

## Trade Issue Brief

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### Deeper Integration in ASEAN: Why Transport and Technology Matter for Trade<sup>ii</sup>

New initiatives to close the development gap and expand trade among members of the Association of Southeast Asian Nations (ASEAN) are at the forefront of policy discussion. Countries in Southeast Asia perform relatively well in terms of costs to import and export. Costs are more or less in line with the OECD average. In terms of the amount of time and paperwork it takes to complete a cross-border transaction, however, much progress remains in ASEAN. On average, the association's members require 32 days and 11 documents for an import transaction, compared with 12 days and 6 documents for the average OECD country (World Bank 2008).

There are clear benefits to be gained in addressing these areas. Where might reform initiatives be deepened—and what are the relative impacts of such reform steps? New analysis at the World Bank suggests examining two key areas, among others: port facilities and competitiveness in the Internet services sector. Reform in these areas could expand ASEAN trade by up to 7.5 percent (\$22 billion) and 5.7 percent (\$17 billion), respectively. By contrast, cutting applied tariffs to the regional average in Southeast Asia—an important step—could increase intra-regional trade by about 2 percent (\$6.3 billion) (Shepherd and Wilson 2007).

#### Bolstering ASEAN's Economic Outlook

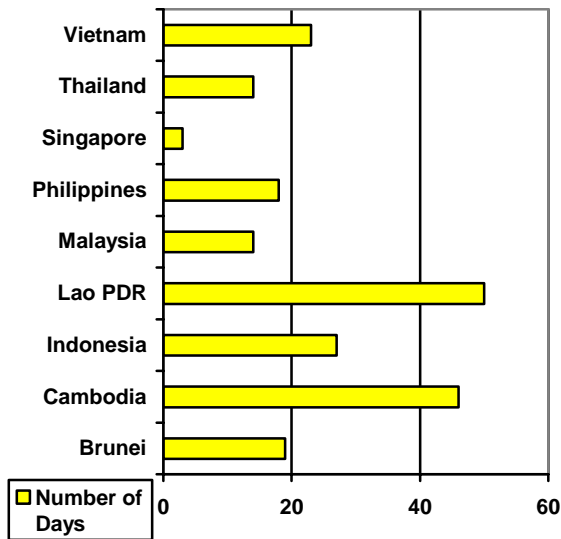
The Southeast Asia region has the potential to reap significant benefits from investments in further trade facilitation reform (Wilson and Otsuki 2007). This would build on the comprehensive tariff reform already realized through the ASEAN Free Trade Agreement. Tariff reform among ASEAN's ten members has proceeded at a brisk pace since the inception of the ASEAN Free Trade Area (AFTA) in 1992. This is particularly true given the development disparities that exist among member countries. After numerous accelerations of the AFTA timetable, tariffs on more than 99 percent of tariff lines covered by AFTA-CEPT are now in the 0 to 5 percent range for the original six ASEAN members (ASEAN-6). ASEAN's four newest members have made the same adjustments to about 77 percent of their tariff lines. For ASEAN-6, the average tariff on goods covered by AFTA decreased from more than 12 percent in 1993 to just 1.74 percent in 2006 (ASEAN 2006).

Nevertheless, progress with respect to many behind-the-border trade facilitation reforms, including port and information technology reforms, has been slow across most ASEAN countries. Based on analysis in SW (2007), it is difficult to detect any significant improvement in the performance of regional transport infrastructure during 2000 to 2005. Singapore has consistently performed well, while Malaysia and Thailand appear to have improved somewhat over the five-year span. All the other sample countries showed relatively consistent rankings, with the exception of Indonesia, which appeared to worsen over time.

The indicators with respect to competitiveness in the Internet services sector are more encouraging; by 2005, all ASEAN economies, with the exception of Vietnam, received rankings above the global average. Interestingly, this category of indicators demonstrated the most homogeneous regional performance of all categories covered in the analysis. Nevertheless, the data suggest there remains room for improvement in the development of information technology

infrastructure and, more generally, in service sector liberalization.

**CHART 1: TIME TO IMPORT (SOURCE: DB 2008)**



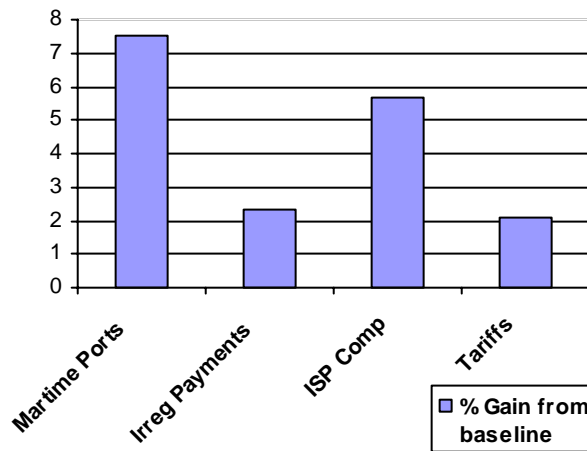
**The Model**

With these figures, among others, used as baseline trade facilitation indicators, SW (2007) conduct an econometric analysis of trade flows in ASEAN using a gravity model. The authors use the model to identify the sensitivity of trade flows to changes in trade facilitation indicators. The trade facilitation indicators examined include (1) the efficiency of maritime and air ports, (2) the extent of irregular payments in customs administration, and (3) the level of competition among Internet service providers (as a proxy for regulation of backbone service sectors). The model controls for the presence of tariffs and standard geographical factors that may influence trade volumes; it is estimated for the years 2000 to 2005.

The results are presented through counterfactual simulations to show the potential gains ASEAN could realize from various reform steps. (The results are subject to the usual caveats in this type of research.) Each of the first four simulations alters *one* of the four trade facilitation indicators so that no ASEAN member performs below the regional average for the given variable. The fifth simulation serves as a benchmark and considers a cut in applied tariffs to the current ASEAN average (8.6 percent)—an ambitious but achievable goal for tariff reform. As the results in

Chart 2 demonstrate, the largest potential gains are realized in the simulations that isolate reforms in port facilities and the Internet services sector. By contrast, the tariff reform scenario yields a much smaller increase in intra-regional trade.

**CHART 2: POTENTIAL TRADE FACILITATION REFORMS**



Overall, the findings with respect to trade trends in ASEAN appear to reflect the fact that AFTA, in its original form, focused almost exclusively on tariff reduction. In fact, the two AFTA founding agreements do not make an explicit reference to trade facilitation. Nevertheless, intra-ASEAN trade has increased by 23 percent since 1993 (ESCAP 2003). This figure is especially significant given that other regions in Asia continue to have particularly low levels of intra-regional trade (WO 2007).

This recent increase in economic integration across ASEAN has broadened the trade policy dialogue to the extent that there is now an official goal of an ASEAN Economic Community (AEC) by 2020. The AEC would represent a single market and production base of 520 million people and a combined gross domestic product of more than \$600 billion. It would allow for the free flow of goods, services, investment, and labor across ASEAN. In light of this ambitious goal, the need for increased prioritization of substantial and far-reaching trade facilitation reforms across the region over the next decade is unquestionable.

## Emerging Trends in Intra-ASEAN Trade

A comprehensive trade facilitation reform program would need to cover areas as diverse as infrastructure, service sector regulation, and customs administration, among others. This approach would likely be prohibitively costly to institute at once as a single initiative. Instead, a building block approach to institute reforms strategically on a priority basis would be optimal. Estimating the range of potential returns to various reform measures requires identifying emerging trade trends.

Analysis in SW (2007) suggests that trade within ASEAN appears to be particularly sensitive to the quality of transport infrastructure and to competition in the Internet services sector. This might be indicative of the emergence of electronic trade and business in the region, as well as a move toward relatively high value merchandise. In addition, these results may reflect the continued importance of transnational production networks in the region, which require platforms to facilitate goods and information quickly.

It may be beneficial for ASEAN economies, therefore, to begin by improving transport links with regional partners and increasing the competitiveness of key service sectors. Such an agenda could include, for example, augmenting the ASEAN open skies area and increased openness to international services trade under the GATS. Although such policies may require more investment, the gains would be significantly more substantial than tariff reductions of comparable ambition.

## Further Reading

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<sup>i</sup> The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors. They do not necessarily represent the view of the World Bank, its Executive Directors, or the countries they represent.

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