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Briefing Note

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ASEAN 2015 – opportunities and challenges

With a year to go until the Association of South East Asian Nations (ASEAN) plans to form a single economic market, Clifford Chance explores the opportunities and challenges for investors in the region.

ASEAN has a combined population of approximately 620 million people, GDP of US$2.4tn in 2013, a growth rate averaging 6% a year, a rising middle class and strong exports. The ten country bloc – Singapore, Indonesia, Malaysia, Thailand, Vietnam, Myanmar, Brunei, Laos, the Philippines and Cambodia – is one of the fastest growing regions in the world. As the 25th ASEAN Summit gets underway in Myanmar, attention is focusing on plans to establish the ASEAN Economic Community (AEC) by December 2015. The intention is to transform the region into an EU-style economic area that will ease cross-border trade and investment as well as the flow of capital and the movement of skilled labour. It's an ambitious goal, with many opportunities but one that also comes with many challenges.

The four pillars of the AEC

The document that describes how the AEC will operate is the AEC Blueprint. Agreed in 2007, this sets out four areas of focus (the four pillars) which will guide implementation.

The first of these pillars is a single market and production base which envisages a tariff–free environment, the free movement of goods and services and the harmonisation of standards, regulations and customs in ASEAN.

In recent years, ASEAN has made significant progress in liberalising trade across the region. More than 70% of intra-regional trade is now free from tariffs[1]. However, tariffs remain on industries that are viewed as of strategic importance such as agriculture, steel and the car industry. There is also a disparity between the levels of liberalisation in each of the member states, as noted by the Asian Development Bank (ADB) in its Outlook report, 2014: "Indonesia, Malaysia, the Philippines, Singapore, and Thailand in particular can claim noteworthy achievements in tariff reduction, trade facilitation, and investment liberalisation, but the newer members – Cambodia, Laos, Myanmar and Vietnam – are lagging."

There has been little progress on the easing of non-tariff barriers between ASEAN members such as import licensing and quotas, customs surcharges and technical standards and regulations such as the quality, safety, packaging and labelling of products. Meanwhile, Indonesia, the largest ASEAN country, has recently introduced measures that further limit foreign ownership of companies and the hiring of foreign workers in certain sectors. The ADB says: "non-tariff barriers could undermine the economic integration process and the realisation of the AEC by 2015. Unlike tariffs, whose effect on trade is certain, the effects of non-tariff barriers is ambiguous."

The second of the four pillars – designed to attract new investors – aims to make the AEC a competitive economic region that will benefit from a climate of fair competition. The region already enjoys high levels of

foreign direct investment (FDI). Indonesia, Malaysia, Thailand, the Philippines and Singapore together received more in FDI last year than China, according to research from Bank of America Merrill Lynch (BAML). The ASEAN-5 received US$128.4bn – a 7% rise in investment in 2013, compared with China which saw a 3% drop in investment to US$117.6bn. BAML says that China's FDI advantage has been eroded by higher wages, stronger GDP growth and steadily appreciating RMB, which has resulted in multinational companies looking at ASEAN.

Five ASEAN countries – Indonesia, Malaysia, Singapore, Thailand and Vietnam have introduced respective laws in relation to competition, and the Philippines has established the Office for Competition under the Department of Justice. Intellectual property is also a focus. Singapore, for example, is keen to protect its high tech and biomedical sectors, while other ASEAN

[1] According to World Trade Organisation figures

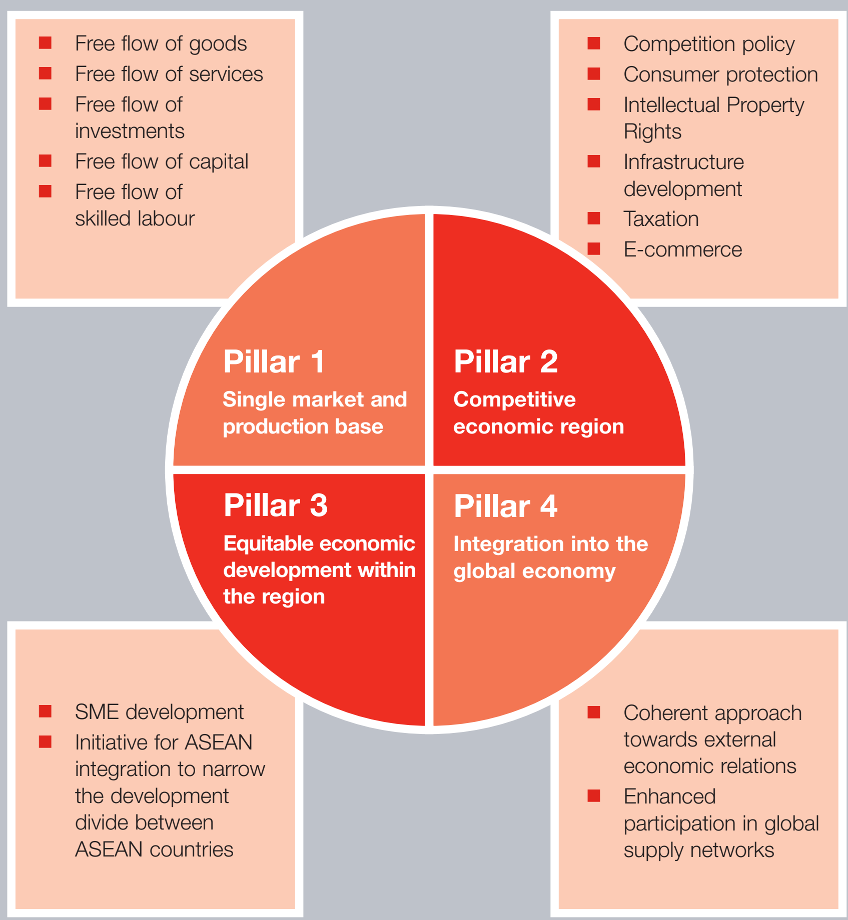
countries are focusing on protecting plants and medicines.

Infrastructure is also vital to ASEAN's plans and projects include the completion of the ASEAN Highway Network and a rail link that would connect Singapore, Malaysia, Thailand-Cambodia, Vietnam and Kunming in China. Plans have also been drawn up to create a unified electricity grid across all ten nations.

The third pillar in the AEC's strategy is equitable economic development to even out the gap between much richer states such as Singapore and Indonesia (which are responsible for around 40% of the region's economic output) and Myanmar which is emerging from years of economic and political isolation.

Finally, the AEC is aiming for greater integration into the global economy to strengthen trade and investment. It has already put in place Free Trade Agreements (FTAs) with major trading partners including Australia, New Zealand, India, China, Japan and Korea and is negotiating a Regional Comprehensive Economic Partnership with these FTA partners to build further economic links.

The four pillars of the AEC



Challenges to economic integration

While ASEAN says it is still aiming for economic integration by 2015, a progress report by the ADB and the Institute of South-East Asian Studies, a think-tank in Singapore, concludes that ASEAN "has no prospect of coming close to…[a] single market by the AEC's 2015 deadline — or even by 2020 or 2025." The ADB says that 2015 should be seen not as a deadline but a milestone. It's a view shared by the American Chamber of Commerce in Singapore which surveyed its members and found that only 23% believe that the AEC's goals will be met next year.

There are a range of challenges to the success of the AEC, not least of which is that the ten ASEAN nations are at different stages of development and there are huge disparities between levels of income. Singapore's GDP per capita, for example, is more than 30 times higher than in Laos and more than 50 times higher than in Cambodia and Myanmar. ASEAN is also a region that encompasses very different political systems, languages, cultures and religions.

Furthermore, there are disparities in good governance and the rule of law and in the ADB's view, there is "slow decision-making and even slower implementation of the AEC's commitments due to the need for consensus building and slow progress in domestic reforms."

In addition, there are different rules and procedures for doing business in each of the member states and there is little progress in harmonising ASEAN's ten different tax systems. There are also very different levels of investor protection across ASEAN – Singapore has stringent disclosure regimes, while Vietnam is in the bottom ten countries in the world for investor protection[2].

Practical considerations to be kept in mind when doing business in this region include, but are not limited to, carrying out appropriate due diligence to evaluate, understand and mitigate the risks associated with the business/local partner, indentifying the relevant regulatory constraints, assessing the prospects of successfully enforcing judgments on counterparties and against assets in ASEAN, as well as analysing how countries in ASEAN exercise sovereignty over businesses.

Opportunities

Despite the challenges, the AEC offers enormous opportunities across a range of sectors including financial institutions, energy and resources, transport and logistics and the development of infrastructure projects.

In the financial sector for instance, ASEAN is introducing the ASEAN Banking Integration Framework, which aims to liberalise the banking market by 2020. Under this Framework, an ASEAN-based bank would be re-classified as a local bank, rather than a foreign bank across the ten ASEAN countries, enabling them to compete with major banks from China, Japan and elsewhere.

ASEAN is also developing an ASEAN single capital market which aims to improve market access, linkages, and liquidity. It is also working to remove capital controls and restrictions, including the elimination of restrictions on current account transactions, FDIs, and portfolio flows.

ASEAN Economic Community at a glance

- 620 million people.
- Combined GDP of US$2.4tn – ahead of Brazil and Russia.
- EU's fifth largest trading partner.
- GDP averages 6% a year.
- ASEAN would rank as the world's seventh largest economy if it were a single country – It could be fourth largest by 2050 if growth trends continue.
- Growing middle class and urbanisation.
- Strong foreign direct investment – although ASEAN faces competition for FDI from China and India.

[2] According to the World Bank

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ASEAN Focus Group

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Clifford Chance has produced a series of essential tips for investing in Singapore, Indonesia, Malaysia, Philippines, Thailand and Vietnam which provide investors with practical guidance for companies seeking to do business in these countries.

We have also produced client briefings on key issues for businesses operating in the ASEAN region:

- ASEAN CIS Framework – now operational
- Alternative investment protection strategies for Indonesia
- Myanmar investment rules in practice
- Vietnam Foreign Direct Investment Guide

If you would like to receive copies of any of the above publications, please email: **Julie Dean** (julie.dean@cliffordchance.com) or **Eddie Hobden** (eddie.hobden@cliffordchance.com)