SPECIAL REPORT

Moving Ahead with the ASEAN Economic Community: Business Initiatives Across Borders

October 2015

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INTRODUCTION: What, Why, When and *also* Who

The efforts of the Association of Southeast Asian Nations (ASEAN) to effectively create an integrated production base and single market of over 600 million in an ASEAN economic community (AEC) has gained traction and more attention. More now understand its potential. Promises to flatten trade barriers, tariffs and increase connectivity between ASEAN countries have been set to allow the formation of regional supply chains, a free flow of goods, services and investment, and increase the competitiveness of the region.

Why the AEC is important for the region is even more evident today, especially when we consider the current and ongoing global economic uncertainty, generated by disparate events such as the fall in commodity prices and China's decision to devalue its Renminbi. Ensuring stability amidst global and regional turbulence underscores one of the original aims of the AEC, when its blueprint was signed into effect in 2003. A more integrated ASEAN can be more resilient and less dependent on external partners.

Intra-ASEAN sources for growth, which include the expected rise of the middle class in Southeast Asian countries, can be drivers of such resilience. The AEC also allows SMEs based in ASEAN economies to plug themselves into regional production networks and markets, and grow into "ASEAN Brands".

Still, some question whether the group of 10 diverse and sovereign governments will meet the looming 2015 deadline they have set themselves. As such, many discussions about the AEC have focussed

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on *what, why* and *when* - what the AEC will mean for businesses, why it should proceed, and when its effects will be felt to increase the region's competitiveness and attractiveness to business.

The question of *who* is to push ahead with the AEC receives less attention. Many analyses emphasise government promises and top down (government-led) initiatives. While the capacity and will of governments are indeed key, there are also significant roles that the private sector can undertake that are too often over looked. After all, even predating the AEC, there are already many multinational companies that are actively linking across borders in ASEAN. These bottom-up (private sector-led) initiatives taken by businesses can help drive the AEC forward and, gain momentum with the AEC's progress in deepening integration. This will include helping to increase efficiencies, lowering costs, regulatory and other obstacles.

Furthering these bottom up initiatives by businesses can combine with public sector efforts to put the right policies, incentives and infrastructure in place. The combined forces of top down government efforts and bottom up initiatives from business, accompanied with a clear direction from ASEAN, can create a better AEC.

In this Special Report, we look at a number of these bottom up initiatives that businesses are taking and that other companies may also profit from. The AEC potentially creates conditions to further production networks in ASEAN and some companies are already taking advantage of this. In so doing, the roles of government in providing the right frameworks, policies and infrastructure are also discussed. We will also consider cross border subregional development plans where neighbouring states are cooperating and creating the frameworks to plug in the private sector. In conclusion, we consider an emerging factor for ASEAN – the competition between China and Japan for influential roles in the region, both economically and politically. This need not be detrimental to ASEAN so long as the grouping has a clear direction of its own integration agenda both from the bottom up and from the top down.

We do not deny that what the ASEAN governments do is very important and indeed critical for the AEC. We do share concerns that the lack of capacity and will in one or more countries can slow and limit progress. The spectre of protectionist measures made in the name of nationalism is a real concern.

Notwithstanding such concerns, this Special Report also hopes to add to the current analyses by pointing out what can be done by businesses and with government encouragement of cross-border frameworks to support a better integrated ASEAN. These efforts can be supplemented with the support of non-ASEAN countries, especially China and Japan.

Table 1: Four pillars of the AEC Blueprint and what it means for ASEAN

Single Market and Production Base	Competitive Economic Region	Equitable Economic Development	Integration into the Global Economy
a) Allows for the free flow of goods, services, investments and the freer flow of capital. b) Standardised rules and regulations; trade costs reduced. c) Businesses enjoy economies of scale resulting in ASEAN gaining export competitiveness.	a) Potential cost savings resulting from synergies of an integrated economic region empowers the AEC to remain as a competitive market. b) Strengthens ASEAN's relevance in the global economy. This is important to ensure that the region continues to attract foreign direct investment in the long term.	a) Reduces the region's development gap. Narrowing ASEAN's development gap strengthens the grouping internally and unifies the group on geo-political and geo-economic priorities. b) Building up Small and Medium Sized Enterprises (SMEs) to have the potential to grow into ASEAN Brands that are competitive globally. c) Improve the region's overall infrastructure and connectivity between ASEAN member states starting at the borders.	a) Establishing itself as the world's next destination for a range of sectors, including manufacturing. This secures ASEAN's relevance as a key driver of growth in both the global economy and regional architecture. b) Secure interest among the regional powers to engage constructively with the grouping on geo-political and economic uses.

1. A PROMISING AEC, AND PROMISES OF THE AEC

ASEAN continues to hold great promise. The region's economic growth has exceeded the global growth average for the past decade, and is the second fastest thriving economy in Asia after China. The regional grouping is also projected to rank as the fourth-largest global economy by 2050.

The AEC offers a framework for what should be done to best capitalise on ASEAN's comparative advantages, while ensuring a sustainable long term growth trajectory. The considerable opportunities of the AEC are summarised in Table 1 (above) and further expanded in the following sections.

1.1. Economies of Scale and Competitiveness

The integration promised by AEC offers companies a chance to take advantage of economies of scale from an expanded single market and production base that allows companies in the region to "draw on the different competitive advantages of various ASEAN economies."[1] The formation of supply chains across borders and the lowering of trade barriers mean intra-ASEAN trade is expected to grow exponentially, increasingly integrating

[1] KPMG (2015), ASEAN Poised for Accelerated Economic Growth.

ASEAN into a competitive economic grouping. In this regard, the diversity of ASEAN – which some see as a hindrance – is actually a key strength.

Businesses in an integrated AEC can better distribute their production nodes according to cost, skill and competitiveness across ASEAN. A wide range of businesses stand to benefit.

As barriers to trade and services continue to fall, an integrated ASEAN has the potential to better compete against neighbouring economies such as China and India.

Some companies can take advantage of the presence of relatively cheaper labour in ASEAN's developing states such as Cambodia, Laos, and Myanmar (CLM). This is done by relocating their labour-intensive operations there. In contrast, where complex assembly lines and workers with more mid-value skills are required, Thailand and Vietnam can offer themselves as ready production bases. This will benefit companies that have different tiers of production sophistication including the car and aero-engine component industry.

Rolls-Royce, for example has explored ways to take advantage of ASEAN's transition towards a single market and production base. The UK based manufacturer and servicer for integrated power systems, has sought to establish its operations across ASEAN, benefiting from economies of scale, and is encouraging its supply chain to do likewise.

For example, the group recently signed a long term manufacturing agreement with a company in Malaysia to supply major aero engine components to the Rolls-Royce assembly and test facility in Singapore. Rolls-Royce also has a facility in Vietnam which manufactures marine winches and thrusters, as well as a Thailand-based supply chain network that produces and exports parts for aero engines to Singapore and the UK.[2]

Caterpillar, the American heavy equipment and machinery manufacturer, is also drawing on the comparative advantages of respective ASEAN member states to set up its domestic manufacturing and sales operations. Its regional ASEAN strategy involves capitalising on Thailand's geostrategic location as an export base to the rest of ASEAN. While Thailand continues to serve as Caterpillar's hub for the rest of ASEAN, the MNC has also boosted investments into Vietnam to manufacture labour intensive heavy welders.[3]

As barriers to trade and services continue to fall, ASEAN has the potential to better compete against neighbouring economies such as China and India. To do this, ASEAN needs to offer companies opportunities of scale by enabling a free flow of goods and services across the region. This will allow ASEAN-based producers to scale up quickly, reduce unit costs, and become more competitive to match or even

[2] Private Interview with Mr. Jonathan Asherson, Rolls-Royce Regional Director, ASEAN and Pacific.
[3] KPMG (2015), 'MNCs in Southeast Asia – the view of Multinationals in ASEAN.'

overtake Chinese and Indian businesses.[4] The potential cost savings resulting from synergies of an integrated economic region empowers the AEC to remain as a competitive market and for its combined economies to remain as an important node in the world's trade network.

Such relevance in the global economy is important to ensure that the region continues to attract foreign direct investment in the long term, fuelling a positive cycle of investment-led growth for ASEAN.

China's rising labour costs and its ambitions to move up the value chain have created a vacuum where the AEC can fill.

The Chinese economy had been built on its ability to provide cheaper labour, which had made locating labour-intensive manufacturing factories in Chinese cities cost-effective for businesses. However, China's rising labour costs and its ambitions to move up the value chain have created a vacuum where the AEC can fill.

1.2. Global Node and Equitable Development

Establishing itself as one of the world's key destination for globally competitive manufacturing helps to integrate the AEC into the global economy. ASEAN also has the potential to serve as a large consumer market for final goods.

According to the Organisation for Economic Cooperation and Development (OECD), it is expected that ASEAN's growing middle class will account for 59 per cent of global middle-class consumption by 2030. With a combined population of about 600 million people, ASEAN presents to the world a potential export market that is larger than the European Union (EU) or North America.

The formation of trade and supply chains across ASEAN also encourages increased intra-ASEAN trade.

According to, Malaysia's Prime Minister Datuk Seri Najib Razak, it is estimated that an increase of intra-ASEAN trade from the current 24 per cent to 40 per cent could result in the ASEAN economy hitting US$2.5 trillion dollars annually.[5]

The AEC can potentially allow two or more countries to benefit from foreign investment as each economy can seek to capture a part of the production network most suited to its strengths and link up with another ASEAN partner.

Increased intra-ASEAN trade is expected to improve the region's overall infrastructure and connectivity between ASEAN member states starting at the borders. This will open up new regions and markets for businesses and investments to expand in, and link up

[4] Private Interview with Mr. Manu Bhaskaran, Director of Centennial Group International and the Founding Director and Chief Executive Officer of Centennial Asia Advisors.

[5] Datuk SeriNajib Razak (2015), The Star Available Online at: http://www.thestar.com.my/Business/Business-News/2015/04/23/ASEAN-to-play-significant-role-in-global-economy-says-Najib/?style=biz Accessed on:21/08/2015.

industrial clusters and special economic zones within a country.

Intra-ASEAN trade is also expected to narrow the development gap within ASEAN though the formation of subregional economic zones across the region (discussed later in Section 2).

Therefore, rather than having ASEAN country's competing head to head with one another for foreign investment, the AEC allows two or more countries to benefit from foreign investments as each economy can seek to capture parts of the production network most suited to its strengths and link up with another ASEAN partner. In this regard, past win-lose scenarios of investment can be transformed into win-win among ASEAN neighbours.

The formation of such complementary networks across ASEAN countries encourages industrial clustering across ASEAN and increases the efficiency of production operations.

1.3. Increased Industrial Clustering in ASEAN

The AEC provides an opportunity for businesses to look at ASEAN as an integrated production base, avoiding potential duplication of its manufacturing facilities across the region.

The AEC provides businesses with a platform to not only capitalise on ASEAN's comparative advantages but also provides MNCs with an opportunity to relocate their manufacturing operations closer to ASEAN's growing middle class.

ASEAN as both a manufacturing hub and large market will help MNCs to save on transportation costs as finished goods and ASEAN's potential consumer market are all within close proximity.

Neighbouring ASEAN countries also stand to benefit from the spill-over effects of companies establishing their production hubs in key ASEAN economies

The following sections provide examples of how the formation of an AEC will attract companies to shift their manufacturing and production bases to ASEAN. This will encourage more industrial clusters to develop across the region. The deepening and widening of production networks across ASEAN with the help from foreign investment, also has the potential to narrow development gaps between ASEAN Member States.

1.3.1. High Cost Manufacturing

High cost manufacturing such as the automobile industry would gain more momentum under the AEC blueprint. ASEAN has become the cornerstone of regional production networks, contributing significantly to value added exports and employment.[6]

Through the AEC, there will be an improvement on customs and standards

[6] ADB and International Labour Organisation (2014),' ASEAN Community 2015: Managing Integration for Better Jobs and Shared Prosperity,' Cataloguing-In-Publication Data.

harmonisation, enhanced transport and logistics facilitation, as well as service and investment liberalisation. This will deepen the regionalisation of production networks and pull regional supply chains from Thailand into Cambodia, Laos Myanmar and Vietnam, also known as CLMV countries.

Carmakers have noted the cost saving benefits of widening and investing more in Southeast Asia to develop its production networks. This year, the president of Mitsubishi Motors Corporation announced that it will relocate its US factories to principal production hubs in Southeast Asia, Japan and Russia, with factories in Japan and Thailand serving the US market. [7]

Neighbouring ASEAN countries stand to benefit from the spill-over effects of companies establishing their production hubs in key ASEAN economies.

The formation of such overlapping primary and secondary production networks within the region, allow for a diversified portfolio of investments to enter and be shared among more ASEAN member states.

For example, MNCs have adopted a Thailand-plus-one initiative, keeping high-value-added manufacturing processes such as product engineering and research and development capabilities in Thailand, but shifting cheaper and more labour-intensive operations to neighbouring CLMV countries.[8]

Such “Plus one initiatives” enable businesses to diversify their political risk, and reduce their costs of production by capitalising on the comparative advantages that ASEAN has to offer.

There is also room in the region for secondary production networks to form and overlap, as barriers to entry into primary production networks in the automobile industry become too high for competitors.

For example, Indonesia is emerging as a potential secondary production hub and market for the automobile industry.

As a new entrant, China’s SAIC Motor Corporation faces high barriers to entry into the automobile industry in Thailand. As such, it decided to enter into a joint venture with America’s General Motors to manufacture and sell low-cost minivans in Indonesia.[9]

The potential to form such overlapping primary and secondary production networks within the region allow for a diversified portfolio of investments to enter and be shared among more ASEAN member states.

1.3.2. Low Cost Manufacturing

As labour and land cost increases in China, garment factories have begun to shift from China to Cambodia, Myanmar and Vietnam (CMV) and Indonesia.

[7] Funakoshi, M. (2015),’ Mitsubishi Motors production hubs will be Japan, Southeast Asia and Russia, Reuters, Available online at: http://www.reuters.com/article/2015/07/27/us-mitsubishimotors-usa-plant-idUSKCN0Q10D120150727 Accessed on: 20/08/2015.

[8] Private Interview.

[9] Ibid.

China's ambitions to move up the value chain enable labour intensive industries in ASEAN to grow, creating employment opportunities for the masses and help develop the region as a competitive global manufacturing hub.

Therefore increased FDI into developing manufacturing industries such as the textiles and garment sectors in ASEAN allow countries to diversify their economy and reduce their reliance on the agricultural sector.

1.3.3. Capital Intensive Industries

Countries with mid-value production industries, such as electronics and apparel, are likely to deepen their comparative advantages in capital intensive manufacturing sectors under the AEC.

Vietnam, which has established a mid-value production network for mobile phones, is likely to double its production of handsets and other electronics by 2025.[10]

For example, businesses such as Samsung are moving large segments of its manufacturing base to Vietnam, setting up factories along the borders of Thai Nguyen province to produce components for mobile devices and other electronics.

The Thai Nguyen province is one of the nodes on the East-West Economic Corridor, a government-to-government initiative between Thailand, Laos, Myanmar and Vietnam, with the potential link with India and Southern China. This initiative, which forms a subregional economic corridor, is aimed at boosting trade and economic development among these countries, and provides trade and corporate incentives that entice private sector investments.

The role of such subregional economic zones and corridors will be discussed in greater detail in Section 2.11 of the report. But the potential benefits to companies such as Samsung include greater cost savings in the form of lower transportation costs and greater efficiency from cross border specialisation and tightly linked supply chain networks.

1.3.4. Services Sector

As industries start to develop across ASEAN, demand for complementary services such as customer support, market based research and technical support will also grow.

It is in this area that countries such as the Philippines, which has developed a comparative advantage in providing Business Process Outsourcing (BPO) services, can support international and regional MNCs.

The Philippines' comparative advantage in the BPO service industry is driven by its young workforce and English-speaking population. It is expected that as more industries develop and expand across ASEAN, the Philippines' BPO industry will grow to account for roughly 11 per cent of

[10] World Bank Data, Available online at: http://data.worldbank.org/country/vietnam Accessed on: 27/08/2015.

the country's GDP by 2020, up from the current 5.4 per cent of its GDP.[11]

1.3.5. High Value-Added Services and Industries

High value-added industries that include the financial service sector and Research and Development (R&D) are likely to cluster around more developed ASEAN countries such as Singapore and Malaysia for their comparative advantages in the knowledge based economy and services sectors.

These countries also have easy access to capital, advanced technology and a highly-skilled labour force. Singapore's experience in the financial sector alongside Malaysia's growing comparative advantage in Islamic financial services may result in both countries becoming complementary financial hubs for the region.

These developed economies are also more open to attracting and developing the talent needed to invent and innovate across various sectors and industries. As such they are in a good position to attract the regional head offices of MNCs, as well as the R&D laboratories of the global pharmaceutical companies.

In order to better attract such high value-added companies, countries such as Philippines, Singapore and Vietnam have ratified the Madrid Protocol,[12] an internationally recognised system which secures trademark registration, and protects IP rights of companies registered in the signatory countries.[13] This improves business confidence that their intellectual assets will be protected according to international standards and laws.

In the long term, the AEC provides a framework that encourages the formation of efficient production networks and value chains that connect the region.

The AEC is aimed at helping ASEAN Member States move up the value chain, widen their regional and global production networks, and become a competitive global economic bloc.

2. CHALLENGES TO ASEAN'S CONNECTIVITY

However, as much as ASEAN's diverse mix of developing and developed economies are a pull for investment and potential growth, it is also an inhibiting factor, and one that has limited the speed of integration for the AEC.

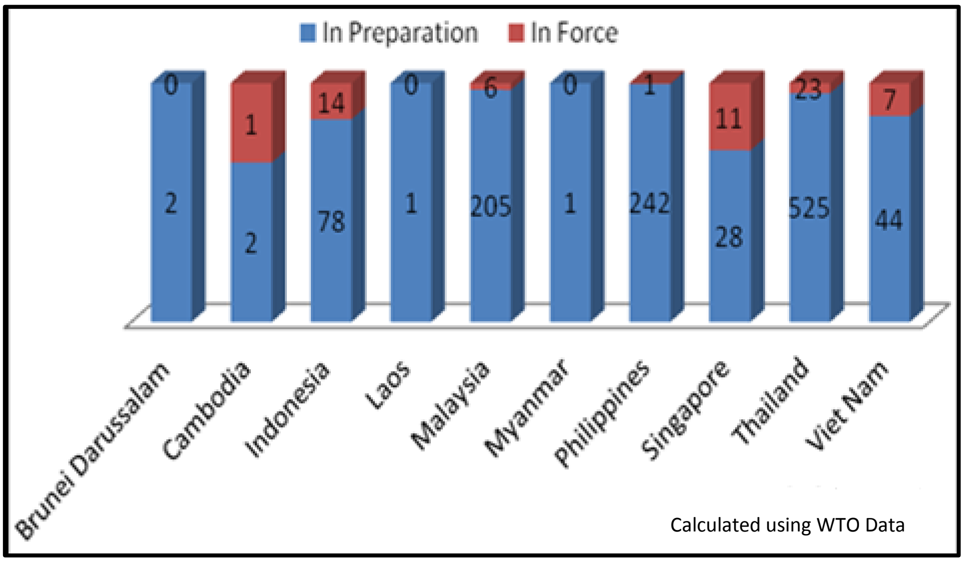
The varying levels of economic development across ASEAN also present a significant challenge to ASEAN's integration and connectivity goals. This is because different ASEAN economies at disparate stages of development may be limited by certain domestic capacities for

[11] World Bank (2013), ' Philippine Development Report; Creating More and Better Jobs,' World Bank Philippine Office East Asia and Pacific Region.

[12] As part of the Intellectual Property Rights Action Plan 2011-2015, all ASEAN member states agreed collectively to accede to the Protocol relating to the Madrid Agreement by 2015.

[13] ASEAN Secretariat (2014) Available Online: http://www.asean.org/news/asean-secretariat-news/item/asean-holds-advanced-training-on-madrid-protocol. Accessed on: 15/8/2015

Figure 1: Number of Technical Barriers* to Trade Implemented by ASEAN Member States



* Technical Barriers to trade are a form of NTB that include a country's quality control regulations, customs duties, and product certification requirements that do not conform to uniform standards across ASEAN.

development or may require different needs. Political and domestic factors may also pose as challenges to greater economic integration in ASEAN.

This section aims to highlight the challenges that hinder ASEAN from deepening its integration to form a single market, followed by accompanying solutions that businesses and investors can consider to circumvent such barriers to investment and trade.

2.1. Rise of protectionism

While most ASEAN governments have expressed support for the formation of the AEC, there has been strong pushback from the domestic private sector. This is particularly so in countries where government support in the form of subsidies, have created industries with artificial comparative advantages.

Then, there is also the rise of economic nationalism among ASEAN countries due to populist demands that have pushed national governments towards more protectionist policies and measures.

Such factors have contributed to the rise of Non-Tariff Barriers (NTBs) that continue to endure even after tariffs have broken down.[14] This is illustrated in Figure 1 (above).

Based on the World Trade Organisation's (WTO) study, Figure 1 shows that nearly all ASEAN Member States have plans to increase technical barriers to trade. Technical Barriers to trade are a form of NTB that include a country's quality control regulations, customs duties, and product certification requirements that do not conform to uniform standards across ASEAN. This study was part of the trade

[14] Private Interview.

organisation's efforts to examine the openness of ASEAN states to global trade and investments.

Besides NTBs, other protectionist measures that are likely to hinder the success of the AEC include the imposition of unique requirements by national governments on foreign investors in the country.

For example, Indonesia implemented a Rupiah-only rule which requires all investors to complete all transactions using the Rupiah. This forces companies to take on additional currency risks and raises the costs and difficulty of doing business in Indonesia.

Presence of inward-looking protectionist measures, even at the national level, tends to present market ASEAN as a complex and costly region to invest and set up business in.

Further, a recent report from the World Bank on East Asia's Pacific economies found that many ASEAN countries tend to restrict foreign ownership and protect local industries and resources. It also found that despite the importance of FDI to spur economic growth, ASEAN countries imposed more laws restricting foreign ownership compared to any other region in the world. [15]

For MNCs looking to invest in ASEAN, the presence of such inward-looking protectionist measures, even at the national level, tend to market ASEAN as a complex and costly region to invest and set up business in.

Instituting and enforcing frameworks such as the ASEAN Comprehensive Investment Agreement, which protects investor interests in ASEAN, will become increasingly important to help ASEAN become a competitive and attractive market for investments. This will help ASEAN move closer to its goal of improving physical and institutional connectivity across the region.

2.1.1. A More Connected ASEAN, through Subregions and Economic Corridors

The rise of such protectionist policies can be attributed to an array of factors, which include domestic pushback from both the public and private sector. Such policies are counterproductive to ASEAN's integration efforts to create an open and attractive market for investors, but ASEAN's Sub-Regional Economic Zones (SREZs) and economic corridors offer an alternative.

SREZs have the potential to allow governments to carve out regions in their countries that provide more corporate and investment incentives to foreign investors, and may have separate and more open rules for investment compared to the rest of the country.

This allows foreign investors to circumvent cumbersome investment rules and requirements that restrict their entry into certain sectors in the country.

[15] The World Bank Group (2014), ' Preserving Stability and Promoting Growth, World Bank East Asia Pacific Economic Update.

SREZs are targeted at attracting foreign investors into areas where governments have earmarked on development and can be seen as a form of public-private partnership initiative aimed at encouraging further economic growth.

SREZs are also targeted at attracting foreign investors into areas where governments have earmarked on development and can be seen as a form of public-private partnership initiative aimed at encouraging further economic growth.

With the help of the private sector, such SREZs and economic corridors are aimed at improving infrastructure connectivity within and between countries, allowing ASEAN to deepen its integration from the bottom up and from the borders.

Furthermore, as SREZs connect peripheral borders to key economic clusters, economic gains can be easily shared with poorer communities by providing employment and improvements to development in these areas. This helps to narrow ASEAN's development gap.

Greater Mekong Subregion

As labour and land costs increase in China and Thailand, the market and economies of the CLMV nations offer a cheaper alternative for industries that are looking to broaden and deepen their production networks in the region.

Created in 1992, the Greater Mekong Subregion (GMS) which connects Cambodia, Yunnan Province and Guangxi Zhuang Autonomous Region in China, Laos, Myanmar, Thailand and Vietnam, offers a potential cost-competitive supply chain production and trade network stretching across key emerging economies in ASEAN and China.[16]

The GMS has recently caught the attention of the private sector as the subregional economic zone offers a market-based economy, rich and diverse untapped resources and better intra-regional logistics. The latter includes harmonised standards and certifications that promote labour mobility and the free flow of cross-border trade within the GMS.

For example, a GMS-Cross Border Transport Agreement (GMS-CBTA) signed by the countries involved aims to facilitate the movement of goods across borders by easing transport requirement within the subregional economic zone.[17] This reduces the amount of time spent on processing documents and eases the flow of vehicles and people at border check points.

Although it took a decade to gain traction, the GMS' efforts to upgrade its basic transport infrastructure such as roads, improved intra-regional connectivity have drawn private investor interest. Foreign investments to improve infrastructure in

[16] Pomfret, R. and Das, S.B. (2013), Subregional Zones and ASEAN Economic Community, In: Das, S.B. Severino, R.C. and Menon, J. eds. *The ASEAN Economic Community: A Work in Progress,* Asian Development Bank and ISEAS Yusof Ishak Institute, pp.304.

[17] GMS-CBTA Website: available online at : http://www.gms-cbta.org/cross-border-transport-agreement Accessed on:15/08/2015.

the GMS has increased from US$4 billion in the early 2000s to over US$10 billion in 2010.[18]

The increase in investments in the region is also because investors are attracted to GMS's large population of 330 million, which accounts for nearly half of ASEAN's total population. Banks such as Standard Chartered and Maybank have also been drawn to the subregional economic zone for the area's infrastructure investment potential and diversified client base that include the corporate and retail banking.

The GMS' proximity to ASEAN's larger market also means that businesses are better able to conduct and exchange market information quickly and easily, and enjoy a lower cost of production.[19]

SREZs can serve as effective building blocks to drive greater economic integration and to enhance ASEAN's overall economic competitiveness.

For the governments involved, attracting foreign investors and businesses to the GMS creates a win-win situation that drives a self-sustaining cycle of economic development that also improves and expands infrastructure and networks at the borders. This is on top of the benefits that can be derived from the transfer of technology and knowledge from MNCs to domestic industries.

[18] Ibid.
[19] Asian Development Bank (2011), ' The Greater Mekong Subregion Economic Cooperation Programme Strategic Framework 2012-2022,' Cataloguing-In-Publication Data, pp. 7.

Therefore SREZs serve as effective building blocks that drive greater economic integration and to enhance ASEAN's overall economic competitiveness.[20]

East-West Economic Corridor

The East-West Economic Corridor (EWEC) is also an example of an economic corridor that aims to strengthen connectivity across borders and within subregional zones. Launched in 1998, it is one of the three economic corridors within the GMS.

One of the infrastructure projects at the EWEC includes a 3,200 km India-Myanmar-Thailand highway that links production networks across Moreh in India to Thailand's Maesot via Myanmar's Tamu, Mandalay and Myawaddy cities.[21] While only sections of the highway are currently operational, the full opening of the highway is expected to take place later this November.

Recently, a 25.6 km section of the EWEC's highway linking Myawaddy-Thinggan Nyenaung-Kawkareik section of the highway in Myanmar was recently opened. The section of the highway is expected to reduce travel time by road from three hours to fourty-five minutes. [22]

[20] Pomfret, R. and Das, S.B. (2013), Subregional Zones and ASEAN Economic Community, In: Das, S.B. Severino, R.C. and Menon, J. eds. *The ASEAN Economic Community: A Work in Progress,* Asian Development Bank and ISEAS Yusof Ishak Institute, pp.303
[21] ASEAN Briefing, Available online at: http://www.aseanbriefing.com/news/2015/09/04/asian-highway-to-link-india-myanmar-and-thailand.html Accessed on:15/08/2015.
[22] Ibid.

It also serves as a connector that links the EWEC's production networks to the Thailand and Indian market. Therefore, the ability to move goods and people faster than before has the potential to facilitate and increase trade between Myanmar, Thailand and India.

Subregion and economic corridors can act as a testbed where ASEAN can first test out integration initiatives which include a more open and liberal investment framework.[23] However, in order to maximise the benefits of improved connectivity between countries, projects need to be accompanied by a clear government vision and direction.

This means ensuring infrastructure developments and investments not only benefit the private sector, but also trickle down to populations living in these areas in the form of employment and overall development.

2.2. Insufficient Capital for Infrastructure Projects

ASEAN's large infrastructure gaps also present a challenge to physical connectivity. Such gaps increase transport and logistics costs in production networks and hinder the potential to expand and link up industrial clusters and regional supply chain networks within the country and across borders.[24] The lack of infrastructure connecting ASEAN countries also prevents the successful implementation of an AEC.

Going forward, ASEAN will require more capital to fund its infrastructure or risk further delaying its goals of becoming an integrated production base and single market. Currently, the ASEAN Infrastructure Fund, which sets aside US$13 billion to address the region's infrastructure need, is insufficient to support the region's infrastructure needs.

Global investment and banking firm Goldman Sachs estimates that ASEAN will require US$550 billion to fund its infrastructure needs through to 2020.

Another factor hindering improvements to the region's connectivity is the capability of different ASEAN member states to mobilise and channel capital and resources towards infrastructure projects. This is because the availability of capital and investments into infrastructure projects vary across Southeast Asian economies.

ASEAN's infrastructural disparity is illustrated in Table 2 (next page), with the levels of efficiency and connectivity of each ASEAN member state ranked according to the Ease of Doing Business and Enabling Trade Index (ETI).

The ETI assesses both the physical and institutional connectivity of each country and takes into account the number and quality of institutions, policies, services and infrastructure in place that facilitates the free flow of goods and service across

[23] Private Interview Mr. Pushpanathan Sundram, Former Deputy Secretary-General of ASEAN for ASEAN Economic Community, ASEAN Secretariat and Senior Research Fellow, SIIA.

[24] Intal, P.J. et al. (2014). 'ASEAN Rising ASEAN and AEC Beyond 2015,' Economic Research Institute for ASEAN and East Asia, pp. 233.

Table 2: ASEAN's Global Competitiveness		
	Ease of Doing Business Index	Enabling Trade Index (ETI)
Singapore	1	1
Malaysia	18	26
Thailand	26	39
Brunei Darussalam	101	NA
Indonesia	114	58
Philippines	95	84
Vietnam	NA	50
Cambodia	**135**	**97**
Lao PDR	**148**	**107**
Myanmar	**177**	**133**
Number of Countries	189	138

borders. Countries that rank lowly on the index imply weak connectivity in these countries.

According to a joint study conducted by International Labour Organisation (ILO) and the Asian Development Bank (ADB), CLM countries stand to gain the most in terms of GDP growth under the AEC, compared to the more developed ASEAN countries. However, these countries will require an increase in capital to develop infrastructure and connectivity within the country and at the borders.

2.2.1. Making Sino-Japanese Competition Work for ASEAN

The competition between China and Japan to become Asia's next leader has spurred these regional powers to adopt extensive engagement strategies for the region. This includes a whole gamut of trade and infrastructure initiatives targeted at funding projects to improve the region's overall connectivity.

For example, China's initiative to launch the Asia Infrastructure Investment Bank (AIIB) is aimed at raising capital for large scale projects that will help to narrow Asia's infrastructure gaps. China has pledged an initial capital of US$100 billion to the AIIB, with an additional total of US$50 billion pledged by the rest of the 57 member countries.

The China-led initiative is also aimed at opening up more maritime trade routes within ASEAN, and aligns with part of China's broader One Belt One Road vision, that will link up parts of Southeast Asia with the Chinese mainland.

The Japanese have also pledged to invest US$100 billion to the ADB, which will support high quality infrastructure projects in Asia. The ADB focuses on subregional zones such as developing ports and industrial zones in Myanmar, as well as other infrastructural upgrading projects in Vietnam, Cambodia, Malaysia and Thailand.

ASEAN and its individual member states need to develop clear and long term development plans to channel capital into appropriate infrastructure projects that will bring maximum benefit to not only the economy but its population.

The injection of fresh capital into infrastructure projects in the region makes ASEAN's goals to improve its infrastructure and connectivity much more attainable.

ASEAN and its individual member states need to develop clear and long term development plans to channel such capital into appropriate infrastructure projects that will bring the maximum benefit to not only the economy but its population.

Having a clear plan and direction on what type of projects are suitable and needed for the economy will put governments in a better position to make informed decisions on whether or not to approve project tenders, especially those made by competing foreign investors. This also means having to turn down projects that may not serve in the best interests of the country or region.

Indonesia, for example, recently decided to reject both Chinese and Japanese proposals to develop a high-speed railway connecting Jakarta and Bandung, opting instead for a more economical medium-speed rail line that offered lower fares for commuters.

The ability for ASEAN member states to manage and evaluate offers and proposals to fund high profile projects will become increasingly crucial especially as competition for economic influence in the region between countries such as China and Japan heat up. By means of economic diplomacy or otherwise, both will attempt to assert their influence and shape the region to suit their own strategic interests.

ASEAN member states must therefore not allow themselves to be caught in the middle, especially when major powers go head to head. ASEAN, individually or as a group, must adopt a partnership approach. Instead of allowing investors or multilateral financiers to drive and dictate regional projects, governments need to play a leadership role to carefully evaluate the offers made by these stakeholders and align them to the country and region's overall long term development agenda.

By doing so, ASEAN's engagement with regional powers will not be viewed as either Chinese or Japanese-centric but ASEAN driven and focused. This ensures ASEAN's interests and goals remain central in the decision making process and reduces the risk of the grouping being influenced by larger powers.

CONCLUSION

ASEAN leaders have been successful to implement 91 per cent of the AEC's priority goals. However, ASEAN needs to have a clearer direction of how to engage with the private sector and align investments from non-ASEAN countries with development plans at both the subregion and regional level.

Simultaneous top down and bottom up efforts especially in SREZs and economic corridors will grow increasingly important as drivers of integration, connecting and pulling ASEAN even closer together from the borders. Industrial clusters will also play a role in rejuvenating economic growth and narrowing the region's development gaps.

In the long term, the linking up of these subregions to globally connected core economic centres throughout the region supports the region's goals of an AEC that is well-networked and globally competitive.

While there is not likely to be a big bang effect at the launch of the AEC by the end of this year, the promises of the formation of an integrated region is not to be discounted. Efforts to tie and develop the region together will be slow and on a step-by-step basis. The benefits of the AEC may also not be immediate and at times difficult to quantify. However in the long run, an integrated and united ASEAN has the potential to bring long term returns not only to businesses and investors in the region but also to its citizens.

AUTHORSHIP AND ACKNOWLEDGEMENTS

This special report is authored by SIIA Chairman Simon Tay, and Policy Research Analyst (ASEAN) Sivashangari Kiruppalini as part of SIIA's programme on ASEAN. The ASEAN programme includes Director for Policy Programmes, Lee Chen Chen and Assistant Director (ASEAN) Cheryl Tan. Research Intern Rahul Mahtani also contributed to this report.

We would also like to thank Economic Research Institute for ASEAN and East Asia (ERIA) for their support of this special report.

The SIIA would like to thank the following individuals for their invaluable input into this special report:

Dr. Hank Lim, Senior Research Fellow, SIIA;
Mr. Jonathan Asherson, Regional Director, ASEAN & Pacific, Rolls-Royce;
Mr. Manu Bhaskaran, Director of Centennial Group International and the Founding Director and Chief Executive Officer of Centennial Asia Advisors; and
Mr. Pushpanathan Sundram, Former Deputy Secretary-General of ASEAN for ASEAN Economic Community, ASEAN Secretariat and Senior Research Fellow, SIIA

All views expressed in this special report are those of the authors, unless otherwise credited.

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The Economic Research Institute for ASEAN and East Asia (ERIA) is an international organisation established by a formal agreement among 16 heads of government at the Third East Asia Summit in Singapore on 21 November 2007. It works closely with the ASEAN Secretariat, researchers, and research institutes from East Asia to provide intellectual and analytical research and policy recommendations. These research and policy recommendations are expected to help leaders and ministers during their deliberations in meetings (such as the ASEAN Economic Ministers Meeting) and in the East Asia and ASEAN Summits.

The objectives of ERIA are to facilitate the building of the ASEAN Community, contribute to the narrowing of development gaps in the region, and to support ASEAN's role as the driver of the deepening of economic integration in East Asia. The ERIA headquarters is based in Jakarta, Indonesia.

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