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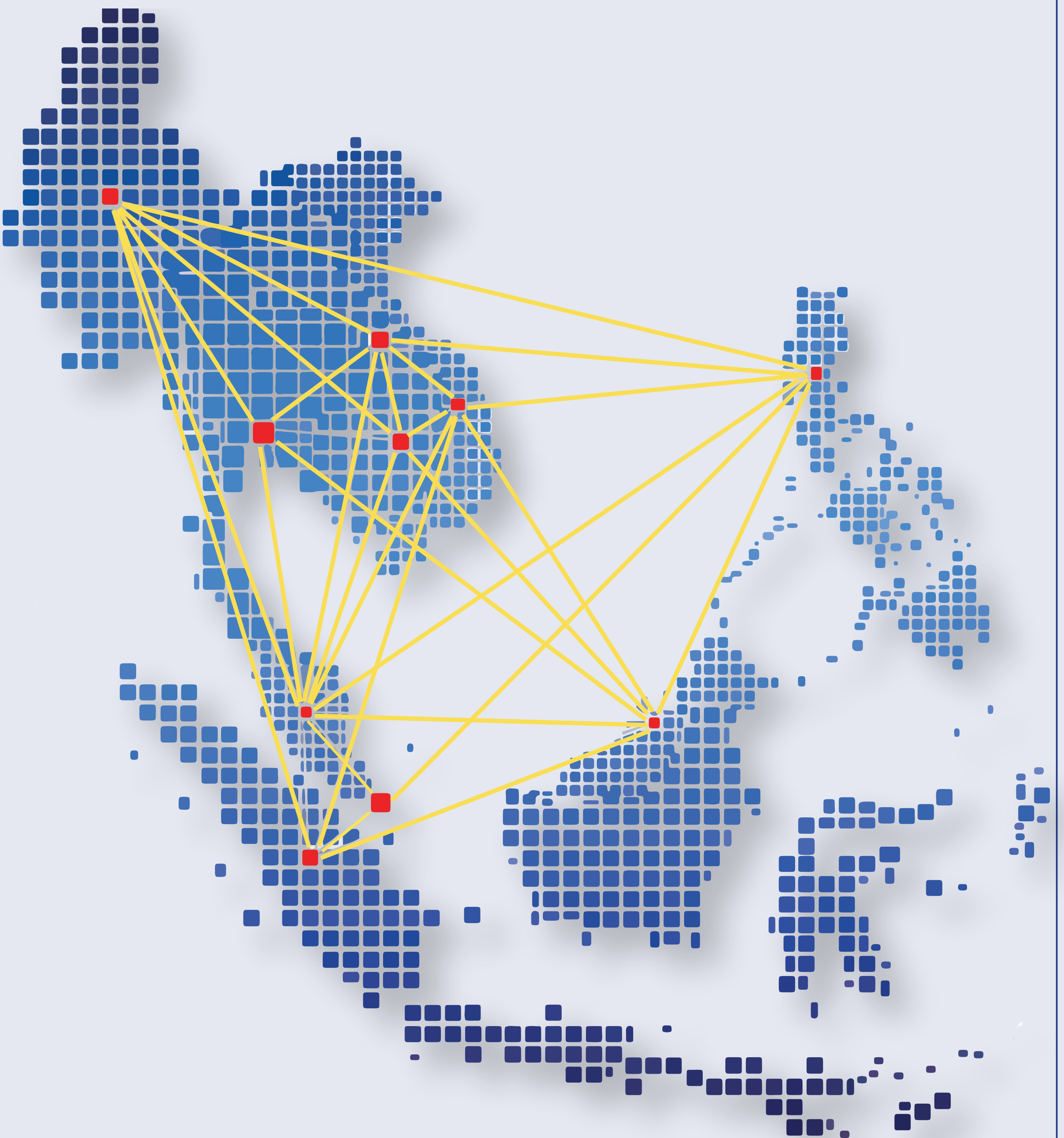
ASEAN@50:
From Crisis to Community and the Coming Changes



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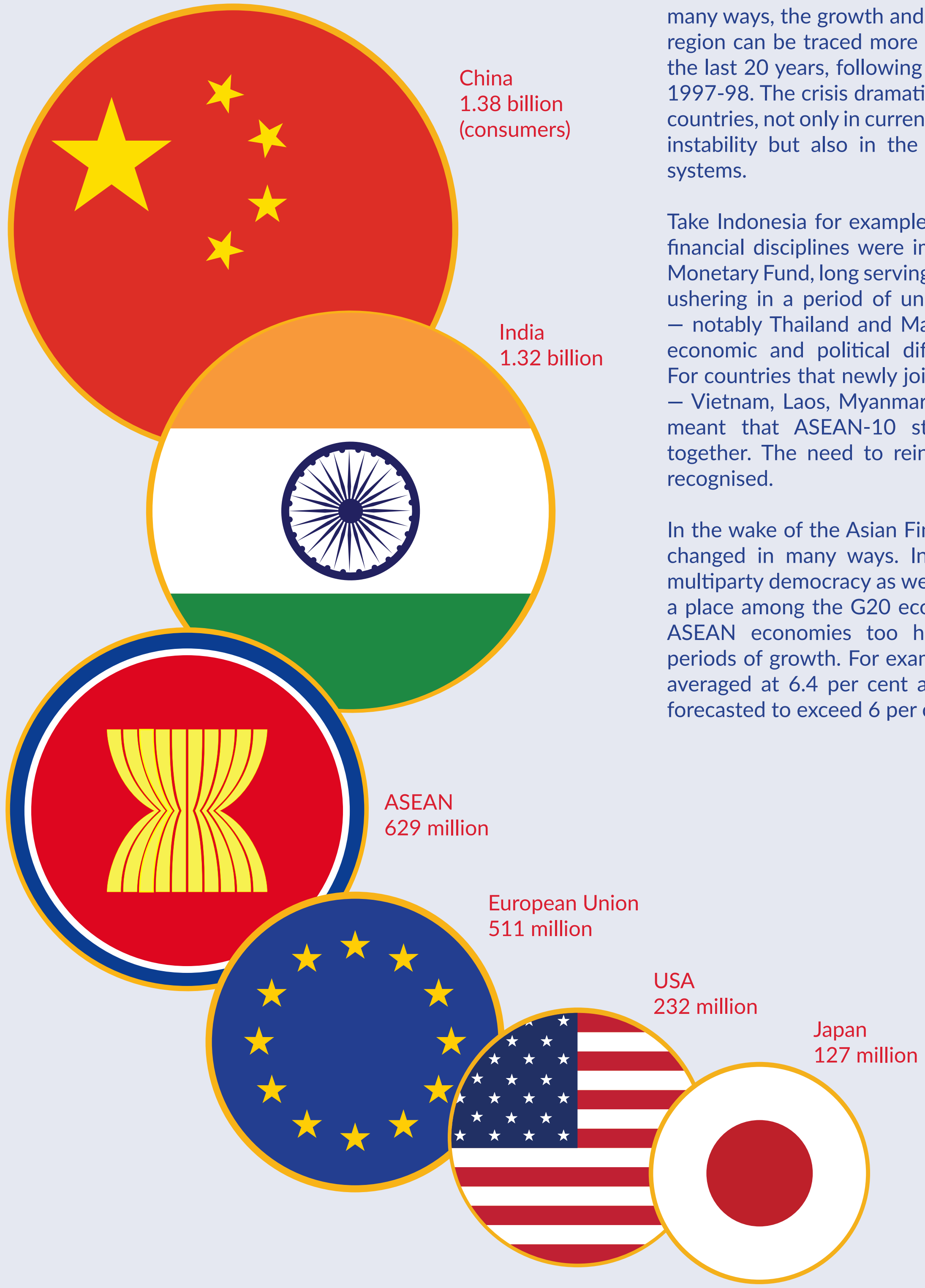
FROM THE ASIAN FINANCIAL CRISIS TO AN ASEAN COMMUNITY

ASEAN: THIRD LARGEST CONSUMER MARKET IN THE WORLD



Source: World Bank, 2016

ASEAN celebrates its 50th anniversary this year. Yet, in many ways, the growth and economic integration of the region can be traced more clearly in the perspective of the last 20 years, following the Asian Financial Crisis of 1997-98. The crisis dramatically impacted many ASEAN countries, not only in currency devaluations and financial instability but also in the real economy and political systems.

Take Indonesia for example. During the crisis and after financial disciplines were imposed by the International Monetary Fund, long serving President Suharto resigned, ushering in a period of uncertainty. Others in ASEAN — notably Thailand and Malaysia — also went through economic and political difficulties and controversies. For countries that newly joined the group in this period — Vietnam, Laos, Myanmar and Cambodia — the crisis meant that ASEAN-10 struggled to move forward together. The need to reinvent ASEAN was gradually recognised.

In the wake of the Asian Financial Crisis, the region has changed in many ways. Indonesia has emerged as a multiparty democracy as well as an economy that merits a place among the G20 economies in the world. Other ASEAN economies too have experienced sustained periods of growth. For example, growth in Vietnam has averaged at 6.4 per cent a year in the 2000s[1], and is forecasted to exceed 6 per cent until 2019[2].

While not without ups and downs, the region has taken efforts to strengthen its resilience and stability. After the crisis, most ASEAN economies have built up their foreign currency reserves and managed their balances to become more resilient. Working with the larger economies of China, Japan and South Korea, ASEAN also created safety nets against a recurrence of such a financial crisis through a network of currency swap arrangements known as the Chiang Mai Initiative Multilateralisation. This is supported by the ASEAN+3 Macroeconomic Research Office as a regional macroeconomic surveillance unit.

Even more, an ASEAN Community — and specifically an ASEAN Economic Community (AEC) — has been inaugurated since the end of 2015. The logic of further integration is accepted; that working together, ASEAN can be more resilient, competitive and even serve as a growth engine. While further steps can and will be taken, ASEAN today already demonstrates a far closer level of integration than seen in the pre-crisis years.

Today's ASEAN represents a combined market of over 600 million people with more than US$2.3 trillion in GDP – the 7th largest economy in the world. Growth continues to outperform global norms, even following the global financial crisis that hit USA and Europe from late 2008. After 2008, with the global economy experiencing a cyclical slowdown, ASEAN's regional growth declined slightly but did not contract. ASEAN economies have even grown since the 2008 crisis, with GDP growth averaging around 5 per cent[3].

In 2016, despite swings in the financial markets and heightened economic volatility triggered by the US elections, ASEAN economies grew at 4.6 per cent[4], surpassing average global growth rate of 3.2 per cent[5].

The region's long-term economic outlook is projected to remain resilient, with an average annual GDP growth of 5.2 per cent between 2016 to 2020[6]. This is higher than the global projected GDP growth, averaging between 3 to 4 per cent[7]. ASEAN is also one of the top destinations for foreign direct investment (FDI), receiving around 16 per cent of the world's FDI among developing economies[8]. These positive economic indicators bode well for ASEAN economic integration, and the promotion of the region as a preferred investment destination.

Two decades after the sharp impacts of the Asian Financial Crisis, ASEAN is now a significant player in the wider region and globally. In the way it is seen and in the ways and areas where its workings are increasingly relevant, compared to the crisis years of 1997-98, ASEAN has been reinvented.

There are however newer challenges that are emerging, together with opportunities. While the achievements of the past 50 years and indeed since the 1997-98 crisis should be noted and celebrated, ASEAN will be challenged to go forward. It is in this context that this Report is offered.

The Report begins by looking at the AEC. Drawing on a recent survey of leading businesses, this report considers the current and emerging perceptions of ASEAN and then discusses potential factors that can drive further growth. Examples discussed are drawn from the digital economy and infrastructure development. Thereafter, a number of emerging trends in politics and economic policy that are challenging ASEAN are considered. The group needs to respond to these challenges and seize opportunities to move ahead. This Report believes this is possible, but to do so will require the further transformation of ASEAN.

FAVOURING THE ASEAN ECONOMIC COMMUNITY

In 2015, ASEAN officially inaugurated the ASEAN Community with three pillars for Political-Security, Economic and Socio-Cultural cooperation and integration. These three pillars are interdependent and mutually reinforcing with an objective to promote peace, stability and shared prosperity in the region. Transforming ASEAN from a loose association of 10 disparate and diverse countries into a Community is a monumental undertaking.

Efforts are therefore ongoing. Following the 2015 inauguration of the ASEAN Community, the ASEAN 2025: Forging Ahead Together blueprint sets out a roadmap for further consolidation, integration and cohesiveness[9]. The aim is to develop an ASEAN that will become a global player that advances sustainable economic growth in Southeast Asia and in the world.[10]

ASEAN's potential has been affirmed by foreign investors who have given the region more attention and increased their stakes in a number of ASEAN countries, often as part of their respective ASEAN-wide strategies. A survey conducted by the Singapore Institute of International Affairs (SIIA) showed high expectations for ASEAN to be the next engine for global growth, with 65 per cent of businesses surveyed expressing strong interest in ASEAN economies.

Investors appreciate the strong potential in the region's integration efforts and are increasingly looking to expand, deepen and diversify existing connections whilst developing new markets in ASEAN. This is especially as traditional markets in Europe and US are facing economic uncertainties[11]. According to the World Economic Forum, ASEAN is a more open market for international trade and investors than either the European Union or the United States[12]. Investors are looking towards predictable, reliable and open markets and, in an uncertain world, ASEAN is becoming a viable alternative.

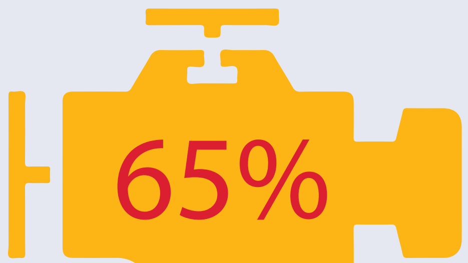
Foreign investors surveyed by the SIIA also saw new elements and opportunities in ASEAN. Investors have come to look at ASEAN not just as a production base but also as a key consumer market. Four factors bear special consideration by investors as potential next drivers for further growth in the region. These are (1) deepening pan-ASEAN supply chains; (2) developing infrastructure; (3) a growing digital economy; and (4) the demographic dividend of a young workforce and growing consumer market.

Fig 1: Why ASEAN is a favoured destination

78 per cent of foreign investors cite the region's **GROWING MIDDLE CLASS** as a key attraction.

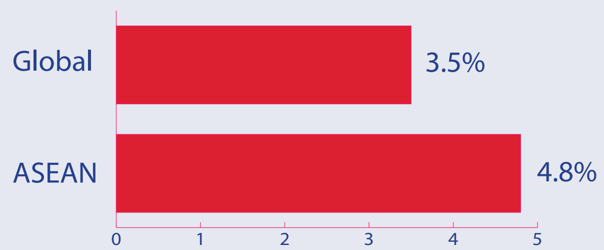
70 per cent of respondents saw investment prospects in ASEAN's potential for **RAPID URBANISATION.**

52 per cent cited ASEAN's **GEOSTRATEGIC POSITION** to the wider Asian region as another attraction.



of businesses surveyed are currently looking towards ASEAN as the next engine for global growth.

Average GDP Growth in 2017



NEXT DRIVERS OF GROWTH

(i) Deepening ASEAN Supply Chains:
Many more companies now have value chains that criss-cross throughout the region. The 10 members of ASEAN are at different levels of economic development and this can and has been used positively to create support for diversified value chains. This is especially seen in the manufacturing sector, with each link in the production chain finding its own value.

As ASEAN integrates more closely through the AEC, companies are adjusting their manufacturing strategies. Firms are fragmenting their value chains to capture parts of the production network most suited to each country's comparative advantage in terms of resources, cost and skills. In response, ASEAN countries are each developing distinct specialisations. Typically, most call centers are in the Philippines, whereas cell-phone manufacturing is often in Vietnam, and R&D and financial services in Singapore[13]. Splitting manufacturing, design, sales and service across the region has spurred companies to develop a more holistic approach to ASEAN and deepen their value chains.

Take, for example, Rolls-Royce, a UK-based company that manufactures and services integrated power systems. The company has sought to establish its operations across ASEAN, benefiting from ASEAN's diverse comparative advantages and economies of scale. 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[14].

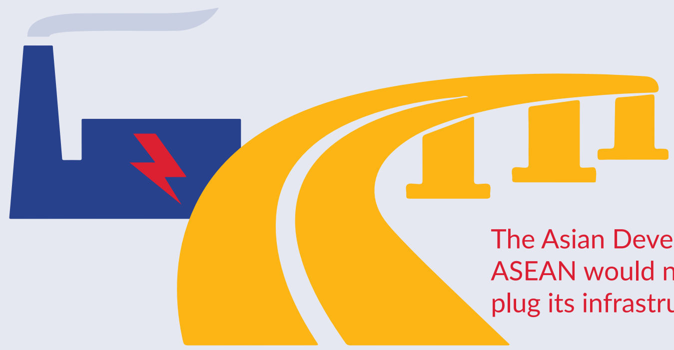
Such granular division of production and task specialisation will enable different ASEAN countries to develop and fine-tune their own comparative advantages in niche sectors, raising overall productivity[15]. If this trend continues, ASEAN economies will be woven together in a tight network of niche regional supply and value chains that will deepen interconnectivity and support long–term growth[16].

At the same time, ASEAN is part of the larger Asian region and is increasingly seen as an integral core for deeper and wider regional integration. The SIIA's survey revealed that 52 per cent of businesses in Singapore found ASEAN's geostrategic position to the wider Asian region as an attraction (Fig. 1). Recently, ASEAN's geostrategic position has gained more attention with regional trade agreements gaining traction.

The Regional Comprehensive Economic Partnership (RCEP) is one effort led by governments that holds promise. The ASEAN-led RCEP aims to standardise free trade agreements of the 10 members of ASEAN with six of their trading partners — China, Japan, India, South Korea, Australia and New Zealand — into one comprehensive agreement. RCEP offers the potential for new economic linkages between countries, supporting the spread of regional production networks that cross borders and deepen economic integration so that businesses can operate more effectively and efficiently. For these reasons, while RCEP negotiations are complex and have already been delayed, many are looking forward to a conclusion of an agreement on at least a first stage of integration for all members.

There are also efforts spearheaded by Japan to push ahead with parts of the Trans-Pacific Partnership (TPP) despite the decision of the USA under the Trump administration to pull out of the agreement. Taken together with the already inaugurated AEC, these wider efforts demonstrate the wish among many in Asia to intensify integration for mutual economic gain.

(ii) Developing ASEAN's Infrastructure Sector:
In 2016, the Asian Development Bank (ADB) estimated that ASEAN would need to commit US$8 trillion from then till 2020 in order to plug ASEAN's infrastructure deficit. This has galvanised attention and recent economic plans put forth by ASEAN states suggest that developing the infrastructure sector has become a top priority for national governments. Across the region, governments in ASEAN have put up ambitious plans to build new infrastructure. Some of these are national projects solely within the country but others – especially road and railway – are intended to link across borders and spur further connectivity and integration.



The Asian Development Bank estimated that ASEAN would need US$8 trillion till 2020 to plug its infrastructure gap.

Some of these plans have begun to materialise. This is not only in the more developed ASEAN countries but also in the newer members. Take for example, Myanmar, which has announced a 225MW power plant in Mandalay to be built and operated by a subsidiary of Singapore-based Sembcorp Industries[17].

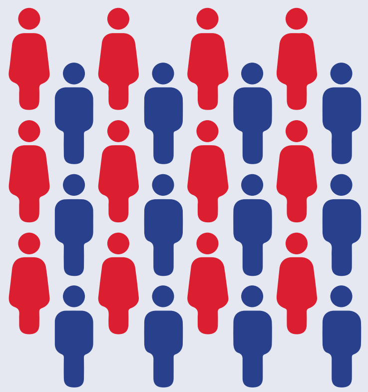
The US$300 million project will be co-funded by the International Finance Corporation (IFC), the Asian Infrastructure Investment Bank (AIIB) and the ADB[18]. While this project is small relative to the overall needs of the country and region, many see it as an important step forward. The project helps demonstrate Myanmar's ability to garner financing from internationally-reputed financial institutions and this boosts investor confidence. Beyond the question of finance, the participation of international funders and stakeholders is also expected to help the project achieve standards acceptable to the international community and better navigate rising environmental and social concerns of infrastructure development.

The positive effects of this and many other infrastructure projects are much anticipated. In the SIIA survey, approximately 70 per cent of respondents saw investment prospects in ASEAN's potential for rapid urbanisation, supported by ASEAN economies moving up the value chain. ASEAN's rapid pace of urbanisation is also bringing about new opportunities in the infrastructure sector. To better understand the future of connectivity in ASEAN and the evolving dynamics of investments in the region's infrastructure, refer to pages 11-12.

Beyond economic activity, infrastructure development also holds the potential to move ASEAN towards becoming an integrated manufacturing hub that is globally competitive. This is especially for projects that benefit intra-ASEAN connectivity and between ASEAN and key partners in the region. As transport and power facilities help to transform the business environment, ASEAN can look forward to developing further comparative advantages in production-related industries.

(iii) Capitalising on ASEAN's Demographic Dividend:
ASEAN's population is not only significant in size; there is a demographic dividend that is anticipated. The working-age population in ASEAN is projected to expand by almost 85 million people over the next 30 years; in comparison, over the same period, China's working-age population will shrink by about 175 million. This demographic dividend can be to ASEAN's advantage both in terms of the region's workforce and its consumer market.

By 2030, it is projected that nearly half a billion of ASEAN's population will be classified as belonging to the middle income class. This is an increase from 29 per cent in 2010 to 65 per cent in 2030[19]. With rising affluence, consumption will become a key growth driver for the region, with investment expected to increase. As ASEAN's middle class grows in both number and affluence, fast-moving consumer goods companies and consumer-facing companies will need to understand the diverse preferences of the "ASEAN Consumer" and meet their rising expectations for better-quality products and services. This potential is increasingly recognised by foreign investors; some 78 per cent of those surveyed cited the region's growing middle class as a key attraction.



Working-age population in ASEAN is projected to expand by ALMOST 85 MILLION PEOPLE over the next 30 years.

Nearly half a billion of ASEAN's population will be classified as MIDDLE INCOME CLASS by 2030.

The benefit of ASEAN's demography can also extend to the workplace. As others like China and Japan cope with their ageing populations, ASEAN's large working-age population will potentially increase productivity, making the region more competitive. The employment and jobs created among the younger workforce can then generate greater domestic consumption and increase the region's savings and ability to invest. Collectively, these developments can act as a key driver for sustained economic growth across ASEAN, with benefits across borders and widely within each society.

(iv) Growing ASEAN's Digital Economy:
As the AEC unfolds, ASEAN is aiming to move up the value chain through innovation and digitisation. One of the strategies to realise this ambition will be to grow a digital economy, across borders.

In the AEC 2025 Vision, ASEAN leaders have announced plans to make breakthroughs in the digital economy space through e-commerce. One example emerged from the recently concluded 49th ASEAN Economic Meeting when ASEAN leaders adopted the ASEAN Work Programme on e-Commerce. The adoption of this programme will help integrate e-commerce considerations into ASEAN's High-level Consumer Protection Principles[20]. If executed well, this will provide consumers with protection and confidence to participate more closely in cross-border e-Commerce transactions across ASEAN.

In accordance with the ASEAN-wide Agreement, at the national level, ASEAN leaders are positioning their economies to benefit from the digital age. A report by consultancy firm AT Kearney predicts that although ASEAN currently lags behind its global peers in the digital economy, it has the potential to leapfrog to become one of the top five digital economies in the world by 2025[21]. To better understand how ASEAN economies are preparing for the digital age, pages 7-8 of this Report illustrate the different approaches that Indonesia and Singapore have adopted to embrace the digital revolution.

ASEAN's move up the value chain also bodes well for its trade prospects. The shift towards a knowledge-based economy dovetails with the rise of "Industry 4.0", where tech concepts like the Internet of Things (IoT) and automated smart manufacturing will take a front seat. Such a move provides ASEAN with an additional comparative advantage for investors. Having industries ripe to take on higher value manufacturing will put ASEAN a step ahead in attracting investors to move both their high and low-tech production processes into the region.

However, the use of technology has become a double-edged sword, spurring both the fourth industrial revolution and changing the style of governance in key ASEAN economies. Citizens in ASEAN are discovering that social media technology can help mobilise social action quickly. The use of online social media platforms such as Facebook, Twitter, blogs and other mobile phone applications is likely to drive dramatic changes to governance in ASEAN. Being connected to online networks has enabled citizens to communicate directly with their leaders, empowering individuals to alter the way politics and businesses are conducted in a country.

Indonesia has the fourth largest number of Facebook users and the fifth largest number of Twitter users worldwide. This can have effects that impact not only the economy but also politics. Twitter and Facebook are being used by Indonesians to influence mainstream politics, opening up new channels for ordinary citizens to express their frustrations.

Take for example, the case in 2009, when Indonesia's Corruption Eradication Commission (KPK) accused former Inspector General Djoko Susilo for bribery and money laundering. As General Susilo was a high profile personnel and an active police general, the police responded by arresting KPK investigator Mr. Novel Baswedan[22]. Through social media activism hundreds of Indonesians galvanised to protest against Mr. Novel Baswedan's arrest as they felt that the police were misusing its power. Pressured by the protests, then President Susilo Bambang Yudhoyono ordered the police to stop interfering with the KPK investigation and General Susilo was subsequently sentenced to 10 years in prison and fined US$45,000[23].

Digital technologies can potentially expose wrong-doings and corruption in ASEAN, fuelling greater transparency[24]. Furthermore, the growing vocal middle class in ASEAN is extracting higher standards of transparency and accountability from foreign businesses. These bottom-up factors are catalysing change at the national level, influencing policy processes as well as the outcomes.

A CLOSER LOOK AT ASEAN'S DIGITAL REVOLUTION

Case Study | Indonesia: Private sector helps grow next wave of country's digital economy

Go Digital 2020

Led by President Joko Widodo, Indonesia has set its sights on transforming itself into Southeast Asia's largest digital economy, underpinned by its Go Digital 2020 vision. Along with the National E-Commerce Roadmap launched in November 2016, these twin initiatives have given Indonesia new impetus to move up the value chain.

The Go Digital 2020 vision has set out considerable ambitions: to create up to 1,000 local tech start-ups, valued at a total of US$10 billion, with a target of US$130 billion in online transactions by 2020. To fulfill this ambition, Indonesia has actively engaged with Silicon Valley entities to learn from their special ecosystem, and has been proactively conducting more entrepreneurship and innovation programmes. To further encourage the transfer of skills, Indonesia is bringing in top tech mentors from around the world to train its local talent.

Grab 4 Indonesia: Private sector closely aligns investment strategies to Go Digital 2020

Since beginning its operations in Indonesia two years ago, Grab, Southeast Asia's leading ride-hailing platform, has committed to aligning its investment strategies to the Indonesian Government's Go Digital 2020 vision through a three-pronged hyperlocal strategy.

In an effort to upskill Indonesia's human capital and to create jobs for the local economy, Grab plans to open an R&D centre in Jakarta, which will hire up to 200 engineers by the end of 2017[25]. This R&D centre will be complementary to the ones already operating in Singapore, Seattle and Beijing. Grab hopes to promote technical exchange and knowledge sharing between the different R&D centres, enabling employees to become 'international engineers'.

The second major pillar in Grab's hyperlocal strategy in Indonesia is focused on enhancing Indonesians' access to mobile payment services. Grab is developing a shared e-money payments platform with a number of local banks, to enable all Indonesians to use this e-payment platform to purchase goods and services at all retail partners of an Indonesian mall owner.

Lastly, through its 'Grab 4 Indonesia' social impact investment fund, Grab also hopes to finance socially responsible companies focused on deepening financial inclusion across all cities and income levels in Indonesia. Grab will invest up to US$100 million into this fund, to empower more technopreneurs, and to grow the next wave of companies in the digital economy.

Southeast Asia's (SEA) digital economy is expected to exceed US$200 billion by 2025.

Capitalising on SEA's growing digital economy will require US$30 - 40 billion of investment over the next 10 years.

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Case Study | Singapore: Government incentives drive the nation's digital economy

Committee on the Future Economy Setting Singapore's Economic Direction

To keep the Singapore economy competitive and to identify new areas for growth, the Singapore government set up the Committee on the Future Economy (CFE), bringing together multi-industry stakeholders from both large and small enterprises, to discuss recommendations to push the Singapore economy forward.

The CFE report recommended seven key strategies for Singapore to build on its strong regional and global connectivity, to support enterprises in scaling up their businesses, and to drive value-creation in both people and enterprises. The recommendations carry a strong focus on innovation and strengthening the capabilities of Small and Medium-sized Enterprises (SMEs) by enhancing their digital connectivity.

Efforts are aimed at supporting local retailers in adopting new technologies to boost productivity and growth. The CFE set out the aim to create a vibrant retail industry of highly productive retailers and local brand owners with global footprints, supported by a highly skilled professional workforce. Recognising changing consumer preferences from brick-and-mortar to e-commerce, Singapore government agencies have committed to equipping the workforce with relevant omni-channel retailing and digital marketing skills to increase their brand presence and productivity.

Another government initiative is organising master classes to teach retail executives and SMEs how to analyse web data, how to utilise search engine optimisation and to give retailers a hands-on experience in building a multi-faceted business strategy for online advertising and e-commerce. These master classes are focused on the core aspects of promoting technological advancement within local SMEs and skills upgrading for employees. Being equipped with the latest know-how ensures local SMEs remain competitive while the economy moves up the value chain.

SEA is the world's fastest growing internet region with an existing internet base of 260 million, which will grow to 480 million by 2020, seeing 3.8 million new users each month.

SEA's e-commerce market size is expected to grow from US$5.5 billion in 2015 to US$88 billion in 2025.

Source: Study by Google and Temasek, 2017

CHALLENGES CONFRONTING ASEAN'S FUTURE

While there are many reasons to look at ASEAN positively, the grouping is also confronted by many challenges. These are not only in the economic sector but also concern politics within and between countries. Unless addressed, these can spillover to create complexities that can undermine ASEAN's future progress. One cluster of uncertainty concerns geopolitics and tensions in the region, while another more directly involves the current limits to the AEC – as seen by corporations focused on ground practices and realities of everyday business.

Growing Geopolitical Uncertainties

Although ASEAN has grown from strength to strength since the Asian Financial Crisis, as ASEAN celebrates its 50th anniversary, ASEAN's role in the politics of the region is under pressure, perhaps more so than at any other time since its creation. Major power rivalries and uncertainties have thrust ASEAN into the middle. There are rising calls to move beyond diplomatic discussion aimed at building trust, towards action or, at least, to bring greater focus and candour to deliberations on sensitive issues[26]. If ASEAN is to meet these growing demands, it must change and evolve. Unless it can respond, the grouping may suffer in terms of its standing and credibility, and also face increasing tests to its unity.

Yet there are limits to what ASEAN as a group of smaller and medium-sized countries can do. The region today is experiencing a new dynamic of power with the rise of China, the resurgence of Japan under Prime Minister Abe, a Russia looking increasingly towards the east and the promise of India. The push by a major power to protect what it considers to be its own 'core' interest can, intentionally or otherwise, undermine ASEAN's unity and therefore put its leadership at stake. At no time has Asia witnessed these major countries be as strong[27].

There are also growing tensions over reefs, rocks and territories in the South China Sea. An increasingly belligerent North Korea has also pushed the region's key actors towards a dangerous game of brinksmanship. America has traditionally been the main guarantor of peace and stability in the Asia-Pacific. However, its recent policies have raised questions about whether this role will continue.

Take, for example, the US withdrawal from the TPP that has created strategic uncertainty across Asia[28]. Under President Donald Trump, the US has adopted a highly transactional approach in its relations with allies and trade partners, moving away from multilateralism in favour of bilateral deals[29].

In contrast, China has deepened and expanded its political and economic footprint across ASEAN and Asia. Chinese economic initiatives such as the AIIB and the Belt and Road Initiative (BRI) are gaining momentum and international attention. These initiatives hold strong promise to plug ASEAN's urgent development and infrastructure gaps and some ASEAN states have jumped on this bandwagon.

Yet if the relationship of some ASEAN members with China is increasingly one of economic dependence, this will pressure ASEAN unity. An example of this danger can be seen in tensions between some ASEAN members and China over the South China Sea[30]. The spill over of political concerns into the realm of economics can be especially seen in the questions surrounding infrastructure development.

Financing ASEAN's Infrastructure Gap

While key infrastructure projects within the region are gaining ground, project financing remains a challenge. Most developing ASEAN economies do not have adequate financial capital to fund critical infrastructure projects and regional powers like China and Japan have stepped in to fill these gaps.

According to the ADB, the infrastructure investment gap—the difference between investment needs and current investment levels—equals 2.4 per cent of projected GDP of ASEAN economies between 2016 to 2020[31]. The ADB has suggested that without China's contribution to infrastructure investments, the gap will rise to a much higher 5 per cent of projected GDP[32]. It is evident that without Chinese investments, ASEAN economies will be unable to bridge its infrastructure gap by themselves. This has given rise to concerns that Beijing may dominate ASEAN's infrastructure sector.

Deep Chinese pockets and the ability to finance large-scale billion-dollar infrastructure under the BRI have also given rise to concerns that ASEAN economies are becoming too reliant on Chinese financing. China's commitment to ASEAN through the BRI stands at US$77 billion[33]. In comparison, although the ADB is scaling up its operations by 50 per cent from $14 billion in 2014 to more than $20 billion in 2020[34], its multilateral investments still pale in comparison to China's BRI investments.

These waves of initiatives have the potential to propel Southeast Asia's export-oriented economies towards greater economic growth. Potentially, the new infrastructural linkages will also allow China and Japan to tap on ASEAN resources and production networks, as well as to connect more easily with their new markets.

But while the geo-economic potential for ASEAN is promising, there is a need to keep an eye on how these economic carrots offered by the major powers are tied in closely with the region's geo-politics. ASEAN leaders must learn to avoid the negative aspects and the tensions arising from potential Sino-Japanese competition and instead align foreign investments with their own needs and development plans; both at the national-level and across ASEAN.

Limitations in the AEC

While the AEC was inaugurated at the end of 2015 by governments, challenges remain in its implementation for the realities of everyday business. Some 33 per cent of foreign investors surveyed do not think that the AEC has benefitted their company's business expansion in the region. Domestic policies of ASEAN countries, a lack of coherent strategy in coping with the digital age, inadequate infrastructure and weak connectivity within and between countries to support the overall goals of the AEC continue to pose challenges.

Approximately 85 per cent of foreign investors who participated in SIIA's survey expressed concern regarding the lack of legal clarity and rule of law in ASEAN economies (Fig. 2). Despite ASEAN leaders reaffirming their commitment to economic integration, concerns highlighted by investors illustrate that at the national level, domestic complications still cloud the region's investment prospects.

In measuring the rule of law based on the experiences and perceptions of the general public and in-country experts, the 2016 World Justice Report ranked Malaysia 56 out of 113 countries. This was a drop of eight places from 2015 while the Philippines dropped by 9 places to 70[35]. Upholding the rule of law remains a serious challenge in these countries. For businesses looking to invest in the region, such challenges tend to market ASEAN as a difficult and costly region to invest in.

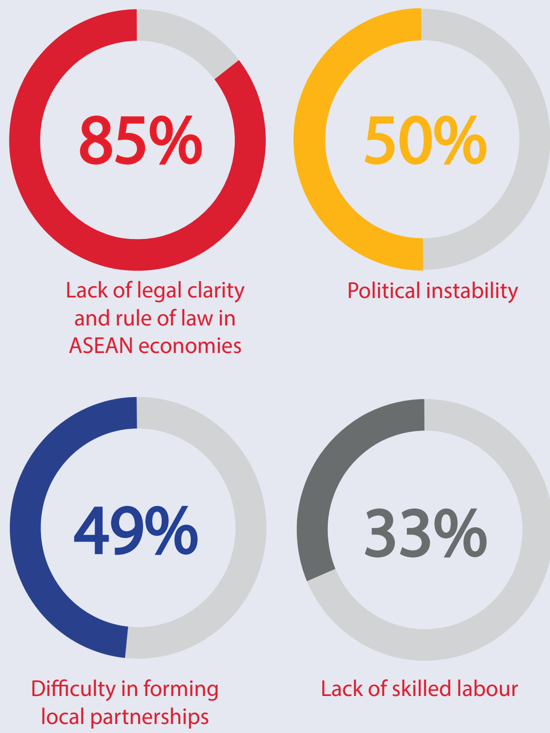
Other challenges concern areas where ASEAN has potential to drive growth. As ASEAN stands at the cusp of a digital revolution, questions regarding ASEAN's ability to navigate the complexities of technological change and digital disruption have surfaced.

The digital divide is of concern – both between ASEAN countries and within each of their societies. There are significant disparities in broadband reliability and penetration across and within ASEAN states. Across ASEAN countries, internet penetration varies from as much as 82 per cent of the population in Singapore to as little as 26 per cent in Laos[36]. Improved broadband infrastructure would enable ASEAN countries to embrace more high-end technologies and upgrade its activities in global value chains.

Even as e-commerce holds potential, it must be recognised that a large number of consumers in the region currently lack access to secure and reliable online banking facilities. This limits their ability to make secure payments online and hinders the growth of the e-commerce sector. A Vela Asia Online Shopper Survey found that only 2 to 11 per cent of digital buyers use online payments in ASEAN (outside of Singapore, which stood at 50 per cent)[37]. Increasing secure e-payment methods is seen as less costly and risky for business owners and will be key in unlocking e-commerce growth in ASEAN.

If ASEAN is to seize the opportunities from the digital age, there is a growing need to build its workforce. Some 33 per cent of foreign investors surveyed by the SIIA cited the shortage of skilled labour in ASEAN as a challenge when expanding into different ASEAN markets (Fig. 2). In order to keep pace with the rapidly-changing job market, ASEAN leaders are widely expected to equip ASEAN's youth with the appropriate skills and knowledge to embrace the digital age. Policies and government initiatives will need to equip the young in Southeast Asia with not just specific information technology skills but also basic literacy, numeracy, problem-solving and socio-emotional skills to keep pace with technological developments[38].

Fig 2: Top concerns of foreign investors

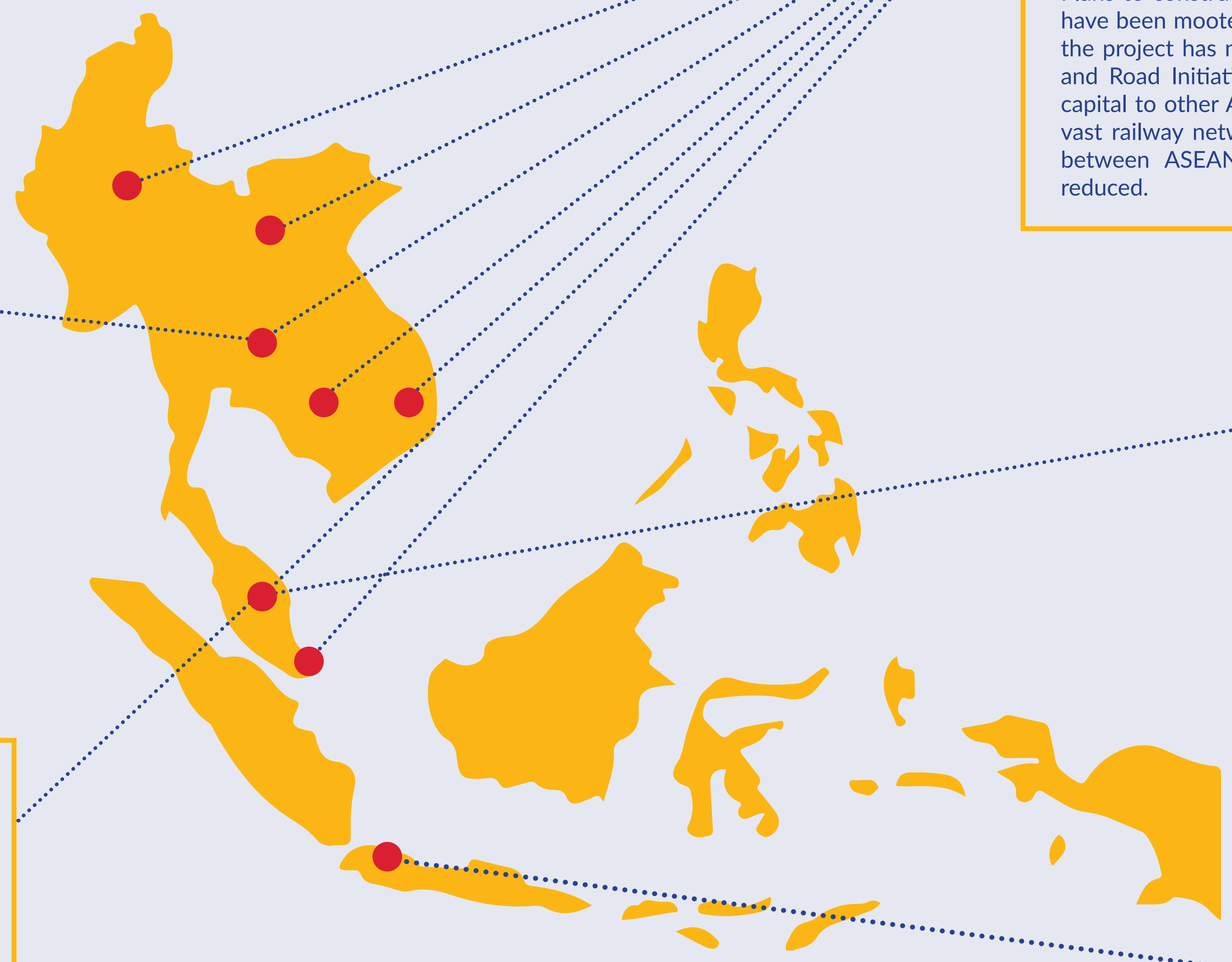


SINGAPORE INSTITUTE OF INTERNATIONAL AFFAIRS

A CLOSER LOOK AT A FEW OF ASEAN'S NEW INFRASTRUCTURE PROJECTS

ASEAN needs infrastructure not only for the development of each member but to develop the real-life connectivity that can assist economic integration and the wider aims of ASEAN Community. Yet the considerable financing need for infrastructure goes beyond what ASEAN can raise for itself, leading most to look at funding from external partners – especially China and Japan. This need creates a dilemma for ASEAN. Each ASEAN member deals with one or the other of these Asian giants on a bilateral basis, with little coordination by ASEAN as a whole.

Despite this dilemma, however, a growing number of large-scale projects – often involving railways – have been announced across the region. Questions arise about whether an ASEAN member state should partner with China or Japan, as well as about the viability and acceptability of the terms offered.



High Speed Rail from Bangkok to Chiang Mai: Thailand

Thailand is planning to build a high-speed railway from Bangkok to Chiang Mai. The US$13 billion, 670km rail line is set to be jointly developed under Japan's famed Shinkansen (bullet train) technology.

The project forms part of Thailand's US$51 billion masterplan to develop a range of motorways, airports and seaports, as Bangkok looks to enhance its role in providing logistics services for ASEAN.

However, construction costs are high as Japan is strict about the standards that the project should adhere to as its high-speed technology has not been used in many countries outside of Japan.

Port Klang expansion: Malaysia

The Malaysian government unveiled plans for a US$46 billion port to be built on Carey Island to complement the existing Klang facilities. The Port Klang expansion project serves as China's flagship Belt and Road project in Malaysia, as it continues to woo foreign investors for development.

Along with other port construction projects like the US$7 billion Melaka Gateway and US$2.9 billion Kuala Linggi International Port, Malaysia could successfully compete with Singapore as Southeast Asia's leading shipping processor.

Pan Asian Railway Network (PARN): Cambodia, Laos, Malaysia, Myanmar, Thailand, Singapore, Vietnam

Southeast Asia's infrastructure push is headlined by the 15,000km Pan Asian Railway Network (PARN), formerly known as the Kunming-Singapore Railway.

The transport network comprises of two segments. The lower segment is made up of the Kuala Lumpur-Singapore High-Speed Railway which links up to Bangkok at the southern tip of Thailand. From Bangkok, the upper segment of the PARN takes on three routes towards Kunming, China.

Plans to construct a route from China to Singapore have been mooted by ASEAN since 2000. However, the project has now come under China's wider Belt and Road Initiative (BRI), as Beijing seeks to offer capital to other ASEAN states along the route. The vast railway network is expected to ramp up trade between ASEAN and China as travel time gets reduced.

East Coast Rail Link: Malaysia

Malaysia aims to construct a 620km route from Tumpat to Kuantan Port, through the mountainous Central Area to Klang. The project is Beijing-backed, with 85 per cent of funding coming from the China Communications Construction Co Ltd and the Export-Import Bank of China.

Jakarta-Bandung HSR: Indonesia

The first of its kind in Indonesia, the railway project aims to connect Halim, East Jakarta to Tegallur in West Java. Built using Chinese technology, the high-speed railway will reduce travel time between the two cities to less than an hour and would help to improve connectivity within Southeast Asia's biggest country.

However, land procurement has been the biggest challenge for the project. However, after a year-long standstill, the project is now making headway, with construction permits being issued in July 2016.

SINGAPORE AS A HUB AND NEXT ASEAN CHAIR

Singapore plays an instrumental role in ASEAN with many using the small city-state as a hub for finance, logistics, transport and other services. In recent years, Singapore has also emerged as a key investor in many ASEAN states; the largest in Indonesia, the second largest foreign investor in Myanmar and the third largest investor in Vietnam.

The Committee for the Future Economy (CFE) discussed earlier has emphasised the need for Singaporean companies – whether small, medium-sized or large – to push out into the region and the world. Regionalisation across ASEAN is clearly part of the future for Singapore economically and also for its politics and its people.

The country also has a role to play in developing two areas discussed in this report: the digital economy, and infrastructure.

Taking on the ASEAN chairmanship in 2018, Singapore aims to focus on initiatives relating to ASEAN's growing digital economy. The figures are promising. Southeast Asia's digital economy holds strong potential, and is expected to exceed US$200 billion by 2025. Transforming the retail space, ASEAN's e-commerce market size is expected to grow from US$5.5 billion in 2015 to US$88 billion in 2025.

Singapore's leaders hope that during its chairmanship, ASEAN can cooperate to streamline trade rules governing e-commerce. This can help all in the region by promoting greater digital connectivity in the region and lowering operating barriers to entry.

For infrastructure, Singapore has set out its hope to work alongside China and other third countries in ASEAN and beyond the BRI. In addition to serving as ASEAN's Chair, Singapore also currently serves as Country Coordinator for ASEAN-China Dialogue Relations. Long standing ties with China on infrastructure and economic development have been re-strengthened following Singapore's Prime Minister Lee Hsien Loong's recent state visit to Beijing in September.

Yet while ties with Beijing are very important, Singapore has consistently sought to continue its close relationships with other key partners including the USA, Japan and India. This network of different relations can assist not only Singapore but the wider ASEAN.

LOOKING AHEAD: TRANSFORMING ASEAN

For the last 50 years, ASEAN has sought to respond to wider and global trends, including the Cold War, the Asian Financial Crisis and the rise of China. In these situations, ASEAN has mostly only been able to play a reactionary role, rather than influence trends more proactively.

However, as ASEAN celebrates its golden jubilee, the world it faces is complex, and the grouping is confronted with unprecedented challenges in the geopolitical, economic and social realms. The return of major power rivalry, the digitisation of ASEAN economies, together with the rise of a vocal middle class are collectively changing the face of ASEAN. These trends, if managed well, can solidify ASEAN unity and transform the group positively. To address these challenges, ASEAN must harness its strengths and leverage on its diversity through the ASEAN Community.

Moving forward, these Community building efforts will allow ASEAN to transform itself from a process-oriented to an action-oriented organisation. In geo-politics, working to deepen ASEAN Community can make the group more effective and provide strategic capital for it to take on a greater leadership role in the Asia Pacific. Such an ASEAN leadership would, moreover, be based not primarily on hard power, but more on norms and institutions, and this can positively promote a rules-based regional order.

For economic integration, ASEAN can continue to thrive and expand. Through deeper connectivity and integration in its own AEC, ASEAN will be in a better position to be competitive and resilient. The AEC can also be the basis for ASEAN-led initiatives such as the RCEP so that intra-Asian integration can aim towards higher quality agreements for trade and investment. This can help make ASEAN a key node in the cluster of economic networks connecting Asian and global value chains.

ASEAN has many good reasons to celebrate its 50th anniversary. Looking at its development over the last twenty years, the group has moved beyond the Asian Financial Crisis to reinvent itself and inaugurate a Community with closer cooperation and integration than anything seen before. New challenges in politics and economic development may arise, but ASEAN today is well positioned to respond, to take advantage of new factors of growth, and to lift the region further.

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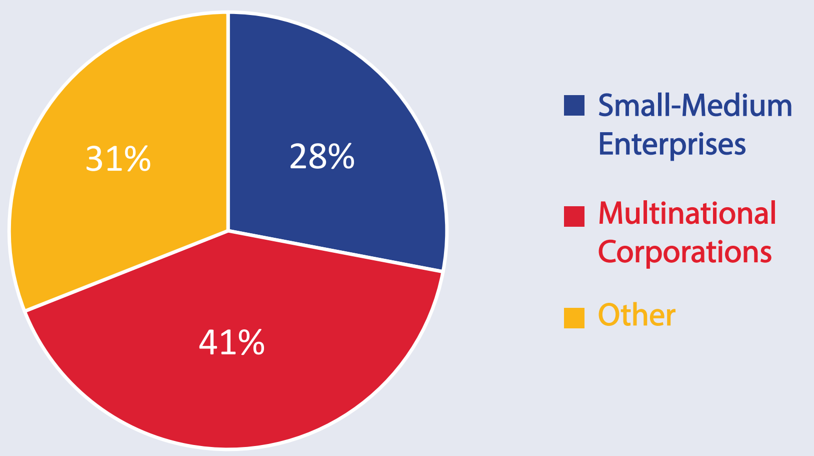
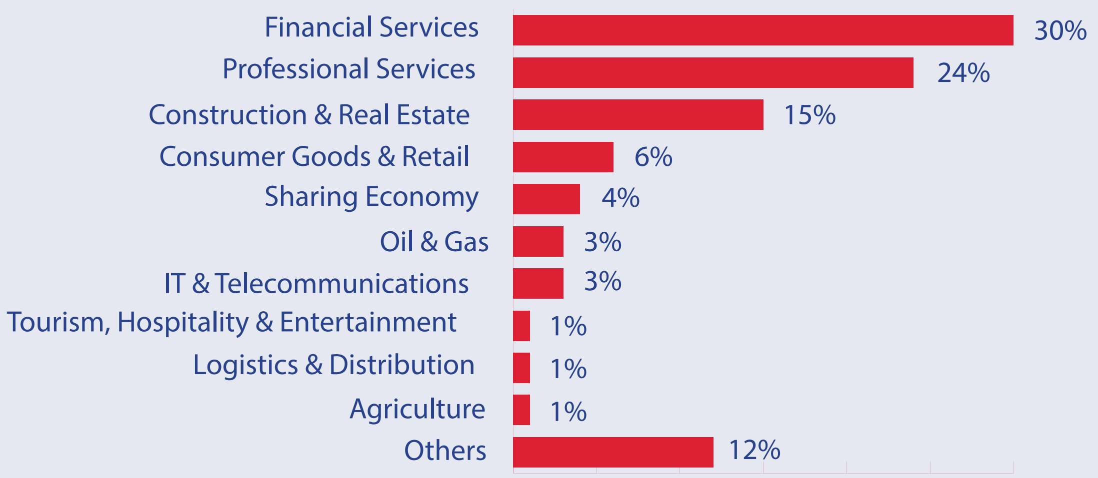
SIIA SURVEY RESPONDENT PROFILE

By Company Type



By Industry



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ABOUT THE SINGAPORE INSTITUTE OF INTERNATIONAL AFFAIRS (SIIA)

The SIIA is an independent think tank dedicated to the research analysis and discussion of regional and international issues, and plays a key role in Track II diplomacy, supplementing official dialogue between governments. Founded in 1961 and registered as a membership-based society, the institute is Singapore's oldest think tank.

The SIIA analyses key political, economic and social trends in ASEAN and key member states and implications for Asia and the rest of the world. Since 2013, the SIIA has ranked highly as one of the top think tanks in Southeast Asia and the Pacific, in the Global Go-To Think Tank Index done by the University of Pennsylvania. In the index, SIIA has consistently ranked among the top 100 think tanks in the world. The SIIA is also a founding member of the ASEAN network of leading think tanks.

The SIIA's annual ASEAN and Asia Forum is Singapore's leading conference for the private sector to better understand regional political, economic and other strategic challenges and their implications for business. Another SIIA flagship programme focuses on sustainability and environmental issues in the resource sector in ASEAN.

ABOUT THE SIIA'S ASEAN PROGRAMME

A core part of our work is to promote awareness of the Association of Southeast Asian Nations (ASEAN), the grouping's activities, and encourage processes of regional cooperation. Our research focuses on collective efforts to build connectivity in ASEAN, such as the ASEAN Economic Community established in 2015.

Our research and events explore the key priorities for ASEAN, especially as the grouping moves beyond 2015. The SIIA also conducts seminars, workshops, corporate briefings and conferences on ASEAN and countries within the ASEAN grouping.

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