive measure of activities that are needed to be implemented. The latest publicly available score reports that over 82% of the target for the "single market and production base" pillar has been achieved. However, this score includes various other elements as well, such as targets which are aimed at facilitating the liberalization process or harmonizing current laws and regulations.

In other words, we can identify two gaps that exist:

- The first gap may be termed as "**liberalization gap**", which shows the differences between the goals of the Blueprint and a fully liberalized region, i.e. one without trade and investment barriers.
- The second gap, the "**implementation gap**", looks at the current status of implementation of the five key ASEAN members, vis-à-vis the Blueprint goals and among themselves.

2.2 Indices used in Measuring Gaps

The key to identifying the liberalization and integration gaps is to make them quantifiable and comparable, despite the different concepts we are dealing with across each dimension. For this purpose, sector-specific indices are constructed for each sector according to various methods described below. The common element for each of the indices is that they have 0 and 100 as endpoints, which represent the absence of liberalization on one extreme and full liberalization on the other.

2.2.1 Goods

An index for liberalization of trade in goods needs to capture not only how much tariffs have been reduced, but also the more complex issue concerning non-tariff barriers as well. These can take the form of import quotas, or more veiled attempts of trade discrimination in the form of technical requirements and sanitary restrictions. One way to measure these NTBs is to calculate ad-valorem equivalents based on demand elasticities, such as by Kee et al. (2009), but due to a lack of updated data for all countries concerned, it may be more practical to employ a method which uses both qualitative and quantitative information. A good approximation of this is the "Trade Freedom Index" developed by the Heritage Foundation (2011).

Progress in liberalization of goods therefore has two parts. The first measures the extent of tariff reduction and is simply the percentage change of the current average tariff of a country applicable for other ASEAN members and the baseline, which is represented by the average tariff of that country when AFTA was implemented in 1993, with the ASEAN tariff database as source. The second part is the "penalty score" from the 2011 Trade Freedom Index which captures the pervasiveness of non-tariff barriers. The composite index for country i is therefore:

$$index_{goods}^{i} = \frac{t_{1993}^{i} - t_{2011}^{i}}{t_{1993}^{i}} * 100 - NTB^{i}$$

where t_{1993}^{i} is the average tariff for country i at the start of AFTA in 1993, t_{2011}^{i} is the current average tariff for country i in 2011, and NTB^{i} is the penalty of non-tariff barriers, which are scored as followed:

20: NTBs are used extensively across many goods and services and/or act to effectively impede a significant amount of international trade.
15: NTBs are widespread across many goods and services and/or act to impede a majority of potential international trade.
10: NTBs are used to protect certain goods and services and impede some international trade.
5: NTBs are uncommon, protecting few goods and services, and/or have very limited impact on international trade.
0: NTBs are not used to limit international trade.

2.2.2 Services

In view of the intangibility and other complexities related to the measurement of trade in services, it is therefore not as straightforward as that for in trade in goods. The liberalization of services is typically negotiated in four modes according to the nomenclature system of the WTO's General Agreement on Trade in Services (GATS)[9]. Hence, subsequent trade agreements—including ASEAN's AFAS—have broadly followed the terminology of GATS. Commitments are made committed in terms of market access, that is, whether a foreign service provider is allowed entry; and national treatment, that is, whether such service provider is treated as a domestic one. This study focuses on only the liberalization in mode 3 market access, as for a host country, it is this mode of supply that exhibits the crucial test of whether a host country has liberalized by allowing foreign entry or not.

A prominent method used to measure the extent of liberalization is based on the seminal work of Hoekman (1995), and further developed by Golub (2003) and Urata and Ando (2009), which employs frequency measures of commitments in liberalization. While the original Hoekman Index assigns three discreet values—endpoints of no liberalization and complete liberalization, as well as a midpoint which covers all intermediate steps, this study uses a more fine-tuned variant of this index.

In a method developed by Urata and Ando (2009), this variant of the Hoekman Index assigns more continuous values of the extent of liberalization/restrictions of foreign market access using the schedules of horizontal and specific commitments of the latest available legal texts: the 7th package of the AFAS, the 5th package of commitments on financial services, and 4th package of commitments on air transport. For country i, the index is:

$$index_{services}^{i} = \frac{1}{n}\sum_{k=1}^{n}\frac{1}{m}\sum_{j=1}^{m} h_{MA\ mode\ 3}{}_{j,k}^{i}$$

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[9] They are: **Mode 1**: Cross-border supply; **Mode 2**: Consumption abroad; **Mode 3**: Commercial presence and **Mode 4**: Presence of natural persons. Mode 3 entails establishment of a service supplier in another Member's territory and is therefore key mode in liberalization. Mode 4, on the other hand, is key in the liberalization of (professional) labor movements, which will be discussed in a later section. (GATS 1995)

where $h_{MA\,mode\,3}{}_{j,k}^{i}$ is the modified Hoekman Index for market access in mode 3 of services for subsector j (e.g. dental services) within sector k (e.g. health services), with simple averages taken for the subsectors in a sector and then for all sectors combined[10], scored according to the following scale:

▪ No foreign ownership allowed/Unbound	0
▪ 1-19% allowed	10
▪ 20-34% is allowed	40
▪ 35-49% is allowed	50
▪ 50-74% is allowed	70
▪ 75-99% is allowed	80
▪ No restrictions	100

The resulting index is not without limitations and caveats: First, any sector that has no commitments (termed as "unbound") in the agreement is automatically treated as if it were a closed sector. The underlying causes may either be that the particular sector is really intentionally closed or it could also be either a new sector or a sector not relevant or existent in the country concerned. Second, simple averages are taken for the sake of simplicity, thus assuming that all subsectors within a sector and all sectors within the realm of services are treated as equal in weight. Assigning different weights to each of the sub-sectors and sectors would have been theoretically possible, but this would present practical problems of determining the appropriate weights for each of the sub-sectors and sectors as well as related data requirements. In computing the scores, some of the sectors deemed as not applicable to the five ASEAN countries—like space transport—are omitted, along with some subsectors in the vague "others" category. Therefore, with these caveats in mind, the resulting index is to be taken not as a precise gauge of the *de facto* liberalization status, but more as a rough indicator based on current *de jure* commitments of signed agreements.

2.2.3 Investment

The findings of Urata and Ando (2009) are used to determine the extent of liberalization in non-service investment sectors, using the same scoring method as outlined above for services, with sources taken from the ASEAN Investment Area (1998) and various national laws on investment regime. The caveats for services apply here as well.

2.2.4 Skilled Labor

Again, a similar methodology to is used to determine the extent of skilled labor. The source is the Mode 4 (movement of natural persons) in the 7th package of AFAS and uses the same formula,

$$index_{labor}^{i} = \frac{1}{n}\sum_{k=1}^{n}\frac{1}{m}\sum_{j=1}^{m} h_{MA\,mode\,4}{}_{j,k}^{i}$$

10 The same method is used for financial services with its three subsectors: insurance, banking and securities.

where $h_{MA\ mode\ 4}{}^{i}_{j,k}$ is the modified Hoekman Index for market access in mode 4 for subsector j in sector k, with simple averages taken for the subsectors in a sector and then for all sectors combined[11], scored according to the following scale adapted from Jing (2007):

▪ No labor movement allowed/Unbound	0
▪ Entry only for managers/specialists	
-for max 5 years	10
-for more than 5 years	20
▪ Unrestricted entry for managers/specialists	50
▪ Restricted entries for others (e.g. job-seekers)	70
▪ No restrictions	100

2.2.5 Capital

The Capital Flow Freedom Index, developed by Park et al. (2011) is used in this case, which attempts "to assess the extent of capital account openness" of ASEAN members from information gathered from central banks and the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions. It is a largely *de jure* assessment scale based on current laws and regulations, i.e. any authorization required would constitute as a restriction, even if it is a mere regulatory formality that is generally approved by the authorities. Park assigns a scale of 0 to 100, with the latter denoting full *de jure* openness, and a score of 25 representing *de facto* openness. Weights for each category are assigned subjectively by Park as follows, with stress on portfolio openness, and the scores for each category are determined by the number of individual measures within each category:

▪ Portfolio inflows	30
▪ Portfolio outflows	30
▪ FDI flows	6
▪ Current account	15
▪ Personal transactions	10
▪ Freedom to use currency	5
▪ Freedom to hedge	4

[11] Again, the same method is used for financial services with its three subsectors: insurance, banking and securities.

2.3 Results: Liberalization and Implementation Gaps

2.3.1 Liberalization Gaps

The extent of the "liberalization gaps" in various sectors as depicted in Table 2.2 show that the AEC Blueprint does not aim for a full liberalization in all sectors. It is evident that the sectors which have achieved significant liberalization progress, such as goods and investment, are those which are expected to be most liberalized by 2015. Conversely, sectors which remain sensitive are on the other extreme, with no effective liberalization goals by 2015 as is the case for skilled labor, or flexibility embedded into the goals, as in the case for financial services and capital.

Table 2.2: Liberalization gaps

	Full Liberalization	AEC Blueprint 2015	Liberalization gaps
Goods	100	100	None: Elimination of tariffs/non-tariff barriers
Services (excluding Financial Services)	100	70	Some: Minimum of 70% ownership in service sectors
Investment	100	95	Almost none: Free investment with "minimal restrictions"
Skilled Labor	100	0	Yes: Facilitation of seven skilled professionals, but no effective liberalization
Financial Services	100	Flexible	Flexibility in the liberalization process for both financial services and capital flows
Capital	100		

Source: AEC Blueprint. The colors correspond to the extent of liberalization, with red denoting an index score of 0-25, orange 26-50, yellow 51-75 and green 76-100.

For **trade in goods**, there is practically no liberalization gap, as the Blueprint calls for an elimination of tariffs and non-tariff barriers by 2015 with the main ASEAN countries leading the process as early as 2010, which does represent the ideal of restriction-free trade. In particular, any prior protected items on the "Temporary Exclusion List" will have to be included in the zero-tariff inclusion list. The only gaps that exist relate some of the items placed in the sensitive list are allowed to maintain a nonzero tariff rate. However, according to the current ASEAN Tariff Database, the number of these items is negligible (less than 0.6%) compared to the near-universal elimination of tariffs.

With tariffs being eliminated, non-tariff barriers (NTBs) have gained prominence as a serious remaining impediment to trade. These NTBs include import quotas, surcharges, licensing requirements, and all sorts of industrial and sanitary standards and have not been adequately addressed under AFTA. Realizing this, the Blueprint underscores this and called for the elimination of as NTBs by 2010 for ASEAN-5 countries, 2012 for the Philippines and 2015 for CLMV countries.

On **trade in services**, there remain some liberalization gaps. The AEC Blueprint demands a much more ambitious plan for liberalization of services than goods. While most of traded goods had had very low or no tariffs associated with them when the AEC was announced, the services sectors were quite restrictive. This is because progress under liberalization under AFAS was, until recently, was very slow and only represented a marginal improvement compared to GATS commitments under the WTO. (Hamanaka 2009).

The Blueprint commits members to impose no restrictions on modes 1 (cross border trade) and 2 (consumption abroad) and gives a very specific timeline in liberalizing service sectors, based on (ASEAN) foreign ownership in mode 3 commercial presence as service suppliers, according to the following timeline:

- Priority integration sectors (IT, health, air transport, tourism): not less than 51% by 2008, and 70% by 2010
- Logistics services: not less than 49% by 2008, 51% by 2010, and 70% by 2013
- All other services sectors (except financial services): not less than 49% by 2008, 51% by 2010, and 70% by 2015

As for **investment**, the Blueprint envisages a "realization of free and open investment with minimal restrictions by 2015", which would imply that the liberalization gap is "minimal". In addition to the liberalization element, the Blueprint also calls for enhanced investment protection and facilitation. In 2009, the ASEAN Comprehensive Investment Agreement (ACIA) was signed[12] and contains both provisions on investment liberalization and investment protection and promotion.

The extent of liberalization in the ACIA is in general similar to its predecessor agreement, the ASEAN Investment Area (AIA) of 1998. All five sectors not falling under the realm of services, i.e. agriculture, forestry, fishery, manufacturing, mining and quarrying as well as services incidental to these sectors fall under the scope of the ACIA and are automatically liberalized[13], unless they are specifically reserved in the "sensitive list". Effectively, the less pervasive the sensitive list is, the larger the extent of liberalization. The Blueprint, which calls for "minimal restrictions", could be interpreted that members have "minimal" items in their sensitive list.

For **labor**, some distinctions have to be made: Firstly, the Blueprint only focuses on "skilled labor" as opposed to semi-skilled or unskilled labor (of which most of the 5.3 million intra-ASEAN migrant workers[14] belong to). Secondly, and the Blueprint calls for the "Mutual Recognition Agreements" (MRAs) for major professions and "develop core competencies for job skills required in all service sectors by 2015".

Of note is that only seven MRAs have been signed for seven professions (engineering, architecture, surveying, accountancy services, nursing as well as medical and dental practitioners), out of several hundreds of service professionals listed under GATS and AFAS. These MRAs recognize professional qualifications of an ASEAN professional in a host country which would facilitate them in carrying out the profession in the host country. However, the catch is that they are still bound by domestic laws and regulations of the country, which would mean that any prospective professional would need to obtain licenses of the host country. These include obvious barriers such as examinations in the host country's native language, not to mention

[12] The ACIA is not yet in effect, as Thailand and Indonesia have not ratified it as of 2011.

[13] Generally, this means that 100% ASEAN foreign ownership is granted. However in some cases, such as for Thailand, any foreign investment over 49% percent would need additional approval from relevant authorities.

[14] Data as of 2007, with the Philippines, Indonesia, Myanmar and Vietnam being the largest suppliers of intra-ASEAN migrant workforce. (ILO, 2010)

other necessary qualifications. A recent study by the International Labour Organisation on the migration of nurses argues that ASEAN's MRAs are merely a "small step forward" and highlights that the key obstacle is that they "do not eliminate domestic regulations which exist in the host country" (Matsuno 2009).

With only a handful of professions covered and domestic regulations incorporated into these professions, this eventually means that there is practically no effective liberalization commitment. However, due to common sensitivities surrounding labor movement liberalization, this is the only common step that ASEAN members can take now. However, this step is to be seen as an initial step towards more concrete forms of liberalization in the future.[15]

Financial services and **capital flows** are treated distinctly in the Blueprint, as they are the only two areas with flexibility allowed in the liberalization plan and are therefore not scored. The key difference that sets them apart from other areas (e.g. other services), is that there is no end-point specified. In other words, the end-game scenario of ASEAN financial integration has not been determined yet—whether a full-fledged integration is aimed for as in the case of goods, or some intermediary stage.

The flexibilities allowed for finance and capital are firstly due to their sensitivities and significance to other sectors of the economies; and secondly to the large differences in financial development and capital account policies among the membership.

For financial services in particular, the liberalization process allows for flexibility and extend to 2020. Even by 2020, the fine print in the Blueprint notes that "members may maintain restrictions as negotiated and agreed in the list of "pre-agreed flexibility"[16]. The first list of agreed sub-sectors to be liberalized by 2015 appears in Table 2.3. It is evident that capital markets and insurance are the sub-sectors most committed to liberalization, whereas for the banking sector, no additional commitments have been made for ASEAN-5 countries. Current plans for opening up the banking sector will be discussed in detail in the next Chapter.

For capital flows, the while there are milestones and sequencing for liberalization, beginning with current account, direct investment, portfolio flows, and other flows, there are also a flexibility clause built into each milestone, i.e. "where appropriate and possible".

Furthermore, safeguard clauses are to be an integral part of the liberalization process. For financial services, measures will be subject to prudential measures and balance of payments safeguards as provided for under GATS, for capital flows, safeguards relate to "potential macroeconomic stability and systemic risk that may arise from the liberalization process" (ASEAN Secretariat 2007)

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15 Information from interviews conducted with Thai trade officials and labor experts, August 2011

16 AEC Blueprint (2007), Strategic Schedule for financial services (footnote 6)

Table 2.3: Sub-sectors of financial services identified for liberalization in 2015 in ASEAN-5 countries

	Sub-sectors	ASEAN-5 Members
Insurance	Direct Life Insurance	IDN, PHL
	Direct Non-life Insurance	IDN, MAL, PHL, SGP
	Reinsurance and retrocession	IDN, MAL, SGP
	Insurance intermediation	IDN, MAL, PHL, SGP
	Services auxiliary to insurance	IDN, MAL, PHL, SGP
Banking		(none of ASEAN-5)
Capital Market	Trading for Own account or for account of customers	IDN, MAL, PHL, THA
	Participation in issues of all kinds of securities	IDN, PHL
	Asset management	IDN, PHL, SGP, THA
	Settlement and clearing services for financial assets	IDN, PHL, SGP, THA
Others	Provision and transfer of financial information	PHL
	Advisory, intermediation and other aux. financial services	PHL, SGP, THA

Source: AEC Blueprint

2.3.2 Implementation Gaps

While the extent of the liberalization gap depicts how far the goals of the Blueprint are from a state of complete integration, implementation gaps are intended to show how far Thailand and other ASEAN-5 countries are currently away from the goals set by the Blueprint, using the methodology described in the previous section and currently available sources.

Table 2.4: Implementation gaps

	Blueprint	Thailand	Indonesia	Malaysia	Philippines	Singapore
Goods	100	85	79	84	84	90
Services	70	36	29	31	39	50
Investment	95	67	78	86	75	100
Skilled Labor	0	6	5	7	15	10
Fin. Services	Flexible	45	55	60	58	63
Capital	Flexible	45	82	65	60	94

Source: AEC Blueprint, various sources detailed in the previous section. The colors correspond to the extent of liberalization, with red denoting an index score of 0-25, orange 26-50, yellow 51-75 and green 76-100.

The results, depicted in Table 2.4, show that, as of 2011, implementation is uneven across sectors, and, in a lesser extent, across countries. In general, goods and investment have high implementation scores, whereas services still lag behind. Also, liberalization of skilled labor is still minimal. As for financial services and capital, it is noteworthy that countries have liberalized to a considerable extent even if the Blueprint allows for flexibility.

A. Implementation in Trade of Goods

Trade in goods has always been the most integrated sector in ASEAN, led by the long-standing tariff reductions under AFTA. As Figure 2.2 shows, all ASEAN-5 countries have eliminated their tariffs by 2010[17]. Owing to this, all ASEAN-5 countries have almost perfect scores for the tariff portion (Table 2.5), with divergences only due to the handful of items in the sensitive lists.

Figure 2.2: Average ASEAN tariff rates

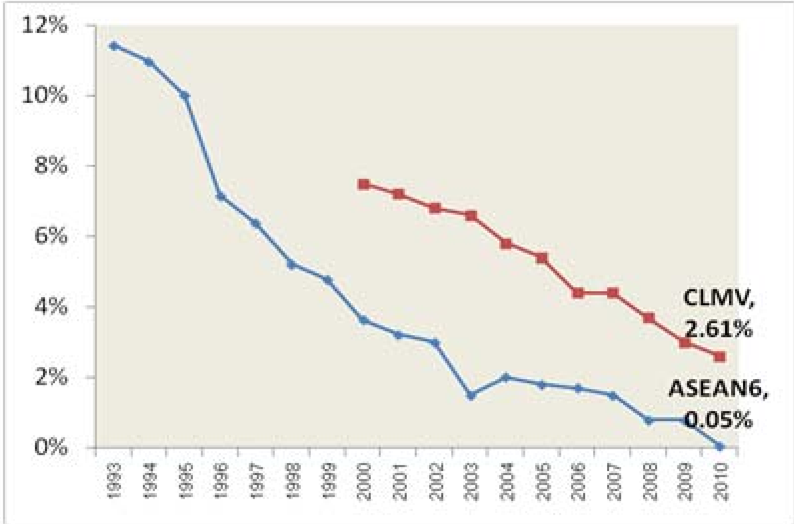

Table 2.5: Implementation Scores for Goods

	Thailand	Indonesia	Malaysia	Philippines	Singapore
Tariffs	100	99	99	99	100
Non-tariff barriers	-15	-20	-15	-15	-10
Score for Trade in Goods	85	79	84	84	90

Source: Tariffs—Authors' calculations from ASEAN Tariff Tables (2010), penalties for non-tariff barriers from Heritage Foundation (2011)

With tariffs eliminated the main obstacles to trade are non-tariff barriers. ASEAN members have reported their list of NTBs, which amount to over five thousand measures for all ten members, hence an elimination by 2015 looks very unlikely. Unlike tariffs, whose jurisdiction only rests with the Customs Department of a country, NTBs are under the purview of numerous government agencies and their removal would require a similar effort on changes in legislation. Ando's (2010) analysis of these NTBs found that among all ASEAN members, NTBs are used in 49% of all tariff lines and that the majority concern technical or sanitary measures. Unlike outright import quotas which are direct barriers to trade, these measures may be good-faith applications of the measures or they could be disguised forms of trade barriers. Correctly identifying trade-distorting measures and eliminating them will prove to be a remaining challenge in the liberalization of goods under the AEC.

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17 Singapore, with its zero-tariff policy both for intra- and extra-regional trade, did not even have the need to undergo through this process

B. Implementation in Trade of Services

Progress on trade in services requires a more taxing effort than goods, as the provisions of services are naturally much more restrictive because they relate to domestic interests and sensitivities, unlike the movements of goods through trade. The Blueprint also recognizes this with a 70% minimum limit, but perhaps is too ambitious as it attempts to cover all services sectors by 2015 (with the exception of financial services).

Currently, the extent of liberalization may fall short of the desired goals. The predominant reason is because commitments are scheduled in such a way that they do not conflict with domestic laws. A case in point here is Thailand's commitments, which do not overstep the bounds of domestic laws and regulations which generally cap the foreign ownership of key services sectors at 49%, without having to secure approval by the authorities.

From a closer look at the different subsectors within services, as depicted in Table 2.6, it is evident that some of the subsectors are more open than others. Construction, tourism and health belong to this group, whereas transport and communications are more restrictive. Another important finding relates to the priority integration sectors: air transport, information technology, healthcare, tourism and logistics[18]. These sectors were targeted by the Blueprint for speedier liberalization that other sectors (51% by 2008 and 70% by 2012), but the low scores for 2011 expose delays in the liberalization process. It is therefore hoped that the current round of negotiations under the AFAS will provide more concrete progress in realizing the goals of the Blueprint as regards services.

Table 2.6: Implementation Scores for Services Subsectors

	Thailand	Indonesia	Malaysia	Philippines	Singapore
Business services	46	39	19	46	72
Communication services	20	13	11	45	33
Construction services	50	28	70	73	100
Distribution services	40	36	10	35	62
Educational services	45	50	40	0	20
Environmental services	38	25	13	25	25
Health-related and social services	25	48	38	36	60
Tourism and travel-related services	25	35	39	43	93
Recreational services	50	24	19	40	22
Transport services	14	11	24	26	16
Score for Trade in Services	36	29	31	39	50

Source: Authors' calculations from AFAS (7th Package) for services and Air transport services commitments (5th Package)

[18]Logistics are not a sub-sector per se under AFAS (and GATS) and are comprised of a cluster of cross-cutting services ranging from transport to communications (Hamanaka 2009)

C. Implementation in Investment

As for investment, gaps are less pronounced. One reason for this is that investment negotiations of the ACIA Agreement[19] are conducted in a negative-list basis, hence any sector not subject to horizontal or specific commitments are automatically liberalized. Table 2.7 shows the implementation scores for the 5 subsectors as calculated by Urata and Ando (2010) and rescaled to allow comparisons. They are derived from existing legal texts and conform to other studies such as Investment Climate Advisory Services (2010). Not surprisingly, the manufacturing sector as the backbone of FDI receipts, are mostly open in all ASEAN countries. Resource-extracting sectors tend to score less, especially in the more resource-endowed countries.

Table 2.7: Implementation Scores for Investment subsectors

	Thailand	Indonesia	Malaysia	Philippines	Singapore
Agriculture, forestry and fishery	50	60	90	65	100
Mining and quarrying	66	96	80	70	100
Manufacturing	84	79	87	90	100
Score for Investment	67	78	86	75	100

Source : Urata and Ando (2009)

The different resource endowments lead to differences in sensitivities. Countries with larger agricultural sectors tend to be more sensitive in protecting their industries, as seen in the fact that Indonesia and the Philippines still have rice and sugar in their sensitive list. Thailand, the Philippines and Indonesia—with their large agricultural sector, are also the countries which are most protective in investment. Singapore, on the other hand, as a regional and global entrepôt, has always been a free trade port not only vis-à-vis other ASEAN countries but with the rest of the world.

D. Implementation in Skilled Labor

Thus far, not much has been committed in the liberalization of labor movements in all ASEAN countries, which is reflected by the very low scores for all five countries. Commitments in the movements of natural persons of the key ASEAN members under current AFAS agreements share similar characteristics:

First, there are no liberalization commitments for a majority of professions, for some members even in those professions where MRAs have been signs, thus earning them no score in the index.

Second, for those professions where labor flows are possible, these only relate mostly to intra-corporate transferees (such as managers and experts, but not job-seekers). Some countries, like the Philippines, will allow flows of professionals only "after a determination of the non-availability of a person in the Philippines who is competent, able and willing, at the time of application, to perform the services for which the alien is desired". (AFAS 2009)

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[19] As the ACIA has not been ratified by all members, its reservation lists are yet to be made public. According to the USITC (2010), one may use the publicly available current reservation lists used in the ACIA's predecessor agreement (AIA) as a proxy.

Third, some countries apply numerical quotas for entry as well to restrict the number of migrant professionals within a sector or from a specific country.

E. Implementation in Financial Services and Capital

Concerning financial services and capital, the scores as depicted in Table 2.4 are uneven and reflect the state of development and sensitivities of members and they serve as a comparison to other sectors. The main observations here are that securities services are more or less open, and, for some countries, insurance as well.

Of note is that Thailand scores lowest in both measures among its ASEAN-5 peers. The key reasons lies within current laws and regulations. For instance, the current Financial Institutions Businesses Act and the Life Insurance Act only allow for 25% foreign shareholdings in the respective businesses (though it has to be mentioned as well that there has been significant progress in the liberalization of Thai securities businesses). Exchange control regulations also impose *de jure* restrictions on capital flows, even if authorizations are generally approved. The next Chapter will provide detailed discussion of these issues.

2.3.2 Conclusion: The Virtuous Cycle Revisited

This chapter, which has measured the key gaps inherent in the AEC Blueprint and in the implementation of members, ends by highlighting the fact that, for the case of Thailand, financial integration is lagging behind its peers.

This brings us back to the virtuous cycle discussed in the previous Chapter, where it is established that for financial integration to reap benefits, liberalization must go hand-in-hand with financial development and institutional quality. For Thailand, however, it seems that current laws and regulations obstruct liberalization efforts. These laws and regulations can be seen as manifestations of fears that Thailand's financial and institutional development may not be ready for further liberalization. We will probe into this aspect in the next Chapter.

Chapter 3: Challenges for Thailand's Financial Integration

The previous chapter demonstrated that Thailand's extent of financial liberalization—both financial services and capital flows—lag behind its ASEAN peers. This chapter will therefore focus solely on the challenges facing Thailand's financial integration, and will begin with an overview of the framework of financial integration of ASEAN and Thailand in the key areas. Then it will attempt to answer the key question of this paper—whether Thailand's financial development is consistent with its current financial liberalization. This will be done by extracting indicators that best represent both development aspects and constructing a composite index.

3.1 Framework of ASEAN Financial Integration

Efforts on ASEAN financial integration started more than 15 years ago with the process to liberalize financial services and capital account, as well as to integrate capital markets. Three Working Committees were created to oversee each of the three ambits. Nevertheless, as mentioned earlier, progress was slow in the first ten years, due to the large policy and institutional differences among the members. A push for acceleration came with the AEC Blueprint in 2007, in the form of more concrete plans for liberalization, though members are practically flexible to implement them. Recently, a new Working Committee was established to oversee the work of payments and settlements, in view of the importance of it as a systemic and physical link to the other three areas.

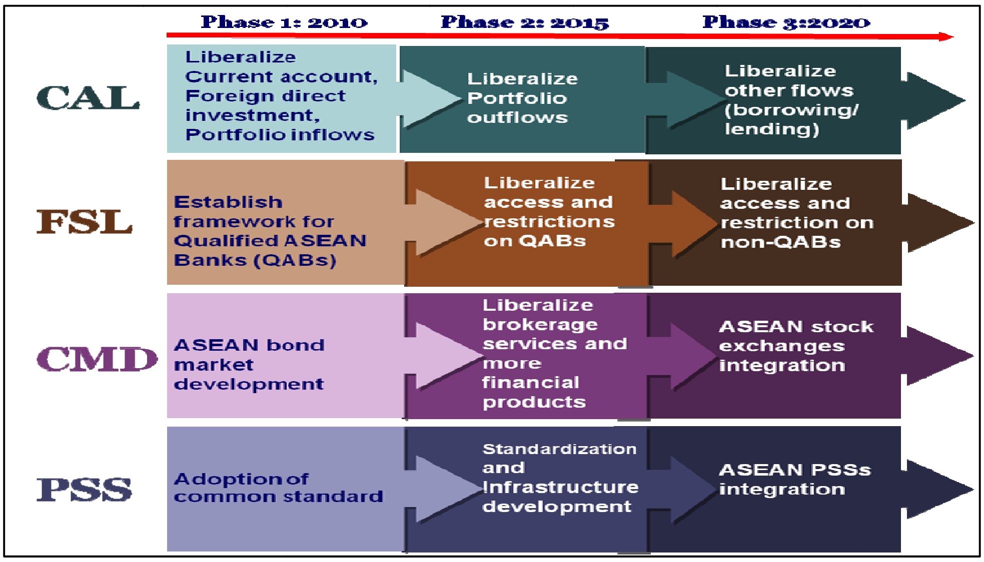
ASEAN ministries of finances and central banks, as well as other key regulators, are the main authorities responsible for driving forward the integration. A summary of the key objectives and current activities of the Working Committees is presented in the following table.

Table 3.1: ASEAN Financial Integration Framework

Working Committee	Objectives	Current Activities
Capital Account Liberalization (CAL)	Provides guidelines for members to liberalize capital account and achieve freer flows.	-Assessing and liberalizing flows according to the sequence: current account, FDI, FPI inflows, FPI outflows and other flows (e.g. loans) -Setting up a general framework for capital account liberalization -Designing individual milestones blueprint for members
Financial Services Liberalization (FSL)	Provides a platform for negotiation of financial services under AFAS	-Negotiation rounds for liberalization under AFAS -Given that banking liberalization has not progressed much, efforts are currently underway to find a common framework to allow entry for qualified ASEAN banks
Capital Market Development (CMD)	Developing regional capital markets, integrate ASEAN stock markets	-Much has been done in the liberalization of service providers in capital market (such as brokerage services), as well as linkages of stock markets and promoting ASEAN as an asset class. -Current work focuses on bond market development and assisting CLMV countries in developing their capital markets
Payment and Settlement System (PSS)	Facilitating the linkages of financial sectors of ASEAN member countries	-Adopting the common standards to facilitate efficient cross-border financial -Improving existing infrastructure and payments environment -Exploring the option of payment and settlement systems linkages within ASEAN

As the AEC Blueprint, agreed in 2007, remained vague in terms of goals and actions on financial integration, there was a recent agreement to refine it and set a target date for integration for 2020. Particularly in the integration of the banking sector when at that time, according to an official, "the level of the banking integration will be measured by the number of Qualified ASEAN Banks (QABs) running cross-border operations throughout ASEAN countries."[20] Applying this with the time lines of the other three Working Committees, as in Figure 3.1, we can see that substantial progress is expected for 2020, though one would expect that flexibilities will be integral to this time line as well.

Figure 3.1: Timelines of ASEAN Financial Integration



The challenge for ASEAN is now to keep pace and move ahead, despite all the flexibilities. Furthermore, the liberalization plans for each of the four areas are closely interrelated and hence it is critical that disruptions be minimized. For instance, it would not make sense if capital markets are integrated while there are still restrictions on portfolio flows.

3.2 Thailand's Role in Financial Integration

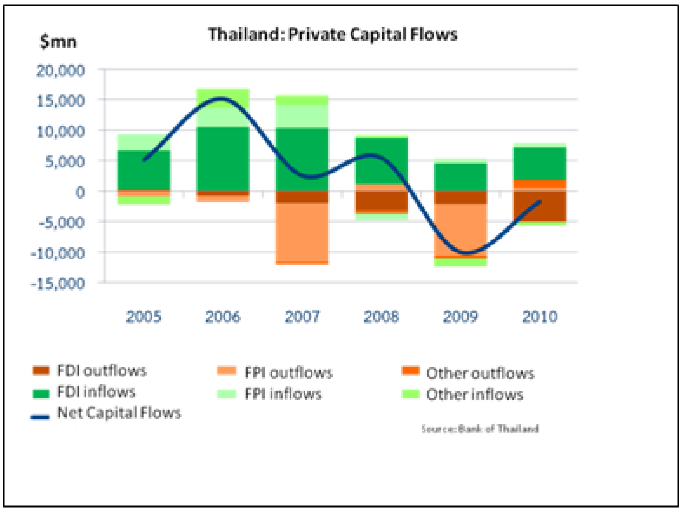
We will now turn to the case of Thailand to provide an overview of policies and plans of financial integration with other ASEAN countries.

3.2.1 Thailand: Capital Account Liberalization

Capital flows to Thailand have increased both in magnitude and volatility, particularly in recent years as emerging markets in Asia, which have been more pronounced as a result of the global financial crisis and subsequent uneven recovery period, not to mention the most recent bouts of volatility resulting from the Euro-Area. The composition has changed as well, with outflows, both direct and portfolio, becoming more distinct (see Figure 3.2)

[20] See http://us.en.vivanews.com/news/read/239951-banks-in-asean-ready-to-integrate-by-2020

Figure 3.2 Thailand: Private Capital Flows



In the context of a managed floating exchange rate system acting as a buffer against capital volatility, capital account policies are regarded by the authorities as one of the potential tools to manage capital flows, along with prudential measures, given that current inflows could give rise to asset price bubbles and be prone rapid reversals. While Thailand has already liberalized inflows of both direct and portfolio investment, at least *de facto*, as noted by Park (2011), controls mainly exist on outflows, as detailed in Table 3.2.

However, Thailand is currently developing a Capital Account Master Plan, which aims to increase transparency liberalization process and making it in line with the development of the Thai economy. While the Plan itself has not been publicly announced, its broad objectives are, according to officials, to gradually liberalize outflows which will reduce the impact of capital flows on the exchange rate as well as strengthen Thailand's International Investment Position.

Table 3.2 Thailand's Current Capital Restrictions

Type	Application	Inflows	Outflows
Direct Inv.	**Residents**	Freely permitted	• Thai companies: Freely permitted • Thai natural persons: Freely permitted up to USD 100 m/ person/year • Direct investment that exceeds the limit is allowed upon BOT approval
	Non-residents	Freely permitted	Freely permitted
Port-folio Inv.	**Residents**	Freely permitted	• Institutional investors: Freely permitted up to USD 50 m/ investor • Portfolio investment that exceeds the limit is allowed upon BOT approval • Individuals and corporate investors (investing through private funds or securities companies): Allowed upon BOT approval
	Non-residents	Freely permitted	Freely permitted

Other flows	**Residents**	Freely permitted	• Lending of Thai companies to non-affiliated entities : Freely permitted up to USD 50m/year • Outward remittances to Thai emigrants: Freely permitted up to USD 1m/recipient/year • Purchase of immovable properties: Freely permitted up to USD 10 m/person/year • Remittance that exceeds the limit is allowed upon BOT approval
	Non-residents (restrictions specific to non-residents' transactions with domestic financial institutions)	For domestic financial institutions borrowing in Thai baht or undertaking transactions equivalent to borrowing in Thai baht from non-residents without underlying trade or investment in Thailand, an overall outstanding limit of Baht 10 million per institution per non-resident group (as a consolidated entity) applies.	For domestic financial institutions providing Thai baht liquidity to non-residents without underlying trade or investment in Thailand, an overall outstanding limit of Baht 300 million per financial institution per non-resident group (as a consolidated entity) applies.

3.2.2 Thailand: Financial Sector Liberalization

A. Banking Sector

In the years following the 1997 crisis, Thailand's financial sector has changed tremendously, which is marked by two key developments. First, the financial landscape has changed: Shareholdings of many distressed banks during the crisis became first state-owned, and were later sold to private foreign hands, while existing finance companies which were transformed into retail banks or upgraded into commercial banks proper. The current landscape therefore has a balanced set of domestic and foreign players, as shown in Table 3.3. (Subhanij and Sawangngeonyuang 2011)

Table 3.3: Thailand's financial landscape

	Jan 1997	Nov 2010
Commercial Banks	31	32
Locally incorporated	*15*	*14*
Foreign bank branches	*16*	*15*
Retail banks	*-*	*2*
Subsidiaries	*-*	*1*
Finance and securities companies	91	3
Credit foncier companies	12	3
IBFs	42	-
Total	176	38

Source: Subhanij and Sawangngeonyuang (2011)

Second, the Thai banking sector has gained considerable strength, exhibiting resiliency in the aftermath of the global financial crisis that erupted in 2008. Since then, Thai banks have experienced an improvement in overall performance. For instance, in 2010, loans rebounded from 1.8 percent contraction to expand by 11.3 percent following the strong economic recovery. Thai banking system continued to experience an improvement in asset quality, following better economic outlook and improved risk management. With falling NPLs and delinquency, Thai banks therefore enjoy rising profits, though operating efficiency, as measured by operating expenses over total income, remained more or less constant. In addition, capital adequacy ratio (CAR) is on an increasing trend and reached 16.2 percent, well above a minimum requirement of 8.5 percent.

Figure 3.3 Thailand: Banking Indicators

Stability, efficiency and competitiveness are therefore the three key goals of the current Financial Sector Master Plan, which spans from 2010 to 2014. Particularly, the objectives of the Plan include reducing operating costs to enhance efficiency, improving competitiveness through increasing the availability of products while improving on quality and price aspects, and enhancing stability through the strengthening of risk management and financial infrastructure. It should be emphasized here that according to this master plan, any foreign new entries will only be considered in the last phase, i.e. in 2014.

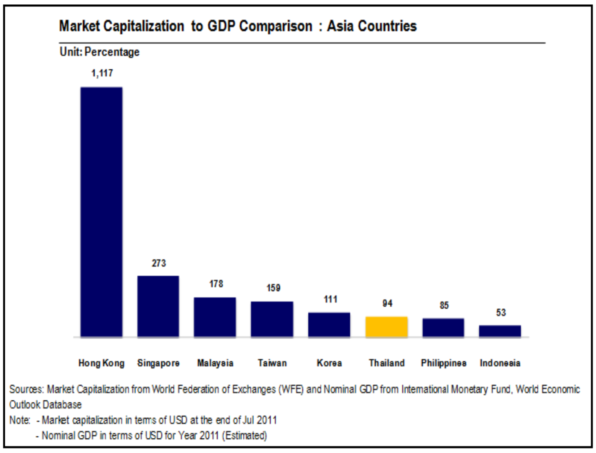
Another notable point to make is that Thai banks have not been very active in venturing abroad to set up services. Thus far, only six Thai banks have exposure to other ASEAN countries as branches or subsidiaries, hence there is much room for gaining exposure abroad, especially within ASEAN.

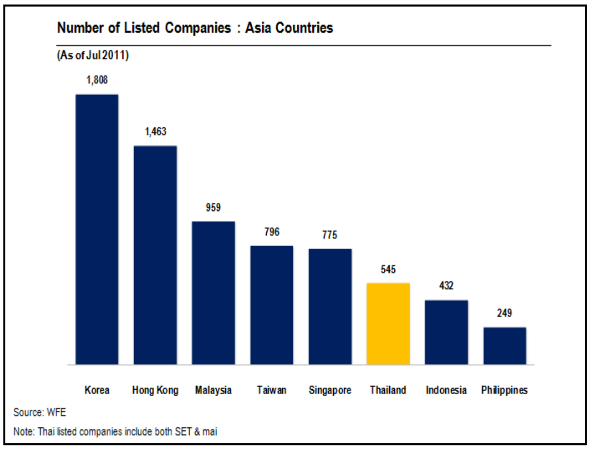
B. Capital Markets

The liberalization of capital markets in Thailand progressed at a much faster pace than for banks. A Capital Market Development Master Plan was formulated in 2009 to guide the development of Thai capital market, in particular aiming to make the Thai capital market, among others, more accessible and competitive, as well as forging greater linkages with the other regional markets. A key part to this includes the liberalization of securities businesses to promote market efficiency, which has been foreshadowed in Thailand's commitments in the AEC Blueprint shown in Table 2.3.

The major stride, however, is the linkages of stock markets within ASEAN. Individually, stock market capitalization to GDP of Thailand stood at 94 percent, quite lagging behind that of Singapore (273 percent) and Malaysia (178 percent). In terms of the number of listed companies in the stock exchange, Thailand also trails both Singapore and Malaysia as well. Interlinking stock exchanges will therefore prevent smaller markets such as Thailand's from being marginalized. By 2012, trading platforms of the Stock Exchange of Thailand will be interconnected to Bursa Malaysia, the Philippines Stock Exchange and the Singapore Stock Exchange, while the Indonesian and Vietnamese bourses will join in later. This will expand network, size and financial instruments of the market as there will be about 3,000 companies trading on these four exchanges and will allows investors to access these markets with single connection. Supporting the linkage, the ASEAN also create the ASEAN asset class called "ASEAN Star Index" which consists of the 30 top ranking stocks from each stock exchange in term of market capitalization and liquidity. The index will be launched in the last quarter of 2012.

Figure 3.4: Market capitalization and number of listed companies





3.3 Thailand's Relative Positioning in Financial Development and Institutional Environment

We recall the "virtuous circle" that financial development and institutional environment is mutually enhanced by financial liberalization and, from the results of the previous Chapter, that the extent of financial liberalization of Thailand lags behind its peers. This part will explore indicators of financial development as well as institutional environment to see Thailand's relative positioning compared with its ASEAN peers, which will therefore reflect its ability to further liberalize financially. We come up with a series of indicators for financial development and institutional environment, test their robustness, and finally construct a composite index to portray the results.

3.3.1 Indicators for Financial sector development

In current literature, there is no precise definition of financial development, and hence it is rather difficult to find an indicator which can directly measure the development of financial sector, as noted by Lawrence (2003). This is echoed by Levine (2005), who argues that there is no uniformly accepted proxy for financial development available. It is therefore necessary to obtain a set of indicators which would capture the *features* of financial development instead. We review existing literature of cross-sectional studies[21] on this issue, and find that several indicators are employed as proxies for the financial development. For instance, Demirguc-Kunt and Levine (1999) employ three indicators for size (commercial bank assets to GDP, central bank assets to GDP, and market capitalization to GDP), two indicators for activity (bank credit to GDP and total value stock traded to GDP), and two indicators to measure bank performance (bank profitability and bank interest margins).

In our search for a handful of significant indicators for financial development, we employ two methodologies: First, we use the indicators according to Huang (2005), who selected eight indicators representing four different areas of financial development. Second, we use a larger set of 26 indicators used in several studies (see previous footnote), and of these, select a representative set of indicators to best represent financial development.

As for the **first method**, Huang (2005) uses eight indicators to represent the state of financial development, which include: (1) liquid liabilities of the financial sector to GDP, (2) private credit to GDP, (3) commercial-central bank asset ratio, (4) overhead costs to total assets of commercial banks, (5) net interest margin of commercial banks, (6) stock market capitalization to GDP, (7) total value of stocks traded to GDP; and (8) turnover ratio of the stock market.

---

[21] These include: King and Levine (1993), Demirguc-kunt and Levine (1999), Beck et al. (2000), Levine et al. (2000), Lawrence (2003), Huang (2005), and Kose et al. (2009)

Huang (2005) argues that these eight indicators sufficiently reflect the four areas of financial development, namely: (a) the size of the financial sector (which is usually regarded as depth), (b) the activity of financial intermediaries, (c) the efficiency of the banking sector; and (d) stock market development. The following are the eight indicators and their rationales in representing the four areas:

A. Size of the financial sector

- ***Liquid liabilities to GDP***: equals currency plus demand and interest-bearing liabilities of banks and other financial intermediaries as a percentage of GDP. This indicator represents the overall size of a country's financial sector, including central bank, commercial banks and other financial institutions[22].

B. Activities of financial intermediaries

- ***Private credit to GDP***: is the sum of all credit issued to private sector by financial intermediaries, including traditional depository money banks and other financial institutions over GDP. It captures the degree of financial intermediation's activities, such as loans, trade credits, and non-securities instruments.
- ***Commercial-Central bank assets***: is the ratio of the commercial banks assets to total assets, which are sum of commercial banks assets and central bank assets. This indicator reflects the activities and importance of the commercial banks relative to the central bank.

C. Efficiency of the Banking Sector

- ***Net Interest Margin (NIM)***: is the accounting value of a bank's net interest revenue as a share of its interest-bearing (total earning) assets. The NIM gauges the inefficiency of the banking sector because the higher NIM implies that the market is not efficiently competitive.
- ***Bank overhead costs to total assets***: is the ratio of accounting value of a bank's overhead costs as a share of its total assets. This indicator captures the cost efficiency aspect. The higher overhead cost could lead to the inefficiency in banking system.

D. Stock market development

- ***Stock market capitalization to GDP***: equals the value of listed shares in the stock market as a percentage of GDP. The variable measures the size of another important part of financial sector, apart from banking sector, which is the stock market.
- ***Total value of stocks traded to GDP***: is the total domestic shares traded on the domestic stock exchanges as a percentage of GDP. It proxies liquidity in the equity market.
- ***Turnover ratio of the stock market***: is defined as the ratio of the total value of domestic share transactions on a country's stock market exchanges over the total value of listed domestic shares. Turnover ratio reflects the liquidity of the stock market.

[22]According to Beck et al. (2000), other financial institutions include bank-like institutions, insurance companies, private pension and provident funds, pooled investment schemes, and development banks.

We then use cross-country data[23] to validate our selected financial development. Using the method employed by Lawrence (2003), we scatter-plot the indicators against per-capita GDP over time. This comes from the argument that financial development eventually leads to economic growth. Hence, if our indicators represent financial development, they should also have a strong relationship with GDP per capita.

We examine such relationship across countries and over time (1960-2009), by narrowing down the sample countries to 37 developed and emerging market countries with data availability, given that they roughly represent the states of development of the ASEAN-5 countries. In doing so, the means of each variable and means of GDP per capita over time for each country are scatter-plotted and shown in the Figures 3.5-3.12 below.

Figure 3.5: Liquid liabilities to GDP

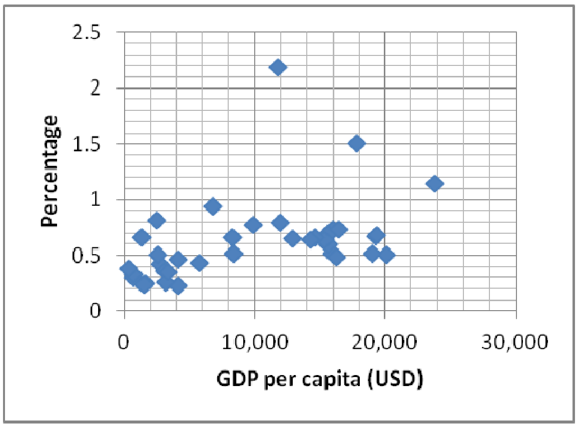


Figure 3.6: Private credit to GDP

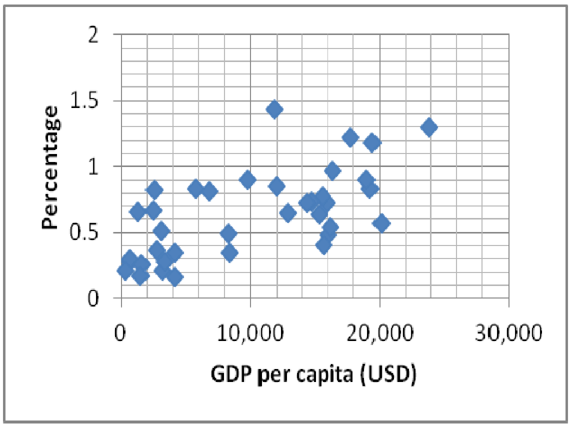


Figure 3.7: Commercial-Central bank assets

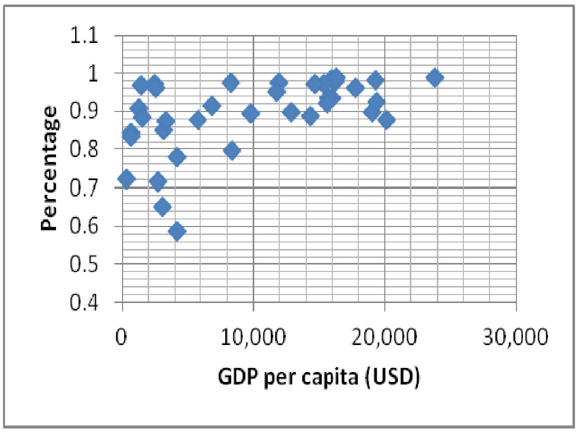
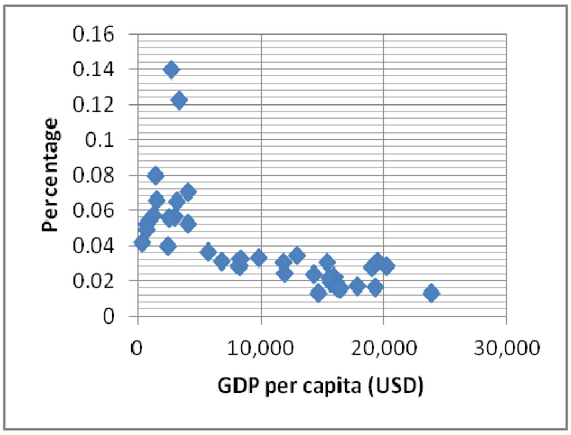


Figure 3.8: Net Interest Margin



[23] Source of data: Financial structure dataset 2010, World Bank, and World Development Indicators (WDI) 2010, World Bank

Figure 3.9: Overhead costs to total assets

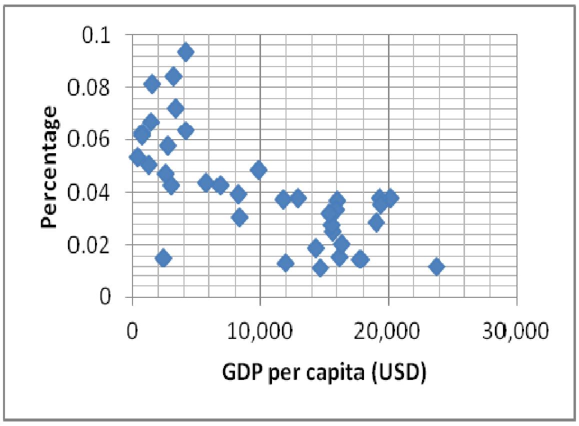


Figure 3.10: Stock market cap. to GDP

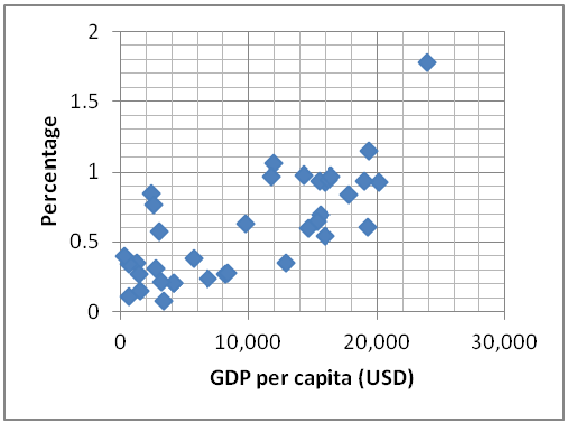


Figure 3.11: Total value traded to GDP

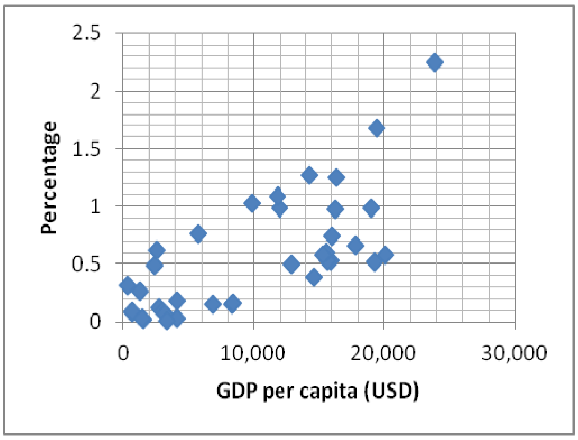
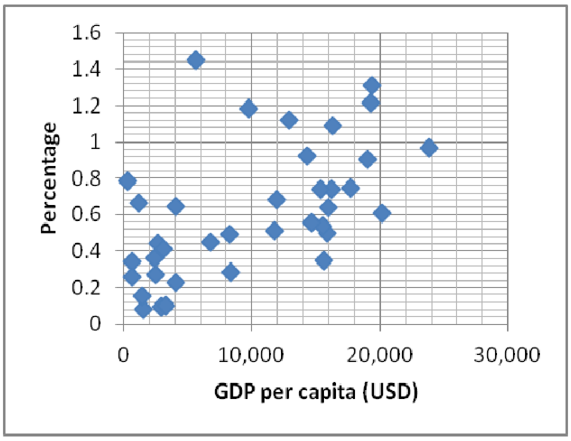


Figure 3.12: Turnover ratio



It is evident that all eight selected financial development indicators have clear relationships with growth of the economies. Countries with high level of economic development as shown by the high GDP per capita are likely to have positive correlations with these indicators, or negative, in the two cases of NIM and overhead costs, which exhibit inverse relationships.

For our **second method**, we employ a larger range of indicators which, according to recent literatures, represent various aspects of financial development. The list of 24 indicators is shown in Table 3.4. In our aim to extract the most significantly representative subset of indicators, we employ a panel regression approach, whereby the dependent variable is again GDP/capita as representative of economic development level. Due to the large number of variables in question, we therefore needed a large number of sample economies aiming to make greater statistically robustness of the results—hence we used the complete set of 209 economies over the same period of 1960-2009.

Table 3.4: List of 24 indicators representing financial development

1. M2 to GDP
2. Liquid liabilities to GDP
3. Commercial banks-central bank assets
4. Bank assets to GDP
5. Absolute value of liquid liabilities
6. Private credit by banks to GDP
7. Private credit by banks and other financial institutions to GDP
8. Bank deposits to GDP
9. Financial system deposits to GDP
10. Bank credit to bank deposits
11. Domestic credit to GDP
12. Bank overhead cost to total assets
13. Net interest margin
14. Bank concentration
15. Bank return on assets
16. Bank return on equity
17. Bank cost-income ratio
18. Bank Z-score (standardized ROA)
19. Non-performing loan to total loans
20. Interest rate spread
21. Stock market capitalization to GDP
22. Value of shares traded to GDP
23. Stock market turnover ratio
24. Number of listed companies (per 10,000 people)

The results of the panel regression show that (1) most of the indicators turned out to be statistically insignificant; and (2) the signs of the coefficients of several indicators not as what they are expected to be. These are most likely to be the result of the high multicollinearity of several groups of indicators (such as M2/GDP and liquid liabilities/GDP).

For this reason, we therefore intend to group the 24 variables into the four areas according to Huang (2005). Among each of the four areas, we select the representative indicator that would best reflect financial development. In doing so, we test the relationship between each indicator of a group against GDP/capita. Then, we select the one which has the largest impact, which is expressed by the largest coefficient. These are portrayed in Table 3.5, in which all four indicators are statistically significant.

Table 3.5: Four key representative indicators

Area	Indicator
Size of financial sector	Liquid liabilities to GDP
Activity of financial intermediaries	Private credit by banks and other financial institutions to GDP
Efficiency of banking sector	Net interest margin
Development of stock market	Stock market capitalization to GDP

From the two methods of selecting a handful of indicators to represent financial development, it is surprising to see that our four key indicators selected to represent the four areas of financial development are included in the eight indicators used by Huang (2005). We will therefore construct scores and composite indices to see Thailand's relative position based on these four representative indicators. For the sake of completeness, however, we will add to these by also constructing an additional set of scores and composite indices using all eight indicators employed by Huang (2005).

Construction of indicator score and composite index

To facilitate the comparison of the financial development of Thailand to those of its peers among ASEAN-5 countries, a scoring approach is employed, with data taken from the 2010 Financial Structure Dataset and the 2010 World Development Indicators, both sets compiled by the World Bank. The scores, ranging from 0 to 100, show the relative performances of these indicators of individual countries in the sample group. A score of 100 implies that country A obtains the best performance in the indicator i, and is calculated using the following formula.[24]

$$\text{Score of indicator i} = \frac{\text{Country indicator i} - \text{Sample minimum}}{\text{Sample maximum} - \text{Sample minimum}} * 100$$

Nevertheless, it is rather difficult to examine the cross-country performances of the ASEAN 5 by comparing each indicator individually. It is therefore necessary to conduct a composite index to represent both financial development and institutional quality. The composite index is derived by the equation as follows:

For a set of indicators in category K with k indicators,

$$\text{Composite index of category K} = \sum_{i=1}^{k} \text{Wi} \;\; \text{x Si}$$

where Wi is the weight and Si is score of indicator i

Results: Financial Development Indicators

The indicators and the composite indices for financial development, using both methods are as follows, with indicators for Japan and the UK shown here as a benchmark:

[24] This methodology is employed in several previous studies such as Lawrence (2003), Browne and Geiger (2009), as well as in the construction of World Bank's financial development index 2010.

Table 3.6: Results: Financial development

	Thailand	Indonesia	Malaysia	Phil.	Singapore	*Japan*	*UK*
Liquid liabilities	20	4	30	9	33	*57*	*48*
Private credit	27	3	35	5	34	*36*	*88*
Net Interest Margin	80	66	90	74	100	*92*	*97*
Stock market cap.	10	9	28	13	20	*13*	*17*
Banks/ central bank assets	72	54	90	4	88	*65*	*94*
Overhead costs	95	90	95	95	100	*96*	*98*
Total value traded	10	3	5	2	18	*11*	*19*
Turnover ratio	5	22	24	8	56	*30*	*46*
4 key indicators: Simple avg. (Ranking)	**34 (3)**	**21 (5)**	**46 (2)**	**25 (4)**	**47 (1)**	*49*	*63*
4 key indicators: Correlation to GDP (Ranking)	**32 (3)**	**17 (5)**	**43 (2)**	**22 (4)**	**44 (1)**	*48*	*62*
All 8 indicators: Simple avg. (Ranking)	**40 (3)**	**31 (4)**	**49 (2)**	**26 (5)**	**56 (1)**	*50*	*64*
All 8 indicators: Correlation to GDP (Ranking)	**18 (3)**	**11 (4)**	**26 (2)**	**9 (5)**	**34 (1)**	*28*	*42*

Note: Rankings are shown in parentheses.

We can draw four main conclusions from the above results:

First, from an overall perspective, the relative positioning of Thailand is in third place among the five ASEAN countries, no matter which method we employ. Second, specifically on the size of the financial sector and financial intermediaries, while Thailand is in the third place as well, the relative distances show that Thailand is much closer to the top two performing countries, i.e. Singapore and Malaysia. Third, on the stock market development, there is a significantly larger gap between Thailand and the leaders in this group. Fourth, on banking sector efficiency, there does not seem to be much divergence among all ASEAN-5 countries.

3.3.2 Indicators for Institutional Environment

While indicators for financial development may demonstrate its depth and efficiency, they are merely one aspect of determining a country's ability to liberalize financially. The other key aspect concerns institutional, i.e. non-financial, environment of a country, which includes issues such as governance and regulatory frameworks. This is because country with a strong financial institutions but a weak institutional environment, be it governance or rule of law, will obviously not be as ready for financial liberalization one which has strengths on both aspects.

On the indicators to represent institutional environment aspect of a country, there are two main sets of indicators currently widely in use, including the Financial Development Index 2010 of the World Economic Forum and the World Governance Indicators 2010 of the World Bank.

The Financial Development Index consists of 24 areas, of which we employ only three that are relevant to the institutional environment, which include: corporate governance, legal and regulatory issues; and contract enforcement. The index gives scoring range from one to seven, where seven is the best possible score for a total of 57 countries assessed.

The World Governance Indicators are an aggregation of different surveys and indices, grouped into six dimensions: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law; and control of corruption. It ranks the governance of the sample countries using percentile approach for 213 economies.

Given that both broadly represent institutional environment, we aim to use both sets of indicators, which would also enable us to make comparisons of the results, which are shown in Table 3.7. Contrary to the variety of methods we used to aggregate indicators of financial development, we only employ simple averages for this case, as the indicators stem largely from surveys as opposed to statistical variables.

Table 3.7: Results: Institutional Environment

World Governance Indicators (percentiles)							
	Thailand	Indonesia	Malaysia	Phil.	Singapore	*Japan*	*UK*
Voice /accountability	35	48	32	45	34	*82*	*92*
Political instability	15	24	47	11	90	*82*	*55*
Govt. effectiveness	60	47	80	50	100	*88*	*91*
Regulatory quality	62	43	60	52	100	*81*	*94*
Rule of law	51	34	65	35	92	*88*	*94*
Control of corruption	51	28	58	27	99	*87*	*91*
Simple average (Ranking)	**46 (3)**	**37 (4)**	**57 (2)**	**36 (5)**	**86 (1)**	*85*	*86*

Institutional Environment part of the Financial Development Index (scoring of 1-7)							
	Thailand	Indonesia	Malaysia	Phil.	Singapore	*Japan*	*UK*
Corporate governance	4.3	4.3	5.0	4.2	5.6	*5.1*	*5.4*
Legal and regulatory	3.4	3.6	4.4	2.8	5.6	*4.6*	*4.9*
Contract enforcement	5.0	3.5	5.1	3.1	6.4	*5.6*	*5.9*
Simple average (Ranking)	**4.2 (3)**	**3.8 (4)**	**4.8 (2)**	**3.4 (5)**	**5.9 (1)**	*5.1*	*5.4*

Note: Rankings are shown in parentheses.

From the results, it could be concluded that financial development and institutional quality of Thailand are in an average level among other ASEAN-5 peers, standing in third place for both sets of indices. In some areas, Thailand comes in second place, such as regulatory quality, which is a positive sign.

Taking Thailand's rankings on institutional environment with those of financial development discussed in the previous section, it is evident that Thailand's relative position is still competitive in terms of readiness for financial liberalization. Returning to our key question on the conditions making up the "virtuous circle", these results clearly show that while Thailand is, in relation with its peers, quite ready in terms of financial development and institutional environment, its willingness to engage in further financial liberalization still trails its peers.

The key message here is that there is room for further financial liberalization for Thailand, which would not only aid the development of the financial sector and institutions, but, more importantly, bring about the benefits of financial liberalization itself.

Chapter 4: Conclusion and Policy Recommendations

Our final chapter aims to recapitulate and highlight the key findings of this study. It is also our aim that these results be put into good use by relevant authorities through a set of policy recommendations.

4.1 Conclusion: Key findings

The key findings of this study can be summed up in the following five points:

- **First**, the ASEAN Economic Community (AEC) is to be seen as a key milestone in process of integration began almost two decades ago by the liberalization of goods. Aiming to create a "single market and production base" of a trade-led, finance-supported integration model, this would bring ASEAN as an economic entity to one of the top global players. Benefits will be accrued from economies of scale and scope, production efficiency, and improved welfare, not to mention the increase collective bargaining power, particularly for smaller members.
- **Second,** while the benefits of trade integration are undisputed, those of financial of integration are not as clear-cut. While theory asserts that financial integration promotes growth and lowers volatility, empirical evidence produces mixed results. This is because for such benefits to surface, there should be necessary conditions: financial sector development and institutional quality as well as the extent of financial liberalization. These conditions are mutually reinforcing and hence can be seen as a "virtuous circle" of financial integration, where the courage to more liberalize its financial sector supports readiness in term of financial sector development and institutional quality.
- **Third**, the AEC does not aim for full liberalization in all sectors: Goods and investment are to be liberalized more than services, and the liberalization of skilled labor is still in very early stages. Financial liberalization, which includes financial services and capital flows, follows a timetable which is extended to 2020 and is very flexible, that is, depending on the readiness of members. We can conclude that the AEC is a form of integration which transcends trade integration with the addition of flows of factors of production to an extent. Goals of the AEC are attainable and should be realized in order to reap benefits from the integrated markets.
- **Fourth,** there are still gaps in implementing the liberalization goals stated in the AEC blueprint. The liberalization of trade in goods and investment progressed very well, while services would need to catch up in order to reach goals. Interestingly, Thailand falls behind other ASEAN peers in financial liberalization, due to existing strict laws and regulation, which result from the hesitation of the authorities to open up, believing that the financial sector development is not adequate enough.
- **Fifth,** an analysis of the indicators selected to reflect (1) Financial sector development, which includes depth and strength of the financial services sector, as well as the ability to cushion shocks from capital movements; and (2) Institutional environment in the form of governance and legal and regulatory framework. From the selected indicators and derived composite indices, we found that Thailand is in a middle relative position

compared to its ASEAN peers. The key message drawn from this observation is that Thailand's relative position of financial development and institutional environment does not match its relative low scores of financial liberalization, which gives room for further liberalization efforts, which will promote financial development, thus completing the "virtuous circle".'

4.2 Policy recommendations

We divide up our sets of policy recommendations derived from our findings into (1) integration under AEC Blueprint in general and (2) financial integration.

On the first set, it should be reiterated that the AEC represents a major milestone in ASEAN's path towards greater economic and financial integration, and fulfillment of the goals set by the AEC Blueprint would propel ASEAN to a key global player. However, implementation remains uneven, with the main reason being that current domestic laws and regulations have not been updated to reflect the integration aspiration of ASEAN. It is therefore important for individual countries to change the "**integration mindset**". By this we mean that there should be political will to incorporate the idea of ASEAN integration into domestic laws, regulations and master plans. In particular, members should strive to:

- Identifying and dismantling unnecessary **non-tariff barriers**, particularly import surcharges and quotas, to complement the ASEAN-wide elimination of tariffs.
- Amending legislations and regulations to conform to the Blueprint, especially those which currently impose caps on **foreign ownership in services and investment** and thus delay or obstruct the integration process.
- Relaxing domestic regulations on movements of professional labor in order to **reduce barriers** which would make Mutual Recognition Agreements more effective.

As for the second set on financial integration, adopting an "integration mindset" is even more relevant, especially for the case of Thailand, where a "virtuous circle" of financial integration can be created with more boldness in liberalization. Thailand has already incorporated this mindset into its Capital Markets Development Plan, which has made great progress in liberalizing securities and asset management companies, while integrating stock markets with those of other AEAN countries. It is hoped that such integration spirit will also exist in the upcoming formulation of Thailand's Financial Sector Master Plan III and the Capital Account Master Plan. This move should strengthen current financial sector development and institutional quality. On this front, we recommend the following:

- Local ASEAN banks should take opportunities of the imminent liberalization process in order to gain from first-mover benefits. Currently, there are only a few ASEAN banks which consider a "go region" strategy. It is also rather difficult for those commercial banks to penetrate and do their banking services in a particular geographical area, culture and type of business activity. However, this does not imply that there is no motivation at all for ASEAN banks to expand their operation regionally. Such banks could gain a larger customer base that supports the economies of scale and thereby build up their overall performances, thus taking their regional expansion as a first step before gaining a footprint in global banking.

- On the home front, banks should also be ready for more competition. In particular, Thai banks would need to increase productivity and efficiency by adopting competent business strategies, such as emphasizing the market positioning and expertise, finding new market opportunities, expanding size for economies of scale as well as offering financial innovations on products, instruments and services with new knowledge and advanced technology to tailor and attract businesses and retail customers. In the meantime, lowering of operation costs should be also addressed. Thai banks might consider increasing the productivity of employees or adopting technology-oriented strategy, which helps minimize operating cost in long run.
- Furthermore, access to the different markets could be processed through many approaches. One of the prominent approaches, which might dominate the industry in the coming years of financial integration, are merger and acquisition activities (M&A), which would aim to increase asset sizes to compete in the other markets, regionally and globally. Also, M&As play a large role in foreign bank purchases of existing local banks, which is an easy way to penetrate the market and reduce risk associated with moving into a new environment of another country. Key to successful M&As lie not only in finding potential partners, but also in a thorough understanding of existing laws and regulations on this matter.
- On capital flows, it is hoped that Thailand's new Capital Account Master Plan would be well-positioned to balance the current mismatch in regulations by allowing more outflows. This would also be in line with ASEAN efforts in liberalizing the capital account. Of course, safeguards should be built in into the liberalization process in order but should not obstruct and interfere with the free flow of capital during normal times.
- Finally, a word on the current ASEAN financial integration framework. It is important that four Working Committees responsible for guiding the financial integration process should strengthen their cooperation, given that their work is interdependent. The success of any area alone would not contribute to the ultimate achievement of the AEC. In fact, it would be rather inefficient that if one would accomplish its milestones while the others are lagging behind. Recently, a senior-level committee has been set up to coordinate efforts and provide guidance—and it is hoped that this committee would address this issue.

List of Acronyms

ACIA	ASEAN Comprehensive Investment Agreement
AEC	ASEAN Economic Community
AFAS	ASEAN Framework Agreement on Services
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
ASEAN	Association of Southeast Asian Nations
ASEAN-5	Indonesia, Malaysia, Philippines, Singapore, Thailand
ASEAN-6	Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand
CAR	Capital Adequacy Ratio
CLMV	Cambodia, Laos, Myanmar, Vietnam
EEC	European Economic Community
EU	European Union
GATS	General Agreement on Trade in Services
GDP (PPP)	Gross Domestic Product (by Purchasing Power Parity)
IMF	International Monetary Fund
M&A	Mergers and Acquisitions
MRA	Mutual Recognition Agreement
NIM	Net Interest Margin
NTB	Non-tariff Barriers
QAB	Qualified ASEAN Banks
WTO	World Trade Organization

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