ASEAN: Regional Trends in Economic Integration, Export Competitiveness, and Inbound Investment for Selected Industries

Executive Summary

The Association of Southeast Asian Nations (ASEAN) was established as a regional organization in 1967 to accelerate economic growth, promote regional peace and stability, and enhance cooperation on economic, social, cultural, technical, and educational matters among Southeast Asian countries. The five founding countriesð Indonesia, Malaysia, the Philippines, Singapore, and Thailandð were later joined by Brunei Darussalem (Brunei) in 1984, Vietnam (1995), Laos (1997), Burma (1997), and Cambodia (1999). Located in a region of the world with rapidly expanding economies, ASEAN has a combined population of 550 million people largely characterized by rising incomes. As such, the ASEAN nations are already an important market for U.S. companies, and they represent significant opportunities for expanded trade and investment. Trade between the United States and ASEAN countries has grown steadily in recent years, and in 2008 it totaled $177 billion.

This report has been prepared by the United States International Trade Commission (USITC, the Commission) at the request of the United States Trade Representative (USTR). The report provides an overview of regional trends in Southeast Asia in the areas of economic integration, export competitiveness, and inbound investment for 6 of 12 priority sectors identified in the ASEAN Economic Community Blueprint adopted in November 2007; the six sectors are agro-based products, automotives, electronics, healthcare, textiles and apparel, and wood-based products. The report also identifies and describes an industry within each of these priority sectors that has undergone either significant changes in regional economic integration with other ASEAN members, export competitiveness, or inbound investment in recent years; in some industries, there have been improvements in several of these areas. The six industries analyzed in greater detail are computer components, cotton woven apparel, hardwood plywood and flooring, healthcare services, motor vehicle parts, and palm oil. Information is provided about each industryǿs export competitiveness, trade flows, investment, and leading competitive factors, including trade facilitation, logistics services, and e-commerce. The major findings are summarized below.

Major Findings and Observations

ASEAN's manufacturing exports benefit from high productivity growth, proximity to large Asian markets, and free trade agreements, but challenges for future growth remain.

> Low wages, high productivity growth in some countries, diverse production conditions, proximity to large Asian markets, and the regionǿs liberalizing trade policy environment, including free trade agreements with a number of countries, have supported the growth of ASEANǿs manufacturing exports. Challenges for ASEANǿs export competitiveness remain in some countries, however, including a shortage of skilled labor and professionals; the lack of a developed system for setting product standards and conformity assessment procedures; unsophisticated consumer markets; and inadequate physical and institutional infrastructure, such as roads and other transport networks, communications, trade facilitation measures (e.g., customs procedures), and intellectual property rights (IPR) protection.

China is a major competitor to ASEAN for foreign investment and manufacturing jobs, but the new free trade agreement between China and ASEAN countries may create opportunities for integrating Asian production supply chains.

China is a major competitor of ASEAN countries in attracting foreign investment and in integrating regional production chains.

However, ASEAN recently concluded an FTA with China. Because China has become an important hub in Asian supply chains, ASEAN countries hope the FTA will offer better opportunities to participate in these networks. ASEAN offers an alternative production location to China for multinational firms wanting to diversify their operations to reduce business and political risks.

A new ASEAN investment agreement was signed in February 2009, and is expected to offer significant improvements for investors.

The ASEAN Comprehensive Investment Agreement (ACIA) will enter into force once it is ratified by all ASEAN members, at which point it will replace the existing ASEAN Investment Area (AIA) and Investment Guarantee Agreement (IGA). Investment in most service industries is covered under the ASEAN Framework Agreement on Service (AFAS). The improvements over the AIA include new investor protections, such as the prohibition of performance requirements, more freedom for investors in appointing senior management, and a more comprehensive investor-state dispute settlement procedure; clear (though nonbinding) timelines for investment liberalization; and benefits extended to foreign-owned, ASEAN-based investors. Member countriesô final offers under the agreement have not yet been published, so it is not yet possible to fully evaluate the ACIAôs expected impact on intra-ASEAN investment.

The "ASEAN Single Window" could facilitate intra-ASEAN trade, but progress remains slow.

The ASEAN Single Window (ASW) is ASEANôs most visible effort to facilitate trade among members, by enabling the rapid exchange of standardized data among countriesô customs agencies. Currently, the ease of importing and exporting varies widely among ASEAN members; procedural requirements are relatively easy to complete in Singapore, Thailand, Malaysia, but very difficult in Laos and Cambodia. Although the ASW has the potential to bolster trade and foster intra-regional supply chains, the development of the ASW has proceeded slowly since its creation in 2005. While there are some indications that work on the ASW is accelerating, faster progress and close consultation with ASEANôs business community on its design would ensure that the ASW contributes robustly to ASEAN economic integration.

Regulatory barriers inhibit improvements in logistics services.

ASEAN countries have committed to liberalize trade and investment in logistics services by 2013. However, while some members have made reforms, others (notably Indonesia) have introduced restrictive regulations that contradict their commitments and the quality of logistics servicesð such as customs brokerage, freight forwarding, and express deliveryð varies substantially from member to member. Logistics services are world-class in Singapore, but poor in Laos, Cambodia, and Burma.

Infrastructure and the legal framework for e-commerce among certain ASEAN members have improved.

Technical infrastructure (such as plentiful broadband connections), a sound legal framework for electronic transactions, and individualsô skills in using computers are prerequisites for the expansion of e-commerce. The ASEAN Secretariat is committed to supporting wider adoption of e-commerce in the region. It has helped members to adopt new e-commerce laws, but has contributed less significantly to infrastructure development. While large gaps persist among ASEAN members in technical infrastructure, legal frameworks, and computer skills, the last decade has seen improvements throughout the region. Vietnam, in particular, has made impressive progress in both infrastructure development and legal reform.

The ASEAN Roadmaps for Integration have achieved mixed success in promoting regional integration in all six industries.

While ASEAN Roadmaps for Integration (Roadmaps) have promoted tariff reductions and streamlined certain administrative procedures, they have achieved mixed success in promoting regional integration. In general, economic factors and national government policies have more influence over regional industrial structures. A number of different forces have contributed to greater regional integration, export competitiveness, and inbound investment in each of the six industries over the last five years, many of which came from outside the region. These forces include Japanese multinationals that invest and manufacture in more than one ASEAN country (motor vehicle parts), the removal of global quotas (cotton woven apparel), and global production sustainability standards (palm oil). ASEAN members often still view each other as competitors for inbound investment and jobs, and the six Roadmaps include no legally binding means to enforce member compliance with their objectives.

Computer components

While the ASEAN region is the world's second largest exporter of computer components, it faces a major challenge from China.

Production of most computer components is led by multinational firms, and ASEAN countries, especially Malaysia, Singapore, and Thailand, have been competitive investment destinations for over 30 years. In the past five years, Vietnam has also emerged as an important investment destination for the electronics sector, and its role in the computer industry in ASEAN is growing rapidly. The ASEAN regionõs total share of global computer components exports was 21 percent in 2008, the latest date for which data are available. But challenges remain from China. China has increased its share of global computer components production at the same time it has become the single largest assembler of finished computers. Many computer components firms are increasing production in China in order to be closer to their customer: the computer assembler.

Competition between ASEAN countries hampers efforts to create a more integrated regional computer components production base.

Using financial incentives and government policies, ASEAN countries that produce computer components compete to attract export-oriented investment and jobs from multinational firms and integrate their economies into the global computer supply chain. These incentives and policies are generally not coordinated between ASEAN members governments, hampering regional competitiveness.

Cotton woven apparel

Tariff reductions have helped facilitate a small but growing amount of integrated production of cotton woven apparel among ASEAN countries. However, trade programs such as free trade agreements have more heavily influenced regional integration.

While integrated production of cotton woven apparel among the ASEAN countries is still at a low level, it has been growing over the last few years. Intra-ASEAN trade in cotton woven fabrics, the primary input in cotton woven apparel, increased by 13 percent, from $168.4 million in 2004 to $190.8 million in 2008. To a certain degree, the reduction in duties on fabric inputs among member countries, as outlined in the ASEAN Roadmap for Integration of Textiles and Apparel, helped facilitate this integration. But in most cases, these duty reductions do not provide an incentive for regional integration when the final apparel is exported outside of the ASEAN region. Other factors have had a greater influence on regional integration in this industry. For example, the ASEAN-Japan FTA implemented in 2008 has been a driver for integrated ASEAN production because of the rules of origin in the agreement. Also stimulating integration are such factors as the increased competition among global suppliers created by the removal of quotas on textiles and apparel and the granting by the United States of normal trade relations (NTR) status to Vietnam.

Hardwood plywood and flooring

Access to legally sourced and sustainable wood supplies is an important competitive factor affecting integration, export competitiveness, and inbound investment in the ASEAN hardwood plywood and flooring industry.

To be competitive, ASEAN producers of hardwood plywood and flooring require access to wood raw materials that are becoming increasingly scarce, and they need to demonstrate to buyers in major markets that wood sources are legal and sustainable. In some fashion, each of the ASEAN countries regulates the volume of timber harvesting in natural forests, and some have imposed complete or partial bans on exports of wood raw materials. Amid mounting pressure to address illegal logging and deforestation, government (and other) buyers in consuming countries are increasingly requiring assurances that wood products are produced from legal and sustainable sources. ASEAN collaboration in responding to these concerns may be helping the industry to integrate in some respects, but ASEAN countries are also working independently in other bilateral and multilateral processes to protect their global competitiveness.

Despite tariff reductions, the region's competitive focus remains on exporting to major industrialized countries.

Intra-ASEAN trade of hardwood plywood and flooring is small compared with exports to non-ASEAN markets; tariff reductions coupled with other trade facilitation measures may encourage more intra-regional trade, but the regionös hardwood plywood and flooring production is heavily weighted toward exports to Europe, Japan, and the United States. Over the past five years, China has become a formidable competitor to ASEAN in global markets, despite its own wood scarcity. Other significant challenges facing ASEAN hardwood plywood and flooring producers in major markets are product standards (such as formaldehyde emissions limits) and procurement policies requiring assurances of legal sourcing.

Healthcare services

Growth of private healthcare firms in the ASEAN market has generated increased trade and investment in healthcare services.

Malaysia, Singapore, and Thailand are the largest exporters of healthcare services, treating the largest number of foreign patients within their borders. Private healthcare firms from these countries have promoted their services in neighboring countries and expanded their presence by investing throughout the region to meet growing regional demand. Additionally, as these healthcare firms have grown, they have attracted increasing investment from investors outside of the ASEAN region.

In response to rising regional trade and investment in the healthcare services industry, member governments and the ASEAN Secretariat have launched efforts to support continued growth.

Governments of ASEAN member countries are encouraging investment in, and promoting exports of, healthcare services through programs that simplify procedures for the movement of foreign patients across borders and liberalize investment barriers. Similarly, the ASEAN Secretariat has facilitated regional healthcare investment through recent negotiations under the ASEAN Framework Agreement on Services, and initiated efforts to conclude mutual recognition agreements in certain medical professions.

Motor vehicle parts

ASEAN has been successful at meeting critical Roadmap targets and facilitating regional integration within the automotive sector. Despite these achievements, the regional automotive industry and market have yet to fully integrate.

ASEAN has eliminated duties or reduced nontariff measures for six members (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) and implemented the ASEAN Industrial Cooperation Scheme (AICO); these initiatives have enhanced regional integration, export competitiveness, and inbound investment. Auto and parts manufacturers, in particular Japanese firms, have used the AICO system since the 1990s to develop an integrated production system in the region. ASEAN, however, has a history of national government intervention in support of local automotive industries through such measures as national car policies and local-content requirements that have protected local industries and encouraged the development of small-country markets. In addition, ASEAN member countries have made limited progress in harmonizing automotive safety and environmental standards and improving customs cooperation and coordination.

Further regional integration is key to improving the competitiveness of the regional motor vehicle parts industry by providing economies of scale.

ASEANǿs large combined market provides it with the size necessary to manufacture components cost effectively. This is particularly important for the auto parts industry, which relies on production volume to lower costs and to supply auto assembly plants from a small number of focused production facilities.

Palm Oil

The Roadmap for Integration of Agro-based Products has had far less impact on the structure of the ASEAN palm oil industry than have multinational corporations and international groups.

Two groups of influential actors have driven ASEAN regional actions in the palm oil industry over the last five years: multinational corporations, which produce and refine palm oil and process it into downstream goods, and international groups, such as the Roundtable on Sustainable Palm Oil (RSPO), through which the corporations seek to influence developments in the palm oil market. Investment and purchasing decisions by multinational palm oil producers and consumers are largely driven by the low price and abundant supply of palm oil (relative to other vegetable oils) and increasingly by sustainability concerns surrounding palm oil production.

ASEAN palm oil cultivation and initial processing can take place on a large scale in only two countries: Indonesia and Malaysia.

Because of climate requirements and the need for milling soon after harvest, palm oil can only be a large-scale, commercially viable agro-based industry in Indonesia and Malaysia, although small-scale palm oil cultivation exists in several other ASEAN countries. The prime growing conditions and developed processing infrastructure in Indonesia and Malaysia make them the most important palm oil suppliers to ASEAN and the world. The low cost of this vegetable oil, coupled with production that far exceeds ASEAN demand, results in most ASEAN palm oil production being exported to large markets such as China, the EU, and India.