Assessing the Socio-Economic Preparedness of Vietnam Towards ASEAN Economic Community

Activity: ICB-1

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This document has been prepared with financial assistance from the Commission of the European Union. The views expressed herein are those of the author and therefore in no way reflect the official opinion of the Commission nor the Ministry of Industry and Trade

Acknowledgement

The authors thank the EU-MUTRAP Project Team Leader, Dr. Claudio Dordi for his overall management of the project. Mr. Nguyen Anh Duong provides inputs for all Sections, whilst being responsible for editing the whole report. Dr. Jean-Marc Philip contributes contents to Sections 2 and 3, whilst analyzing the social progress in Section 1. Dr. Leonardo Borlini writes inputs for the Background, Sections 1 and 3. Dr. Leonardo Borlini and Dr. Claudio Dordi also writes Appendix 4 in the Annex. Dr. Vo Tri Thanh undertakes analysis of Vietnam's national account in Section 1, and contributes inputs to Section 4. Ms. Tran Binh Minh writes inputs for Sections 1 and 3 related to Vietnam's efforts towards AEC. Dr. Le Xuan Sang contributed other inputs on financial system and institutional improvement in Sections 1 and 3.

The authors are indebted to Mr. Truong Dinh Tuyen - former Minister of Trade – and Mr. Do Huu Hao – former Vice Minister of Industry and Trade – for their constant guidance, support and comments. In addition, we believe that the peer review by Clemens Boonekamp helps improve the Report substantially. In addition, we do appreciate the thoughtful recommendations by Professor Nguyen Hong Son, Rector of the VNU University of Economics and Business. We are also grateful to participants in the policy networking sessions in Hanoi (on 12 December 2014) and Ho Chi Minh city (on 19 December 2014) for valuable insights and comments on the draft research outcomes.

Finally, the authors extend special thanks to Ms. Mai Thu Huong, EU-MUTRAP Project Officer, and staff of the Asian Management and Development Institute (AMDI) for their continuous support and arrangement of related activities, without which this Report would not have been completed.

The views and opinions expressed in this paper are solely of the authors and may not necessarily reflect those of the Government of Vietnam, the EU Delegation to Vietnam and the EU-MUTRAP Project.

Executive Summary

1. This Report seeks to analyse Vietnam's preparedness – at aggregate, sectoral and firm levels – to the full membership of AEC by the end of 2015. In doing so, the authors provide a comprehensive assessment of Vietnam's socio-economic progress in various aspects/sectors towards the implementation of the AEC.

2. The authors attempt to measure the Vietnam's preparedness by comparing current socio-economic situation with that of a member of an aspired RICH economic community in the region. The RICH concept covers the four goals AEC aims to achieve, namely those of ***R***esilience, ***I***nclusiveness, ***C***ompetitiveness and ***H***armony. In each aspect of Vietnam's economic development, accordingly, the analysis attempts to highlight the extent to which the economy has achieved the above criteria.

3. Within the limited scope, this Report only focuses on important aspects of Vietnam's preparedness for the AEC. The aspects under coverage include national accounts, trade, inflation, financial markets, development indicators, and measures of social progress. Meanwhile, the Report excludes the issues related to foreign investment, especially the implementation of the ASEAN Comprehensive Investment Agreement (ACIA), since there is another activity under EU-MUTRAP Project to deal exclusively with the topic.

4. *Section 1* briefly analyses the economic and socio-economic progress of Vietnam, as well as its institutional environment, through an analysis of national accounts, development indicators, trade, financial market and institutional capacity improvement.

5. With the adoption of *Doi Moi* (Renovation) since 1986 and subsequent Government's intensified support for the private sector, Vietnam has embarked simultaneously on domestic market-oriented reforms, international economic integration and maintaining macroeconomic stability. GDP increased at an average annual rate of 6.5% since then, whilst the figure for 1990-2010 even reached 7.8%. Economic structure switched towards higher shares of industry-construction and services, and smaller share of agriculture-forestry-fishery. Inflation was reduced to one-digit level, with high gross investment relative to GDP and proliferation of foreign trade. In particular, being part of ASEAN, Vietnam has enhanced trade relations and economic integration under the ASEAN+ framework. The economy also finds itself increasingly engaged in the ASEAN+ production network.

6. The socio-economic development in Vietnam has attained significant substances of inclusiveness and harmony. High and continuous economic growth has been accompanied by sustained expansion of employment. This led to substantial improvement of people's income and, thus, reduction of poverty incidence. During 1985-2012, Vietnam recorded an increase in GDP per capita (in PPP-adjusted constant international USD for 2005) by 275%. The foreign-invested sector has always maintained high growth of value added and trade till 2013.

7. The continuous reforms and enhancement of economic freedom, with associated increase in new opportunities, appealed to foreign investors and made Vietnam's

relatively more competitive compared with regional countries. Various products have revealed comparative advantages, whilst products with dynamic comparative advantages are being developed. Vietnam's trade has become more complementary to the ASEAN and its partners.

8. Looking forward, however, Vietnam still encounters issues with the lack of resilience and insufficient competitiveness in socio-economic performance. Whilst integrating itself more deeply into the regional and world economy, the country was yet to build up sufficient capacity to deal with adverse shocks in the international markets. Such shocks are quite wide-ranging, covering global financial crisis, global economic recession, changes in capital flows, hikes in commodity prices, conflicts between economic partners, etc. Labour productivity in Vietnam remains far behind those of ASEAN countries. The slower economic growth since 2010, whilst economic restructuring failed to match expectations, led to the diversion of foreign investment towards other regional economies. The supporting factors for further economic growth, such as infrastructure and labour force, lack the momentum and even resources for substantial upgradation.

9. Notwithstanding sustained inclusiveness, Vietnam faces the challenge of ensuring fair shares of growth-induced benefits across social groups. The top quintile continued to reap high share (over two fifths) of income. Income inequality, measured by Gini index, failed to be reduced substantially.

10. *Section 2* presents the targets and blueprints of the AEC, which lay on four Pillars. Under the Pillar of single market and production base, ASEAN aims at the following targets: (i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) freer flow of capital; and (v) free flow of skilled labour. The Pillar of competitive economic region relies on the adoption and enforcement of a truly coordinated competition policy, with specific targets in the areas of competition policy, consumer protection, IPRs and infra-structure development, taxation and E-commerce. The Pillar of equitable economic development focuses on the development of SMEs and IAI, with the identified sectors being food, agriculture and forestry and food security. Finally, in order to enable ASEAN businesses to compete internationally, to make ASEAN a more dynamic and stronger segment of the global supply chain and to ensure that the internal market remains attractive for foreign investment, it is crucial for ASEAN to integrate more deeply into the global economy. As such, ASEAN has to further promote external economic relations and participation in global supply networks.

11. *Section 3* analyses the progress of ASEAN and Vietnam towards the AEC. Literature reviews show that ASEAN made significant progress for the two phases under review (2008-2009; 2010-2011). As a whole, 67.5% of targets have been achieved under phase I and II, with Pillar four: "*Integration with the Global economy*", being the best performer and Ppillar one "S*ingle market and production base*" the worst performer. Such results may be explained by two reasons: (i) the number of targets is much more important in the first pillar than

in the fourth one; and (ii) it seems easier to take decisions related to economic relations with third countries.

12. Within ASEAN substantial economic cooperation has been achieved in the "ASEAN" way, not through rules and regulations, but through discussion and consultation, and consensus (relations-based governance). The so-called ‘ASEAN Way’ is based on the principles of non-interference, informality, minimal institutionalization, consultation and consensus, non-use of force and non-confrontation. By mid-2014, however, only a partial implementation had been achieved. The AEC has come a long way, but it has fallen short of the high standard and time frame it has set for itself.

13. Vietnam has been quite successful in terms of degree of fulfilment and liberalization and timely implementation of the set Blueprint for AEC, with some commitments/clauses even being earlier accomplished. Vietnam outperformed in the first two pillars (i.e. single market and production base, and competitive economic region), and went at the same path for the last two pillars (i.e. equitable economic development, and integration with the global economy).

14. Under the pillar of single market and production base, Vietnam has made timely progress in reducing tariff, facilitating trade and modernizing customs, etc. Vietnam is in an advanced stage of development towards a full implementation by 2015, covering about half of all import and exports by this time. There have been no violations of the scheduled commitments in opening up of financial sector for foreign and non-state investors. Vietnam has made all preparations to open the labour market in 2015.

15. Under the pillar of competitive economic region, Vietnam has improved the legal framework and taken more actions with respect to anti-competitive practices. Efforts to ensure more equal treatment between the domestic private enterprises, SOEs and FDI enterprises are receiving more attention. The regulations and mechanism for consumer protection were gradually upgraded. IPR protection and infrastructure development were assigned more priorities.

16. Under the pillar of equitable economic development, Vietnam has paid increasing attention to the development of SMEs. The IAI program areas and/or projects contribute either moderately or substantially to narrowing development gaps.

17. Under the pillar of integration with the global economy, Vietnam continued to make vivid attempts and progress. Thanks to bold and comprehensive reforms and liberalization efforts, Vietnam became member of the WTO in 2007. Even after the WTO accession, the country went on to negotiate and/or implement other ambitious FTAs such as ASEAN-Japan Comprehensive Economic Partnership, ASEAN-Australia-New Zealand FTA, ASEAN-India FTA, TPP, Vietnam-EU FTA, RCEP, Vietnam-Korea FTA, etc.

18. With a view towards the AEC, Vietnam has the current strengths of golden demographic structure, robust economic growth, high employment and social progress, strategic geographical position, large production base, solid financial

institutions, FDI-induced engagement in regional production network, and progressively open trade and investment regime.

19. As it weaknesses, Vietnam suffers from the shortage of institutional adequacy, underdevelopment of infrastructures, inadequate human resources, lack of competitiveness and dynamic efficiency, eroding financial system, and slow paces of domestic regulatory reforms.

20. The AEC also increases opportunities for Vietnam, particularly in terms of intra-regional trade, improving competitiveness and attracting FDI, improving financial system, enhancing macroeconomic stability, reinforcing institutional systems and other ASEAN-specific ones.

21. Engagement in the AEC and the rise of China and India also hardens the competition for Vietnam. In this process, Vietnam may risk falling into the middle income trap. Other threats also lie in the regional-specific and ASEAN-related issues, such as political-security conflicts in the region, territorial disputes, etc.

22. *Section 4* provides some policy recommendations for both Vietnam and ASEAN in accelerating preparation for AEC. The horizontal recommendations include: (i) prioritization of AEC's agenda and definition of clear integration vision; (ii) improving supervision and follow-up mechanism; (iii) strengthening the institutional architecture; (iv) reinforcing regulations; and (v) strengthening institutional environment and governance within AMSs.

23. By outlining the distinguishing features which underpinned the main passages of the EU's institutional development for community-building process, the authors suggest that: (i) ASEAN requires an effective system for settling disputes that may arise, and ensuring compliance with the rules of the framework; (ii) ASEAN needs to strengthen the mechanisms for monitoring and guaranteeing compliance with international rules by States to which they are addressed, before disputes arise; (iii) ASEAN must work towards the implementation of a regional competition law and the creation of a central competition authority in charge of enforcing such law together with the member States' National Competition Authorities acting as peripheral enforces; (iv) reinforcing ASEAN's institutional base is increasingly urgent; and (v) lowering tariffs is not sufficient to obtain the potential benefits of trade liberalization that should lead to a greater investment unless a broader enabling environment has been established.

24. Acknowledging that effective and deeper integration within ASEAN framework has proved and will continue to be beneficial, the authors also made specific recommendations for Vietnam. The recommendations are related to: (i) the policies to promote more effective economic integration; (ii) the policies to strengthen macroeconomic stability; (iii) the policies to ensure effective capital account liberalization; (iv) the policies related to information dissemination, monitoring and surveillance; (v) the sectoral policies and (vi) other policies.

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ACRONYMS AND ABBREVIATIONS

AADCP	ASEAN-Australia Development Cooperation Program
AAMNP	Agreement on the Movement of Natural Persons
AANZFTA	ASEAN-Australia-New Zealand Free Trade Area Agreement
ABF	Asian Bond Fund
ABMI	Asian Bond Market Initiative
ACIA	ASEAN Comprehensive Investment Agreement
ACFTA	ASEAN-China Free Trade Area
ACMF	ASEAN Capital Market Forum
ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
AEC	ASEAN Economic Community
AECMEP	ASEAN Community Monitoring and Evaluation Program
AEM	ASEAN Economic Ministers Meeting
AFAFGIT	ASEAN Framework Agreement on the Facilitation of Goods in Transit
AFAFIST	ASEAN Framework Agreement on the Facilitation of Inter-State Transport
AFAMT	ASEAN Framework Agreement on Multimodal Transport
AFAS	ASEAN Framework Agreement on Services
AFDM+3	ASEAN+3 Finance and Central Bank Deputies' Meeting
AFIF	ASEAN Financial Integration Framework
AFMM	ASEAN Finance Ministers' Meeting
AFMM+3	ASEAN+3 Finance Ministers' Meeting
AIF	ASEAN Infrastructure Fund
AFTA	ASEAN Free Trade Area
AIA	Framework Agreement on ASEAN Investment Area
AIMO	ASEAN Integration Monitoring Office
AIMR	ASEAN Integration Monitoring report
AITIG	ASEAN-India Trade in Goods Agreement
AJCEP	ASEAN-Japan Comprehensive Economic Partnership agreement
AKFTA	ASEAN-Korea Free Trade Area
AMMAS	ASEAN Multilateral Agreement on Air Services
AMAFLAS	ASEAN Multilateral Agreement on the Full Liberalization of Air Freight Services
AMAFLPAS	ASEAN Multilateral Agreement on the Full Liberalisation of Passenger Air Services
AMC	ASEAN Member Country
AMRO	ASEAN+3 Macroeconomic Research Office
AMS	ASEAN Member State
ANZ	Australia – New Zealand
APEC	Asia-Pacific Economic Cooperation
APN and TAGP	ASEAN Power Grid and Trans ASEAN Gas Pipeline
APSC	ASEAN Political-Security Community

APTA	Asia Pacific Trade Agreement
ASCC	ASEAN Socio-Cultural Community
ATIGA	ASEAN Trade in Goods Agreement
ATSP	ASEAN Tourism Strategic Plan
AUNP	ASEAN-EU University Network Programme
BEC	Broad Economic Categories
BO	Build – Operation
BOP	Balance of payment
BOT	Build – Operation – Transfer
BRAD	Bank for Rural and Agriculture Development
BSAs	Bilateral Swap Arrangements
BSEC	Black Sea Economic Cooperation
BT	Build – Transfer
CAL	Capital Account Liberalization
CEPs	Comprehensive Economic Partnership
CEPT	Common Effective Preferential Tariff
CEPT-AFTA	Common Effective Preferential Tariffs for ASEAN Free Trade Area Agreement
CGIF	Credit Guarantee and Investment Facility
CIEM	Central Institute for Economic Management
CLMV	Cambodia, Lao PDR, Myanmar and Vietnam
CMD	Capital Market Development
CMI	Chiang Mai Initiative
CMIM	Chiang Mai Initiative Multilateralization
CPL	Competition Policy Law
CPR	Committee of Permanent Representatives
CTC	change in tariff classification
EFTA	European Free Trade Area
EIU	Economic Intelligence Unit
EHP	Early Harvest Program
EPA	Economic Partnership Agreement
ERIA	Economic Research Institute for ASEAN and East Asia
ETWG	Working Group on Economic and Financial Monitoring
EU	European Union
EWS	Early Warning System
FDI	Foreign Direct Investment
FOB	Free-On-Board
FSL	Financial Services Liberalization
FTA	Free Trade Area
GATT	General Agreement on Tariff and Trade
GATS	General Agreement on Trade in Services
GCI	Global Competitiveness Index
GSO	General Statistics Office of Vietnam
HLTF	High Level Task Force
HSL	Tariff-Reduction – Highly Sensitive List

IAI	Initiative for ASEAN Integration
ICOR	Incremental Capital-Output Ratio
ICT	Information and Communication Technology
IGA	Investment Guarantee Agreement
IL	Inclusion List
ILO	International Labour Organization
ILSSA	Institute of Labour Science and Social Affairs
IMF	International Monetary Fund
IPAP	Investment Promotion Action Plan
IPN	Integrated Production Network
IPR	Intellectual Property Right
IPRP	Intellectual Property Rights Action Plan
IT	Information Technology
ITA	Information Technology Agreement
IZ	Industrial Zone
JSCB	Joint-stock commercial banks
KPI	Key Performance Indicator
LAIA	Latin America Integration Association
LMICs	Lower Middle Income Countries
MAAFS	Multilateral Agreement on the Full Liberalisation
MAAS	Multilateral Agreement on Air Services
MFSC	Monetary and Financial Stability Committee
MFN	Most Favoured Nation
MNCs	Multinational Corporations
MOF	Ministry of Finance
MOIT	Ministry of Industry and Trade
MOLISA	Ministry of Labour – Invalids and Social Affairs
MONRE	Ministry of Natural Resources and Environment
MPAC	Master Plan on ASEAN Connectivity
MPI	Ministry of Planning and Investment
MRA	Mutual Recognition Arrangement
MSMEs	Micro, Small, and Medium Enterprises
MTR	Mid-Term Review
NAFTA	North American Free Trade Area
NCA	National Competition Authority
NCIEC	National Committee for International Economic Cooperation
NIEs	Newly Industrialized Economies
NPLs	Non-Performing Loans
NSW	National Single Window
NT	National Treatment
NTB	Non-Tariff Barrier
NTM	Non-Tariff Measure
NTR	National Trade Repository
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries

PSS	Payment and Settlement Systems
PREM	Poverty Reduction and Economic Management ASEAN Trade Facilitation
PPP	Public-private partnership
PRC	People’s Republic of China
RCA	Revealed Comparative Advantage
RCEP	Regional Comprehensive Economic Partnership
REER	Real Effective Exchange Rate
RIA	Regulatory Impact Assessment
RIATS	Roadmap for Integration of Air Travel Sector
RICH	Resilient, Inclusive, Competitive, and Harmonious
ROL	Rule of Law
ROO	Rules of Origin
RTA	Regional Trade Agreement SAM Social Accounting Matrix
RVC	Regional Value Content
R&D	Research and Development
SBV	State Bank of Vietnam
SCIC	State Capital and Investment Corporation
SEDP	Socio-Economic Development Plan
SEDS	Socio-Economic Development Strategy
SEOM	Senior Economic Officials’ Meetings Central Bank of Myanmar
SITC	Standard International Trade Classification
SL	Tariff-Reduction – Sensitive List
SME	Small- and medium-sized enterprise
SOCBs	State-owned Commercial Banks
SOEs	State-owned Enterprises
SPCD	Strategic Program of Customs Development Coordinating Community on Services
AFMM	ASEAN Finance Ministers’ Meeting
SPS	Sanitary or Phytosanitary Measures
SSC	State Securities Commission
ST	Stress Test
STRI	Services Trade Restrictiveness Index
SWOT	Strengths- Weaknesses-Opportunities-Threats
TBT	Technical Barriers to Trade
TEL	Temporary Exclusion List
TFP	Total Factor Productivity
TI	Transparency International
TPP	Trans-Pacific Partnership
TPR	Trade Policy Review
TRIMS	Agreement on Trade-Related Investment Measures
TRQ	Tariff-Rate Quotas
UNCTAD	United Nations Conference on Trade and Development
UNECE	United Nations Economic Commission of Europe
UNIDO	United Nations Industrial Development Organization

US	United States of America
USD	US dollar
USITC	United States International Trade Commission
VA	Value Added
VaR models	Value at Risk models
VHLSS	Vietnam Household Living Standard Survey
VJEPA	Vietnam-Japan Economic Partnership Agreement Vietnam
VEPR	Vietnam Centre for Economic and Policy
VLLS	Vietnamese Living Standards Surveys
VN	Vietnam
VNB	Vietnam Development Bank
VND	Vietnam Dong
VN-US BTA	Vietnam-US Bilateral Trade Agreement
WB	World Bank
WC-CAL	Working Committee on CAL Work Plan
WCFSL	Working Committee on Financial Services Liberalization
WCO	World Customs Organization
WEF	World Economic Forum
WDI	World Development Indicators
WDR	World Development report
WHO	World Health Organization
WTI	World Trade Indicators
WTO	World Trade Organization

BACKGROUND

The year of 2015 is approaching, which sees ASEAN member states (AMSs) moving closer to establishing their own economic community. The aspiration has been complemented with pledged efforts at both national and ASEAN levels. Various works and programs have been implemented by AMSs so far. A range of analytical efforts, particularly those by Economic Research Institute for ASEAN and East Asia (ERIA), were dedicated to assessing the implementation of commitments towards realizing the ASEAN Economic Community (AEC). Still, understanding what it may mean by joining the regional economic community and, more importantly, accelerating the preparation for such community are critical for each and every AMS, including Vietnam.

From Vietnam's perspective, ASEAN integration marked an essential first substance of international economic integration. Nevertheless, the country emphasized the need for broader-based integration with all partners, not just ASEAN. In fact, international economic integration in Vietnam was initiated as early as in 1986, when the country started to transform itself into a socialist-oriented market economy. By the end of 2000, the country had already signed bilateral trade agreements with all major partners. The country even went on to join the World Trade Organization (WTO) in 2007, after which it further deepened integration attempts by negotiating various new bilateral and multilateral agreements such as FTA with the European Union, Trans-Pacific Partnership agreement, EFTA, , among the others.

As part of the dynamic ASEAN region, Vietnam finds itself attached to regional integration and development. This attachment is even more meaningful as ASEAN assumes greater centrality in regional economic integration process. Contributing to AEC efforts will require Vietnam to significantly enhance its institutional capacity, trade facilitation and connectivity, which ultimately benefits the country's own development in all socio-economic aspects. Nevertheless, the challenge lies in whether Vietnam can harmonize ASEAN integration with other integration tracks that it has been pursuing. That is to say, being a member of the AEC by 2015 should **not** lead to mere divergence of economic relations away from other major and traditional partners, including the EU. In addition, even with regional integration as an intermediate step to broader economic community, Vietnam needs to overcome the weaknesses inherent in its socio-economic structure. Otherwise, with sizeable economic disparity with more advanced partners, Vietnam may less than fully benefit from the AEC. This requires proper and gradual shift in economic structure that can accommodate evolutions under regional economic community. In this regard, a comprehensive assessment of Vietnam's readiness to form an active part of AEC by 2015 proves to be necessary.

This Report seeks to analyse Vietnam's preparedness – at aggregate, sectoral and firm levels – to the full membership of AEC by the end of 2015. In doing so, the authors provide a comprehensive assessment of Vietnam's socio-economic progress in various aspects/sectors towards the implementation of the AEC. On the basis of identifying current gaps and issues that potentially prevent Vietnam's effective participation in 2015, the authors draw out key policy recommendations to better prepare the country for such participation.

The Report represents the main outcome of a collective effort led by MUTRAP experts in collaboration with Vietnam's authorities with the goal of analysing the Vietnam's achievements and efforts towards the AEC and to support the Government strengthening the position of Vietnam in this direction.

✓ *Objectives*

The study has been broken down into three (3) major objectives; namely:

- To support the Government of Vietnam to identify and address the main challenges in order to be prepared for joining the ASEAN Economic Community (AEC), and to ensure full participation of the country, by stock-taking the necessary reforms to be implemented to that effect.

- To identify action plans in order to ensure full participation of the country to the AEC with capacity to take advantage of opportunities and mitigate challenges in the process.
- To share experiences of the EU in its community-building process.

Complementary specific goals of the present document can be listed as follows:

- To review Vietnam's socio-economic progress so far in comparison with standards/criteria required for membership in a dynamic economic community such as AEC.
- To analyse the strengths, weaknesses, opportunities and threats (SWOT analysis) for some major aspects and sectors of Vietnam when AEC comes into force.
- To recommend policy actions by the Government of Vietnam, business associations and enterprises in Vietnam so as to enhance preparedness towards the prospect of AEC.

✓ *Approach and Methodology*

As the key approach throughout this Report, the authors attempt to measure the Vietnam's preparedness by comparing current socio-economic situation with that of a member of an aspired RICH economic community in the region. The RICH concept covers the four goals AEC aims to achieve, namely those of Resilience, Inclusiveness, Competitiveness and Harmony. This follows the approach of the Asian Development Bank Institute, acknowledging that "*…Defining collective aspirations with highly diverse members is extremely difficult. National goals invariably differ across countries. Besides, it is not easy to ensure that the aspirations espoused are "ambitious enough" for setting broad goals, while being "pragmatic enough" for countries' development over a two-decade horizon…*".[1] Specifically, ***R****esilience* means the capacity to handle volatilities and shocks, from within or outside the region, reducing the likelihood of economic crises. It requires strong institutions and solid macroeconomic policies run by effective managers, capable of assessing risks and taking action. It also requires a regional framework for macroeconomic cooperation and management: the key challenge for ASEAN member states in this regards is, thus, enhancing macroeconomic and financial stability. ***I****nclusiveness* is the need for ASEAN to make economic development equitable, provide opportunities through cooperation strategies that reduce income gaps within and across countries, promoting citizen welfare, and, hence, supporting equitable growth. ***C****ompetitiveness* requires a business environment where successful firms operate in efficient markets under effective national and regional regulations, as ASEAN products must compete globally with improved productivity and more indigenous innovation. ***H****armony* stems from environmentally sustainable development and growth under an ever-growing acceptance that ASEAN is a family of nations, where member countries live in peace, working together to resolve common problems.

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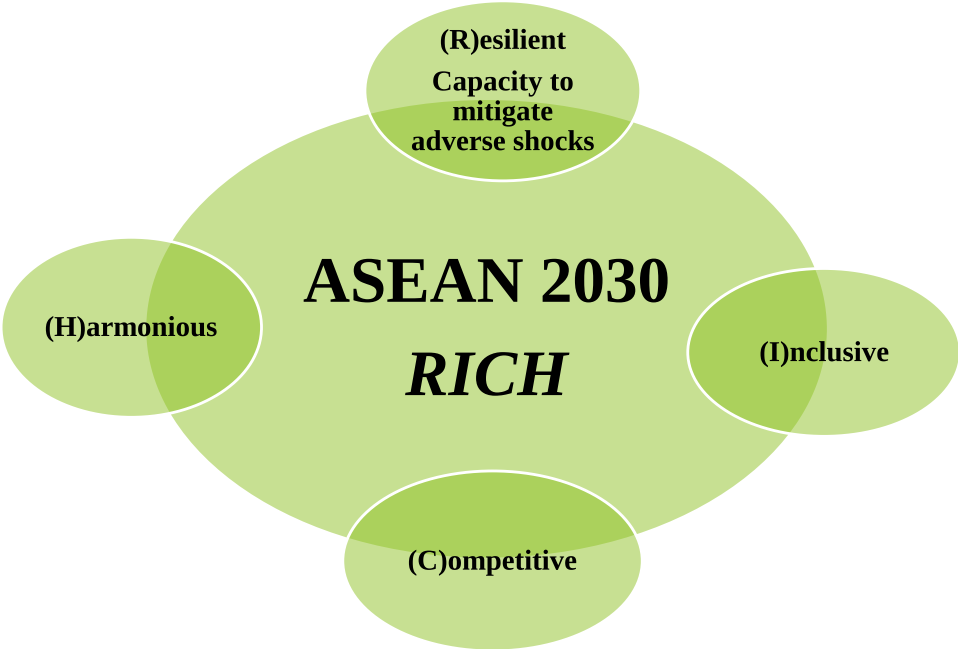
1 Asian Development Bank Institute (2012, p. 3). In-depth background studies were prepared: one for each ASEAN member and more than 20 thematic papers on key issues and challenges the region will face. Goals from long-term national development plans were included and extensive consultations were held -in member countries, with the ASEAN Secretariat, and with national and regional think tanks. Surveys of opinion leaders were conducted. The study complemented these inputs with a "strengths- weaknesses-opportunities-threats" (SWOT) analysis. The conclusion is that by 2030 the region seeks to become Resilient, Inclusive, Competitive, and Harmonious- a "RICH " ASEAN.

Figure 1: RICH Framework



Source: ADBI (2012).

The key question lies in whether Vietnam is prepared to be an integral part of a RICH ASEAN, *assuming that* ASEAN aspires to become a RICH community. In each aspect of Vietnam's economic development, accordingly, the analysis attempts to highlight the extent to which the economy has achieved the above criteria. For instance, with regard to national accounts, the authors look into how economic activities in the country incorporate wide participation of the people (*i.e. inclusiveness*) as well as how such activities are prone to cope with domestic and external shocks (*i.e. resilient*). From such angle, the capacity to adjust of the people, business communities as well as management of the Government constitutes the key subjects of analysis.

Under the approach defined above, the report mainly employs qualitative methodologies. *First*, the literature review is provided on the basis of various studies related to socio-economic development of Vietnam as well as projections until 2015. *Second*, the authors update data and analysis on current economic and regulatory development of Vietnam by the end of 2013, with a view to see how well the country has fulfilled the predetermined set of criteria. As a note, however, only some relevant - not all - criteria is used in the analysis of each aspect/sector in the context of the present report, which mirrors a choice due to the relevance for the element under discussion of a certain criterion, and the amount and quality of information at disposal of the authors. As to the latter point mentioned, the authors also rely on consultation with experts and relevant stakeholders in Vietnam to acquire greater inputs and invaluable insights for their final analysis. *Finally*, the analysis takes into due consideration some the late achievements and shortcomings of the most advanced regional area of economic integration, namely the European Union (EU): the comparison with such supranational organization, featured by an institutional framework so penetrating that it does not find any similar counterpart in the globe, could support a more comprehensive assessment of the 'ASEAN Way', paving also the way towards the AEC when addressing some needed institutional reforms..

A relevant caveat of the study must be stressed from the beginning. The analysis of the Vietnam's progress towards the AEC is partial and has been drawn from different sources of information. The very necessity of assessing precisely the efforts and actions required by each ASEAN member state (AMS) to achieve the targets identified for the AEC is the main reason why the authors of the present study suggest that the ASEAN Secretariat together with the

AMSs should implement a more effective and transparent monitoring and follow-up system. Therefore, when all the relevant information is accessible more organically the present study may constitute the basis for a more thorough assessment of the relative position of Vietnam.

✓ *Scope of the Report*

Within the limited scope, this Report only focuses on important aspects of Vietnam's preparedness for the AEC. The aspects under coverage include national accounts, trade, inflation, financial markets, development indicators, and measures of social progress. Meanwhile, the Report excludes the issues related to foreign investment, especially the implementation of the ASEAN Comprehensive Investment Agreement (ACIA), since there is another activity under EU-MUTRAP Project to deal exclusively with the topic.

✓ *Contents of the report*

The Report seeks to analyse Vietnam's preparedness – at aggregate, sectoral and firm levels – to the full membership of AEC by the end of 2015. In doing so, the authors start with providing a comprehensive assessment of Vietnam's socio-economic progress in various aspects/sectors towards the implementation of the AEC. Then, they present the AEC Blueprint, analyse the progress made up to now and focus of identifying current gaps and issues that potentially prevent Vietnam's effective participation in 2015. Finally, the authors draw out some key policy recommendations to better prepare the country for such participation.

The remainder of the Report is divided into four different Sections:

- Section 1: Vietnam's socio-economic progress;
- Section 2: Targets and blueprints of the ASEAN economic integration (AEC);
- Section 3: Progress towards the AEC; *and*
- Section 4: Policy recommendations;

Section 1 briefly analyses the economic and socio-economic progress of Vietnam, as well as its institutional environment, through an analysis of national accounts, development indicators, trade, financial market and institutional capacity improvement.

Section 2 presents the targets and blueprints of the ASEAN economic integration (AEC), which lay on four Pillars, namely:

- Pillar A: Single market and production base;
- Pillar B: competitive economic region;
- Pillar C: equitable economic development; *and*
- Pillar D: integration with the global economy.

Section 3 analyses the progress of ASEAN and Vietnam towards the AEC. The Section presents a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis about Vietnam's position within ASEAN, the remaining challenges that AMSs have to cope with in the regional economic integration process and that Vietnam is facing regarding the AEC target.

Section 3 also places some conclusions drawn from the different analyses and tries to foresee the direction Vietnam and other AMSs are pursuing towards building a regional community. Specifically, the Section seeks to identify the efforts and progress of ASEAN's economic community, regarding whether an ASEAN++ framework or an ASEAN union will be in place.

Section 4 provides some policy recommendations, such as prioritizing the AEC's agenda, defining a clearer integration vision, improving supervision and follow-up mechanism, strengthening the institutional architecture, reinforcing regulations, strengthening institutional environment and governance within the AMSs, etc. In this regard, the authors stress the lack of supranational bodies and underline the difficulty to reach an effective AEC in its true meaning and make some comparison with the process followed by the EU member states (especially the euro zone)

1. VIETNAM'S SOCIO-ECONOMIC PROGRESS

1.1. *Geography and population*

Vietnam occupies the eastern and southern part of the Indochinese peninsula in Southeast Asia, with the East Sea along its entire coast, bordering the Gulf of Thailand, Gulf of Tonkin. China is to the north and Laos and Cambodia are to the west. The land area of Vietnam amounts to 330,363 sq. km; its terrain varies from: low, flat delta in south and north; central highlands; hilly, mountainous in far north and northwest. In such area, Vietnam benefits from substantial energy and mineral resources. Proven oil reserves total 3.4 billion barrels. Along with natural gas deposits and coal, Vietnam's energy resources are a major source of export earnings. Other main natural resources comprise: phosphates, manganese, bauxite, chromate, forests, and hydropower. After decades of neglect, the country's transport and communications infrastructure has improved markedly since 1990.[2]

With a total population of approximately 600 million people, the ASEAN community is - before the EU and the North America Free Trade Agreement (NAFTA) - the most populated economic community in the world. Among this community, the population of Vietnam (90.4 million at the end of 2014) ranks third, after that of the Republic of Indonesia (251 million in 2013) and the Republic of Philippines (nearly 106 million in 2013). The Kingdom of Thailand (67 million in 2013), the Union of Myanmar (55 million in 2013), and Malaysia (about 30 million in 2013) follow. With a population of about 15 million, 7 million, 5 million, one finds, respectively, the Kingdom of Cambodia, the Lao People's Democratic Republic, the Republic of Singapore. Finally, the least populated member of the ASEAN is Brunei Darussalam (415.717 in 2013).[3]

1.2. *National Accounts*

1.2.1. <u>Supply side analysis</u>

ASEAN is the second-fastest growing economy in Asia, after China. It has expanded by 300% since 2001, as shown in Figure 2. ASEAN's economic growth has outpaced that of many other regional and global economies. According to the Word Development Indicators (WDI) published by the World Bank (WB) in May 2014, total GDP of ASEAN reached about USD 3,600 billion (in PPP) in 2012. ASEAN economies remained buoyant as nominal GDP grew by 5.7 percent at USD 2.31 trillion in 2012. The continued growth of the region is reflected in the improved GDP per capita at USD 3,751 from USD 3,591 in 2011.

With the adoption of *Doi Moi* (Renovation) since 1986 and subsequent Government's intensified support for the private sector, Vietnam has embarked simultaneously on domestic market-oriented reforms, international economic integration and maintaining macroeconomic stability. The country succeeded in getting a rapid and continuous growth. Since then, GDP increased at an average annual rate of 6.5%, inflation was reduced to one-digit level, gross

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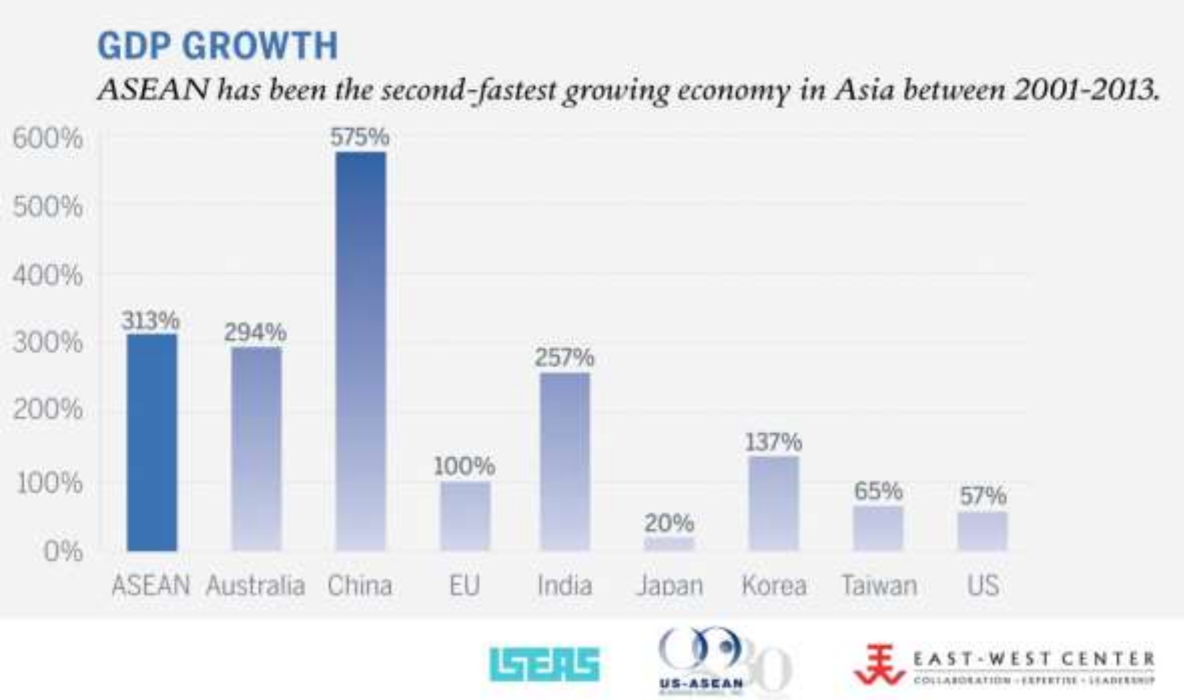
2 See Economic Intelligence Unit (EIU, 2008, p. 3), which goes further in stating that: "However, even with substantial investments it has proved difficult to keep up with rapidly rising demand."

3 Source: http://www.statistiques-mondiales.com/asie.htm. Similar official figures with reference to 2012 are available at: http://world-statistics.org/.

investment increased to 36% of GDP and foreign trade was both expanded and diversified. Vietnam became one of the fastest-growing economies in the world, averaging around 8% annual gross domestic product (GDP) growth from 1990 to 1997, but was still a relatively poor and closed country with a per capita income of only 365 USD, when the country joined ASEAN in 1995.

Figure 2: ASEAN GDP Growth (2001-2013)



Source: Asia matters for America[4]

The country continued to have an average growth of 6.5% over the period 1998-2003. Such period was the most successful period in Vietnam's recent history, as a WB report emphasizes: "Vietnam has been one of the most successful East Asia economies in the past couple of decades, growing faster than all its neighbours except China" (WB, 2007).

In addition, Vietnam's portion in gross domestic income of ASEAN constantly increased between 2000 until 2008, when the economic recession was triggered by the global financial crisis. This is a particularly meaningful piece of information, since it testifies that the ASEAN countries performed significantly well during the period at issue, and Vietnam relatively well among them.

The rate of economic development in Vietnam since the 1990s has been exceptionally rapid, and has remained unsurpassed by most developing countries. In early 1990s, the country was among the poorest in the world. It was emerging from decades of war, which had left a damaged infrastructure, many people dead and millions injured or displaced. Following the national unification in 1975, Viet Nam faced an economic crisis, including serious food shortages. In the late 1970s and early 1980s, economic development was paralysed by high inflation, low productivity, low-quality export standards, energy shortages and inefficient management of the economy (Levinson and Christensen, 2002). Food supply fell short of

4 http://www.asiamattersforamerica.org/asean/data/gdppercapita

national demand, and some areas of Viet Nam suffered from chronic food insecurity. In 1987, for example, the state-owned media reported that ‘about ten million people in the Northern provinces suffered severely from starvation’ (ibid). In response, the Government of Vietnam began a process of economic reforms, shifting towards a more market-based economy using a trial-and-error approach. There was gradual recognition of the important contribution of private initiative to economic development. In 1986, during the Sixth Party Congress, liberal reformers gained critical influence in the party By the late 1980s, considerable economic, social and political reforms were underway, contributing to noteworthy improvements in economic conditions and in human development – albeit unequally so. The government began recognising contracts signed between state enterprises as well as with private entrepreneurs in order to address bottlenecks in the supply of agricultural inputs (e.g. tools and fertiliser) (Levinson and Christensen, 2002). A decisive political shift came in the late 1980s, which enabled significant economic reforms and a ‘multi-directional foreign policy orientation’.[5]

According to the World Competitiveness report, Vietnam significantly improved its macroeconomic situation (87th, up 19 places -after jumping to almost 20 percent) since 2010-2011, as well as its competitive strengths and enjoyed of relative stability with moderate inflation, a stable exchange rate, increased reserves and reduced country risks. Inflation was back to single-digit levels in 2012, Vietnam also advances in the goods market efficiency pillar (74th, up 17), thanks to lower trade barriers and a less heavy tax rate on businesses.

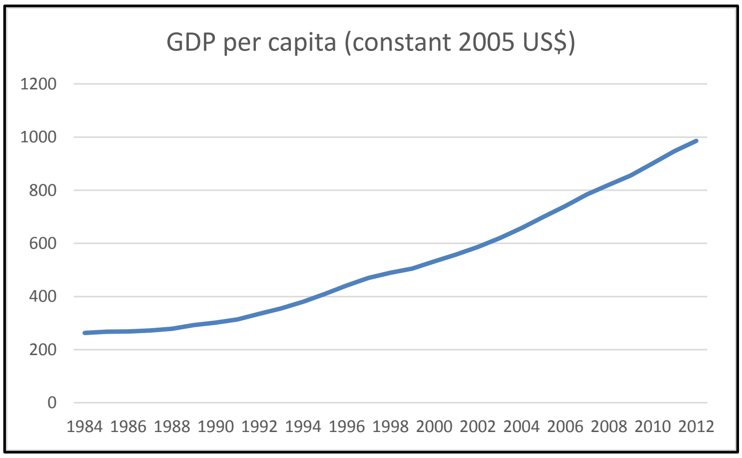
The success of Vietnam’s economic performance is even more striking when compared with countries featured by similar structural conditions at the beginning of the period at hand. For example, Bernabè and Krstic (2005) draw parallels between Viet Nam and Burkina Faso in the early 1990s. Both had a gross domestic product (GDP) per capita of roughly USD 240 per year, a poverty rate of approximately 55% (based on national poverty lines) and a concentration of poor people in rural areas (about two-thirds of rural households were poor). Both were highly rural and agricultural economies, with approximately 80% of the population living outside urban areas. Yet, between 1990 and 2010, they followed distinct development paths. Vietnam enjoyed high average annual growth rates between 1990 and 2008, coupled with dramatic reduction in poverty over the same period. Burkina Faso, on the other hand, has seen moderate growth and little poverty reduction in the past two decades. The two economists highlight low levels of inequality, high levels of human capital, structure of employment and population density. Vietnam built on this foundation with a set of well-designed and well-implemented development and reform policies.

Although Vietnam is much richer today than it was thirty years ago, level of national economic development remains relatively low, with a per capita income of about 20 % of U.S. GDP per capita. However, in spite of the turmoil in the recent years, GDP per capita constantly improved, from USD 262 in 1984 to USD 986 in 2012 (Figure 3). The progress of Vietnam’s economic conditions over the last 15 years may be better assessed once divided into shorter periods of time. The years 2001-2005 has marked an expansion period for the economy. The economic growth was rather high, reaching average of 7.5% per annum in 2001-2005. From supply side, the growth rate was mainly induced by industry-construction sector. Export growth was rapid and continuous, averaging at 18.4% p.a. in 2001-2006. Investment also rose from 35.4% of GDP in 2001 to 41.5% GDP in 2005. FDI began to flow in, while the private

5 Among the other achievements, Economic reforms included *Doi Moi* policies and foreign policy aimed and succeeding at re-establishing economic relationships with the US (which removed its trade and aid embargo) and neighbouring countries (when it became a member of the ASEAN).

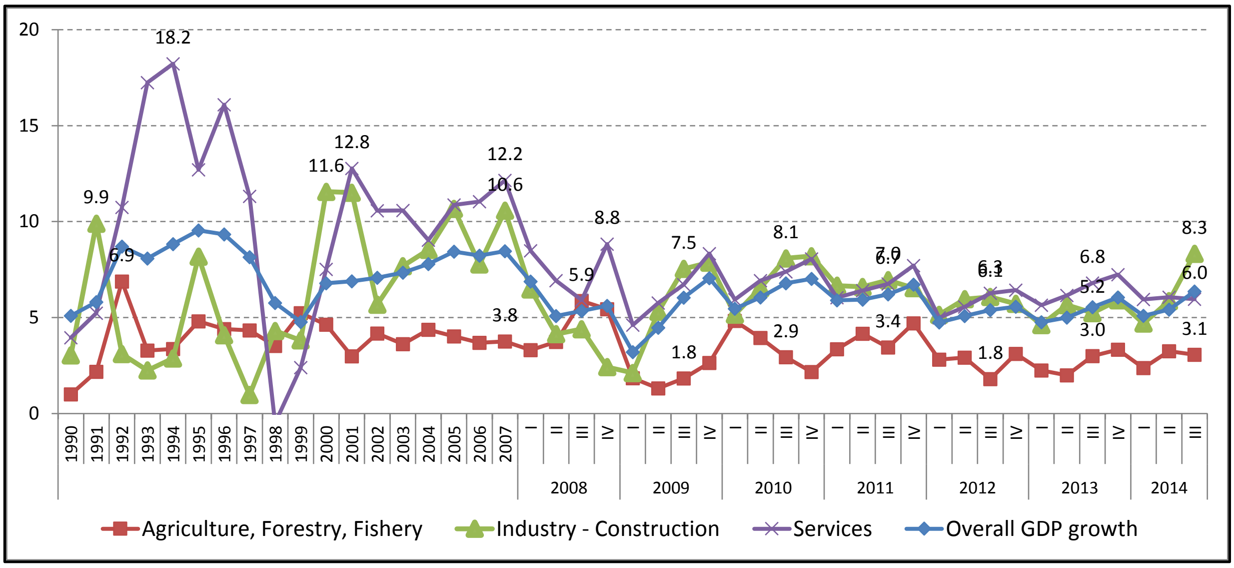
sector flourished. Trade deficit tended to increase, but remained small relative to GDP. Meanwhile, inflation was controlled at one-digit level, despite soaring in the years 2004 and 2005.

Figure 3: Evolution of GDP per capita of Vietnam (1984-2012)



Source: World Development Indicators 2014.

Figure 4: GDP growth rate, 2005-2013 (%)



Source: Authors' compilations from various sources.

Since 2006, Vietnam's economy has maintained lower growth as compared with previous years. The annual GDP growth, during 2006-2010, has stood at 6.92% per year, much lower than the average of previous period. The highest growth could be seen in 2007 with 7.15%. It has been then going down and being affected by the increasing of commodity price in late 2007, the economic downturn and global financial crisis in late 2008 and the European sovereign debt crisis since 2010. As a result, Vietnam could not achieve the 2006-2010 five-year-plan's target of economic growth rate of 7.5-8%. The first half of this period has witnessed a higher growth rate with the booming of the economy (Figure 4). This also evidenced the relatively insufficient resilience to adverse shocks in international markets.

The following years of 2011-2013 recorded modest performance in terms of GDP growth, with 5.25% and 5.42% in 2012 and 2013 respectively. While advanced and emerging economies have been gradually recovered after the 2008-2009 global financial crisis, Vietnam has been stagnant, likely because of its inherent difficulties, leading to a lower growth in 2012, even lower than the rate of 2009 when Vietnam was significantly affected by the crisis.[6] In this context, since late 2008, the Government has adopted sound policies in order to cope with the macroeconomic instability and the effects of both internal and external factors, consisting also of high public spending on infrastructure and social welfare (Box 1). Still, Vietnam's economic growth in this period has been smaller than in 2006-2010 as well as in 1990-2010, which undermines the country's competitiveness in attracting foreign investment.

Box 1: Key Economic Management Measures during the Period of 2008-2011

In early 2008, to cope with macroeconomic instability and internal and external unfavourable factors, the Government issued Resolution No. 10/2008/NQ-CP dated 17 April 2008, specifying 8 groups of measures to curb inflation, stabilize the macroeconomic environment, and to ensure social security and sustainable growth. However, because of negative impacts of the global financial crisis and economic recession, the Government then issued Resolution No. 30/2008/NQ-CP dated 11 December 2008 on 5 urgent measures - towards loosening fiscal and monetary policies - to prevent economic downturn, maintain economic growth and ensure social security. In 2009, the Government enforced a series of specific policy measures to implement Resolution No. 30, including policies on interest rate subsidy and credit support, tax exemption and reduction, export promotion, investment and consumption stimulus, social security, job creation, poverty reduction, stabilization of people's livelihood, etc. The economic stimulus package of about USD 8 billion - to implement these measures - significantly helped stabilizing macroeconomic environment, preventing economic downturn, facilitating gradually economic recovery, and creating jobs and ensuring social security. In 2010, as the global and domestic economy recovered but still faced with many difficulties, the Government approved Resolution No. 18/NQ-CP dated 6 April 2010 on measures to strengthen macroeconomic stability with more prudent fiscal and monetary policies. In early 2011, acknowledging complicated developments of the international and domestic economy with mounting risk of macroeconomic instability, the Government issued Resolution No. 11/NQ-CP dated 24 February 2011 on key measures to control inflation, to stabilize macroeconomic environment and to ensure social security. Specifically, monetary policy was tightened and became more prudent; fiscal policy was also tightened, with reduction of public investment and state budget deficit; other measures were undertaken to promote manufacturing, business and export activities, to narrow down trade deficit; and social security was strengthened.

Source: CIEM (2013).

6 Real GDP expansion is expected to gather momentum in 2014-18, averaging 6.4% a year, up from an estimated 5.4% in 2013. This will reflect a steady acceleration in private consumption growth, which will gradually recover from the negative effects of spiralling inflation in 2011-12. Investment and trade growth in 2014-16 will be weighed down owing to the adverse impact of anti-China riots on investor sentiment and widespread damage to export-oriented manufacturing facilities. Nevertheless, we still expect investment to expand by an annual average of 9.2% in 2014-18, up from 5.3% in 2013. According to the EIU's forecasts, foreign investment, especially in the export-oriented electronics sector, will continue to accelerate, driving an average annual increase of 13.4% in exports of goods and services in 2014-18. Vietnam will continue to benefit from the relocation of low-cost export manufacturing from China, as well as a slight firming of demand in the US and EU. Import growth will also remain rapid as Vietnam sucks in inputs for the export sector and the equipment needed for investment. See, EIU (2014).

GDP by sector

From yet another angle, it is worth assessing how the GDP has evolved within the different economic sectors (Table 1).

Table 1: GDP growth by sector

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total	**7.55**	**6.98**	**7.13**	**5.66**	**5.4**	**6.42**	**6.24**	**5.25**	**5.42**
Agriculture, forestry and fishery	4.19	3.8	3.96	4.69	1.91	3.29	4.02	2.68	2.64
Industry - construction	8.42	7.29	7.36	4.13	5.98	7.17	6.68	5.75	5.43
Services	8.59	8.39	8.54	7.55	6.55	7.19	6.83	5.89	6.57

Source: GSO, various years

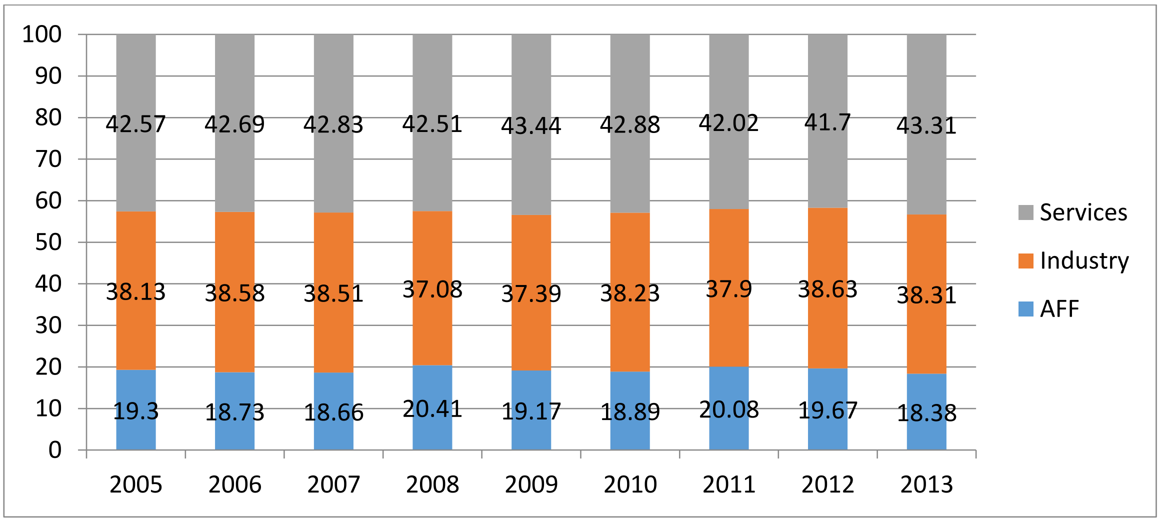
Table 1 shows that the growth rate of the service sector was at the highest during 2005-2010, reaching the peak (at 8.6%) in 2005 and gradually reduced after that. The industry and construction sector ranked second in terms of growth rate, but was significantly impacted by the global financial crisis in 2008, only 4.1% and at the lowest since 2000 and slowly recovered in the 2008-2010. Despite such dynamics, which testifies a considerable slowdown, after 2007, a cross-sector comparison highlights that, like for most of its ASEAN counterparts, the services sector is currently the main catalyst for Vietnam's economic growth.[7]

During 2011-2013, all the three sectors of agriculture, forestry and fishery; industry and construction; and service sector have downward trends as compared to the previous years. The agriculture, forestry and fishery has achieved higher growth rate only in 2011 (4.02%) and lower in 2012 and 2013 (2.68% and 2.64% respectively). The industry and construction has experienced growth rate of 5.5% to 6.7% in 2011-2013, which is at the lowest since 2000. In spite of having better growth rate than other sectors, the service sector could not maintain the above eight percent of the period, and slowing down to 5.9% and 6.6% in 2012 and 2013 respectively.

With the contribution of about 20% to the GDP (Figure 5), the agriculture, forestry and fishery had better performance thanks to high exports in some sub-sector such as coffee, pepper, rice, cassava. The agriculture sector, during the period of 2006-2010, experienced high value added of approximately to 80%. This is mainly because of increase of international prices for Vietnam's key exported agricultural products. However, in 2012 and 2013, this sector faced unfavourable conditions due to the falling world prices, higher production costs and the poor weather conditions. In addition to the economic downturn and global financial crisis in 2008-2009, this is also the reason for lower growth and contribution to the overall GDP of the economy.

7 Over time, as the agriculture sector has decreased over the last seven years. In 2012, services sector contributed the highest share to GDP in all ten ASEAN Member States, ranging from 35% to more than 60% of GDP. After ASEAN5's economy has gradually shifted to the tertiary sector, the BCLMV country group is currently developing their secondary and tertiary sector.

Figure 5: GDP structure by sector, 2005-2013 (%)



Source: GSO (2014).

The industry and construction sector has maintained the leading sector in the economy, with an average share of above 38% percent of the GDP. In 2005-2008, the industry expansion was induced by the increasing of external demand for goods from Vietnam and the high growth of construction resulted from higher investment in socio-economic infrastructure development and the expansion of real estate market. The following years have witnessed negative spill-over effect from the economic downturn and global financial crisis. Large inventories and slow consumption has constrained the growth of industrial output. The manufacturing sector, which considered as the driver of growth for industry sector, has been facing more and more protectionism-induced barriers in export markets, increasing competition with imported products in the domestic market as the import tariffs on many items are gradually phased out in line with commitments under the WTO and other free trade agreements, the inefficiency of production and business, underdevelopment of supporting industries, and the lack of electricity support for production.

GDP by ownership

By ownership, the foreign-invested sector has always maintained the high growth during 2005-2013, except for 2009, when the foreign-invested sector growth is lower than that of the non-state sector (Table 2). With such high growth, the contribution to GDP of the foreign-invested sector is continuously increased from 15.16% in 2005 to 19.55% in 2013. The non-state sector, including the collective, private and household sub-sector, has played an important role in contributing to the overall GDP and maintained at its stable growth of 6.03% in 2005 and 5.35% in 2013 respectively. The growth rate of the state sector has sharply declined through years, from 7.55% in 2005 to 4.84% in 2013, leading to a contribution of 32.2% to overall GDP.

Such figures clearly evidence that the economic structure has shifted away from the state sector to higher shares of the non-state and foreign-invested sectors. Some reasons explaining the economic structure shift by ownership can be put forward: (i) the number of state-owned enterprises (SOEs) is falling due to the ongoing process of SOE reforms, including rearrangement and restructuring SOEs through equitization, acquisition, and dissolution; (ii) many SOEs have produced inefficient performance during the economic integration period and low responsiveness to the fluctuation of regional and global economy, especially in the economic downturn and global financial crisis in 2008 and 2009; (iii) rapid development of the non-state sector has been considerable; and (iv) the foreign invested sector has maintained high value added growth during last years and its growth is much higher than the average of overall GDP growth.

Table 2: GDP growth and structure by ownership, 2005-2013 (%)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
GDP Structure									
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
State sector	37.62	36.69	35.35	35.07	34.72	33.46	32.68	32.57	32.20
Non-state sector	47.22	47.24	47.69	47.50	47.97	48.85	49.27	49.35	48.25
Foreign-invested sector	15.16	16.07	16.96	17.43	17.31	17.69	18.05	18.08	19.55
GDP growth									
Overall GDP growth	**7.55**	**6.98**	**7.13**	**5.66**	**5.40**	**6.42**	**6.24**	**5.25**	**5.42**
State sector	7.37	6.17	5.91	4.36	3.99	4.64	4.46	5.68	4.84
Non-state sector	6.03	5.29	6.03	5.82	6.63	7.08	7.44	4.91	5.35
Foreign-invested sector	13.22	14.33	13.04	7.85	4.81	8.07	6.30	5.38	6.71

Source: GSO (various years).

ASEAN comparison

Compared with other ASEAN countries (observed through PPP adjusted measures), Vietnam enjoyed the highest GDP per capita growth performance over the period (Table 5), in spite of starting from the second lowest point.

The total GDP of ASEAN was about USD 3,600 billion (in PPP) in 2012, but presented a strong discrepancy between ASEAN members. On the one hand, Indonesia captured more than 1/3 of ASEAN GDP, while, on the other hand, Laos got only half percent of the community wealth.

Table 3: GDP per capita in ASEAN (PPP adjusted constant 2005 international USD)

	1984	2012	Growth rate
Indonesia	1,594	4,272	168%
Thailand	2,571	8,463	229%
Malaysia	5,926	14,822	150%
Philippines	2,546	3,801	49%
Singapore	18,729	53,266	184%
Vietnam	885	3,318	275%
Myanmar	n/a	n/a	N/a
Cambodia	n/a	2,150	N/a
Brunei Darussalam	59,271	45,979	-22%
Lao PDR	853	2,522	196%

Source: World Development Indicators.

Table 4: Member states of ASEAN GDP for 2012 (PPP)

Rank	Rank	Rank	Country	2012 GDP (PPP)	2012 GDP (PPP)

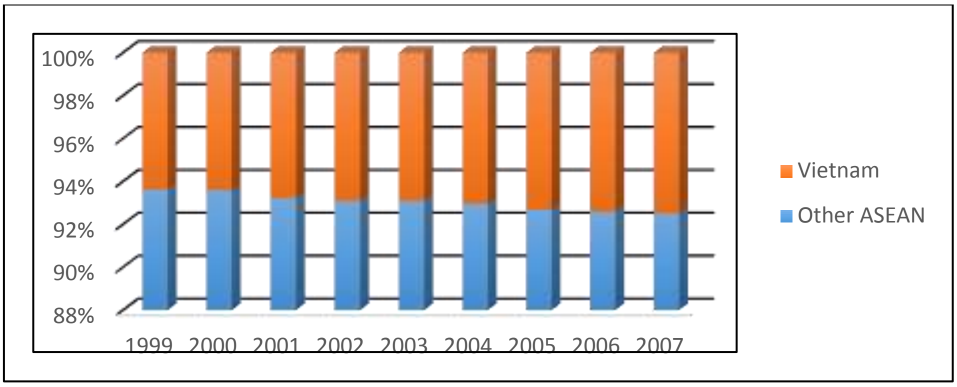
ASEAN	Asia	World		Billions of USD	% of total
1	5	15	Indonesia	1,208.54	33.74%
2	10	24	Thailand	643.27	17.96%
3	12	29	Malaysia	491.97	13.73%
4	13	32	Philippines	424.74	11.86%
5	15	38	Singapore	327.56	9.14%
6	16	41	Vietnam	320.45	8.95%
7	28	75	Myanmar	88.75	2.48%
8	36	102	Cambodia	36.01	1.01%
9	39	121	Brunei	21.91	0.61%
10	41	129	Laos	19.16	0.53%
			Total	**3,582.35**	**100.00%**

Source: World Development Indicators.

In addition, the share of Vietnam in overall gross domestic income of ASEAN has constantly increased between 2000 until 2008 when the economic recession was triggered by the global financial crisis. This is a particularly significant performance, as the ASEAN countries performed significantly well during this period.

The quality of economic growth deserves some careful considerations. Total Factor Productivity (TFP) is one indicator of quality of economic growth, among others. In the period of 1990-1996, TFP was the most important factor to economic growth (contribution of 43-83% of GDP growth). In contrast, the contribution of capital accounted for the largest share since 1997 (45-102% of GDP growth), and the figure tended to increase over time. During this period, Vietnam's economic growth was heavily dependent upon the expansion of capital, while the contributions of labour and TFP were very modest despite the fact that the country had more advantage of labour instead of capital. Technology level, labour skills, and management capacity was only improved slowly. Without more applications of science and technology alongside human resource development, the mere increase in capital and the number of labours can hardly lead to high and sustainable growth. In particular, the quality of economic growth during 2007-2011 was also weaker than the period of 2002-2006. In the years of 2007-2010, TFP only contributed 5% to GDP growth, i.e. smaller than the annual average figure of 33% during 2002-2006. In 2009 and 2010, TFP's contribution was even negative (-1% and -29%, respectively). The dependence of the economy's development on capital then became most serious during 2007-2011 (73% compared with the average figure of 46% during 2002-2006), while the growth rates were lower.

Figure 6 : Evolution of Vietnam and other ASEAN countries gross domestic products between 1999 and 2007



Source: World Development Indicators.

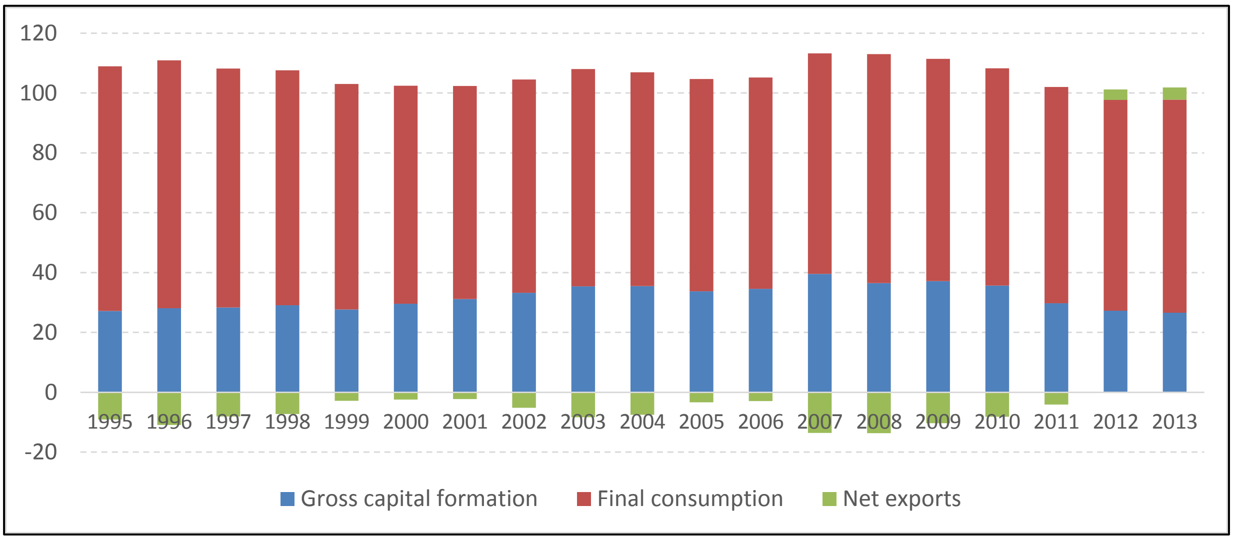
Another indicator of growth quality is labour productivity. Vietnam's labour productivity grew very slowly, and the average pace of growth in 2007-2011 (3.7% per annum) was much slower than that in 2002-2006 (5% per annum). Improving labour productivity presents a critical concern if Vietnam wants to avoid the middle-income trap and strengthen the competitiveness of the economy. In comparison with other countries, Vietnam's labour productivity is still low. The figure in 2010 was nearly USD 5,900 (in USD value in 1990), equivalent to 13.2% of Japan, 23.3% of Malaysia, 12% of Singapore, 13.3 of South Korea, 46.5% of China, 37% of Thailand, and 69.9% of Philippines.

1.2.2. Demand side analysis

The expanding economy was induced by simultaneously encouraging consumption, gross capital formation and trade. As Figure 7 reveals, the share of gross capital formation in GDP soared from 27.1% in 1995 to almost 39.6% in 2007. This rapid expansion was partly realized at the expense of the final consumption, which decreased from 81.8% to 73.7% in the same period. To a significant extent, the expansion of gross capital formation and contraction of final consumption helped improve capacity for exports, whilst reducing demand for imports. Accordingly, exports and imports also followed the overall growth of the economy, the former rising slightly faster that the latter, hence resulting in smaller trade deficits (2.9% in 2006 compared with 9.1% in 1995).

Since then, gross capital formation accounted for a smaller share of GDP. In 2013, the figure already dropped to 26.6%. Final consumption was also sluggish, accounting for stable shares of 70-76% in 2007-2013, with the figure for 2013 being 71.2%. The change in net exports, however, was more profound. Immediately after the WTO accession, Vietnam suffered from huge trade deficits. The trade balance was only improved since 2011 due to contraction of aggregate demand (especially demand for investment and imports), and improved management of trade. In 2012-2013, Vietnam even recorded trade surplus, which respectively contributed 3.5% and 4.1% to GDP.

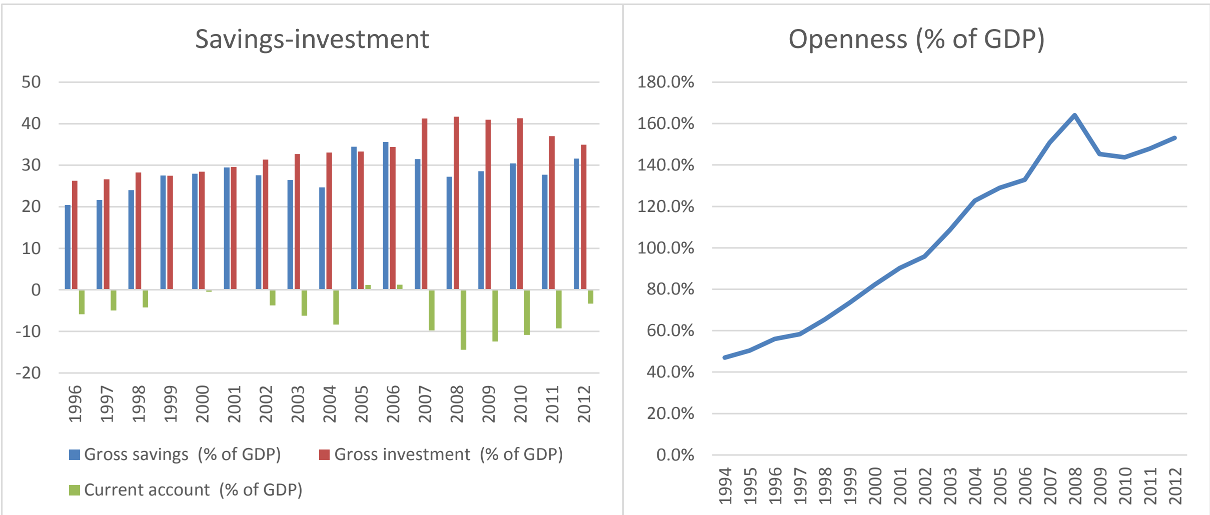
Figure 7: Composition of GDP by expenditure (1995-2013)



Source: GSO.

However, domestic savings was rather stable since 2007 amid a still strong investment, hence resulting in enlarging current account deficit. The surge in investment was largely offset by rising imports, given investment growth has been fed by foreign direct investment (FDI). Viewed over time, foreign trade and FDI have improved significantly, although new registered FDI has started to trend downward. Average annual FDI rose sharply after it was authorized in 1988, even when the global economy was affected by the financial crisis in 2008. The contraction of investment demand (due to macroeconomic downturn and inflation control efforts) since 2011 then led to smaller investment-savings gap. However, openness, while in constant rise before the crisis, experienced a decline after this crisis. Still, Vietnam achieved remarkable result in terms of openness for less than two decades (Figure 8, right).

Figure 8: Savings-investment and openness of the Vietnamese economy



Source: World Development Indicators.

Table 5 tabulates the more detailed growth and structure of GDP by expenditure item. The share of gross capital formation in total GDP has been reduced from 33.76% in 2005 to 26.59% in 2013. It growth has also gone down from 11.15% in 2005 to only 5.45% in 2013 (Table 5). The sub-components of gross capital formation have contributed in unstable manner, with a reduction of gross fixed capital to 5.3% in 2013, and its proportion reduced sharply as compared to that 2009-2011 because enterprises has to reschedule their production and concentrate on selling inventories in previous years to repay bank loan and expand production since late 2009 (CIEM, 2011). The other reason could be the impacts of economic downturn and global financial crisis in late 2008 and 2009.

Gross capital formation decreased sharply in 2011, by almost 6.84% (at 2010 constant price). Although State investment experienced only a slight decrease compared to the previous years, the investment from other sectors declined significantly. This implies that the non-state sector was most vulnerable to tightening monetary policies in 2011. Growth of gross capital formation gradually recovered in 2012 and 2013, albeit still lower than previous period. This reduction has also been shown in the decline of investment ratio (over GDP) when it went down to nearly 30% in 2012 (VEPR 2013). The decline of investment has facilitated the stabilization of macroeconomic environment; however, it could have impacts on the slow-down of growth in the short-term and growth of productivity in the longer term, especially when the economy's technical structure has not been adjusted.

Table 5: Growth and structure of GDP by expenditure, 2005-2013 (%)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
GDP growth	**7.55**	**6.98**	**7.13**	**5.66**	**5.40**	**6.42**	**6.24**	**5.25**	**5.42**
Gross capital formation	***11.15***	***11.83***	***26.80***	***6.28***	***4.31***	***10.41***	***-6.84***	***2.37***	***5.45***
Gross fixed capital formation	9.75	9.90	24.16	3.84	8.73	10.89	-7.81	1.87	5.30
Change in inventories	33.48	37.17	54.56	26.88	-26.18	5.44	3.60	7.15	6.75
Final consumption	***6.01***	***7.54***	***9.71***	***7.66***	***2.66***	***8.51***	***4.35***	***5.07***	***5.36***
Government	8.20	8.50	8.90	7.52	7.60	12.28	7.12	7.19	7.26
Private	5.84	7.47	9.78	7.67	2.25	8.19	4.10	4.88	5.18
GDP structure	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Gross capital formation	***33.76***	***34.54***	***39.57***	***36.49***	***37.17***	***35.69***	***29.75***	***27.24***	***26.59***
Gross fixed capital formation	31.27	31.36	35.11	31.81	33.86	32.64	26.82	24.20	23.56
Change in inventories	2.49	3.17	4.46	4.69	3.31	3.05	2.93	3.04	3.03
Final consumption	***70.96***	***70.62***	***73.66***	***76.50***	***74.27***	***72.55***	***72.26***	***70.43***	***71.19***
Government	5.47	5.53	5.55	5.63	5.78	5.99	5.91	5.93	6.15
Private	65.49	65.09	68.11	70.87	68.49	66.56	66.35	64.50	65.04
Net export of goods and services	***-3.32***	***-2.91***	***-13.57***	***-13.64***	***-10.37***	***-8.21***	***-4.13***	***3.50***	***4.09***
Errors	-1.40	-2.25	0.34	0.65	-1.07	-0.03	2.12	-1.17	-1.87

Source: GSO (various years).

Final consumption has accounted for the large proportion in the GDP structure by aggregate demand, about 70% to 76% during the selected period. In 2008, final consumption accounted for 76.5% (which is at the highest) and its growth rate was 7.66%. Therefore, the share of gross capital formation decreased slightly to 36.5%. This is because of the high inflation in 2008 (up to 19.9%) and the rapid increasing of GDP per capita (in 2008, it was VND 17,150 million) and consumption per capita (VND 12,591 million in 2008).

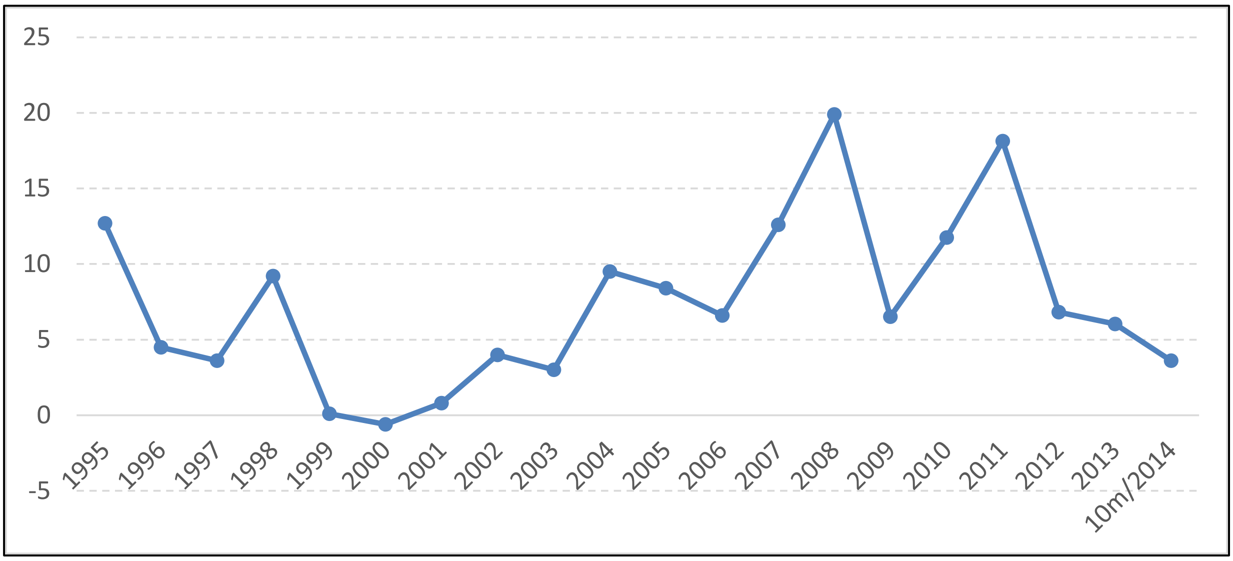
The growth rate of government consumption ranged from 7-8% during 2005-2013, except a rise to 12% in 2012. It is commonly seen that the increase in the government expenditure is often at the central level, while the local expenditure is at the moderate. It shows that (i) investment expenditure at the local level is limited because of reduction of local budget revenues as the narrow-down of economic activities and the frozen real estate market that led to the significantly declining of land-use fees and taxes; and (ii) it is an evidence for the expansion of fiscal policies from the central budget to cope with the decrease of aggregate demand.

Table 5 also show that Vietnam has maintained trade deficit since 2005. The year 2012 has experienced the first trade surplus since 1993, which was estimated at USD 780 million. The main reason that trade balance has changed from its deficit in previous years to surplus in 2012 and 2013 includes export value of garments and textiles and telephones of some big FDI enterprises has significantly increased, meanwhile the import value of machines, material and other intermediate inputs has sharply decreased due to stagnant production and business.

1.2.3. Inflation

While Vietnamese growth remained high, so did inflation. With the exception of the years 1999-2001 due to impacts of Asian monetary and financial crisis, annual CPI-based inflation generally exceeded 4% (Figure 9). The figure even reached 23% in 2008 and 18% and 2011, mainly a reflection of the global price shocks in these years, outcomes of macroeconomic stabilization since mid-2011. Inflationary pressure gradually eased, leading to almost continuous decrease of year-on-year inflation rate. The figure reached 18.1% at the end of December 2011, fluctuated in the range of 6-7.1% till the end of 2013 before hitting a low of 3.6% in October 2014. The volatility of inflation was also narrowed down since 2013, while the figure was more likely to decrease than to rise again (Figure 16).

Figure 9: Inflation, 1995-October 2014



Source: GSO.

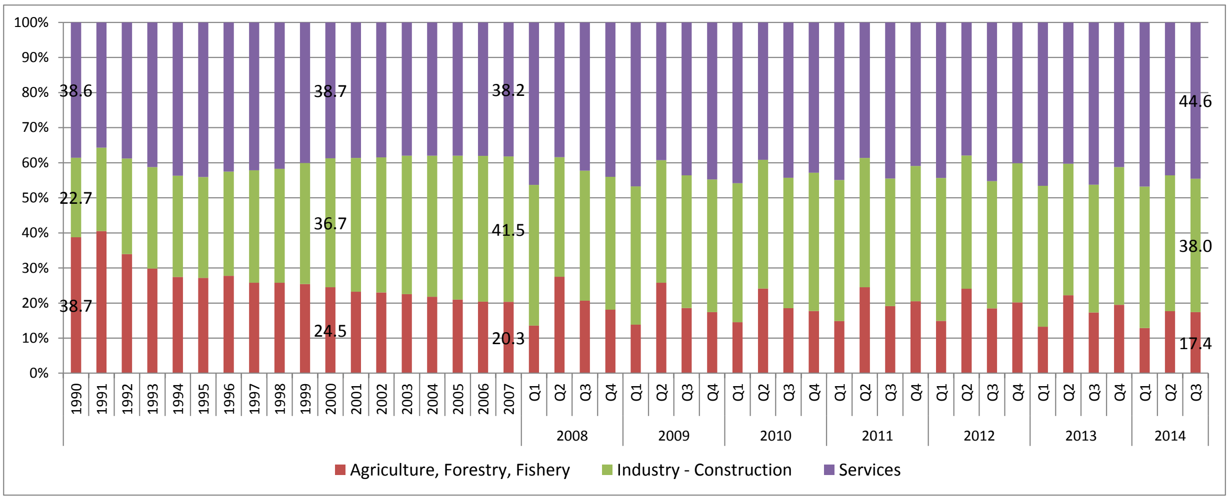
There are several reasons for the fall of inflation in recent years. *First,* the bolder and more concrete measures to control aggregate demand, including both monetary and fiscal policies, dampened the pressures from demand-pull factors on inflation, i.e. public investment, credit growth, etc. The ratio of investment over GDP was reduced from 41.9% in 2010 to 34.6% in 2011, 33.5% in 2012 and even 30.4% in 2013. Credit growth also plunged to 12.0% in 2011 and 8.9% in 2012, and almost 12.5% in 2013. *Second,* the exchange rate was also stabilized, thereby deterring the adverse impacts on inflation. *Third,* the global commodity prices also experienced slower growth in 2011-2012, and even fell significantly in the years 2012-2013, which helped ease inflationary pressures in Vietnam. *Finally,* the Government was more active in communicating various policy measures to the people, thereby aligning inflationary expectations with the macroeconomic stabilization objectives.

After the more turbulent years of 2007-2011, stabilization measures implemented in 2011-2013 helped Vietnam restore macroeconomic stability by reducing inflation, strengthening external accounts and stabilizing the foreign exchange market. Looking forward, there still exists several sources of concern for inflationary changes. On the one hand, the inherent causes of inflation were not fundamentally addressed in the recent periods, namely the reliance of economic growth on expanding public investment and credit growth, high import content of export, price liberalization of some basic goods and services, etc. Lower inflation rate in the past years resulted largely from the severe contraction of aggregate demand, instead of innovative changes in aggregate supply to meet aggregate demand. On the other hand, the coordination of macroeconomic policies for a common objective remains far from full effectiveness. Notwithstanding the recent Decision No. 1317 of the Prime Minister to improve macroeconomic coordination, the failure of fiscal policy to catch up with monetary policy reduced the desired impacts on macroeconomic situation, and sometimes even increased concerns of the market participants about actual direction of policies. Finally, the presence of major SOEs with dominant positions in several markets such as retail oil and petroleum, electricity, food, etc. prevented the impacts of price liberalization, and effectively means that enterprises can increase prices of basic goods and services once they are given more autonomy in setting such prices. The upward adjustments of prices in the years 2011-2013 were largely unjustified, and in many cases were even contrary to public announcement.

1.2.4. Sectoral level

Like many other countries, the share of agriculture in Vietnam's GDP has decreased over the last decade, while that of industry has slightly increased and the part of services more significantly (Figure 10). This changing structure is a consequence of the sustained economic growth during this period. In 1990, agriculture, forestry and fishery altogether accounted for 38.7% of GDP, industry-construction accounted for 22.7%, and services made up a share of 38.6%, while in 2007, the share of added value in GDP was 20.3% for agriculture, 41.5% for industry-construction and 38.2% for services. In the first 9 months of 2014, the figures ended up with respective values of 17.4%, 38.0% and 44.6% for agriculture-forestry-fishery, industry-construction, and services.

Figure 10: Evolution of Vietnam's value added by economic sector, 1990-2014



Source: World Development Indicators.

✓ *Agriculture*

Agricultural progress has been the hallmark of economic success attributed to *Doi Moi*. The pervasive land and market reforms in agriculture fostered a transition from a system of production based on public ownership and control towards one in which farm households possessed effective property rights over land and farm assets and made production decisions guided by market signals. This transition significantly increased production incentives and output. From 1990 to 2011, agricultural production nearly doubled, transforming Vietnam from a net food importer to the world's second-largest exporter of rice. In 2009, the country exported over 5 million tonnes of rice placing Vietnam second only to Thailand in the world rice market.8 Average annual growth rate of agriculture-forestry-fishery sector in the 5 years after the WTO accession in 2007 reached 3.5%. This figure exceeded the target in the Socio-Economic Development Plan (SEDP) for 2006-2010 (of 3-3.2%) but was still 5 percentage points lower than that in the 5 years before WTO accession. The sector's growth gradually decelerated since 1999 and this tendency was maintained during the first 5 years of WTO membership. The agriculture- forestry-fishery sector experienced unstable growth, induced by variable weather conditions as well as volatilities in external and internal demand for the sector's inputs and outputs. Yet growth of the sector was still relatively high by international standard.[9]

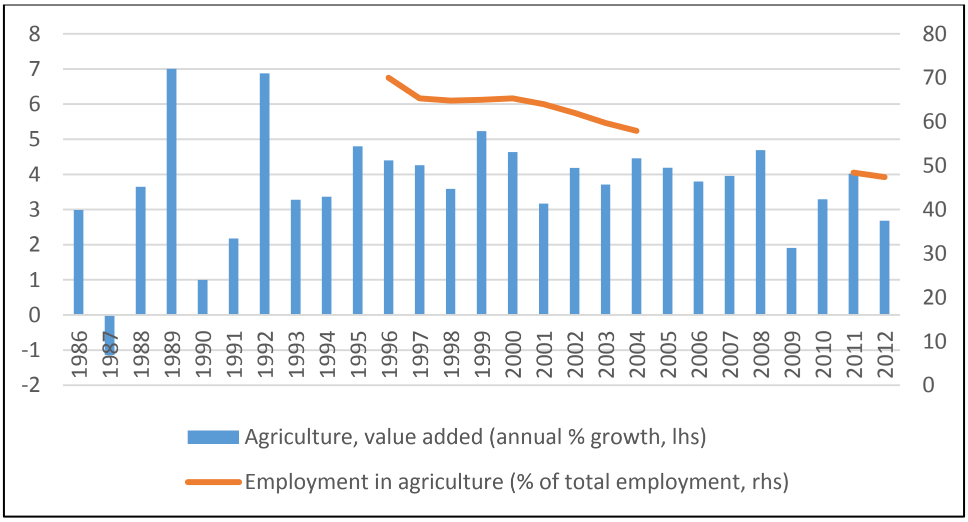
Meanwhile, the move of activities from agricultural sector to other sectors reduced number the employees working in the agricultural sector (59% of the total labour in the economy in 2003 compared with 73% in 1990). Vietnam is today known as a major producer of agricultural commodities, which are largely exported. Development of food grain production, agricultural restructuring towards high-value fruit trees like coffee, rubber, cashew, litchi, longan and the like, as well as strong development of agriculture, including domestic animals, fowls and forestry have been paid special attention in Vietnam. The country is now the world's biggest peppercorn exporter and the third biggest coffee and rubber exporter.

According to Alston et al. (2009), not only total value added in agriculture increased, but technological changes have driven the output well above inputs (Figure 11) and were mainly triggered by large public investment in this sector.

Figure 11: Value added and employment in agriculture

8 Cervantes-Godoy and Dewbre (2010).

9 The main reasons for high growth rate in 2007-2008 were good agricultural crops, and rapid increase in international prices for Vietnam's key exported agricultural products. As a consequence, Vietnam saw expansion of areas for perennial crops, especially rubber and cashew. In 2009, as international prices of most agricultural products dropped dramatically10, the agriculture-forestry-fishery sector then suffered from severe slowdown, with recorded low growth rate of 1.8% - the slowest level since 1991. To a certain extent, international economic integration positively affected growth of the agriculture-forestry-fishery sector. This can be justified on the grounds that Vietnam has been one of the leading exporters of various agricultural products such as coffee, rice, cashew, pepper, etc., while market access for such products has been significantly improved after joining the WTO. However, trade barriers in major markets encountered by Vietnam's agricultural products were not very restrictive before the WTO accession; thus, the improvement of market access thanks to the WTO accession was not the driving factor for growth of the agriculture-forestry-fishery sector. In another aspect, the implementation of trade commitments altered protection structure for domestic sub-sectors in terms of both input and output.



Source: World Development Indicators.

Huyen and Tuan (2009) argue in favour of several factors influencing the development of the agricultural sector, namely: (i) Land allocation to farmers and transformation of agricultural cooperatives and state-owned farms into household enterprises, hence reducing the state-ownership to a negligible 3% share; (ii) Increasing the shares of capital and labour force in inputs (87% added value); (iii) Development of irrigation and adequate provision of inputs for agriculture like machines, insecticide, and chemical fertilizers; (iv) Application of advanced biology achievements to diversify products, raise productivities and product quality; and (v) Trade liberalization and export promotion.

However, the CIEM (2013) contends that, based on comparative advantages, Vietnam's agricultural products can be classified into the following categories:

- Category 1: The products which have high comparative advantage and competitiveness, with capability to expand export market via international economic integration. These products include paddy, rice, coffee, cashew, pepper, forestry products, and aquacultural products.
- Category 2: The products which still have opportunity to expand their market, but also face with many challenges. The two products in this category are fruit and vegetable, and salt.
- Category 3: The products with weak comparative advantage and competitiveness, which are prone to significant adverse impacts by international integration, namely cattle, sugarcane, and cotton.
- In the years after the WTO accession, for several agricultural products that have no comparative advantages, the reduction of import tariff made way for more severe competition in the domestic market between imported and locally produced items. Some products under Category such as sugarcane and cotton – despite high protection by the Government - still have their weaknesses revealed, and are unable to develop in the context of tougher competition from foreign suppliers. For some products under Category 2 such as mulberry, some tropical fruits and vegetables, peanut, beans of all kinds, etc., mass production is difficult because of weak competitiveness. Meanwhile, a

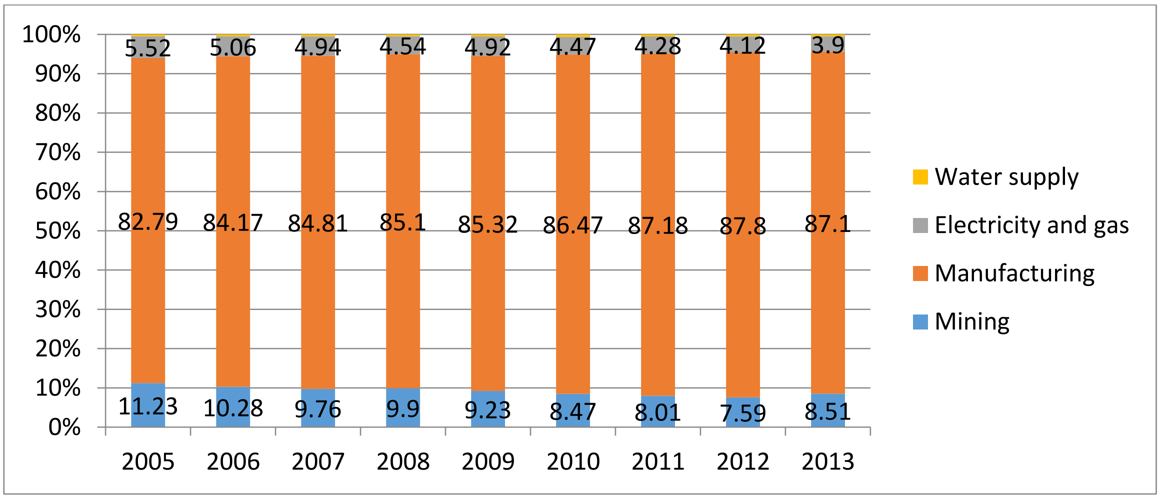
proportion of local manufacturers and businesses are not well-prepared and adaptable to the new situation.[10]

✓ *Industrial production*

The mining industry has accounted for 11.23% in 2005 and declined to 8.51% in 2013 in the industry sector. It gradually decreased it value-added growth rate, except for 2012, as there has been a reduction of crude oil exploitation and natural gas. The decline was due to the "technical limits of oil mines and the export restriction of coal for domestic consumption" (Pham Van Ha, 2011). Therefore, the export of crude oil in 2011 increased by 46% in value but only 3.6% in volume. The value of coal export grew by 3% but the volume declined by 11%. The similarity can be seen in 2013, showing a tendency of decreasing role of mining industry in contribution to the overall growth of the sector.

The electricity, gas supply and water supply, sewerage and waste management has accounted for small proportion in the sector (only about 5% for both), however, they have high growth rate (even though not equal through times). They play an important role in providing essential input and supporting the development of other industries in the sector. Moreover, the declining rate of 2008-2009 derived from the decreasing demand of electricity, water and gas as being affected by the global economic crisis.

Figure 12: Industrial structure by sub-sector, 2005-2013 (%)



Source: GSO, various years.

The sub-sector seems to have little recovered in 2010, when the growth rate amounted to 11.4% (compared to the previous year and at 2010 constant price). According to a report by the GSO, the high growth rate in 2010 was mostly for meeting the domestic demand, however, by the end of the year, the manufacturing industry has experience high inventory rate as compared to previous years. Since 2011, it experienced the growth rate of 9%-10%.

10 See CIEM (2013, pp. 47-50).

Table 6: Industrial growth by sub-sector (at 2010 constant price), 2010-2013

Sector	2010	2011	2012	2013
Industry	**10.5**	**9.1**	**8.8**	**9.2**
Mining	1.0	1.9	6.8	-0.6
Manufacturing	11.4	9.7	8.9	10.1
Electricity, gas supply	11.3	10.7	10.3	8.5
Water supply	15.3	7.2	8.2	8.9

Source: GSO (2014).

By ownership, the state sector has accounted for the smallest share of industrial output, at 25% in 2005 and 17% in 2013 (Table 7). At constant 1994 prices, it is noted that, the industrial value of the FDI sector grew steadily at two-digit rates with not much fluctuation (except 2009). However, at the same time, the shares of state and non-state sector fluctuated with wide amplitudes (VEPR, 2012). For example, during 2005-2009, the industrial production value of the state sector averaged at 5%, and then increased quickly to 13.4% in 2010, before falling to 10.9% in 2011.

Table 7: Structure of industry output at current price by ownership (%), 2005-2013

	2005	2006	2007	2008	2009	2010	2011	2012	2013
State	24.9	22.1	19.9	18.1	18.3	19.1	17.6	16.4	16.9
Non-state	31.3	33.5	35.4	37.3	38.5	38.9	37.8	37.3	35.9
Foreign invested	43.8	44.4	44.7	44.6	43.2	42.0	44.6	46.3	47.2

Source: GSO (various years).

One technical reason for the decline of the State sector could be the privatization process which has narrowed down the size of the state sector, which caused the capacity to move out to the non-state sector. When the privatization process has been slowed down since 2008-2009, the other reason can be identified in the inefficiency of investments (with the noticeable example of inefficient Vinashin).

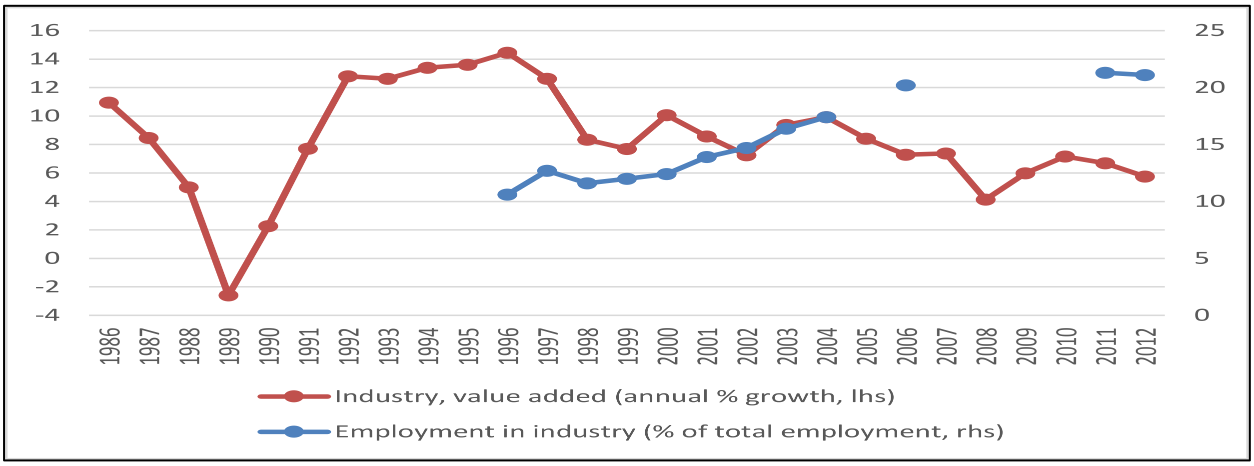
Table 8: Industrial growth at 2010 constant price by ownership (%), 2010-2013

Type of ownership	2010	2011	2012	2013
State sector	10.1	10.8	8.9	8.7
Non-state sector	9.6	7.6	7.3	7.8
Foreign invested sector	11.5	9.7	8.9	10.1

Source: GSO (2014).

The foreign-invested sector has contributed a large proportion the industry output, which exceeded 40% since 2004 and continued to increase. With stable growth, the foreign-invested sector has been confirming the leading role in the sector. Nevertheless, the stable share of FDI in GDP showed that their expansion of economic activities was not matched by that Vietnam's comparative advantage are still labour-intensive and the industry sector, particularly the manufacturing industry is still the assembling work for advance economy. The moving up of regional and global value chain is still an issue for Vietnam.

Figure 13: Industrial growth and employment



Source: World Development Indicators.

Amid the overall economic growth and the macroeconomic stabilization, Vietnam's industrial production has risen significantly. Industry and construction contributed to 38.6% of GDP in 2012 and 38.4% of GDP in the 3rd quarter of 2014, up from 28.9% in 1986. Since early 1990s and just before the financial crisis in 2008, the industry value added growth rates averaged higher than 10%, in spite of a declining trend since 1996 (Figure 13). Industry – construction has the most significant impact on overall GDP growth rate thanks to the largest scale (contribution of more than 40% to GDP), whilst usually having the highest growth rate in the economy. In the period of 2007-2011, the average growth rate of this sector was 7.0%, which was much lower than that of 10.2% for the period of 2002-2006, and also smaller less than the 5-year-plan target of 9.5-10.2% for the period of 2006-2010. Except high figure in 2007, growth of the industry-construction decelerated rapidly in the period of 2008-2011 compared to the period of 2002-2006, and even reached the lowest levels since 1991. As industry-construction is the driver of growth, its dramatic slowdown led to downturn in the overall economy. However, the growth rates of sub-sectors in industry-construction differed remarkably among themselves. While low growth rates of industry-construction in 2008 and 2011 were caused by the contractions of mining and quarrying, and of construction, the key for modest growth in 2009 was poor performance of manufacturing sub-sector.

The top manufacturing sectors — food processing, cigarettes and tobacco, textiles, chemicals, and electrical goods — experienced rapid growth. Industrial employment had been increasing as well. Garments and textiles remained main exporting manufactures over the past decades.

Subsidies were progressively cut, though state enterprises still receive priority access to resources, including land and capital. The government is also continuing the slow process of "equitizing" a significant number of smaller state enterprises, transforming them into shareholding companies and distributing a portion of the shares to management, workers, and private foreign and domestic investors. However, to date, the government continues to maintain control of the largest and most important companies.

According to Huyen and Tuan (2009), several policies spurred the development of the industrial sector of Vietnam: first, the mentioned policy of privatizing large share of numerous state enterprises, letting the private initiative to lead the industrial growth; second, the policy encouraging foreign direct investment to purchase domestic companies; third, the government support for promoting the private sector; Forth, the opening up of domestic enterprises to foreign trade so as to increase the export of industrial goods and import of materials and machines; fifth, the government policy of import substitution and shielding of domestic production through tariffs and direct support.[11]

11 Similar considerations are put forwarded, among the others, by the various Country reports on Vietnam, published by EIU in the last decades.

Figure 14: Share of manufacturing export in total merchandise export of Vietnam

Source: World Development Indicators.

These policies led to a significant increase of manufactured export from 40% of merchandise exports in 1998 to nearly 70% in 2012 (

Figure 14).

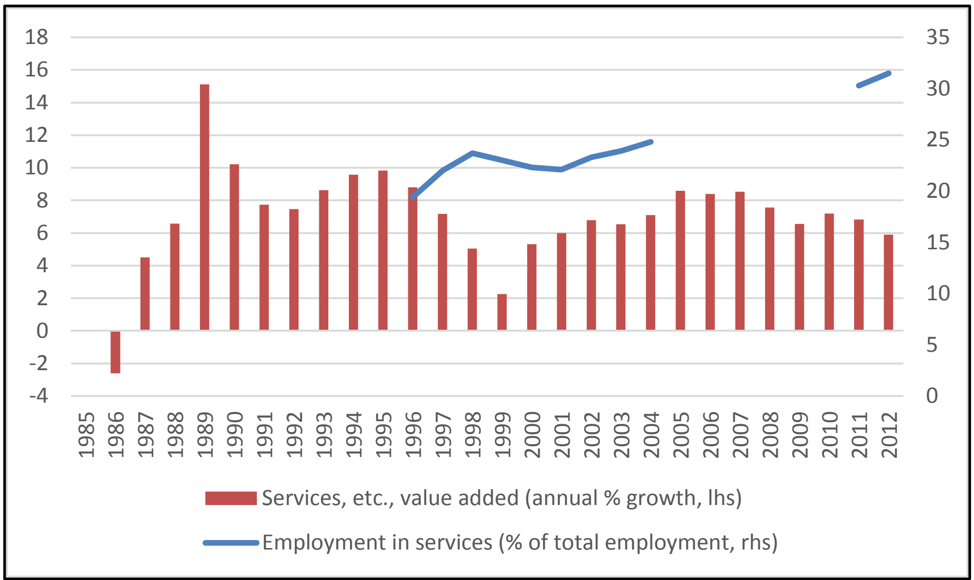
- ✓ *Service sectors*

The market-oriented economic reforms in Vietnam pushed the growth and development of the service sector. Since the early 1990s, the growth rate of services has been quite persistent and averaging 7.3% (

Figure 15). It contributed to a permanent increase of services share in GDP from 32.5% in 1990 to 44.6% in the third quarter of 2014 (Figure 10). As already highlighted, this is in line with what happens in most of the ASEAN members, where the services sector plays the current role of main catalyst for Vietnam's economic growth. Despite overall economic difficulty, the service sector achieved remarkable progress. The sector attained higher average growth rate in the 5 years after WTO accession (7.5%) than in the previous 5 year (7.1%). This performance was contrary to those of the whole economy and of industry-construction sector, which decreased after the WTO accession. Shortly before and after the WTO accession (2005-2007), the international and domestic economic contexts were favourable, which helped accelerate the growth of service sector to the average level of 8.1% per annum. In 2007-2011, the average growth rates of key service sub-sectors (which accounted for significant shares of service sector or played important roles in overall economic development) - such as trade, hotels and restaurants, transport-post-tourism, banking-finance, and education- training - were higher than that of the whole service sector.

In Vietnam, trade, hospitality, restaurants, tourism and road transportation experienced rapid development. In recent years, other services joined this group, such as science, technological, educational and training services, as a reflection of government's policy to promote human resource development and science. The country also remained an attractive touristic destination with more than 7 million tourists in 2013.

Figure 15: Value added and employment in services



Source: World Development Indicators.

However, the growth rates in the 2000s were slightly lower than the 1990s, which resulted partly from the less inspiring policy than in the industrial sector. For instance, legalization of private services such as pharmaceutical industry transformed Vietnam public health service into a highly unregulated private-public system, which affected the delivery of Vietnam's health care services[12]. Liberalisation of other service sectors also lagged behind, including banking, insurance, telecommunications, air transportation, sea transportation, manufacturing support services, consulting services and the like, while real estate business remains inefficient.

1.3. Development indicators

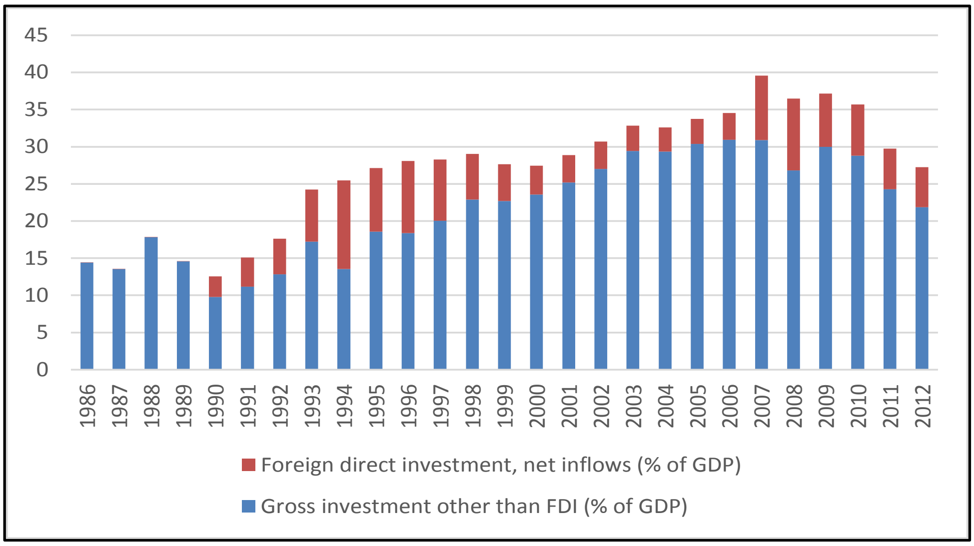
1.3.1. Investment

Till 2010, the investment ratio (over GDP) in Vietnam has been consistently high. The figure even reached a peak of nearly 40% in 2007 - right before the crisis. However, investment peaks of above 40% before the crisis were likely unsustainable, since they were based on excessive lending by banks to the inefficient SOEs and/or diverted to non-productive sectors such as real estates, securities. Since 2011, due to the macroeconomic stabilization, the investment ratio then subsided to a level of above 25% of GDP in 2012 (

12 See Sepehri et al. (2002).

Figure 16). Still, the subsequent decline is somehow worrying, since the domestic sector has been hit hard by the declining domestic demand, rising interest rates and a slowdown in credit growth during 2012-2014.

Figure 16: Foreign Direct Investment in Vietnam

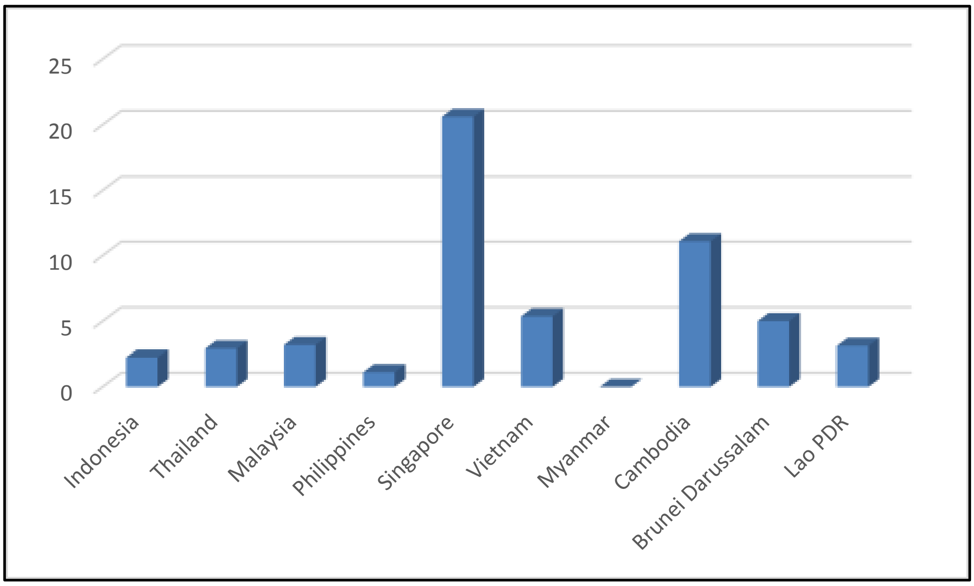


Source: World Development Indicators.

The contribution of FDI has been also rising over time with pre-crisis peaks, but also maintaining level of about 5% of GDP thereafter (

Figure 16). In 2011-2014, the amount of FDI was stable between USD 10.5 - 11.5 billion each year, which has been considered as a sign of confirmed investors' confidence in Vietnam. As Figure 17 shows, despite the falling level of FDIs, Vietnam still ranked third in the ASEAN region in view of the received FDIs in 2012, after Singapore and Cambodia.

Figure 17: FDI as % of GDP in ASEAN, 2012

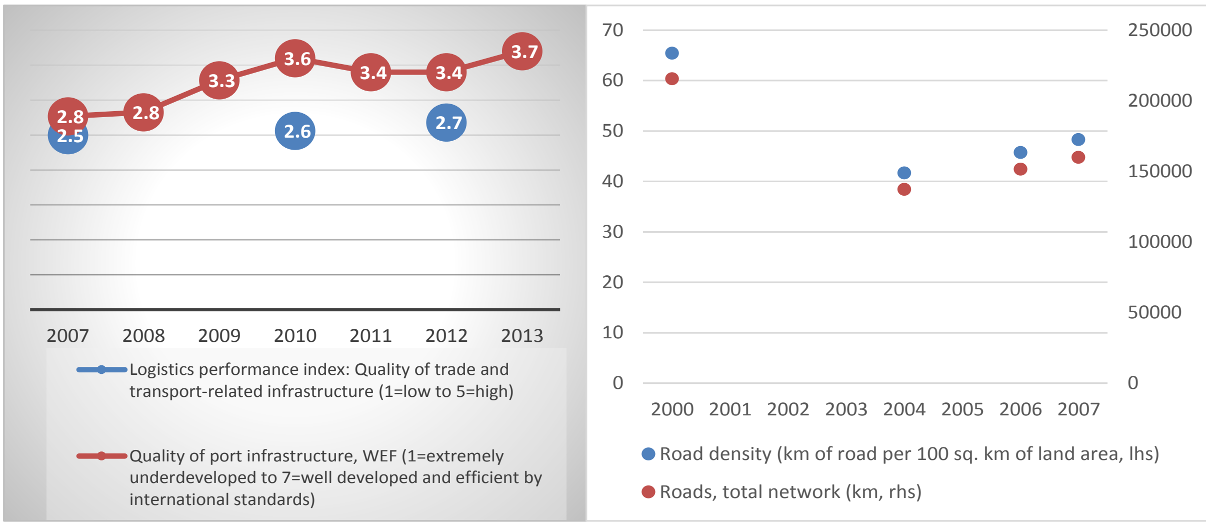


Source: World Development Indicators.

In the early years, FDIs were mainly concentrated in import substitution and non-tradable industries (like oil, construction, transportation and communication), but recently shifted towards export-oriented and labour-intensive industries and the real estate sector. This encouraged Vietnam to participate more deeply in the regional and global production network. However, the linkages of those FDIs with local economy still remain very limited.

Despite rapid expansion of private investment and FDI in the last two decades, the state sector still accounted for a large share in total investment, which is the pillar of the overall economic efficiency and stability in Vietnam. However, State investment in important sectors was modest. Infrastructure, strained by rapid economic growth, remained far below the needs of the population, more especially roads and ports, notwithstanding some improvement in recent years. As Figure 18 suggests, the quality of the infrastructure has somehow improved but remains far below the level considered high. At the same time, investment in new roads stagnated, causing traffic congestion, roads degrading and the like.

Figure 18: Investment in infrastructure



Source: World Development Indicators.

1.3.2. Competitiveness

During the 2000s, Vietnam generally increased its competitiveness, which made way for a higher growth rate and per capita income. Still, the pattern of increase was not even over time. During the period 2002-2006, Vietnam was among the least dynamic countries in the region, although it lost competitiveness among other ASEAN countries. The late 2000s, however, marked a period of both important improvements and declines, partly reflecting an unstable macroeconomic environment and investment climate, with high budget deficit, rising public debt, high inflation, strong devaluation of VND and remarkable hikes of interest rates.

More recently, Vietnam has improved its positions by 5 ranks, from 75 up to 70 out of 148 surveyed economies globally, according to the latest 2013-2014 Global Competitiveness Index (GCI). However, since the country had lost ground in the previous GCI studies, it simply went back to the level it had reached in 2006. The improvement of the macroeconomic environment, the control of inflation at a single-digit rate, and the efficiency of the local commodity markets are some basic elements which ae expected to help Vietnam move up the ladder in 2014 and the years after.

1.3.3. Infrastructures

According to the World Competitiveness report, Vietnam improved the quality of transport and energy infrastructures, albeit from a very low base (82nd, up 13). Nevertheless, even in a regional context (

Table 9), Vietnam lagged behind in all roads, railway, port and air transport infrastructure well behind its regional peers.

Table 9: Regional comparison of Vietnam on infrastructure rankings (2009)

Country	Roads	Railway	Port infrastructure	Air transport infrastructure
Vietnam	96	51	85	79
China	55	28	70	80
Singapore	1	8	1	2
Malaysia	25	21	33	32
Indonesia	87	61	92	67
India	92	20	91	71
Thailand	34	54	41	25
Philippines	110	99	128	119
Cambodia	69	100	97	91
South Korea	16	10	27	18
Japan	21	3	36	50

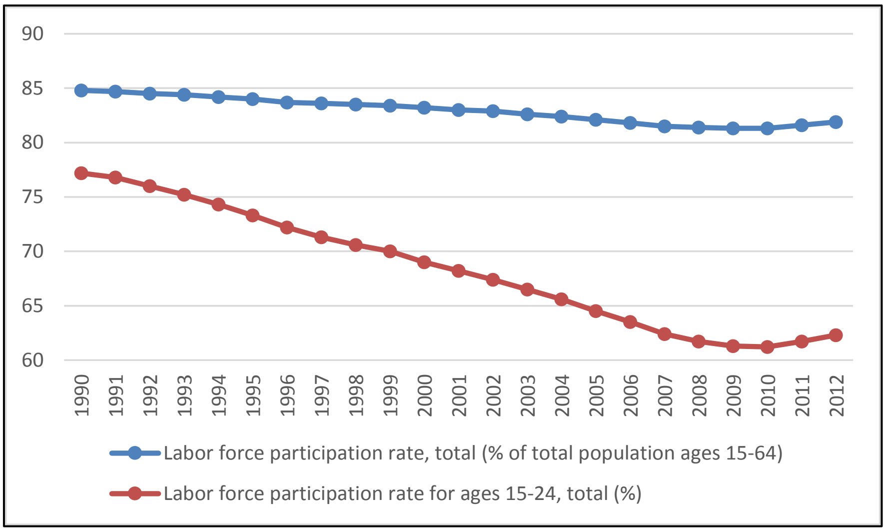
Source: WEF Global Executive Opinion Survey, Institute for Strategy and Competitiveness, Harvard Business School.

1.3.4. Employment and entrepreneurship

In 2012, Vietnam's labour force was estimated at 81.9% of the total population. The labour force participation rate has decreased over time (Figure 19). This came primarily as a result of declining participation by the 15-24 age group, reflecting the fact that young people stay longer in school. Still, Vietnam approached the golden demographic structure with potentially better participation rate and larger contribution to economic growth. In 2010-2011, Vietnam was capable to put in place a more modern efficient labour market, to improve innovation significantly: such process was driven by an extension of its local demand, and export market.[13]

Figure 19: Labour force participation

13 In 2007-2011, the urbanization and structural shift of agricultural land further induced the movement of rural labours to urban areas. The rural labour force grew more slowly, only by 1.6% per annum (as compared to that of 2.6% per annum during 2002-2006). The urban labour force was expanded rapidly by 5.5% per annum (compared to 4.3% per annum in 2002-2006). Consequently, the urban areas accounted for an increasing share in labour force, from 24.0% in 2002 to 25.4% in 2006 and 28.6% in 2011. Because of slower growth, female labour saw their share in labour force decrease from 48.6% at the end of 2006 to 48.4% in 2011. However, the pace of such decrease became smaller over time. Contrary to the descending trend during 2002-2006, the labour participation rate was improved for all groups of labour, increasing from 70.3% at the end of 2006 to 77.4% in 2010, and 77.3% in 2011. The proportion of economically active labours in rural areas (80.6% in 2011) was much higher than that in urban ones (70.0%) and reflected own development since 2006 (the figure for 2006 was 73.3%). The participation rate was higher for male than for female, attaining 82.0% and 72.8% respectively (comparing to 74.7% and 66.1% respectively at the end of 2006). The underlying reasons were in the same direction, leading to higher overall participation in the labour market. On the one hand, deeper economic integration during favourable world economic context induced expansion of labour-intensive industries. On the other hand, the global financial crisis and economic recession and related consequences resulted in higher participation rate, especially in rural areas.



Source: World Development Indicators.

Table 10: Employment growth in ASEAN

Country	*Employment growth (%)*
Vietnam 1991-2007	2.4
Korea 1969-1988	3.2
Malaysia 1977-1996	3.5
Thailand 1976-1995	3.0
Taiwan 1963-1982	3.4
Indonesia 1977-1996	2.9
Philippines 1961-1980	3.3

Source: Hai and Porter (2010).

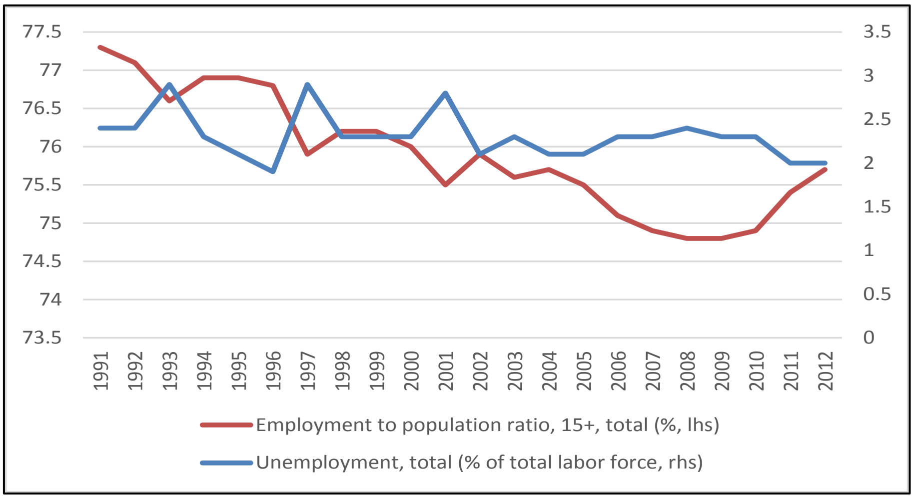
Vietnam has also suffered from the global crisis, but, even with thousands of enterprises going bankrupt, job creation has been sustained, especially in the formal sector. In fact, approximately 80,000 enterprises made lost and/or went bankrupt in 2011. Nevertheless, the overall quality of employment has diminished (Gaëlle, 2012), while employment growth lags behind GDP growth. In addition, compared to its regional peers, the employment growth record of Vietnam has not been impressive (Table 10), which may be due to the large labour force participation rate as well as the sectoral distribution of investment. Namely, investments in Vietnam have been mainly concentrated in the capital-intensive sector, which absorbs only 10% of all jobs.

Still, Vietnam has a robust record in terms of employment and unemployment, as

Figure 20 and

Figure 21 suggest. In 2012, the unemployment rate is as low as 2%, while the employment rate as high as 75.7%.

Figure 20: Employment and unemployment rates in Vietnam

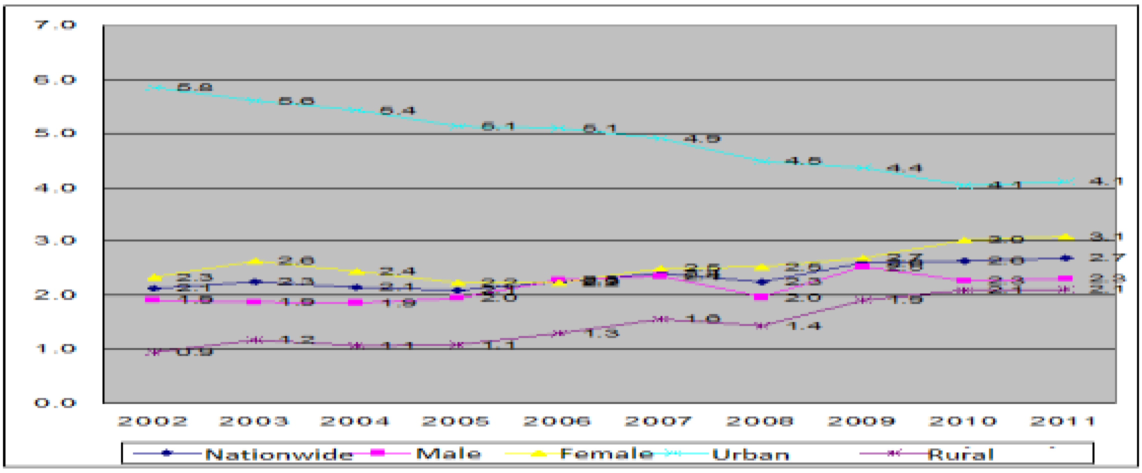


Source: World Development Indicators.

GSO of Vietnam presents slightly different figures as unemployment rate in Vietnam averaged 2.5% from 1998 to 2013, reaching a high peak of 4.5% in 1998 and a low record of 1.8% in 2012.[14] However, the labour and employment situations had some improvements. In spite of the macroeconomic difficulties, the structural shift of employment was still evident. Since 2007, agricultural employment went down on average by 65 thousand people each year (compared to the decrease by 117 thousand people each year during 2002-2006). Employment in industrial sector rose more rapidly, on average by 624 thousand people per year (compared to the figure of 548 thousand people during 2002-2006), while employment in services increased at almost the same pace (by about 623 thousand people each year, i.e. smaller than the figure of 678 thousand people for 2002-2006). In 2011, more than 24 million labour worked in agriculture, making up a share of 47.6% of total employment. During 2007-2011, the share fell by 7 percentage points, while the corresponding figure for 2002-2006 was 9 percentage points.

14 Source: http://www.tradingeconomics.com/vietnam/unemplyment-rate

Figure 21 : Unemployment Rate, 2002-2011 (%)



Source: MOLISA (various years); GSO (2011); data for 2011 are estimated from "The Labour and Employment Survey for the first 6 months of 2011" by GSO.

Economic integration clearly induced creation of new jobs; accordingly, the sectors with high employment growth after the WTO accession were more open ones and related to technology upgrade for competition such as services sub-sectors, especially new and modern ones such as science and technology (growth by 25.4% per annum), banking and finance, insurance (9.6% per annum); however, these industries accounted for small shares. Construction also experienced employment high growth shortly after 2007 (8.1% per annum) because it built assets and infrastructures for new production premises or expanded existing ones. The most rapid growth was in manufacturing sub-sector, which attracted an additional figure of nearly 425 thousand employments each year, or 28% of additional jobs. The employment structure also exhibited drastic changes in the last 10 years. During 2007-2011, the most rapid employment growth was observed in the three groups of technical labour, namely skilled labour in agriculture and fishery (increasing by 35.6% per annum), individual services workers, social order - security guards, and skilled salespersons (25.9% per annum), and assemblers and operators of machines and equipment (22.6% per annum). In addition, the group of primary clerks and technicians in offices also grew steadily, by 11.2% per annum. These developments were consistent with the larger exports of agricultural products and labour-intensive products, and with the tendency of improving and upgrading technologies, machines and equipment of enterprises. By the end of 2011, the above-mentioned four groups of labour altogether accounted for 37.3% of total employment (increasing from 15.6% in 2006). The participation in AEC may put further incentives and pressures for employment development in Vietnam.

As far as wages are concerned, average monthly wages adjusted for inflation nearly doubled in Vietnam during the previous decade, including progress in minimum wage, as the GSO's reports on monthly average income per employee in state sector show. Quite remarkably, thanks to increasing exports, liberalizing the domestic sectors for foreign investment and drastic changes in domestic enterprises, economic integration arguably had significant impacts on wage improvement. The average wage (at current prices) was VND 2.691 million/worker/month in 2010, or 2.6 times higher than that in 2006 (equivalent to average growth of 26.8% per annum), much faster than the years 2002-2006 (8.8% per annum). The average growth of wage (at comparable prices) reached 13.5% per annum in 2006-2010, i.e. more rapid than the improvement of labour productivity (by 4% per annum in the same period). This increase was equivalent to that in China, and much faster than the world level (by 2% per annum, on average).

Noteworthy, several ASEAN countries, including Vietnam, have raised their minimum wage standards recently to adjust their respective salary levels to the rising costs of living and to provide their citizens with higher purchasing power. The ASEAN countries that have recently raised minimum wages are Thailand, Vietnam, the Philippines, Malaysia and Indonesia. In Vietnam, the general legislative standard for minimum wages throughout the country is stipulated under Chapter VI of Vietnam's Labor Code (2012). This, in essence, enacts a government-set minimum wage base standard to be given to employees that varies by region and industry as recommended by the National Wages Council, a 15-man advisory agency made up of representatives from the Ministry of Labor – Invalids and Social Affairs (MOLISA), the Vietnam General Confederation of Labor and the representative organization of regional employers. There are currently four different regional minimum wage levels in Vietnam that are amended periodically on a non-regular basis. Since 2003, Vietnam has increased its minimum wage levels ten times, with the real minimum wage rate increasing by over 100 percent from 1994 to 2008. Furthermore, Vietnam's general minimum wage rate was increased by way of Decree 103/2012/ND-CP in 2013, lastly emended and updated with Decree 103/2014/ND-CP. Specifically, the minimum wage with effect from 01-01-2015 will be VND 3.1 million (USD145.5) for Region 1, VND 2.75 million (USD 123.3) for Region 2, VND 2.4 million (USD 107.6) for Region 3 and VND 2.15 million (USD 96.4) for Region 4.[15] This represents an average increase of about 14.3 percent.

Still, productivity indicators are more problematic, especially if compared with those of other ASEAN States: one year before the AEC is set to bring greater mobility to the region, Vietnamese labour productivity has been found to lag behind its neighbours. The International Labour Organization (ILO) recently announced that labour productivity in Vietnam is among the lowest in the Asia-Pacific region.[16] A survey conducted last year by the organization found that Singaporean productivity was nearly 15 times that of Vietnam's, while Japan's was 11 times higher and South Korean 10 times higher. Vietnam's productivity was just one-fifth of Malaysia's, and two-fifths that of Thailand, according to the ILO study. The report also pointed out a recent slowdown in Vietnam's productivity growth. From 2002-2007, productivity increased by 5.2 percent on average every year, among the fastest in the region. Since 2008, however, that rate has fallen to 3.3 percent. A similar trend is confirmed when assessing the evolution of productivity in Vietnam and other ASEAN countries using the GDP per person employed (constant 1990 PPP USD), (

15 Region I covers the rural and urban districts of Hanoi, Ho Chi Minh City, Hai Phong, Bien Hoa City, Thu Dau Mot City, Vung Tau City of Ba Ria-Vung Tau Province, and some rural districts of Dong Nai and Binh Duong Province. Region II covers the remaining rural districts of Hanoi, Hai Phong, Hai Duong City, Hung Yen City, and some rural districts of Hung Yen Province. Region III covers the remaining provincial cities, Chi Linh town, and some rural districts of Hai Duong and Vinh Phuc Province. Region IV covers the remaining localities. See: http://www.wageindicator.org/main/salary/minimum-wage/vietnam.

16 *See* http://www.thanhniennews.com/society/vietnamese-labor-productivity-lags-behind-asean-neighbors-report-26253.html.

Table **11**). Such issue should be addressed with targeted policies and high priority: the completion of the AEC could otherwise considerably affect the good performance of Vietnam in terms of low unemployment rate on durable basis.

Table 11: Evolution of productivity in Vietnam and other ASEAN countries, GDP per person employed (constant 1990 PPP USD)

Country	GDP per person employed (constant 1990 PPP USD)
Vietnam 2009-2013	6,272
Korea, Rep. 2009-2013	45,478
Malaysia 2009-2013	24,857
Thailand 2009-2013	16,764
Singapore 2009-2013	49,719
Indonesia 2009-2013	11,461
Philippines 2009-2013	8,667
Cambodia 2009-2013	5,449
Malaysia 2009-2013	24,857

Source: WDI (2014).

The AEC in 2015 is expected to provide more opportunities for growth across the region. But there prevails material misunderstanding about what this will mean for migration flows in the region and at the country level. People sometimes refer to a free movement of labour, as in Europe, but that prospect remains distant. At present it is difficult to foresee how a cohesive regional community will affect the labour market in each AMS. However, it can be safely stated that much will depend on i) the integration policies for migrants; ii) the anticipation of the potential impacts of large numbers of skilled workers finding higher-paid work abroad through Mutual Recognition Arrangements (MRAs); iii) the supplementation of the AEC's goal of equitable economic development across the region with by the Socio-Cultural Community pillar of ASEAN integration. As this new economic community (or at least the *sense* of ASEAN community) emerges, there will be opportunity for the greater mobility of workers who move across national boundaries to fill skills shortages, increase their incomes and gain new experiences. However, discussions have primarily focused on labour mobility for skilled workers through MRAs that provide freedom of movement and rights to work across the region for professionals in eight fields - accountancy, engineering, surveying, architecture, nursing, medical services, dental services and tourism.

Because Vietnam's wages are close to the median wages for the region, economic integration could mean movements of workers both in and out of the country. For Vietnam, well-planned integration could lead to increased domestic productivity through skilled migration, but it is important to anticipate the potential impacts of large numbers of skilled workers finding higher-paid work abroad through the MRAs. Yet, migration among professional categories is and will only represent a very small proportion of the labour migration flows in South-East Asia. It is important to remember that the AEC is not a standalone process; it is very much complemented by the Socio-Cultural Community pillar of ASEAN integration, which supports AEC's goal of equitable economic development across the region. The contribution of low- and semi-skilled migrant workers should not be forgotten. And taken in isolation, the emerging AEC does not sufficiently address social issues including safe migration, protection from exploitation, access to skills training, and welfare provisions for workers.

1.3.5. Institutional capacity improvement

The previous analysis underlined the remarkable progress Vietnam has achieved since the Doi Moi revolution and the institutional capacity improvement can be started to be analysed through the competitive indicators and international rankings elaborated by international observers, as reported in Table 12.

Table 12: Economic indicators and international rankings

Organization	Title	Ranking of Vietnam
Economist Intelligence Unit	Resilience amid turmoil benchmarking IT industry competitiveness 2009	56 out of 66
International Monetary Fund	Gross Domestic Product (PPP)	38 out of 182
World Economic Forum	Global Competitiveness	70 out of 148
World Bank	Ease of Doing Business	99 out of 188
Heritage Foundation/The Wall Street Journal	Index of Economic Freedom	147 out of 177 (2013)
Transparency International	Corruption Perceptions Index	116 out of 177

Source: Authors' compilation.

The different reports above referred express that the less competitive indicator is related to "Economic Freedom", which refers to an institutional environment both too bureaucratic, not completely open, and sometimes opaque. The index of Economic freedom is below the regional average (58.5) and even more below world average (60.3) and three sub indicators have declined in comparison with the previous year studies: freedom from corruption, business freedom, government spending and monetary freedom.

Table 13 shows that Vietnam is somewhat well placed among other ASEAN countries insofar as the different elements considered by 'Doing Business' are concerned. According to the 2014 Doing Business World bank report, Vietnam was *ranked 99 out of 189 economies, which means nevertheless that the country needs to do even more in order to improve its position, all the more because the country's ranking has not improved much since 2005.* "[17].

Table 13: Vietnam position in The World Bank Doing Business

Economy	Ease of Doing Business	Starting a Business	Constru ction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency
Singapore	1	3	3	6	28	3	2	5	1	12	4
Malaysia	6	16	43	21	35	1	4	36	5	30	42
Thailand	18	91	14	12	29	73	12	70	24	22	58
Brunei Darussalam	59	137	46	29	116	55	115	20	39	161	48
Vietnam	99	109	29	156	51	42	157	149	65	46	149
Philippines	108	170	99	33	121	86	128	131	42	114	100
Indonesia	120	175	88	121	101	86	52	137	54	147	144
Cambodia	137	184	161	134	118	42	80	65	114	162	163

17 From <http://www.worldbank.org/en/news/press-release/2013/10/29/vietnam-ranks-99th-for-ease-of-doing-business-in-new-report>

Lao PDR	159	85	96	140	76	159	187	119	161	104	189
Myanmar	182	189	150	126	154	170	182	107	113	188	155

Source: the World Bank 2014 Doing Business report.

Within ASEAN, the comparison with Singapore is particularly striking. Indeed, Vietnam ranks 157th for "*Protecting investors*" while Singapore is ranked 2nd and there are significant differences for most of other sub indicators. Vietnam is nevertheless well placed in comparison with other ASEAN countries and future efforts are most expected from countries such as Lao and Myanmar in order to reduce the gap between the different ASEAN countries in that domain.

Covering the period between 2005 and 2014, the five most problematic factors for doing business in Vietnam are reported in

Table 14. As far as legal environment is concerned, Vietnam has significantly improved, although it is still considerably lagging behind in many areas.

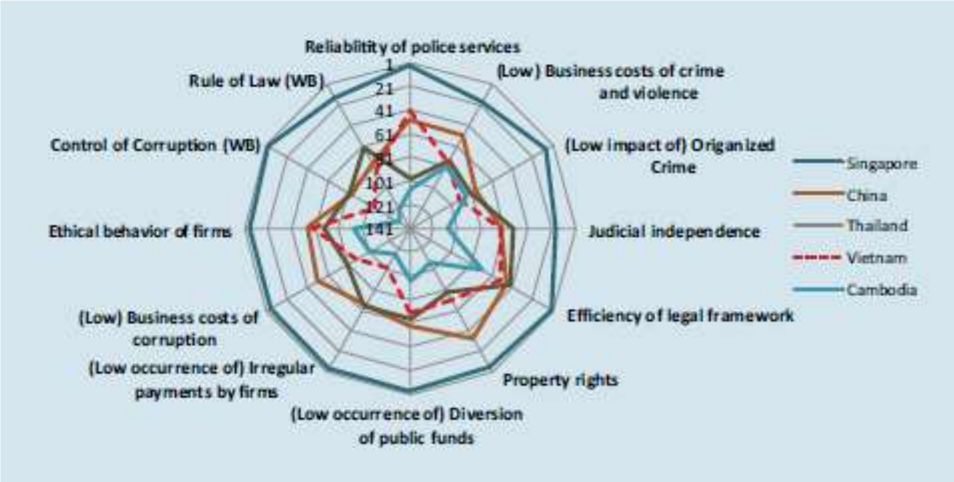
Table 14: Five most problematic factors for doing business in Vietnam

2006-2007		2010-2011		2013-2014	
Factors	**% Response**	**Factors**	**% Response**	**Factors**	**% Response**
Corruption	20.29	Access to financing	17.7	Access to financing	18.4
Access to financing	16.72	Inflation	12.7	Policy instability	11.4
Inadequate infrastructure	15.89	Policy instability	10.9	Inadequately educated workforce	10
Crime and theft	14.21	Inadequately educated workforce	10.2	Inflation	9.9
Tax rates	12.67	Inadequate infrastructure	9.9	Inadequate infrastructure	8.5

Source: World Economic Forum.

Figure 22 gives a broader overview of Vietnam's regional ranking in terms of rule of law, corruption, legal framework and other related areas.

Figure 22: Vietnam's regional ranking in terms of legal framework



1.3.6. Social progress

Vietnam is among the rare countries in the world achieving significant social progress as seen through poverty, inequality and human development measures. The country has to a significant extent harmonized economic growth, social progress and equality. Alongside high and stable economic growth, the development opportunities were broadened and inclusive to all people. Accordingly, the growth-induced benefits were expanded and widely distributed, while inequality only increased slightly. This success resulted of a set of well-designed and well-implemented development and reform policies as Table 15 emphasizes.

Vietnam is also recognized as one of the early achievers of the Millennium Development Goals on poverty reduction (Hai and Porter, 2010). As Table 15 emphasizes, the poverty rate fell dramatically from 58% in 1993 to 14.5% in 2008 and further to 9.8% in 2013, being a reflection of the decline of both urban and rural poverty (Figure 23). The poverty rate continued declining even over the crisis years. However, the risk of re-impoverishment is still acknowledged as material.

Table 15: Evolution of socio-economic indicators in Vietnam

Poverty levels
Population living below USD 1.25 per day: 63% (1995) to 2.4% (2012)
Population living below the national poverty line: 58% (1993) to 9.8% (2013)
Key human development indicators
Under-five mortality (out of 1000 live birth): 56 (1990) to 24 (2013)
Total adult literacy rate: 88% (1989) to 93.4% (2012)
Primary school net enrolment: 89% (1991) to 98% (2012)
Inequality
Gini coefficient: 33 (1993) to 35.6 (2012)
Income share held by wealthiest 20%: 43% (1993) to 46.2% (2010) and 43% (2012)
Income share held by poorest 20%: 8% (1993) to 6.5% (2010) and 7% (2012)

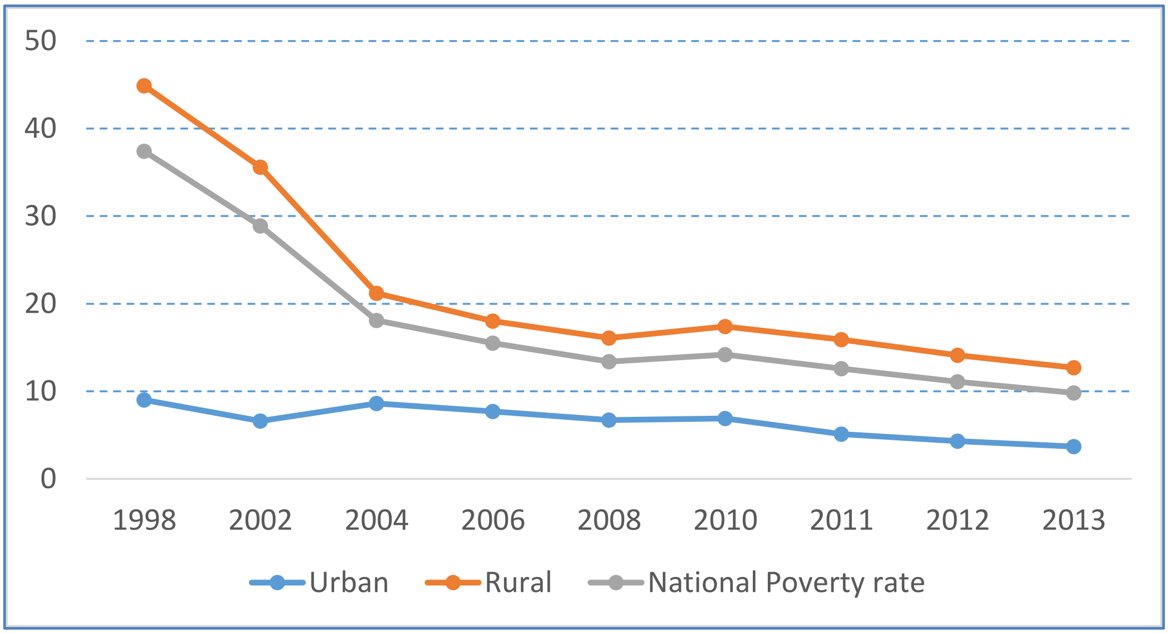
Source: Overseas Development Institute (2011) and World Development Indicator (2014).

However, income poverty alone is by no means sufficient as it fails to comprehensively portray the situation of poverty in Vietnam. Multidimensional poverty, also called 'non-monetary measure of poverty', combines the number of people who are 'multidimensionally' poor and the depth of poverty, i.e. the average number of deprivation of each multidimensional poor. This index measures 9 different types of deprivation in healthcare, education and living standards rather than paying special attention to average income. Using these indices for measuring multidimensional poor, the multidimensional poverty rate of Vietnam was 23.3 percent in 2008, i.e. much higher than income poverty, particularly in the Mekong River Delta (50%), North Mountainous Areas (40%). The multidimensional poverty rates in Lai Chau, Dien Bien and Ha Giang were all above 73%. In 2008, 12 provinces had multidimensional poverty rates of over 50%.[18] The national figure, however, then fell to 6.4% in 2010-2011.

Besides, the progress in poverty reduction may not be sustainable over the mid-long run: many near-poor people encountered high risk of falling back to poverty. At the end of 2011, the poverty rate remained high (about 38%) in the communes and districts with particular disadvantage, border communes, coastal communes, islands and communes with high density of ethnic minorities. Approximately 900 thousand households were classified as near poor, which accounted for 34% of total ethnic minority households. Supporting policies for the poor failed to distinguish between the lazy poor people from those being poor for other reasons; therefore, they failed to induce poor people to escape from poverty.

Poverty was only measured in terms of income, and the low poverty line led to high proportion of near poor people. The identification of the poor presented another shortcoming. Many criteria such as the usage of clean water, school drop-out rate among children, child malnutrition have not been considered.

Figure 23: Urban and rural poverty decline in Vietnam



Source: GSO.

Finally, although the living standard in Vietnam has been significantly improved, the gap between rural and urban areas remained large. The gap was widened in all consumption and

18 Source: United Nations Development Program (2012).

social indicators. The rural-urban gap also became larger relative to overall inequality. The poverty rate in rural areas went down from 21.2% in 2004 to 13.2% in 2010, while the urban figure decreased from 8.6% in the same period. At the moment, about 8 million rural people and 1.3 million urban people still lived in poverty.

Table 16: Inequality in ASEAN countries

Country	Gini coefficient	Year
Malaysia	46.2	2009
Philippines	43.0	2012
Thailand	39.4	2010
Singapore	39.0	2004
Indonesia	38.1	2011
Laos	36.2	2012
Vietnam	35.6	2012
Cambodia	31.8	2011

Source: CIA – The World factbook and World Development Indicators (2014).

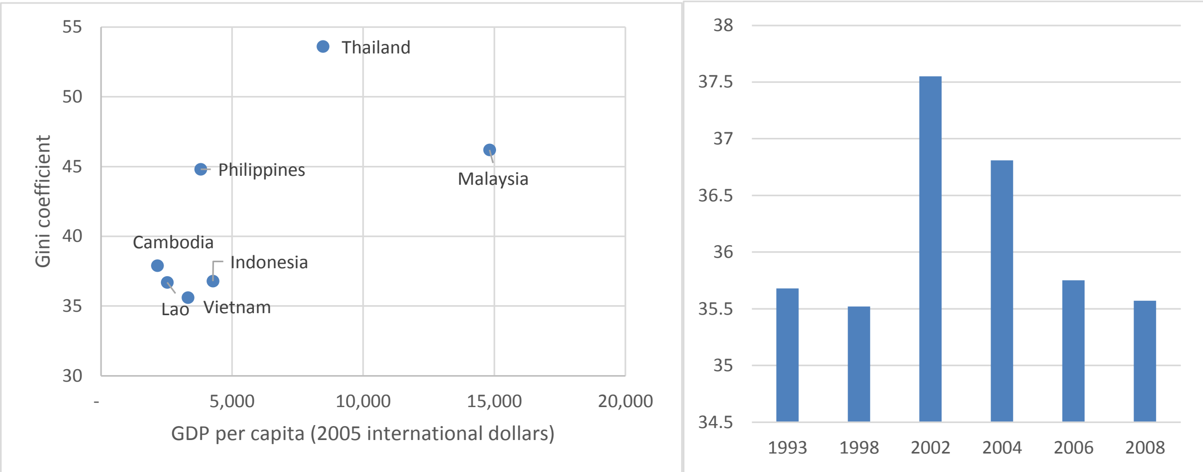
According to Philip Abbott et al.'s report: "Rapid economic growth has also brought reduced poverty. Using the World Bank's $1 per day headcount index, extreme poverty had already decreased to 15% by 1993 and to only 2% by 2002. Vietnam's own standard puts poverty at much higher levels, but they nevertheless decreased from 58% in 1993 to 37% in 1998 and only 29% in 2002 (VASS, 2007). While poverty decreases may be the results of many and combined factors, Abbott's report suggests that "trade reform has played a role in this success" and that "Vietnam is an illuminating example of the potential linkage between trade and development[19]". When comparing Vietnam inequality indicators with those of other ASEAN countries, table 17 shows that Vietnam is a country having the lowest inequality coefficient, measured by the Gini index. At the other extreme, Thailand and Malaysia have the most unequal income breakdown.

Nevertheless, income inequality in Vietnam has been widening or persisting, which is partly explained by the high economic growth the economy experienced over the past two decades. In particular, large increase in inequality has been seen at the beginning of the 2000s (Figure 24, right), which then declined only marginally in the course of the decade. Weighing the benefits stemming from capital account liberalization and fiscal consolidation against the distributional effects is of primary importance.[20] Awareness of these effects might lead some governments to choose to design policy actions in a way that redresses the distributional impacts. For instance, greater resort to progressive taxes and the protection of social benefits for vulnerable groups can help counter some of the effect of fiscal consolidation on inequality. By promoting education and training for low- and middle-income workers, governments can also counter some of the forces behind the long-term rise in inequality. This holds even truer, when considering the goals of inclusiveness and resilience of the 'RICH' notion: an inclusive area is

19 See Abbott et al. (2008).
20 See Furceri and Loungani (2013).

by definition less unequal, and a better and widespread distribution of wealth makes a region far more capable to handle volatilities and shocks, from within or outside the region, reducing the likelihood of economic crises to keep a well-functioning welfare system and to adjust excessive concentrations of wealth is crucial to maintain a balanced economic growth over the long run.[21]

Figure 24: Income inequality and GDP per capita in ASEAN (left) and Gini index for Vietnam over time (right)



Source: World Development Indicators and CIA Factbook.

The overall good Vietnamese economy reflected onto the quality of life (

Table 17). The human development index – approximating the quality of life – has grown moderately in Vietnam, but is still surpassed by most of its Asian peers.

Table 17: Quality of life indicators for ASEAN

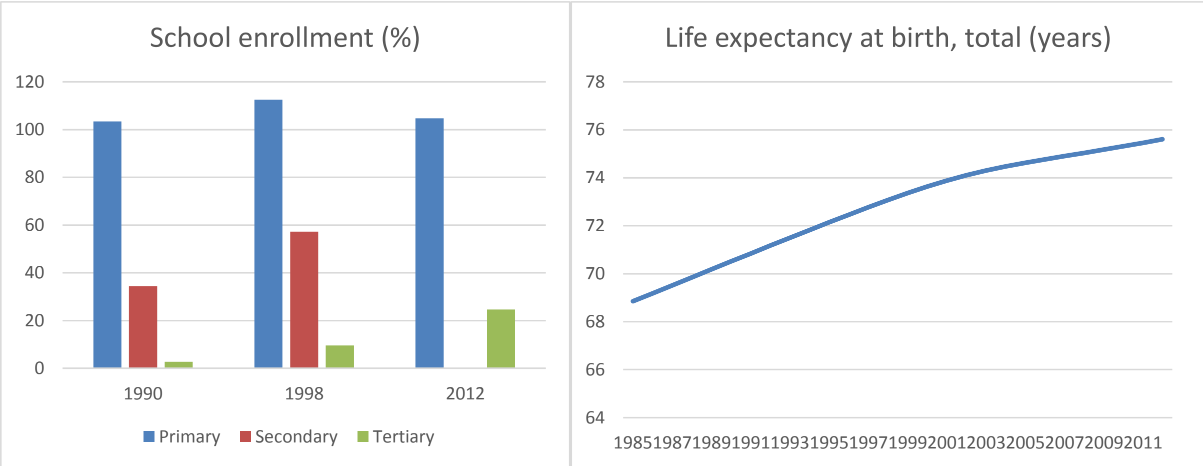
	HDI rank	Human Development Index (HDI)	Life expectancy at birth (years)	Mean years of schooling (years)	Expected years of schooling (years)	GNI per capita rank minus HDI rank	Non-income HDI value
South Korea	12	0.877	79.8	11.6	16.8	16	0.918
Singapore	27	0.846	80.7	8.8	14.4	–19	0.831
Malaysia	57	0.744	74.7	9.5	12.5	–3	0.775
China	89	0.663	73.5	7.5	11.4	–4	0.707
Sri Lanka	91	0.658	74.4	8.2	12	10	0.738
Thailand	92	0.654	69.3	6.6	13.5	–11	0.683
Philippines	97	0.638	72.3	8.7	11.5	12	0.726
Indonesia	108	0.600	71.5	5.7	12.7	2	0.663
Viet Nam	113	0.572	74.9	5.5	10.4	7	0.646

21 See Berg and Ostry (2011).

India	119	0.519	64.4	4.4	10.3	–6	0.549
Lao PDR	122	0.497	65.9	4.6	9.2	3	0.548
Cambodia	124	0.494	62.2	5.8	9.8	12	0.566
Bangladesh	129	0.469	66.9	4.8	8.1	12	0.543

Source: United Nations.

Figure 25: Human development components in Vietnam



Source: World Development Indicators.

Several components of the HDI show improvements. The quality of education has improved, but enrolment rates remains at low levels, more especially for secondary, and tertiary sectors, where Vietnam lags behind the other ASEAN countries. Notwithstanding lower income relative to other Asian countries, Vietnam made remarkable progresses in education and training. The national education system has been established with relative completeness, unification and diversification, covering all communes and wards throughout the country, including all levels of education and training. Technical facilities of schools have been upgraded and improved. The education system has been diversified regarding type of school (public, semi-public and private), method of teaching (regular, irregular) and resources to gradually integrate into the world education system. On the other hand, Vietnam scores well on the health component of HDI, proxied by the life expectancy (Figure 25, right).[22]

In summary, Vietnam has grown steadily for more than two decades. Such a growth also incorporated substance of inclusiveness, thereby helping to significantly reduce inequalities and poverty. Still, the foundations of Vietnam's long-term economic development and prosperity remain fragile. The subsequent analyses will delve more deeply into aspects of socio-economic performances in Vietnam.

1.4. *Trade analysis*

Both exports and imports were increasing and reached the record high levels in 2008. They were then hit severely by the global financial crisis and economic recession, but started to

22 See CIEM (2013, pp. 169).

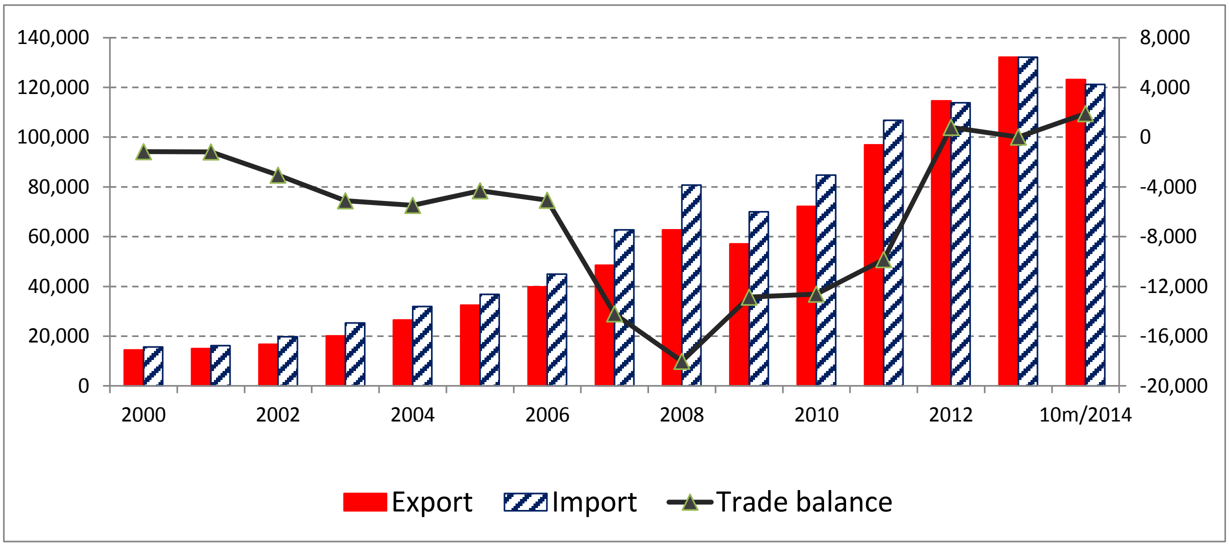
increase since 2010 thanks to the recovery of the domestic and international economy. ASEAN member states are among Vietnam's leading trade partners, accounting for 15 percent of the country's total trade.

1.4.1. Imports

Imports rose very quickly over the last decade, surpassing export's growth. During pre-crisis years (2006-2008), the average annual growth of imports was 18% (Figure 26). In 2012, the trade account recorded its first surplus since 2001, mainly reflecting a sharp slowdown in import growth. Since 2007, imports also became more volatile. The figure jumped by 40% in 2007 and 28.6% in 2008. Due to impacts of the global financial crisis and domestic economic downturn, import went down by 13.3% in 2009. However, imports quickly recovered in 2010 and 2011, respectively. Overall, in the period of 2007-2011, imports increased by about 2.4 times, from USD 44.9 billion to USD 106.7 billion. The average growth rate of imports in this period reached 18.9% per annum. The ratio of imports over GDP attained the peak level of 88.6% in 2008, then dropped to 72.0% in 2009 and then climbed to 87.1% in 2011. Import growth was generally slower in 2007-2011 than in 2002-2006, during which imports went up by 2.8 times and the average annual growth rate of imports was 22.6%. Notably, imports only jumped in a couple of years after Vietnam became member of the WTO.

As an explanation to the above pattern, Vietnam has gradually adapted to the WTO "practices", at both policy and enterprise levels.[23] The surge in prices of imported goods (in VND) due to the increased VND/USD exchange rate also weakened demand for these items. Increased imports till 2011 were partly induced by the widened investment-savings gap, which in turn resulted from huge increases in (both domestic and foreign) investment (Figure 8). Besides, the dramatic rise in imports of consumer goods was due to (overall) income improvement, added by the "wealth effect" and the tariff reduction of some imported consumer goods (Vo Tri Thanh and Nguyen Anh Duong 2009). Finally, import expansion also served domestic production.

Figure 26: Vietnam's Trade, 2000-October 2014



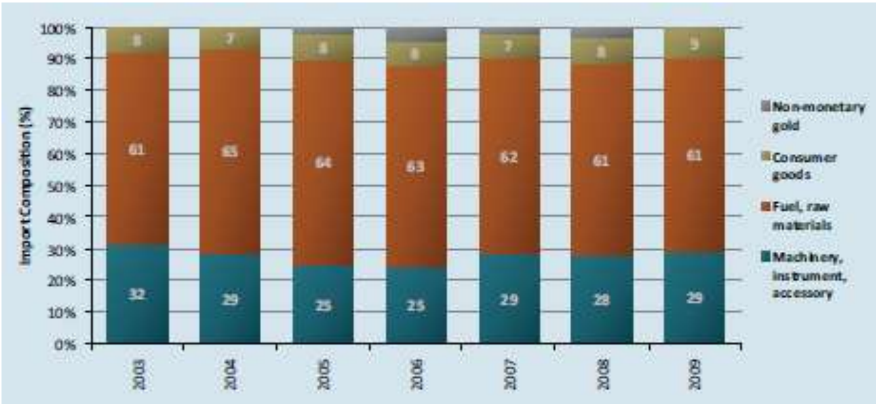
23 The policymakers gradually became able to restrain import more effectively without violating WTO regulations. Meanwhile, to some extent, Vietnamese products became more competitive relative to imported ones.

Source: GSO.

Truong Dinh Tuyen et al. (2011) empirically estimate several factors that influenced imports in the 1990-2010 period. On the one hand, the increase of nominal VND/USD exchange rate made Vietnam's products become more expensive (in current VND), thereby causing higher imports. Meanwhile, *other things being equal*, the disbursement of FDI capital increased demand for imported goods. Specifically, if disbursed FDI capital went up by 1%, the import volume rose by about 0.3%. High GDP growth is also associated with higher demand for imported goods to serve domestic consumption and production. Noticeably, the tariff cut under WTO commitments induces further import demand in the absence of technical measures to restrain import.

Import expansion quickened in 2013, as greater economic stability enticed foreign investment back to Vietnam, in turn supporting a rise in imports of capital goods.

Figure 27: Composition of Vietnam's import



Source: GSO.

Vietnam mainly imports manufactured products, which altogether contributed more than two thirds in the overall imports (Figure 27). Within this category, machinery, equipment and spare parts dominate, reflecting the feeding of the investment cycle but Vietnam's heavy reliance on imported materials for the operation of the manufacturing sector as well. Petroleum, steel, fabrics and plastics represent other relevant imports. Given the low-tech and labour-intensive industrial sector, import is also dominated by low value-added products.

Vietnam's imports mainly come from several key countries and regions. Vietnam's imports from key trading partners grew relatively fast during the period of 2001-2013, in which the pace was slower in the 2007-2013 period compared to the 2001-2006 (Table 18). Notably, the growth rate of imports from the US and Korea were the highest in the 2007-2013 period, which attained 26.89% per annum in 2007-2013, or 8.78 and 12.60 percentage points higher than the previous period (18.10% and 14.29% per annum in the 2001-2006 period). Imports from China also grew at the average rate of around 25.84% between 2007 and 2013, which was down by 6.10 percentage points. Imports' growth rate from the EU25 and Japan were17.05% and 13.79% per year in the period of 2007-2013, respectively, slightly exceeding that in the 2001-2006 period by 2.22 and 1.14 percentage points.

Table 18: Vietnam's import growth rate from selected trading partners, 2001-2013 (%)

Import growth	2001-2006	2007-2013	Change
	(1)	(2)	(3) = (2) – (1)
ANZ	23.51	7.15	-16.37
ASEAN	18.86	7.88	-10.98
CHINA	31.94	25.84	-6.10

EU25	14.68	17.05	2.22
INDIA	30.48	18.46	-12.03
JAPAN	12.65	13.79	1.14
KOREA	14.29	26.89	12.60
US	18.10	26.89	8.78

Source: MUTRAP (2014).

Like imports from China, Vietnam's imports from ANZ, ASEAN and India all grew at slower rates in the 2007-2013 period, resulting in the significant drop of more than 10 percentage points. Specifically, the respective growth rate of imports from India and ANZ both felt by -12.03 and 16.37 percentage points, and reached 18.46% per annum and 7.15% per annum in the same period. Exports from ASEAN to Vietnam attained the average annual growth rate of 7.88% in 2007-2013, or 10.98 percentage points less than the 2001-2006 period.

Although Vietnam's imports from ANZ and India decelerated dramatically, the impact was insignificant due to the modest share of imports from those markets in relative to total imports of Vietnam. Nevertheless, the faster growth rates of imports from Korea, Japan, EU25 and the US may be a signal for positive change in Vietnam's import structure because those markets are potential sources of modern technology. Besides, relatively high growth rates and shares of imports from China and ASEAN indicate the heavy dependence of Vietnam on imports from these two partners.

In the structure of imports by trading partner (Table 18), China is the most important source of Vietnam's import, followed by ASEAN, Japan, Korea and the EU. The five countries and regions accounted for about 70% of total imports of Vietnam during the period of 2004-2013, and up to 75.78% in 2013. In particular, the share of China went up continuously from 24.30% in 2004 to 20.25% in 2007, down to 19.79% in 2008, relatively stable at about 23% in 2009-2011 and jumped up again to 27.98% in 2013. In contrast, the proportion of ASEAN followed a downward trend since 2006, from 27.95% to only 18.30% in 2012 and 16.16% in 2013. Korea's share in total imports of Vietnam was quite significant and gradually went up from 8.51% in 2007 to 15.68% in 2013. The increase of imports from China also partly occurred due to EPC works that Chinese contractors performed in Vietnam. Thus, trade policy makers should pay attention and better respond to the increasing trend of import from this market, and technical measures should be taken to ensure the quality of imports by EPC contractors (CIEM 2013).

Trade intensity index indicated the attractiveness of Vietnam's market to other East Asian countries. More importantly, in parallel with the country's open-door policy and international integration, Vietnam became more and more attractive to almost all other trading partners. The country is a highly potential destination for exports from ASEAN, though trade intensity index of the latter with respect to the former only increased slightly from 4.1 in 2004 to nearly 4.7 in 2007, before decreasing to almost 2.9 in 2010-2012. The indices with China and Japan also went up continuously in the period of 2004-2012, from 1.6 to 2.1 and 1.8 to 2.0, respectively. South Korea also shows potentials of further export to Vietnam, with the trade intensity index falling from about 3.8 to only 3.6 in the 2004-2010 period and then rising to 4.3 in 2012.

Table 19: Trade intensity index of Vietnam's imports from selected trading partners, 2004-2012

	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
ANZ	1.65	1.47	2.50	1.86	1.55	1.39	1.43	1.45	1.21
ASEAN	4.09	4.24	4.67	4.38	4.22	3.96	2.94	3.07	2.89

CHINA	1.59	1.61	1.56	1.85	1.81	2.50	1.91	1.95	2.09
EU25	0.23	0.20	0.20	0.21	0.20	0.21	0.25	0.24	0.26
INDIA	1.93	1.58	1.84	1.89	2.11	1.91	1.39	1.41	1.40
JAPAN	1.76	1.87	1.88	1.87	2.02	2.07	1.89	1.91	2.04
KOREA	3.79	3.53	3.11	3.16	3.46	3.62	3.60	3.94	4.33

Source: MUTRAP (2014).

More importantly, the trade intensity index of most trading partners in Asia with respect to Vietnam was larger than the corresponding figures of Vietnam with respect to those countries. The only exception was Japan, indicating that Vietnam could reap net benefit from trade with Japan in the 2004-2009 period. Meanwhile, the net benefit of Vietnam in trading with China was very modest. On the other hand, the former's net benefits in trading with EU25 and the U.S. were considerable.

As reflected in the trade complementarity index, imports from most trading partners (except the US) could satisfy import demand of Vietnam during 2004-2012. Surprisingly, the degree of complementarity was biggest with EU25, though import value from EU25 was less than expected. Meanwhile, those of exports from ASEAN, South Korea and Japan show some slight improvement in the 2009-2012 period, and much improved compared to corresponding figures in 2004. The pace of improvement of the trade complementarity index was most remarkable in the case with China, which jumped up by almost 16.5 points in 2004-2012.

Table 20: Trade complementarity index of selected trading partners' exports with Vietnam's imports, 2004-2012

	2004	2005	2006	2007	2008	2009	2010	2011	2012
ANZ	41.54	40.26	40.58	39.41	37.64	33.66	34.38	33.76	32.48
ASEAN	47.78	50.16	52.42	53.68	57.33	60.88	57.26	60.88	62.46
CHINA	39.63	40.50	41.90	43.58	44.69	53.93	47.97	50.98	56.14
EU25	62.52	62.80	62.50	65.04	65.99	71.65	67.83	66.84	64.79
INDIA	54.92	55.90	60.78	59.93	61.71	59.50	57.92	59.48	57.09
JAPAN	48.21	48.65	49.04	53.29	54.87	60.73	58.89	58.30	60.25
KOREA	55.23	53.97	52.82	55.35	59.39	61.34	60.40	65.84	70.11

Source: MUTRAP (2014).

1.4.2. Exports

Vietnam's exports continues to grow (

Figure 26). During the period of 2007-2011, export still maintained the upward trend following the accession to the WTO, but also became more volatile than the years of 2002-2006. Annual export growth was relatively high in 2007 and 2008 (21.9% and 29.1%, respectively). However, exports decreased by 8.9% in 2009 following the outbreak of the global financial crisis and economic recession. Since 2010, export value bounced back, increasing by 25.5% in 2010 and 34.2% in 2011. Overall, exports grew by 2.4 times in the period of 2007-2011, from USD 39.8 billion to USD 96.9 billion. The average growth rate of exports attained 19.5% per annum, higher than the target for 2006-2010 (16% per annum). Still, export growth was slower in 2007- 2011 than in 2002-2006, during which export value jumped by 2.6 times, i.e. on average by 21.5% per annum. The ratio of exports over GDP increased continuously, and attained 79.0% in 2011 (compared with only 65.2% in 2006). During the period of 2007-2011, the contribution of exports to economic growth was significant, reaching 113.2%, i.e. much higher than those of final consumption (89.4%) and capital formation (66.4%) (Truong Dinh Tuyen et al. 2011). The trend of export expansion continued with steady pace, leading to the export values of over USD 132 billion in 2013 and USD 123.1 billion in the first 10 months of 2014. Thus, even in a volatile economic environment, Vietnam could make the best of export potentials, and transform those potentials into income for its citizens and the whole economy. Following the trend in 2002-2006, the achievements of Vietnam's exports during 2007-2014 were driven by: (i) world trade growth; and (ii) liberalization and improvement of competitiveness.

The constant market share (CMS) analysis using Vietnam's export data for the periods of 200-2004, 2004-2007 and 2007-2008 - by Vo Tri Thanh and Nguyen Anh Duong (2011) - shows that the above factors had positive impacts in all concerned periods. The contribution of the world trade growth to Vietnam's export growth increased from 53% in 2001-2004 to 61% in 2004-2007, before contracting to 48% in 2007-2008. As an explanation for these high figures, Vietnam's export was very small relative to global export, so the former was very sensitive to growth of the latter. From econometric estimation using data for 1990-2010, the impact of the WTO accession on export volume (excluding crude oil) was less significant than that of Bilateral Trade Agreement with the US (VN-US BTA). Meanwhile, Vietnam's export was affected more significantly by world economic growth. Specifically, if world GDP increases by 1%, Vietnam's export volume should go up by 4.4%.

Obviously, exports became the main driver of Vietnam's economic growth both before and after the WTO accession. Impressive export performance contributed considerably to job creation and facilitated the shift of economic structure in accordance with the world economic development. Nonetheless, the difference between export growth in 2007-2013 (even in 2007 and 2008) and that of 2002-2006 was not significant, implying that the WTO accession did not help foster export growth, or that Vietnam's enterprises could not take most advantage of new opportunities in other WTO members. Spectacular growth of exports in 2011 thus was a rare highlight.

When it comes to export composition, Vietnam mainly exports labour-intensive, low-tech and agricultural products, except from crude oil, which accounts for about a fifth of all exports. This export structure has been mainly driven by Vietnam's largely technologically unsophisticated industrial structure, which has been changing only sluggishly.

Table 21 gives an overview of export share of Vietnam by partner. Such figures are consistent with the conclusions of CIEM (2013). As can be seen, since 2007, Vietnam enjoyed higher growth rate of exports to most markets than in 2002-2006. Notably, the average growth rates of Vietnam's exports to South Korea and China in the period of 2007-2011 were much higher than those in 2002-2006, reflecting the fact that Vietnam could exploit export opportunities in relatively new destinations (i.e. South Korea and China), while other traditional ones (namely EU, Japan and the US) were maintained.

However, export growth was unstable during 2007-2013. In 2007 – 2008, exports to almost all key markets increased dramatically. In particular, the average growth rate of exports to South Korea attained 45.9% per annum during this period. In 2009, the financial crisis and economic recession negatively hit the world economy, thereby reducing world import demand and Vietnam's exports to most countries and regions. During the year, Vietnam could only increase exports China and South Korea. As an implication, Vietnam's enterprises could realize opportunities to expand exports even in difficult situations. In 2010-2013, exports to all key markets recovered. Notably, export growth rates in this period were generally higher than those in 2007-2008, except for such destinations as Australia, ASEAN and the U.S. Over time, as a reflection, benefits from export opportunities under AFTA and VN-US BTA deteriorated much quicker than those under relatively new ones such as ACFTA, AKFTA and VJEPA. However, the export growth to ASEAN hardly change in 2007-2013 compared with 2001-2006, reflecting the possible trade diversion away from ASEAN after the WTO accession.

Table 21: Vietnam's growth of exports to selected trading partners, 2001-2013 (%)

Export growth	2001-2006	2007-2013	Change
	(1)	(2)	(3) = (2) – (1)
ANZ	20.14	-0.17	-20.31
ASEAN	17.79	17.90	0.12
CHINA	17.83	26.98	9.15
EU25	14.47	13.69	-0.78
INDIA	50.89	46.85	-4.04
JAPAN	12.29	14.47	2.18
KOREA	19.20	32.46	13.26
US	47.90	14.46	-33.44

Source: MUTRAP (2014).

The key markets accounted for the lion's share of Vietnam's exports, which reached averages of 85.9% in the period of 2002-2006 and of 81.6% during 2007-2011. Truong Dinh Tuyen et al. (2011) argue for two major policy implications from this result. *First,* export orientation and export structure should be tailored to specific markets in order to better grasp potentials of each market and of economic integration arrangements that the country participated. *Second*, Vietnam's export markets are relatively concentrated, thus very vulnerable to external shocks that may arise in one or 2 key markets. From the observation of diversified export markets and the increase of Vietnam's exports to some markets even in 2009, Vietnam should attempt to further diversify its export market. Exports were still concentrated in some key markets, but the total share of major partners such as ASEAN, Japan and the EU was gradually reduced. Meanwhile, the shares of some markets like the U.S., China and South Korea in Vietnam's total exports were increasing. As a note, transportation costs in the current globalization context has decreased significantly, but still affected trade flows of many countries (Doanh and Heo, 2009; Trang et al., 2011). Thus, other regional partners still accounted for significant share in Vietnam's imports and exports.

Table 22 presents the trade intensity of Vietnam with some selected trading partners from 2010 to 2012, which shows the importance of trade with these trading partners in comparison with trade to the rest of the world. A value greater than unity indicates larger trade flows than might be expected.It shows that Japan, ASEAN, China, and Korea are still important customers of Vietnam's export with the index being larger than 1 during the period of 2004-2012. However, the attractiveness of ASEAN market continuously declined in 2010-2012 as the index dropped to only 1.90 in 2012 compared with the highest of 3.06 in 2009 though it is still greater than 1. Japan is always an important export market of Vietnam. Vietnam's trade intensity index with Japan maintained the high value of more than 2 during the period of 2004-2012 with the peak of 3.29 in 2009.

Table 22: Trade Intensity of Vietnam's export to selected trading partners, 2004-2012

TI	2004	2005	2006	2007	2008	2009	2010	2011	2012
ANZ	5.66	6.52	7.63	6.31	5.33	3.10	2.86	1.98	1.91
ASEAN	2.39	2.78	2.57	2.75	2.53	3.06	2.02	1.92	1.90
CHINA	1.43	1.16	0.89	0.89	0.89	1.42	1.04	1.20	1.34
EU25	0.65	0.59	0.60	0.62	0.59	0.45	0.57	0.63	0.64
INDIA	0.24	0.27	0.26	0.19	0.28	0.44	0.54	0.59	0.55
JAPAN	2.74	2.65	2.62	2.63	2.81	3.29	2.26	2.37	2.35
KOREA	0.97	0.79	0.84	1.03	1.09	1.71	1.50	1.70	1.52

Source: MUTRAP (2014).

Trade intensity of Vietnam with China and Korea varied considerably during the studied period. Korea is increasingly more attractive with the index having exceeding 1 since 2007 and maintaining the value between 1.5-1.7 during the period of 2009-2012. Vietnam's exports to China became smaller in 2006-2008 as the index was below 1. The attractiveness of China grew since 2009 when the trade intensity increased to 1.42, then down to 1.04 in 2010 before recovering to 1.20 and 1.34 in 2011 and 2012, respectively. ANZ is a promising market with the index larger than unity. Yet its attractiveness has lessened gradually in recent years, which is consistent with the decrease of Vietnam's exports to this market. The trade intensity index of Vietnam with ANZ was only 1.91 in 2012 compared to the peak of 7.63 in 2006 and then continuously decreased to 2.86 in 2010 and 1.98 in 2011.

Although EU25 is one of the most important markets of Vietnam, export to this destination is smaller than might be expected as the trade intensity index always is less than 1 during 2004-2012, despite improving since 2009. The index with EU25 attained 0.64 in 2012 compared to the lowest of 0.45 in 2009. Notwithstanding the highest growth rate of exports to India, this market is still unattractive to Vietnam with its exports attaining a very low trade intensity index. The figure of Vietnam's export trade intensity index with India was only 0.5 in 2010-2012, which considerably increased from that of 0.19 in 2007. Whether the ASEAN – India trade in goods agreement and the Vietnam-EU FTA currently under negotiation can make the EU and India markets become more attractive or not remains to be seen.

The export similarity index of Vietnam with selected trading partners is illustrated in Table 23. Vietnam's export pattern is increasingly reflected in that of China with the export similarity index increasing continuously, from only 41.78 in 2004 to 50.76 in 2009 and amounted to 55.81 in 2012. China's export structure was most similar to that of Vietnam in 2012.The index between Vietnam and China also reached a peak of 57.01 in 2011. Vietnam's export structure is increasingly similar to that of ASEAN and India. The similarity index in relation with ASEAN jumped from only 39.32 in 2004 to around 50 in the period of 2009-2012. The index with India maintained at around 48 in 2008-2012 with the highest of 53.83 in 2009. This level of export similarity partly explains why Vietnam's exports could not penetrate the Indian market (CIEM 2013).

Table 23: Export Similarity between Vietnam and selected trading partners, 2004-2012

XS	2004	2005	2006	2007	2008	2009	2010	2011	2012
ANZ	31.24	29.79	28.94	29.55	29.05	28.96	27.23	27.82	27.49
ASEAN	39.32	40.60	43.66	45.39	50.00	49.98	50.04	50.82	50.51
CHINA	41.78	41.51	42.09	43.50	44.60	50.76	55.56	57.01	55.81
EU25	31.90	32.52	34.64	36.62	38.40	41.52	41.62	43.24	43.75
INDIA	41.37	41.28	45.49	45.82	47.80	53.83	47.86	47.16	48.63
JAPAN	19.91	20.63	23.02	25.15	27.81	29.32	32.21	33.07	32.74
KOREA	25.30	25.53	28.40	30.49	34.64	34.42	39.36	43.25	43.19

Source: MUTRAP (2014).

The indices with EU25, Japan and Korea increased steadily. The indices in relation to Korea and EU 25 were about 43 in the period of 2010-2012, about 10 points higher compared to previous years. The export structure of Vietnam differed most noticeably with that of Japan as the export similarity index was lowest during the whole studied period. The continuous growth of the indices with EU 25, Japan and Korea, to a certain extent, can be explained by the movement of export-oriented Japanese and Korean firms to Vietnam, especially in manufacturing and assembling industries.

As a general rule, lower values indicate that more trade may arise between Vietnam and its trading partners. Thus, through the measure of export similarity, Vietnam has more potential opportunity for expanding exports to Japan and Korea, two economies with highly protected agricultural sectors. On the other hand, the FTAs with India and China seem as though they would create few impacts on Vietnam's exports because of the relative similarity of the export bases, though intra-industry trade has been growing along with the growth in global supply chains.

Table 24 tabulates the Trade Complementarity (TC) index[24] between Vietnam and selected trading partners. As such, Japan and EU25 were the most compatible partners for products from Vietnam. The index with Japan maintained its high score of more than 50 over the 2004-2012 period, and attained 51.61 in 2012, smaller than 56.68 in 2008 but still the highest among

[24] This index ranges from zero to 100 and compares the export strengths of Vietnam with the import needs, as revealed by actual trade flows, of other countries. High values are indicative of potentially more trade creation and a value of 100 indicates the most favorable match-up.

studied countries and territories. Meanwhile, the TC index of the EU25 continuously increased from 38.27 in 2004 to 51.68 in 2011 but slightly reduced to 47.92 in 2012. The figures for ASEAN and Korea were relatively large, ranging around 40 during the same period. However, the index with respect to China fluctuated significantly, up from 29.64 in 2004 to 41.54 in 2008, down to approximately 36 in 2009-2010 before going up again to 38.50 and 39.59 in 2011-2012, respectively. Notably, the index in trade with India dropped considerably during the 2010-2012 period, from 68.46 in 2009 to only 39.59 in 2012. The TC index between Vietnam and the ANZ increased significantly in the period 2004-2008, from 39.82 to 51.11. The index then maintained relatively high and stable scores of more than 50 during the period 2009-2012 with the peak of 52.10 in 2009.

Thus, by the TC index, Vietnam's exports are most likely to meet the import demand of Japan, ASEAN, EU25, and ANZ. Vietnam's export structure also highly satisfies the needs of Korea. India appears to be the least attractive partner for Vietnam's exports with the dramatic decrease of the TC index recently.

Table 24: Trade Complementarity between Vietnam and selected partners, 2004-2012

Trade Complementary	2004	2005	2006	2007	2008	2009	2010	2011	2012
ANZ	39.82	41.10	44.30	46.23	51.10	52.10	51.68	52.07	50.11
ASEAN	36.51	39.51	42.34	44.17	46.82	46.89	42.02	43.99	44.79
CHINA	29.64	30.89	34.18	35.59	41.54	36.37	36.97	38.50	39.59
EU25	38.27	40.09	42.24	44.50	48.06	49.15	50.61	51.68	47.92
INDIA	57.43	57.35	56.74	60.58	62.46	68.46	36.05	36.71	34.48
JAPAN	51.26	54.10	56.64	55.60	56.68	53.25	53.64	54.05	51.61
KOREA	43.66	46.46	47.94	46.56	47.41	43.12	41.17	42.64	41.45

Source: Authors' calculation from COMTRADE database.

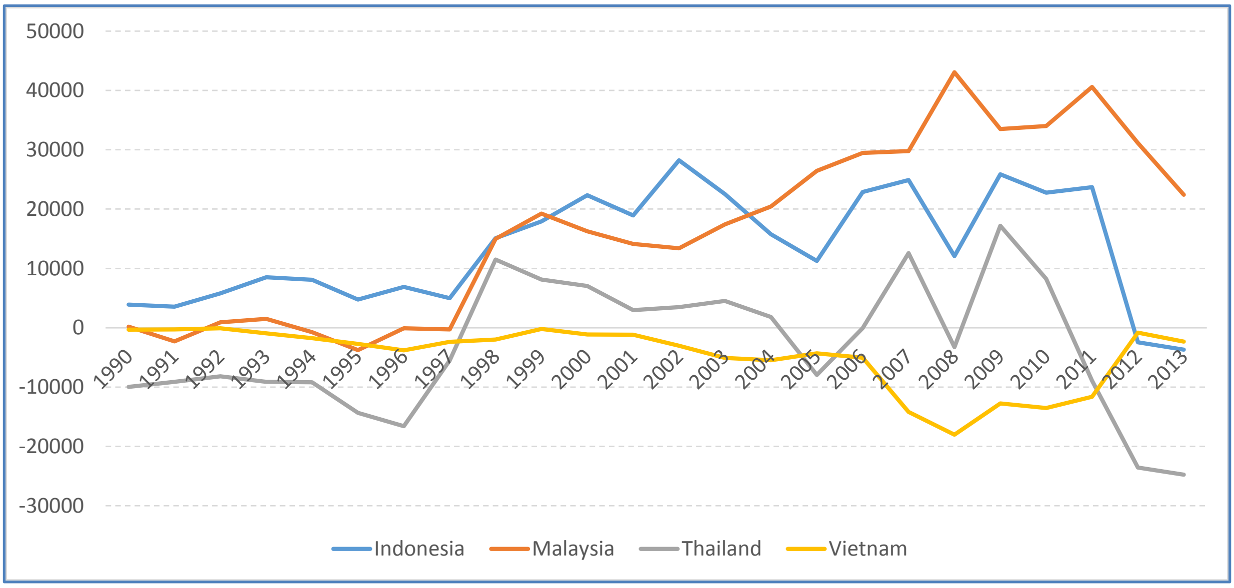
According to Truong Dinh Tuyen et al. (2011), the trade agreements, bilateral and regional FTA have immensely induced the change of Vietnam's export structure by market. Because many FTAs were signed and implemented almost simultaneously, separating trade creation effect and trade diversion effect of each FTA on Vietnam's exports is no easy task. However, larger exports to most markets indicate that FTAs are mostly beneficial to Vietnam's export growth. In that context, the shift in export structure by market was driven by Vietnamese enterprises taking good advantage of new opportunities in export markets, albeit to different extents.

1.4.3. Trade Balance

In 2008 Vietnam had a fairly large trade deficit, representing 16% of GDP. With the hit of the global economic crisis in 2009, the growth became negative and then again resumed averaging 7% over 2010-2012, but still maintaining the trade deficit to an average of 12% of GDP. The deficits were quite large in 2007-2008, associated with the widening investment-savings gap (

Figure 26). In recent years, the trade balance was improved, with modest surplus. Nonetheless, the trade surplus was largely due to contraction of aggregate demand which induced smaller growth of imports.

Figure 28: Trade balance in a regional context



Source: World Development Indicators.

Figure 28 illustrates trade balance trend of some ASEAN countries. Malaysia, Thailand and Indonesia have fairly balanced trade until late-1990s and then started generating surpluses, primarily as a result of the cutbacks in imports. On the other hand, Vietnam has a negative trade balance throughout the entire observed period. Luckily, the remittances and the other financial flows Vietnam received (FDI and portfolio inflows) helped finance the current account deficit, thereby resulting in sustainable balance of payments.

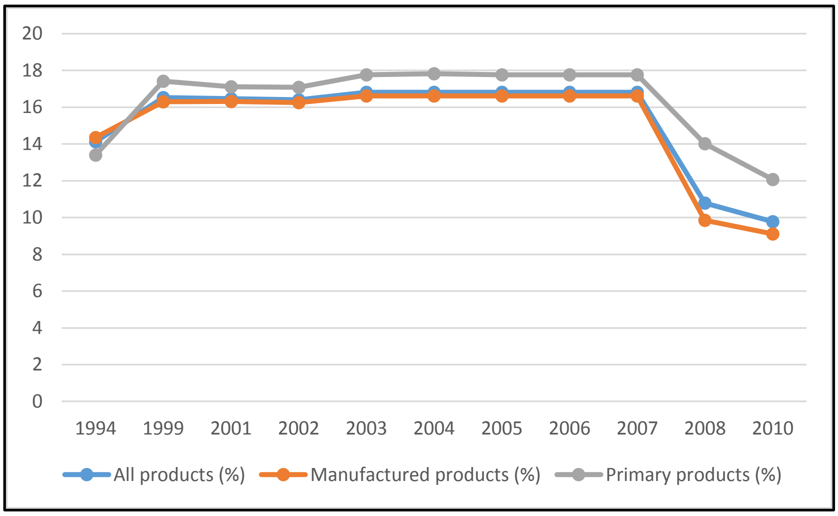
1.4.4. FTAs, Tariffs and Trade Facilitation

Trade between Vietnam and other ASEAN member countries has quadrupled over the past decade, climbing to nearly USD 40 billion in 2013 from USD 9 billion in 2003. This resulted partly from Vietnam's commitments to the long-term objective of regional and global economic integration through participation in APEC, AFTA, the WTO and a growing network of FTAs – both individually and as a part of ASEAN.

During the period at issue, export duties were dramatically reduced; the weighted average tariff rate fell from 20% in the early 1990s, to about 15 % in the early 2000s. Tariffs on industrial products were cut by 13% on average, tariffs on agricultural products were reduced by 20% (Figure 29).

As well emphasised by the CIEM (2013), notwithstanding large scope of both opportunities and challenges, the decisive factors underlying how to take advantages of these opportunities and to overcome these challenges depend crucially on institutions and policies (or management activities of authorities at all - mainly central and provincial - levels) as well as enterprises' activities.

Figure 29: MFN Tariff Rate, Simple Average, Vietnam



Source: World Development Indicators.

Import tariffs, despite falling over time, remain at 9.8% on average, while non-tariff trade barriers (NTBs) and customs procedures remained significantly costly and time-consuming. Presently, there are 10,721 tariff lines of 8-digit harmonized commodity description. The removal of the non-tariff barriers has been slow, partly because it took some time for Vietnam to update a solid database of NTBs.

Currently, Vietnam administers four different categories of tariff rates: the common tariff rate, the most-favoured-nation rate, ASEAN-specific preferential tariff rate, and the Early Harvest Program (EHP) tariff rate under the framework of China-ASEAN FTA. The common tariff rate, which is 70% higher than the most-favoured-nation rate, applies to those countries which have not established normal trade relationships with Vietnam. Products of Chinese origin enjoy the most-favoured-nation rate of duty, except that EHP tariff rate applies to products listed under certain chapters of Vietnam's tariff nomenclature.

Vietnamese tariff schedule can be summarized to 10,721 tariff lines of 8-digit products under harmonized system. Divided into 16 categories, Vietnam's tariff averages 9.8%. The simple average tariff rates for agricultural products and for non-agricultural products stand at approximately 12% and 9.1%, respectively.

1.5. Financial market

1.5.1. Performance and domestic regulatory reforms

✓ *Banking and Security Markets*

Since its liberalization in 1989, Vietnamese financial sector has rapidly developed in market scale, number and type of institutions. Vietnam has swiftly shifted its banking system from mono-banking model to two-tier banking model. In early 1990s, there were only 4 state-owned commercial banks (SOCBs). To date, the number and type of financial institutions have experienced a rapid growth with all form of ownership. As of June 2013, the number of joint-stock commercial banks (JSCBs) accounts for 34, after recent bold steps of the State Bank of Vietnam (SBV) in restructuring (largely vis-à-vis M&A). Among 5 SOCBs, only Vietnam Bank for Rural and Agriculture Development (VBARD) is pure SOCB. The number of Foreign-invested credit entities (including 100-% foreign capital banks, joint – venture banks, foreign bank branches, and foreign bank representative offices) is totally accounted for as much as 100. In addition, there are also 18 financial companies, 12 financial leasing companies and 968 people credit funds that provide specific type of credit to the country (Table 25).

Table 25: Key indicators of financial institutions in Vietnam by June 2013

	Financial institution	Total chartered capital	Average chartered capital	Number of institutions
1	SOCBs	121,055 bil. VND	20.176 bil. VND	5
2	Social policy banks	8,988 bil. VND	8.988 bil. VND	1
3	JSCBs	177,773 bil. VND	5.229 bil. VND	34
4	Foreign bank branches	615 mil. USD	12.3 mil.USD	50
5	Joint – venture banks	458.5 mil. USD	114.6 mil.USD	5
6	100-% foreign capital banks	19,547 bil. VND	3,909.4 bil. VND	5
7	Foreign bank representative offices	NA	NA	50
8	Finance companies	20,316.9 bil. VND	1,128.7 bil. VND	18
9	Financial leasing companies	3,650 bil. VND and 13 mil.USD	327 bil. VND	12
10	Credit co-operatives	559 bil. VND	0.57 bil. VND	968

Source: SBV statistics and compiled by Ha Van Duong (2014).

It is important to note that among financial institutions, the SOCBs have the highest amount of average chartered capital, meanwhile, the credit co-operatives have the smallest (Table 25).

Since 2001, a relatively new type of financial institutions in Vietnam has emerged – securities companies. To date, the number of securities companies shrank to 103 from 105 after the period of stock market meltdown during 2011-2012. Vietnam stock market has significantly contributed to mobilizing long-term, low–cost capital for the economy, particularly in 2007 and 2009. In addition, the bond market plays a significant role in raising capital, amounting for 17-19% GDP recently; nevertheless, the corporate bond market still accounts for a tiny proportion of the financial market (Table 26).

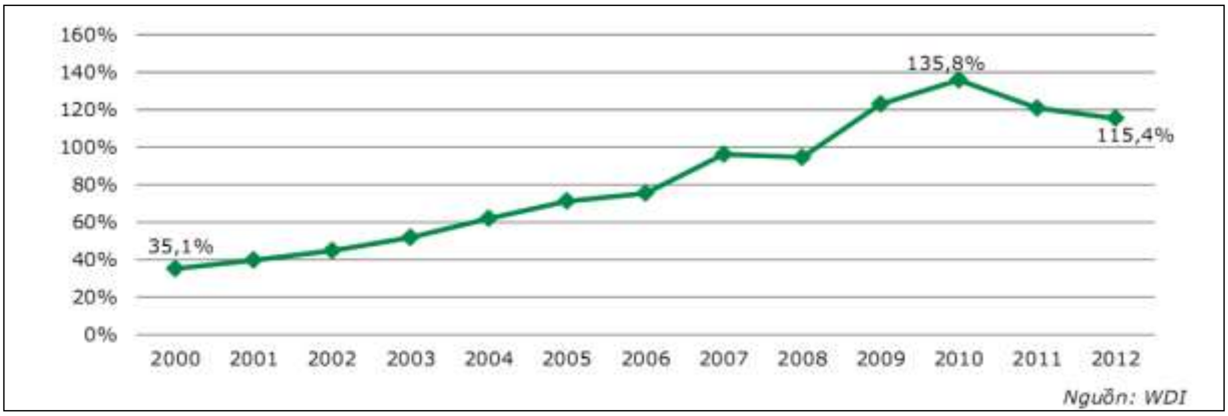
Table 26: Some Basic Indicators of Vietnam's Security Market (2006-2013)

	12/2006	12/2007	12/2008	12/2009	12/2010	12/2011	12/2012	12/2013
Total stock market capitalization (% of GDP)	22.8	43.0	19.0	55.0	28.3	20.0	23.0	31.0
Total bond market capitalization, Of which, corporate bond	NA	NA	~19.0	NA	19.6 (5.55)	17.1 (3.31)	16.6 (1.95)	19 (2.65)

Source: CIEM (2013) and authors' compilation/elaboration from various sources.

As to its structure, Vietnam's financial market is regarded as a bank-based one, i.e. the banking sector is still dominant in terms of capital intermediation for the economy. For instance, the banking sector's credit to economy accounts for 115.4% GDP in 2012, after falling from the record high of 135.8% GDP in 2010 (Figure 30). Bearing in mind that the country's banking intermediation ratios have been much more higher than those of other economies in transitions in Eastern Europe (about 40-50%), but much lower than those of other AMSs (for instance, Singapore and Malaysia (about 200% GDP)). Despite its less important role in capital mobilization in comparison to a number of ASEAN peers, Vietnam's banking sector contains a variety of risks that threaten the country's financial stability.

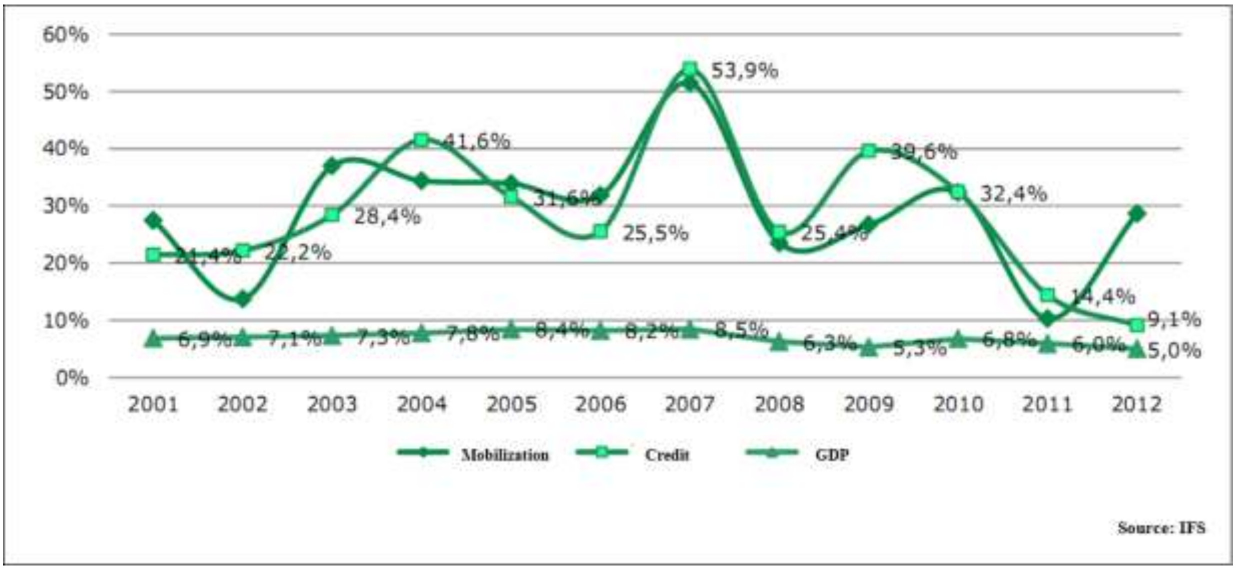
Figure 30: Vietnam's banking credit to the economy as percentage of GDP, 2000-2012



Source: VPBS (2014), taken from WDI.

It is noteworthy that high growth rates of lending and borrowing have long been attributed to the high ratios of banking intermediation (especially during 2004-10) (Figure 31) and high inflation (CPI) in the economy (particularly in 2008, 2011).

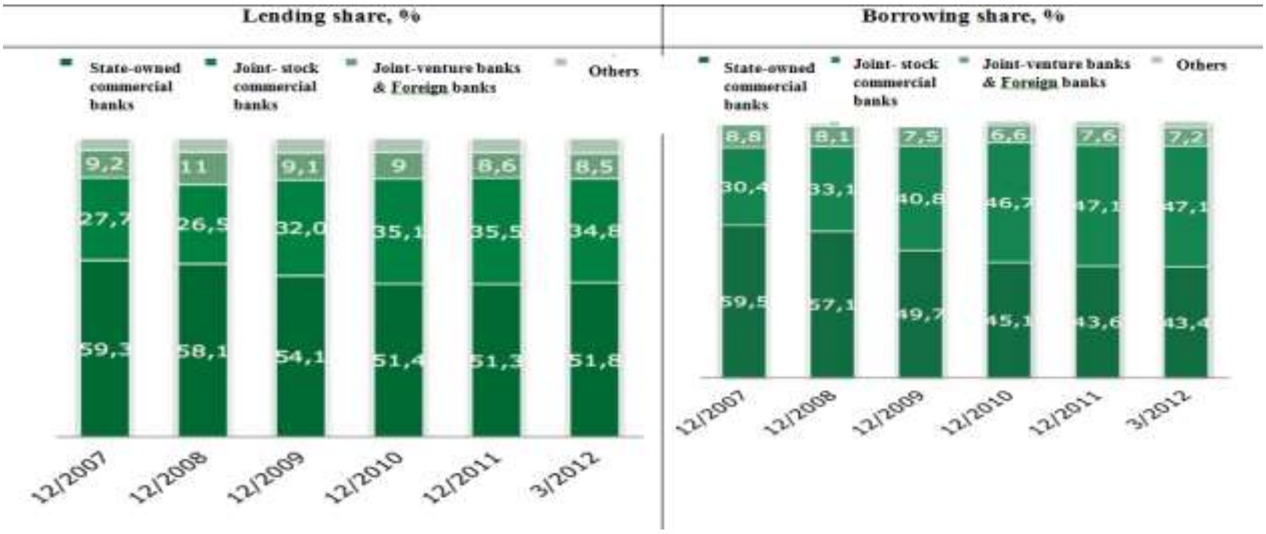
Figure 31: GDP and y-o-y lending and borrowing growth rates, %, 2001-2012



Source: SBV and GSO.

As per banking market share, with a declining tendency, the SOCBs has long occupied a lion share of credit market, accounting for 53.9% and 51.8% in 2007 and the first three months of 2012, respectively. Similarly, in deposit structure, the SOCBs share is decreasing from 59.5% to 43.4% in the corresponding period, “devoting” the leading position to the JSCBs since 2009 (Figure 32).

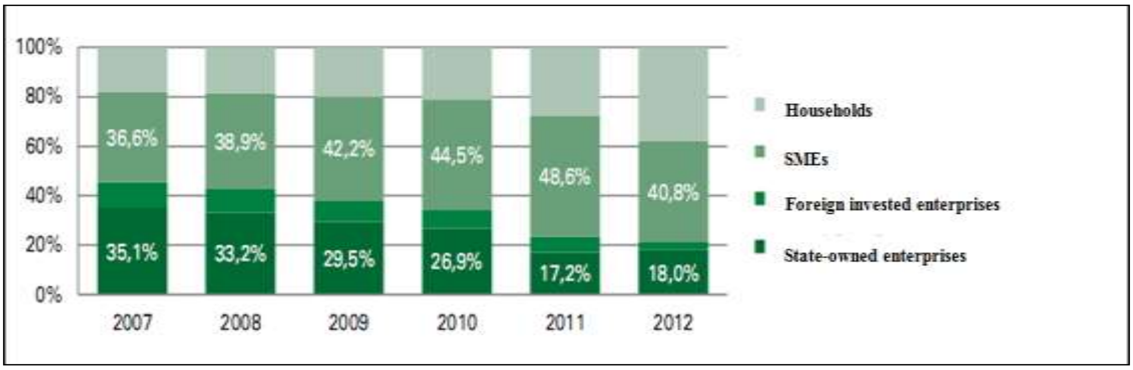
Figure 32: Structure of lending and borrowing markets by bank ownership, 2007-3/2013, %



Source: SBV.

Notably, despite the fact that Vietnam has implemented significant liberalization in banking sector since 2007, the proportions of foreign-invested credit entities remain limited and experienced a moderate and declining market position (Figure 32) despite an increase in absolute term (credit up from about VND 90 trillion to VND 210 trillion, deposit grew from VND 90 trillion VND to VND 185 trillion during 2007-2010). Key factors behind the market structure, inter alia, have been the fact that: (i) Domestic banks, particularly SOCBs have had traditional bank customers, well-established system of branches/offices and profound knowledge about domestic customers' habits and orientations; and (ii) foreign-owned credit institutions' intention to serve largely foreign customers due to well-established relationships and their concern about poor quality of book-keeping and governance of domestic companies, especially SMEs.

Figure 33: Credit structure by customer/ownership, 2007-12, %

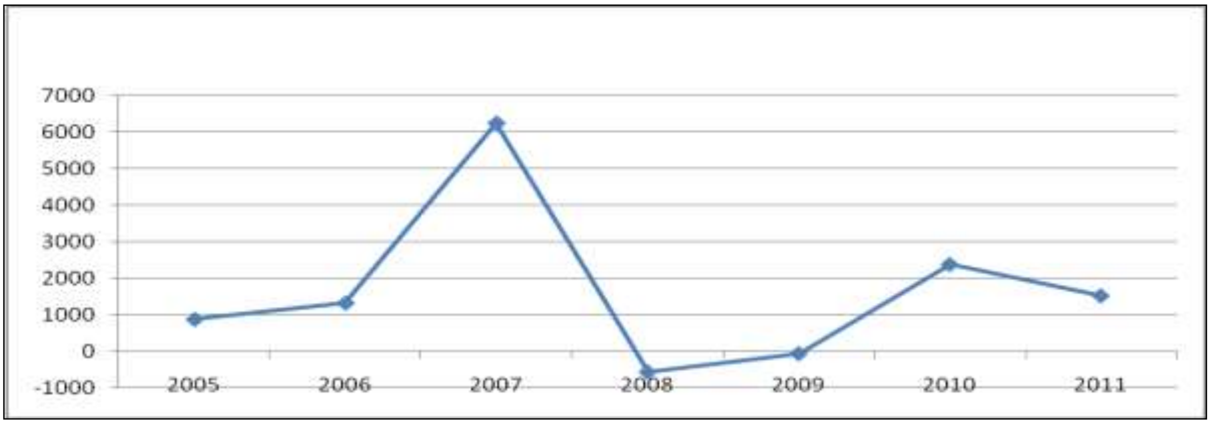


Source: SBV.

Regarding lending structure by bank customers, it is noteworthy that, over time, household business units and SMEs have been devoted to get more loans. Meanwhile, credit to SOEs has experienced a decreasing trend. Foreign-invested companies occupy a smallest and shrinking proportion. Again, the reason behind this tendency has been the fragmentation in Vietnamese lending market.

The indirect foreign (portfolio) investment saw huge ups and downs since 2006. In an anticipation of WTO accession impacts, the portfolio investment skyrocketed to about USD 6.3 billion in 2007 and subsequently plunged to about - USD 500 million in 2008 when the global financial crisis erupted. Since 2009, the inflow has recovered further (Figure 34).

Figure 34: Portfolio investment inflow into Vietnam, 2005-2011, mil. USD

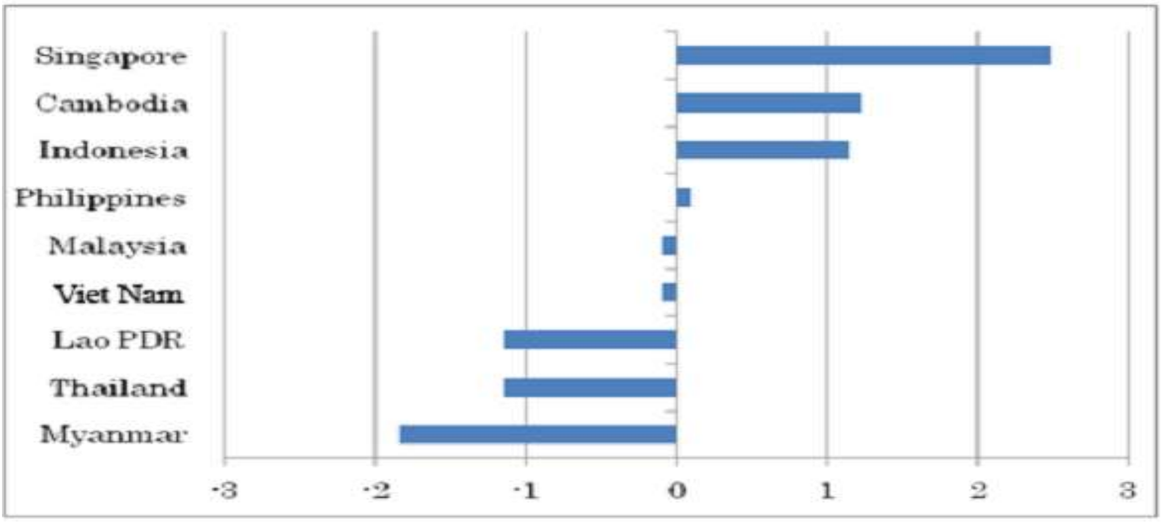


Source: State Securities Commission of Vietnam.

Notably, foreign investors account for about 25% of total daily trading volume during 2006-2009 (Nguyen Xuan Trinh et al. 2010) and for a range of 15-18% in 2011-2013, maintaining a net buying position annually. Despite low EPS, high P/E and recent undervalued (below nominal) prices of two third of Vietnamese stocks, there have been some major factors hindered the portfolio inflow in recent years (from foreign investors' perspective/view) such as relatively huge exchange rate fluctuation, other macroeconomic instability (particularly very high inflation) and financial risks (for instance, non-performing loans). Furthermore, Vietnam's stocks are largely small, with market capitalization of the biggest company of only nearly USD 5 bil. - much smaller than its peers in Thailand, Indonesia (about USD 30 billion). Last but not least, the limits (rooms) for foreign investors' ownership in a company of a number of industries (maximum 49%) and a bank (maximum 20-30%) (see next section) and the lack of derivative markets have also, to a certain extent, distracted the investment inflows.

As per degree of financial liberalization, Vietnam has not gone so far in 2009 in comparison to other AMSs and not much significant progress has been made recently.

Figure 35: Capital Account Openness in ASEAN Countries, 2009



Source: Yung Chul Park and Shinji Takagi (2012).

✓ *Domestic Regulatory Reforms*

Regulatory reforms can be broadly defined as the legal and institutional changes aimed at improving the quality of state policies and regulations, through which setting up a more favourable environment for businesses and citizens and to develop and to make the economy more competitive and efficient in wide variety of sectors. In other words, regulatory reforms is aimed at supporting governments to improve the regulatory quality - that is, reforming regulations that raise unnecessary obstacles to competition, innovation and economic growth, while ensuring that regulations efficiently serve important social objectives. Among the other things, such process of ameliorating and modernizing the very institutions supervising and governing the different economic sectors of a certain country or regional area responds to the already mentioned goal of 'Competiveness', requiring a business environment where successful firms operate in efficient markets under effective national and regional regulations. The afore-mentioned notion of efficiency in to be interpreted as including all its main facets, namely allocative, productive and dynamic efficiency.

As a key policy direction in the SEDP for 2011-2015 and the Socio-Economic Development Strategy (SEDS) for 2011-2020, Vietnam attempts to promote deeper, wider and more effective integration into the international economy, seeking to attain rapid and sustainable development and achieve the strategic target of fundamentally becoming a modern industrialised economy; to significantly improve the people's material and spiritual life; and to further consolidate the position in international arena. Vietnam is currently implementing the SEDS for 2011-2020 and the SEDP for 2011-2015, with the goal of achieving major breakthroughs in institutional reform, infrastructure development, and human resource development as well as renovating the growth paradigm. At the same time, Vietnam will continue to implement more fully commitments in the WTO, regional and bilateral integration frameworks. Furthermore, the country is negotiating FTAs with various economies and regions, with wider scope of commitment and higher standards.

Some of the most considerable regulatory reforms, occurred in Vietnam in the last decade or so, have concerned the banking and security markets. The key directions of reforms can be summarised as follows:

(i) setting up a basic ground for a modern financial system;

(ii) upgrading gradually financial regulations and infrastructure get-ting them compatible with that of the regional peers;

(iii) adjusting legal framework and related regulations on financial institutions in conjunction with international integration agreements (WTO and FTAs, including AFTA, AEC). Detailed regulatory reforms and commitments in banking and securities areas can be seen in Appendix 3. The below will largely address key regulatory reforms that directly affect the performance of financial institutions in Vietnam in the context of AEC commitments' implementation.

1.5.2. Regulation of financial markets

✓ *Banking Sector*

Banking sector activities in Vietnam are largely regulated by Law on Credit Institutions (1997, 2010), Law on State Bank of Vietnam (1997, 2010), and Ordinance of Foreign Exchange (2005). The country has lately implemented relevant regulatory reforms in a wide range of ban king activities. According to WTO commitments, the array of banking activities offered to foreign credit institutions is practically the same (11 activities) as the group of activity open to their domestic competitors, except for market limitations on accepting deposits 2013 in VND in the initial 5 years of the business opening (see Appendix 4).

As for acceptance of deposits and other repayable funds from the public, shortly after WTO accession, the SBV promulgated Official Letter No 1210/NHNN-CNH 2007 to gradual easing limitations on foreign bank's branches in accepting VND deposits over a 5-year phase ending in 2011 when national treatment to foreign competitors are granted. In 2010, the amended and supplemented Law on Credit Institutions 2010 provides detailed regulations allowing commercial banks, financial companies and financial leasing companies to provide all types of deposits and repayable funds from the public (Article 98, 108, 112) for full national treatment (NT) in 2011.

Similarly, for lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction, the Decision No. 1096/2004/QD-NHNN were amended and supplemented by Decision No. 30/2008/QD-NHNN, stipulating that credit institutions eligible for factoring services include domestic commercial banks, joint venture banks, 100% foreign owned banks, finance companies, financial leasing companies and foreign branches. Law on Credit Institutions 2010 further allow commercial banks, finance companies and financial leasing companies to provide all types of credit (Articles 98, 108, 112).

As for trading on own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, some legal documents are amended and supplemented, the full national treatment has been gradually granted for foreign exchange and derivative products (Decision No.1452/2004/QD-NHNN), exchange rate and interest rate instruments (Decision No. 62/2006/QD-NHNN), and money market instruments (Decision No.07/2008/QH-NHNN).

Regarding asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services, Law on Credit Institutions 2010 allows commercial banks and finance companies to provide asset management services (Article 107, 111) and recent Circular No.04/2012/TT-NHNN of the SBVN stipulates that all credit institutions in Vietnam and Foreign Branches are eligible for trust services and can act as loan agents for bank operation (Table 27).

In short, the Government of Vietnam has put remarkable efforts in regulatory reforms in order to allow more types of financial institutions to engage in wider equity participation and wider range of banking activities. Table 27 below outlines such process of reform.

Table 27: Key regulatory reforms in Vietnam's banking sectors to implement international commitments

Banking activities: WTO Commitments	Relevant Vietnamese laws and regulations	Specific content
(a) Acceptance of deposits and other repayable funds from the public	Official letter No 1210/NHNN-CNH 2007	Step-by-step easing limitations on foreign bank's branches in accepting VND deposits over a 5-year phase ending in 2011 when national treatment to foreign competitors are granted
	Law on Credit Institutions 2010	Article 98, 108, 112 allow for commercial banks, finance companies and financial leasing companies to provide all types of deposits and repayable funds from the public
(b) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction	Decision 1096/2004/QD-NHNN (amended and supplemented by Decision No 30/2008/QD-NHNN)	Credit institutions eligible for factoring services include domestic commercial banks, joint venture banks, 100% foreign owned banks, finance companies, financial leasing companies and foreign branches
	Decision No 1627/2001/QD-NHNN dated December 2001; Law on Credit Institutions 2010	Article 98, 108, 112 allow for commercial banks, finance companies and financial leasing companies to provide all types of credit

(c) Financial leasing	Law on Credit Institutions 2010	Article 108, 112 specifies that finance and financial leasing companies could offer financial leasing services Article 103 specifies the requirement for commercial banks to establish joint venture companies or subsidiaries to provide financial leasing services. Article 123 specifies that foreign branches not allowed to conduct financial leasing
(d) All payment and money transmission services, including credit, charge and debit cards, travellers' cheques and bankers drafts	Official letter No.32326/NHNN-TTGSNH Law on Credit Institutions 2010 Decision 226/2002/QD-NHNN	The Official letter specifies regulations on opening and operating ATM, which emphasizes the MFN and NT treatment.
(e) Guarantees and commitments	Decision No.26/2006/QD-NHNN	Article 3 notes that all credit institutions eligible to provide guarantees and commitments Article 7 notes the national treatment in a sense that the balance of guarantees should be kept less than 15% of charter capital for both foreign and domestic suppliers
(f) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise	Decision No.1452/2004/QD-NHNN	Foreign exchange and derivative products: open FX dealings regulation for all types of credit institutions
	Decision No. 62/2006/QD-NHNN	Exchange rate and interest rate instruments: Foreign branches, joint venture and 100% foreign owned banks allowed to provide interest rate swap agreements
	Decision No.07/2008/QH-NHNN	Money market instruments: there is no discrimination regarding the issuance of promissory notes (full national treatment)
(h) Money broking	Law on Credit Institutions 2010 Decision No. 351/2004/QD-NHNN	Article 107 restricts money broking services to commercial banks and foreign branches in Vietnam only
(i) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services	Law on Credit Institutions 2010	Article 107, 111 allow commercial banks and finance companies to provide asset management services.
	Circular No.04/2012/TT-NHNN	All credit institutions in Vietnam and Foreign Branches eligible for trust services and act as loan agents for bank operation
(j) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments	Law No.49/2005/QH11 on Negotiable Instruments	Settlement and clearance for negotiable instruments: in compliance with commitments
	Decision No.87/2007/QD-BTC	Settlement and clearance for securities: joint venture and 100% owned banks, foreign branches

(k) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services	Decree No. 10/2010	The provision and transfer of financial of financial information legalized between banks.
(l) Advisory, intermediation and other auxiliary financial services on all activities listed in subparagraphs from (a) to (k), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy	Law on Credit Institutions 2010	Article 107, 111, 116 implies all credit institutions are open to provided advisory services.

Source: Doan Le Mai (2013) and authors' updates and modifications.

- ✓ *Regulatory reforms in licensing conditions and legal form of credit institutions*

According to WTO accession commitments, foreign-invested credit institutions are entitled to conduct banking business in Vietnam in the form of bank branch, joint venture bank and 100% foreign-owned bank. Before WTO accession, in 2006, the ratification of Decree No. 26/2006/ND-CP officially specifies concrete conditions for establishment of foreign-invested credit entities in domestic banking sector. For example, Article 8, specifies the licensing criteria and procedures including the paid-capital requirement for parent bank in establishing branches (USD 20 billion) and in establishing joint venture and commercial entities with 100% foreign capital contribution (USD 10 billion), which practically fits the WTO commitments. The Law on Credit Institutions also provided the conditions regarding activities for Credit Institutions to be licensed. Recently, Circular No.40/2011/TT-NH specifies the participation of foreign capital contribution (less than 50% of foreign capital contribution in case of Joint venture and more than 50% in case of 100% foreign-owned bank).

Regarding foreign financial companies, Decree No.81/2008/ND-CP (Article 8) specifies the required charter capital of 10 billion USD for parent company to conduct business. For foreign financial leasing companies, Decree 95/2008/ND-CP amended Decree No. 16/2001/ND-CP (Article 8) in respect to the licensing criterion for foreign suppliers (from USD 5 million to USD 10 billion).

- ✓ *Regulatory reform in foreign equity participation in domestic banks*

Foreign equity participation in domestic banks has been expanded in recent years. Decree No. 69/2007/ND-CP on 20/4/2007 on foreign investors' purchase of shares of Vietnamese commercial banks provides principles on foreign equity participation, specifically:

1. The maximum shareholding percentage for foreign investors (including existing foreign shareholders) and their affiliated persons is 30% of the charter capital of a Vietnamese bank.

2. The maximum shareholding percentage for a foreign investor other than foreign credit institution or his/her/its affiliated person is 5% of the charter capital of a Vietnamese bank.

3. The maximum shareholding percentage for a foreign credit institution and its affiliated person is 10% of the charter capital of a Vietnamese bank.

4. The maximum shareholding percentage for a foreign strategic investor and his/her/its affiliated person is 15% of the charter capital of a Vietnamese bank.

In special cases, the Prime Minister may, at the proposal of the State Bank of Vietnam, decide to allow a foreign strategic investor or his/her/its affiliated person to hold shares exceeding 15% but not exceeding 20% of the charter capital of a Vietnamese bank.

Besides, national treatment in state-owned commercial banks is specified clearly in Section 6, Article 4.

Recently, the Government issued Decree No. 01/2014/ND-CP dated on January 3, 2014 on purchase of shares of Vietnamese credit institutions by foreign investors provides further participation for foreign investors. The new extensions of foreign stake in the degree are that the proportion of share ownership of a foreign investor and his/her relatives should not exceed 20% of the charter capital of a Vietnamese credit institution; and of a foreign entity should not exceed 15%. The total proportion of share ownership of foreign investors in a Vietnamese non-bank institution shall comply with the legal texts on public and listed companies.

In special cases to implement the restructuring of non-performing credit institutions for the sake of the prudent banking sector, the Prime Minister will decide the proportion of share ownership of a foreign entity and a foreign strategic investor, however, the total proportion of share ownership of foreign investors in a restructured non-performing credit institution might exceed the set ceiling proportion in case by case.

- ✓ *Security activities*

The key legal framework for the security market operation in Vietnam is the Securities Law No.70/2006/QH11 and is further improved by the Amended and Supplemented Securities Law No.62/2010/QH12 in 2010 and other regulations (more than 40 effective legal documents were ratified, specified in detail market regulations, for example, Decree No. 14/2007/ND-CP and the Amending and Supplementing Decree No.84/2010/ND-CP) (see Appendix 3).

- ✓ *Legal framework for foreign investors' participation*

The legal framework for scope of activities of financial institutions in Vietnam security market has been improved over times. The Securities Law 2007 regulates the legal scope of activities as following: (i) brokerage services, (ii) proprietary trading, (iii) underwriting and placement of issues as an agent, (iv) advisory and other auxiliary financial services, and (v) asset management/ portfolio management). The amended and supplemented Securities Law 2010 supplements domain (iv) to fund management companies and domain (v) to securities companies since 2011. In addition, the Decision 27/2007/QD-BTC on the establishment and operation of securities companies and Decision No.35/2007/QD-BTC (amended and supplemented by Decision No. 2529/2007/QD-BTC) on the establishment and operation of fund management companies, add more detailed provisions to the applicable range of activities.

The foreign participation in Vietnam's stock market has also been gradually relaxed. According to the WTO commitments, within the first 5 years from the date of accession, the legal forms for foreign security service suppliers to establish commercial presence are representative offices and joint venture with foreign participation capped at less than 49%. Notably, branches and 100% foreign-owned securities service suppliers were not allowed. Since 2011, 100% foreign-owned securities was allowed to operate in Vietnam (in 2013, Maybank Kim Eng became the first securities company with 100%-foreign capital).

The first two legal forms were later institutionalized by Decision No.124/2008/QD-BTC (for representative offices) and Decision No.55/2009/QD-TTg (for joint venture, allowing the equity contribution of less than 49%) and for the maximum of foreign stake for foreign investors of 49% for listed companies and 30% for non-listed ones); however, since 2010, the proportion is 49% for both listed and non-listed companies.

Regarding foreign investors' participation in security market activities, Decision 121/2008/QD-BTC stipulates that foreign investors may conduct investment activities on Vietnam's securities market in the following forms: (1) direct investment by: (i) Purchasing and selling floating stocks, bonds and other securities; (ii) Purchasing and selling shares and non-listed securities; (iii) Making bids to purchase auctioned securities or equities of equitized enterprises; (iv) Making capital contributions to establish securities investment funds at a percentage prescribed by the Prime Minister for foreign parties; (v) Making capital contributions to Vietnamese enterprises at a percentage prescribed by the Prime Minister for foreign parties; and (2) indirect Investment (by trusting fund management companies to manage their investment capital under investment management contracts with the latter).

- ✓ *Financial supervisions and prudential measures*

Regulatory reforms in supervision of financial system has significantly advanced lately. Key aspects of the SBV in regulatory reform's on the supervision of the banking sector include: (1) resolving NPLs in banking sector; (2) gradual standardization of NPLs classification based on international standards and best practices; (3) shifting key standards application from Basel I to Basel 2; and (4) strengthening on-site inspection and compliance supervision, meanwhile laying initial ground for risk-based supervision. These efforts can be seen in legal documents. For instance, in order to strengthen regulatory and supervising measures, the Decision 83/2009/QD-TTg provides detailed provisions on rights and obligations of bank regulatory commission at SBV. Besides, the SBV has issued legal documents specifying prudential ratios to manage credit risk (Decision 18/2007/QD-NHNN), liquidity risk, operation risk, interest rate risk - (Decision 437/2006/QD-NHNN) - for the sake of safety operation of the credit institutions.

The power of State Securities Commission (SSC) has also significantly enhanced in recent years especially in overseeing the securities market and imposing the market disciplines and enforcement. Decision 127/2008/QD-BTC defines and specifies more clearly the securities market surveillance. Decision No.112/2009/TT-TTg specifies the organization, responsibilities and powers of the SSC. In addition, the SSC is also further empowered with Circular No.37/2011/TT-BTC on administrative penalties in securities markets. As a result, in 2011, 6 securities companies, which could not meet the prudential ratio for securities firms (6% for domestic securities services suppliers and 4.8% for OECD foreign securities) were put under special supervision.

In order to guarantee the transparency and prudential issue required by GATS general principles and guidelines, legislation on the regulation of Vietnamese securities market is promulgated and revised as necessary. For example, Circular No.74/2011/TT-BTC provides regulation on securities transaction; Circular No.226/2010/TT-BTC on financial prudential ratios; and Circular No.09/2010/TT-BTC on disclosure of information.

- ✓ *Capital account liberalization*

As to the capital account restrictions, in general, Vietnam commitments of financial liberalization under GATS are in accordance to Article 8 of the Regulations of IMF. The general moves are summed up below:

1) Current account transactions:

Since June 2005, Vietnam began to remove restrictions on current account transactions in compliance with Article 8 of the Regulation of the IMF. To date, Vietnam has completed full liberalization of foreign exchange transaction and settlement in almost all current account transactions in conformity to international commitments (IMF, WTO); by doing so, narrowing legal gaps in foreign exchange management with other countries. Positive changes in regulatory reform are evident in Ordinance of Foreign Exchange (2005) (Ordinance No.28/2005/PL-UBTVQH11 on foreign exchange control). A number of ineffective provisions in the Ordinance were revised, supplemented in a timely manner. The Ordinance also helped concentrate provisions of foreign exchange management to a sole legal unit. As a result, there has been a simplification of administrative procedures in granting li-censes and enhancement of legal efficacy.

2) Capital account transactions:

Over two decades or so, Vietnam has gradually remove restrictions on capital account transactions of foreign investors and foreign borrowing. Based on the principle of prudential and safety management of foreign exchange and capital transactions, on one hand, Vietnam allows foreign investors (inward FDI and outward FDI) to flow, on another hand, she supervises closely the portfolio investment (via specific accounts opened in an assigned bank).

3) Other measures of financial liberalization

Along with the above-mentioned financial liberalization, internal financial liberalization was also gradually implemented. First of all, foreign exchange surrender requirements were step-by-step eased from 80% (1998) to 50% (1999), 40% (2001) and down to 30% (2002), and finally eliminated (0%) in 2004. Second, the dual/ multiple exchange rate regime for various transactions was abolished in 1989 and a unified, single official exchange rate system for all transactions had been put in practice. However, if the IMF de facto classification is applied, Vietnam would be categorized to as an economy with multiple-exchange-rate regime (Mai Thu Hien 2013). Last, other types of financial depression have also gradually removed.

- ✓ *Vietnam's efforts in ASEAN financial cooperation and integration*

The Asian financial crisis in 1997 and AEC commitments provided a direct impetus for countries to strengthen for regional financial cooperation. Having suffered the ASEAN financial crisis and global crisis, AMSs, including Vietnam have reached a consensus on the need to enhance their own risk management abilities in order to prevent and resolve any future financial crises. They needed to do so by strengthening regional financial cooperation, instead of depending merely upon support from international financial organizations, including the IMF, and from advanced countries.

Regional financial cooperation can be subdivided into two categories, namely strengthening crisis management regimes, and developing a regional bond market. Notably, all two forms of financial cooperation have already put in place before 2008, *i.e.* the year of AEC implementation.

Since the financial crisis in the late 1990s, Vietnam has made joint efforts with other AMSs to create cooperative schemes for resolving and preventing any future crises. They have focused on two pillars – establishing a regional financing arrangement, and strengthening the surveillance and monitoring framework. Measures to establish a regional financing arrangement include the conclusion of bilateral swap arrangements (BSAs) under the ASEAN + 3 (Chiang Mai Initiatives). As the financing network of BSAs among regional countries has been successfully established, members have discussed multi-lateralization of the CMI to set up a more advanced regional liquidity provision framework based upon it. The strengthening of regional surveillance and monitoring regimes has been dealt with as a major challenge in ASEAN + 3. The CMI, adopted at the ASEAN + 3 Finance Ministers' Meeting in May 2000, established a network of BSAs under which, in times of financial crisis, member central banks provide liquidity to their counterparts up to certain agreed-upon amounts. As of December 2007, the number of BSAs reached 17, with the total funding volume amounting to USD 84 billion. In addition, as a member of AEC, Vietnam has made efforts to developing the BSAs of the CMI into a more efficient regional financing framework. In 2006, to enhance the effectiveness of the financing framework, a collective decision-making process was introduced, whereby financing countries are called upon within two days after the outbreak of a crisis, and fully provide the support required after deciding upon financing within one week.

Vietnam and other members in the region have also made joint efforts to build systems for surveillance and monitoring of regional financial and economic developments and to strengthen their policy cooperation through these systems. In May 2006, the technical Working Group on Economic and Financial Monitoring (ETWG) and the Group of Experts (GOE) were created. These groups support member countries in building policy collaboration through regular monitoring of economic and financial developments, and at the same time enhance their crisis management capabilities by facilitating early detection of crisis symptoms. During the Finance Ministers' Meeting in May 2007 in Kyoto, Japan, the ministers agreed to tighten the connections among the ERPD, ETWG and GOE, to further promote their functions of surveillance of regional economic and financial developments.

In April 2007, Vietnam (deputy governor of the SBV) joined the Monetary and Financial Stability Committee (MFSC), which handles regional monetary and financial monitoring, and performs such activities as risk and crisis management and resolution. In May 2007, the MFSC decided to launch a regional monetary and financial monitoring system and then in November 2007, agreed to build a regional crisis management and resolution network.

Developing the regional bond markets is one of noteworthy joint effort of Asian countries, including Vietnam. The creation of the Asian Bond Fund (ABF), a fund comprising foreign exchange reserves held by regional member central banks, is important milestone of the regional financial cooperation and integration. Its investment in regional bonds is contributing to the development of regional bond markets. ASEAN + 3 is seeking ways to promote issuance of bonds within the region and member countries through the Asian Bond Market Initiatives (ABMI), and to build a common substructure (a credit guarantee, credit rating and settlement system) that can foster regional bond market development. In addition, bond-type funds were also created, invested in jointly by member countries, to boost regional bond markets and diversify the investment targets of members' foreign exchange reserves. As a result, the ABF-1 and ABF-2 were established in July 2003 and April 2005, respectively, and have been in operation ever since (Jung 2009).

Active and proactive participation in the regional fora to promote deeper and more efficient cooperation is also a top priority of Vietnamese government in recent years. In this regard, the Ministry of Finance (MoF) and SBVN have been continuously participating in the ASEAN and ASEAN+3 financial processes and attended the ASEAN meetings, particularly the ASEAN Central Bank Governors' Meeting, the ASEAN Central Bank Deputy Governors' Meeting and other Working Group Meetings such as Financial Services Liberalization (FSL), Capital Account Liberalization (CAL), Capital Market Development (CMD), ASEAN Infrastructure

Fund (AIF), ASEAN Payment and Settlement Systems (PSS),) and Credit Guarantee and Investment Facility (CGIF) Meetings. Furthermore, the SBVN has been cooperating and collaborating with the Ministry of Finance regarding meetings such as ASEAN Finance Ministers' Meeting (AFMM), ASEAN+3 Finance Ministers' Meeting (AFMM+3), ASEAN+3 Finance and Central Bank Deputies' Meeting (AFDM+3) and Special ASEAN Finance Ministers' Meeting (Special AFMM).

In a nutshell, Vietnam has actively and proactively engaged in the financial cooperation and integration to help promote financial development, efficient and safety integration with the AMSs and other Asian countries.

1.6. *Institutional capacity improvement*[25]

Over the two decades, the market-oriented reforms and economic integration helped improving economic institutions (in a broad definition) in Vietnam remarkably as follows:

(i) The basic legal framework for such institutions was established and improved further towards a market economy and to comply with international rules and provisions Vietnam is currently subject to.

(ii) The organizations involved in the supervision, regulation, implementation and management of different economic activities were restructured and strengthened.

(iii) The enforcement mechanism including supporting policies and mechanisms experienced up-gradation and enhanced effectiveness to establish fair competition in the business environment and ensure that Government interventions only seek to correct market failures.

1.6.1. Improvement of Legal Framework for a market-oriented economy

Under the pressure put by the need of implementing main international commitments and market-oriented reforms, Vietnam's legal and institutional framework has been significantly improved, especially in the pre-WTO accession period. Most efforts have sought to internalize international commitments into domestic laws to: create a business environment with fair competition and transparency; develop various markets of production factors, particularly financial markets; reduce the Government intervention in markets through price control, resource allocation, ownership, protection measures, subsidies and monopoly; and create a socio-economic environment satisfying relevant criteria for Vietnam to be recognized as a market economy. Gradual liberalization of production factor markets, particularly financial markets are among salient merits that helped improve efficiency of resource allocation and facilitate domestic go global.

In order to comply with the WTO and other free trade agreement commitments, many legal documents (such as Enterprise Law, Investment Law and guiding documents) were issued, revised and amended. They helped make the business environment more transparent and reduce time, efforts and transaction costs of enterprises in fulfilling administrative procedures. Business start-ups as well as market exit became easier. Competition environment incorporated greater soundness, and more level between SOEs and private enterprises and between domestic and foreign enterprises.

[25] This content is largely drawn from the CIEM (2013).

The promulgation and amendment of some laws and legal documents (for instance, Law on Credit Institutions in 2010) created further improvement towards liberalizing markets, abolishing monopoly, creating a fair competition between enterprises of all ownership types, and encouraging non-state sector to provide public services. It facilitated rapid development of those markets, with transformation from monopoly into competition, and encouraged non-state participation in providing services. Such improvement also created favourable conditions for applying many new technologies, diversifying services, improving quality and reducing product prices.

As for financial markets, continuous improvements of regulations over Vietnam's securities market (i.e. the Securities Law in 2006 and related documents) helped such a relatively new market become an increasing important channel for mobilizing long-term capital in Vietnam. In addition, to strengthen the role of monetary policy, the Law on SBV was amended on 19 June 2010. The amended and adjusted contents include regulations on liberalizing the basic interest rate and managing interest rates in line with market mechanism. The Law on SBV stipulates more clearly missions and responsibilities of the National Assembly, the Government and the SBV in implementing monetary policy. The National Assembly decides the tentative inflation target for each period. The Government identifies inflation target and orientations for conducting monetary policy each year. The SBV prepares the scenarios of inflation targets for each period, on the basis of which the Government will submit to the National Assembly for determination of targets and related monetary policy measures each year. However, a myriad of shortcomings prevailed. Some laws and documents were featured by varying and modest quality. Many documents were incomplete, inconsistent with other related ones, ambiguous and inefficient in addressing the targeted issues. Some legal documents had to be amended and adjusted many times, thereby undermining actual enforcement. As one of the main reasons, many officials had limited skills in drafting legal documents, analysing and formulating policies. This reason is added by the lack of wide consultation on legal documents' contents right after the idea is formulated.

1.6.2. Re-organization of the government and the administrative apparatus

To ensure effective socio-economic development policies reflected in the legal documents, the policy enforcement structure has been continuously improved. Right after Vietnam joined the WTO, the Government required ministries/government agencies at both central and local levels to review their roles and functions of macro management, seeking to improve management efficiency in line with economic reforms and international economic integration. In 2007-2008, the management roles and functions of all ministries and government agencies at both central and local levels were supplemented and amended towards unambiguous division with better accountability and deeper decentralization to increase management efficiency. The functions of the Government and public administrative agencies at all levels basically shifted from direct to indirect management via legal documents and macroeconomic instruments. Many ministries and ministerial-level agencies were merged, thereby reducing the number of agencies directly under the Central Government from 38 to 30.

The reorganization of Government apparatus in 2007-2008 sought to separate public administration function of public administrative agencies from management of enterprises' activities. This may help reducing unnecessary or improper administrative interventions in the process of production and business, which could cause adverse social consequences. After separating the organizations with mandate of providing essential services from ministries and public administration agencies, some new organizations were established to regulate price, manage quality, etc. in these fields.

Because the function of business management was separated from the function of public administration, the ministries and government agencies had no management function over assets and business activities of affiliated SOEs. Instead, the State Capital and Investment

Corporation (SCIC) was established to supervise the SOEs and corporations which used state capital and/or benefited from public investments.

Reform of the judicial system played a very important role in improving legal enforcement and protection of legitimate benefits of people and the State. The system of courts, prosecutors and agencies of investigation, judgment execution and judicial affairs support recently underwent positive changes. Some economic, labour and administrative courts were established under the People's Supreme Court and provincial courts in order to ensure that the trials become more professional, stricter and fairer. According to the Judicial Reform Strategy till 2020, functions of courts would be deeply decentralized and the system of courts will have authorities independent from different levels of governments, with better accountability.

Notwithstanding significant progresses in reforming legal framework and legal enforcement structure, Vietnam failed to clearly improve the efficiency of legal enforcement. There are several reasons for this situation. First, sanctions remained absent or ineffective, failing to deter illegal behaviours. This reduced incentives for and accountability of executors. Ambiguity in some legal documents also undermined transparency and fairness in public administration. The guiding documents were slowly issued and at times contained articles contradicting with other laws or legal documents.

The legal information often lacked timeliness and accuracy, or with slow update. Vietnam has neither mechanism on physical and legal responsibilities in case of wrong and insufficient information nor an efficient mechanism to encourage enterprises of all ownership types to invest in disseminating legal information. The propaganda and popularization of legal regulations were inclined to formalism. Building an efficient legal aid and consultancy system - to help people, organizations and enterprises protect their legitimate rights and benefits – received hardly adequate attention.

Due to inefficient propaganda, many people lacked sufficient awareness of the rule of law, role, position and meaning of laws in adjusting socio-economic relationships. A portion of officials had insufficient acknowledgement of the role and functions of legal documents. Accordingly, they paid inadequate attention to studying regulations and using legal consultancy in management and administration. The weak system of Vietnamese courts partly undermined legal enforcement. Vietnam remained in shortage of qualified lawyers and judges.

1.6.3. Enforcement Mechanism

International economic integration, particularly the accession to the WTO, had big impacts on improving Vietnam's legal framework in line with market economy mechanisms and international economic integration. As widely recognised, a well-functioning market consists of a set of rules, institutions and agents that interact mutually to achieve efficiency in the management of resources. Free demand and supply interaction is not a sufficient condition for perfect (or workable) competition; market failures and anti-competitive behaviours are a serious threat to market functioning. Correctly functioning market dynamics depend upon existing efficient regulations and correct supervision. These conditions are both of the utmost importance, together with the existence of a specific authority to ensure that regulatory and supervisory duties are performed in an efficient manner. To some extent, the Vietnam has recently upgraded and improved the institutional framework and legal enforcement necessary for market regulations and supervision. The most notable improvement in legal enforcement mechanisms was induced by the Project No.30 on simplifying administrative procedures for the years 2007-2012. Under a gradually improved legal framework, efforts to simplify administrative procedures increased the efficiency of government apparatus, reduced time and costs for enterprises and people in accessing public administrative services and prevented bureaucracy, harassment and corruption of officials. The Project No. 30 sought to reduce 30% of procedures in investment and business. In its first phase, over 1.000 administrative procedures were abolished. The second phase of the Project would be carried out mainly in the areas of tax, customs, labour and business registration. About 54% of enterprises, surveyed by the Secretariat of Business Forum in 2009, recognized the improvement in administrative procedures.

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In summary, Vietnam has achieved major progresses in socio-economic aspects. Economic growth has been high and continuous, accompanied by high export growth, expansion of employment and improvement of people's income. Still, the growth paradigm has for long relied on expansion of credit and public investment, which increased pressures on the State budget, public debt as well as macroeconomic stability. The recent macroeconomic difficulties caused Vietnam to focus more on stabilization measures and accept slower growth. Microeconomic reforms were also slowed down and failed to match efforts to deepen integration into the regional and global economy. In this regard, ensuring the harmony and inclusiveness of economic growth and income improvement is less than sufficient; Vietnam still needs to pay more attention to ensuring the resilience and competitiveness of its growth process.

2. TARGETS AND BLUEPRINTS OF AEC

The ASEAN was founded on August 1967 by five countries: Philippines, Indonesia, Malaysia, Singapore, and Thailand. AFTA agreement was signed on 28 January 1992 in Singapore by six countries, as Brunei had joined the ASEAN in 1992. Vietnam joined the ASEAN in 1995, Laos and Myanmar in 1997 and Cambodia in 1999. ASEAN today comprises ten countries, crosses three time zones and encompasses over five hundred million people.

In December 1997, ASEAN adopted the "Vision 2020" at the Summit in Kuala Lumpur. This vision expresses the wish to transform ASEAN into a stable, prosperous, and highly competitive region with equitable economic development, combined with reduced poverty and socio-economic disparities. In Vietnam, the Hanoi Plan of Action was the first step in a series of actions launched to reach these goals.

The intention to set up the AEC between the members of the community was already included in the ASEAN Vision 2020, but it was only officialised in the Declaration of ASEAN Concord II at the summit in Bali on October 2003. The aim of AEC is to transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development and a region fully integrated into the global economy.

Within ASEAN, much economic cooperation has been achieved in the "ASEAN" way, not through rules and regulations, but through discussion and consultation, and consensus (relations-based governance). However, it has been stated that ASEAN must move away from these "relationship-based" governance mechanisms to ones that are more "rules-based" and "market-driven".26 With economic expansion in the region and closer economic cooperation among the members of ASEAN, international trade and investment in the region are increasingly becoming subject to international regulation by a rules-based system, with a rules-based framework evolving to regulate economic relations *inter se*. Member states have been moving slowly towards developing a rules-based framework for economic cooperation among themselves, which has culminated in the ASEAN Charter: at the 12th ASEAN Summit in January 2007, the leaders agreed to hasten the establishment of the AEC by 2015 and to transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and free flow of capital.

Hence, on November 2007, the ASEAN leaders adopted the ASEAN Economic Blueprint at the 13th ASEAN Summit in Singapore. The AEC would form a large and diverse economic entity by end 2015. The AEC areas of cooperation include human resources development and capacity building, recognition of professional qualifications, closer consultation on macroeconomic and financial policies, trade financing measures, enhanced infrastructure and communications connectivity, development of electronic transactions through e-ASEAN, integrating industries across the region to promote regional sourcing and enhancing private sector involvement for the building of the AEC.

The AEC Blueprint outlines actions and measures and time lines for completion by the 2015 deadline. However, by mid-2014 only a partial implementation had been achieved. While tariff

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26 Severino (1999).There have been at least twenty Summits among the ASEAN countries. They adopted about twenty basic legal documents. All these are dedicated to realizing the ambitious goal of the ASEAN countries to be developed.

elimination had largely been on schedule, there are difficulties with removal of NTBs and services and investment liberalization.

In summary, the AEC has come a long way, but it has fallen short of the high standard and time frame it has set for itself. ASEAN therefore has to find the political will and management capability to fulfil all goals in the AEC Blueprint – arguably, by prioritizing the more urgent and shortly achievable - and embark on further liberalization, rationalization, and integration to seize the opportunities and successfully meet the economic challenges of the 21st century. Moreover, it must also be stressed that the economic integration of ASEAN is not only about the development of a Single Market, but also about the development of Integrated Production Network (IPN). While the creation of the European Single Market indirectly created the environment for new networks of businesses and production, in Asia, counter-intuitively, these networks already exist despite some trade barriers. International and regional production networks are market-driven and involve the breaking up of production processes into fragmented segments that can be carried out in different cross-border locations and eventually coordinated for assembly into final products. Production networks make use of each location's advantages to boost productivity and cut costs, while bolstering investment and technological transfer. The East Asian fragmentation of manufacturing production and export appears as follows: China, Japan, and the Republic of Korea are home countries for production networks, with China increasingly functioning as the major assembly base (factory of the world). The ASEAN countries of Malaysia, Philippines, Singapore, and Thailand encourage inflows of MNCs' investments, successfully absorbed new production technologies and develop local supporting industries, and became major exporters of machinery parts and components. The success of these ASEAN economies led to a second wave of production networks to Indonesia and CLMV, as they are able to absorb the relocation of labour intensive segments and enter international markets requiring only a limited range of skills.

To achieve the main AEC blueprint's objectives fully and face the complex process of economic challenges of the 21st century, it seems also necessary a process of institutional reform and enhancement of the Association's architecture itself. We devote more careful and extensive considerations to such profile of the present report. For the time being let us remark that ASEAN currently lacks a binding court to harmonize laws and standards within the region. The Association has been so far effective in the capacity envisioned at its creation, as it successfully promotes peaceful relations within the region diminishes the effect of outside forces in the states while concurrently promoting the economic development of all its nations. However, to continue to progress and maintain relevancy in today's world, ASEAN must form a court or similar institutions to deal with the increasingly complex and contentious matters facing the region. Noticeably, in 2007 it was also adopted the so-called ASEAN Charter. The Charter adopted by AMSs was intended to instil a greater incorporation of rules and formality into the regional bloc's operations. ASEAN members wanted the Charter to help in regional integration in the three pillars of political-security, economic, and socio cultural matters. The Charter of the ASEAN has been hailed as a legal instrument that would integrate the ten constituent members as a community and a regional organization. Ostensibly, the Charter has three strategic thrusts in support of the vision of the ASEAN Community. The first is to formalize ASEAN as an institution while streamlining its decision-making processes. *Second*, the Charter seeks to strengthen ASEAN institutions. Third, it seeks to establish mechanisms to monitor compliance and settle disputes. The Charter aims at transforming ASEAN from an institution that fosters purely political relationships into one that fosters compliance by member countries to their promises and obligations. In short, it seems clear that ASEAN needs to look towards rule-based principles for economic integration. This echoes the existing literature on legalization.[27]

Finally, it is worth recalling that the AMSs have relied on non-ASEAN sources of law to support their regional economic integration into the AEC. For instance, AMSs have used WTO dispute resolution to resolve issues that could have been resolved using the ASEAN Enhanced Dispute Settlement Mechanism. Also, the AMSs conducting cross-border inspections have used UN agreements as legal support rather than use the ASEAN Trade in Goods Agreement.[28] Finally, economic integration between the AMSs has arguably benefited from the previous experience and outcomes of other regional areas and, above all, the EU. Whether the EU is an appropriate template for ASEAN, or, whether, given the apparently unique circumstances of European integration and Southeast Asian regionalism, analogies between the two are counterproductive, is a rather complex issue. On the contrary, it seems crystal-clear that the EU's uniquely modus operandi and deep economic integration cannot be replicated by ASEAN simply by institutional mimesis.[29]

2.1. Key contents of AEC framework and commitments

Serious efforts toward a deeper economic integration among the ASEAN members started only in 1992. Initial obstacles included the widespread pursuit of import substitution policies of industrialization, the small extent of intra-ASEAN trade, and the wide differences in economic size, development level, and industrial competence giving rise to widely divergent perceptions of benefits and costs of integration. The switch to outward-looking development strategies and external pressures (such as the formation of the European Union Single Market and the North American Free Trade Area) pressured ASEAN to form a free trade area (FTA) in 1992. The challenges of globalization, slow recovery from the Asian financial crisis, and the economic rise of China and India further pressured ASEAN into deep integration in 2003 with the formation of the AEC: in October 2003, ASEAN decided to establish the AEC by 2020 but later decided to advance it to 2015 (with a longer time line of 2018–2020 for CLMV).

The AEC is a highly ambitious effort at deep integration, which includes factors of production as well as a dispute settlement mechanism. It represents the realization of the end goal of economic integration as espoused in the Vision 2020, which is based on a convergence of interests of AMSs to deepen and broaden economic integration through existing and new initiatives with clear timelines. In establishing the AEC, AMSs act in accordance to the principles of an open, outward-looking, inclusive, and market-driven economy consistent with multilateral rules as well as adherence to rules-based systems for effective compliance and implementation of economic commitments.

The AEC envisages the following key characteristics: (a) a single market and production base,

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27 See Appendix 4 in the Annex to this Report.

28 Using non-ASEAN legal instruments to implement ASEAN-level commitments has pros and cons. On the one hand, such practice could undermine the legitimacy of the ASEAN agreements. On other hand, using non-ASEAN legal instruments could give AMS greater confidence by giving them more experience in dealing with each other, albeit in a non-ASEAN context/manner.

29 For an extended assessment of the issue see Appendix 4 in the Annex to this Report.

(b) a highly competitive economic region, (c) a region of equitable economic development, *and* (d) a region fully integrated into the global economy. These characteristics are inter-related and mutually reinforcing.

At the same time, the AEC addresses also the development divide and accelerate integration of the CLMV through the Initiative for ASEAN Integration and other regional initiatives. Other areas of cooperation are also to be incorporated such as human resources development and capacity building; recognition of professional qualifications; closer consultation on macroeconomic and financial policies; trade financing measures; enhanced infrastructure and communications connectivity; development of electronic transactions through e-ASEAN; integrating industries across the region to promote regional sourcing; and enhancing private sector involvement for the building of the AEC.

2.2. The Four Pillars of AEC

Four pillars have been identified to reach AEC targets, namely: single market and production base; competitive economic region; equitable economic development; and integration with the global economy.

- *Pillar one: single market and production base*, with the following targets: Free Flow of Goods; Free Flow of Services; Free Flow of Investment; Free Flow of Skilled Labour, Freer flow of Capital;
- *Pillar two: competitive economic region*, with the following targets: competition policy, consumer protection, intellectual property rights (IPRs) and infrastructure development by mean of enforcing regulations, taxation policy and e-ASEAN framework agreement;
- *Pillar three: equitable economic development*. The purpose of this pillar id to narrow the development gap between ASEAN-6 and CLMV thanks to the development of Small and Medium Enterprises (SMEs) and the Initiative for ASEAN Integration (IAI). The identified key sectors are food, agriculture and forestry and the main policies are more especially focused on improving food security;
- *Pillar four: integration with the global economy*. This pillar is focused on having a coherent approach toward external economic relations and enhanced participation in global supply network by mean of signing FTA with non-ASEAN countries. Regional economic integration for East Asia is progressed in a gradual and phased manner (building-block approach).

Incorporating the required elements of each target and implementing action in the Blueprint is expected to ensure the consistency and coherence of these elements as well as their implementation and proper coordination among relevant stakeholders.[30]

2.2.1. Pillar A: Single market and production base

An ASEAN single market and production base aims at the following targets: (i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) freer flow of capital; and (v) free flow of skilled labour.

30 The clear indication of the required actions to be taken by the AMSs for all the targets of each pillar provides the Blueprint For a complete illustration of such actions

✓ *A1. Free flow of goods:*

Free flow of goods is one of the principal means by which the aims of a single market and production base is achieved. A single market for goods (and services) will also facilitate the development of production networks in the region and enhance ASEAN's capacity to serve as a global production centre or as a part of the global supply chain.

The target of goods liberalisation is to eliminate tariffs on all products, except for those phased in from the SL and HSL, for CLMV 2015 with flexibility on some sensitive products up to 2018. This target could be reached through removal of tariffs or through removal of non-tariff barriers in some cases. Also, efforts on the following, i.e., trade facilitation; custom integration; ASEAN single window; and standards and technical barriers to trade would facilitate the realization of establishing a single market and production. For the first two-year period (2008–2009), ASEAN has targeted the implementation of the entry into Force of ASEAN Multilateral Agreement on Air Services (MAAS) to ratify MAAS and its Protocols 9 Entry into Force of the ASEAN Multilateral Agreement on the Full Liberalisation of Air Freight Services (MAAFS).

More in detail, under the heading "Free Flow of Goods", the AEC Blueprint establishes that the Common Effective Preferential Tariffs for ASEAN Free Trade Area (CEPT-AFTA) Agreement is reviewed and enhanced to become a comprehensive agreement in realising free flow of goods and applicable to ASEAN needs for accelerated economic integration towards 2015 and calls for the complete elimination of tariffs on all intra-ASEAN goods in accordance with the schedules and commitments set out in the CEPT-AFTA Agreement and other relevant Agreements/Protocols; the full elimination of NTBs; the putting in place of ROOs which are responsive to the dynamic changes in global production processes so as to: facilitate trade and investment among AMS, promote a regional production network, encourage development of SMEs and the narrowing of development gaps; and promote the increased usage of the AFTA CEPT Scheme; trade facilitation (through simple, harmonised and standardised trade and customs, processes, procedures and related information flows are expected to reduce transaction costs in ASEAN which will enhance export competitiveness and facilitate the integration of ASEAN into a single market for goods, services and investments and a single production base); customs Integration;[31] the creation of the ASEAN Single Window (ASW), through the implementation of measures of simplifying, harmonising and standardising trade and customs, processes, procedures and the application of ICT in all areas related to trade facilitation would be paramount in the ultimate creation of an ASW. The ASW is an environment where ten National Single Windows (NSW) of individual AMSs operate and integrate.

✓ *A2. Free flow of services*

Free flow of trade in services is one of the important elements in realising AEC, where there is substantially no restriction to ASEAN services suppliers in providing services and in

31 The 2005-2010 Strategic Plan of Customs Development aims to: (a) integrate customs structures; (b) modernise tariff classification, customs valuation and origin determination and establish ASEAN e-Customs; (c) smoothen customs clearance; (d) strengthen human resources development; (e) promote partnership with relevant international organisations; (f) narrow the development gaps in customs; and (g) adopt risk management techniques and audit-based control (PCA) for trade facilitation.

establishing companies across national borders within the region, subject to domestic regulations.

It is important to note that liberalisation of services has been carried out through rounds of negotiation mainly under the Coordinating Committee on Services. Negotiations of some specific services sectors, such as financial services and air transport, are carried out by their respective Ministerial bodies. Rather remarkably, in liberalising services, there should be no back-loading of commitments, and pre-agreed flexibility shall be accorded to all AMSs.

All restrictions on trade in services, including financial services, should be removed by 2015. Nevertheless, measures for the financial services sector is subject to prudential measures and balance of payment safeguards. This target should be accessed progressively: according to the Blueprint for the AEC, 4 priority services sectors (air transport, e-ASEAN, healthcare and tourism) should liberalized by 2010, whereas the fifth priority services sector (logistics services) by 2013. In addition, equity participation of other ASEAN countries should reach 70% by 2015 for all services sectors. In facilitating the free flow of services by 2015, ASEAN is also working towards recognition of professional qualifications with the view of facilitating movement within the regions (see, *infra*, free flow of skilled labour).[32]

- ✓ *A3. Free flow of investment*

This target is key to enhance ASEAN's competitiveness in attracting foreign direct investment (FDI) as well as intra-ASEAN investment. Sustained inflows of new investments and reinvestments will promote and ensure dynamic development of ASEAN economies. ASEAN investment cooperation is being implemented through the Framework Agreement on the ASEAN Investment Area (AIA) 1998,[33] while investment protection is accorded under a separate agreement i.e. the ASEAN Agreement for the Promotion and Protection of Investment, 1987 or commonly referred to as ASEAN Investment Guarantee Agreement (IGA).

- ✓ *A4. Freer flow of capital*

Enhancing freedom for capital flows serves to strengthen ASEAN capital market development and integration and to allow greater capital mobility; ASEAN intends to have well-integrated and smoothly functioning regional financial system, characterized by more liberalized capital account regimes and inter-linked capital markets. Within the context of ASEAN, the AEC Blueprint (under "Freer Flow of Capital") calls for the following specific actions as preconditions for capital account liberalization (CAL): (i) achieve greater harmonization in capital market standards in ASEAN in the areas of offering rules for debt securities, disclosure requirements and distribution rules; (ii) facilitate mutual recognition arrangement or agreement for the cross recognition of qualification and education and experience of market professionals;

32 More in general, the free flow of services aims at achieving the objectives of AFAS to enhance cooperation in services amongst ASEAN Member Countries; improving the efficiency and competitiveness of the region; fostering the diversity of production capacity, supply and distribution of services of services of their suppliers within and outside AMSs; liberalising trade in services by expanding the depth and scope of liberalisation beyond those undertaken by the AMSs under the General Agreement on Trade & Services (GATS) with aim to realising free trade in services.

33 Under the AIA, all industries (in the manufacturing, agriculture, fishery, forestry and mining and quarrying sectors and services incidental to these five sectors) shall be open and national treatment granted to investors both at the pre-establishment and the post-establishment stages, with some exceptions as listed in member countries' Temporary Exclusion Lists (TEL) and Sensitive Lists (SL). The TEL is to be phased-out based on agreed timelines. Although the SL does not have a timeline for phasing-out, they will be reviewed periodically.

achieve greater flexibility in language and governing law requirements for securities issuance; (iv) enhance withholding tax structure, where possible, to promote the broadening of investor base in ASEAN debt issuance; and (v) facilitate market -driven efforts to establish exchange and debt market linkages, including cross-border capital raising activities.

It is crucial noting that the Blueprint, for the liberalization of capital movements, has furthermore established the following guidelines: (i) Ensuring an orderly capital account liberalization consistent with member countries' national agenda and readiness of the economy; (ii) Allowing adequate safeguard against potential macroeconomic instability and systemic risk that may arise from the liberalization process, including the right to adopt necessary measures to ensure macroeconomic stability; and (iii) Ensuring the benefits of liberalization to be shared by all ASEAN countries (see more in Appendix 1).

In addition to these broad guidelines, the timeline of various measures have been put forth by three ASEAN frameworks on capital account liberalization, namely: (i) the AEC Strategic Schedule, through 2015; (ii) the ASEAN Capital Market Forum (ACMF) Implementation Plan, through 2015; and (iii) the Working Committee on CAL (WC-CAL) Work Plan, through 2015.

Nevertheless, these documents suggests that nothing concrete or binding has yet been agreed on. In particular, the ASEAN Strategic Schedule appears to be quite general, while the WC-CAL Work Plan is still at an early stage, with lists of specific rules said to be being prepared. The principles of harmonization and mutual recognition are advocated by the ACMF implementation Plan as a means of promoting the regional flow of financial products. It is not clear what is envisioned for the years beyond 2015, as it is unrealistic to expect full capital account liberalization to be achieved by 2015 in all countries (Yung Chul Park and Shinji Takagi, 2012).

In 2011, the ASEAN Central Bank Governors adopted the ASEAN Financial Integration Framework (AFIF) to provide a general approach to the liberalization and integration initiatives under the AEC. The AFIF aims to have a semi-integrated financial market by 2020. The ASEAN Central Bank Governors agreed on the end-goal of financial integration, which recognizes that: (a) each AMS has its own initial conditions; and (b) each AMS may define its own milestones and timelines to achieve the common end goal of financial integration. Some members may be able to achieve the end goal earlier, while some may follow later depending on its own conditions.[34]

In a nutshell, under the AEC Blueprint, among the other pillars, ASEAN seeks to achieve a well-integrated and smoothly functioning regional financial system, characterized by more liberalized capital account regimes and inter-linked capital markets. However, given great differences among AMSs and impacts of global financial crisis, the set goal for CAL by 2015 is hardly to be achieved.

✓ *A5. Free flow of skilled labour*

Under the AEC plan, skilled workers and members of seven professions – doctors, dentists, nurses, engineers, architects, accountants and surveyors – are able to move freely from and in Vietnam. AMS should focus on facilitating the issuance of visas and employment passes for ASEAN professionals and skilled labour who are engaged in cross-border trade and investment

34 Phillipine Central Bank (2012).

related activities; and facilitating towards harmonization and standardization.

Factors driving skilled labour mobility in ASEAN include large disparities in wages and employment opportunities, geographic proximity and socio-cultural-linguistic environment, and disparities in educational developments. As more ASEAN countries move up the technological ladder, liberalizing trade in goods and services and in FDI would not be enough, and a larger pool of professional and skilled labour becomes necessary. Until such time when domestic educational and training institutions are able to supply the necessary high level manpower, and domestic economic growth is able to absorb this high level manpower, countries will still have to depend on foreign talent or export talent. However, even with adequate domestic supply there is still need for foreign talent to provide competition, stimulation, and synergy to improve the quality and productivity of domestic talent. Some countries like Singapore, and to a lesser extent Malaysia, regard foreign talent as an upgrading and competitive tool and have active policies to promote their inflows. Most ASEAN countries, however, have yet to move away from protecting domestic professionals and skilled workers through constitutional provisions, policies, regulations, and practices.

ASEAN is working towards recognition of professional qualifications and intends to take collective actions for managed mobility or facilitated entry for the movement of workers engaged in trade in goods, services, and investments, according to the prevailing regulations of the receiving country.35In The AEC Blueprint, strategic actions on free flow of skilled labour include facilitating the issuance of visas and employment passes, MRAs for major professional services, core concordance of services skills and qualifications. Enhanced cooperation for the movement of natural persons was finalized in late 2012.

By the end of 2014, numerous MRAs on professionals have been signed among AMSs, among which it is worth recalling the following: the ASEAN MRA on Engineering Services – signed at Kuala Lumpur, Malaysia on December 5, 2005; the ASEAN MRA on Nursing Services – signed on Cebu, Philippines, on December 8, 2006; the ASEAN MRA on Surveying Qualifications and the ASEAN MRA on Architectural Services, both signed at Singapore, on November 19, 2007; the ASEAN MRA on Medical Practitioners Singapore, and the ASEAN MRA on Framework Accountancy, both signed in Singapore, on August 25, 2008; the ASEAN MRA on Dental Practitioners, signed at Cha-Am, Thailand, on February 26, 2009,

- ✓ *A6. Priority integration sectors*

Twelve (12) priority sectors were identified for accelerated economic integration. These are agro-based goods, air transport, automotive products, eASEAN (including ICT equipment), electronics goods, fisheries, health care products, rubber-based goods, textiles and clothing, tourism, logistics, and wood-based products.

- ✓ *A7. Food, Agriculture and Forestry*

This is to enhance intra-and extra-ASEAN trade and long-term competitiveness of ASEAN's food, agriculture and forestry products/commodities

35 The above-mentioned objectives are among the constitutive elements of the so called 'Bali Concord II', decided at 9th ASEAN Summit, 2003 for completion of MRAs for qualifications in major professional services by 2008 to facilitate free movement of professional/s killed labour/talents in ASEAN. This date is now 2015 instead of 2008.

2.2.2. Pillar B: competitive economic region

The ground for the construction of a highly competitive economic region is the adoption and enforcement of a truly coordinated competition policy. The second pillar of the AEC encompasses the following targets: competition policy, consumer protection, IPRs and infra-structure development, taxation and E-commerce.

- ✓ *B1. Competition policy*

The main objective of the competition policy is to foster a culture of fair competition. Institutions and laws related to competition policy have recently been established in some (but not all) AMSs. There is currently no official ASEAN body for cooperative work on CPL to serve as a network for competition agencies or relevant bodies to exchange policy experiences and institutional norms on CPL.

- ✓ *B2. Consumer protection*

The AEC Blueprint emphasizes that consumers cannot be precluded in all measures taken to achieve this integration. Consumer protection measures are already being developed in tandem with the proposed economic measures to address the already emerging consumer protection.

- ✓ *B3. Intellectual property rights (IPR)*

Regional cooperation in IPR has been guided by the ASEAN IPR Action Plan 2004-2010 and the Work Plan for ASEAN Cooperation on Copyrights which aim to develop a culture of learning and innovation supported by a friendlier IP profile to businesses, investors, inventors and creators in ASEAN. In addition, these Plans are also designed to foster better public awareness, coordination and networking, predictability, capacity building, and contribution of IP industries to competitiveness and development.

- ✓ *B4. Infrastructure development*

AEC blueprint recognises the need for transport cooperation, including transport facilitation and reduction of service link costs. The coverage of transport include all modes, ranging from road, railway to maritime and air transport. The AEC blueprint acknowledges that financing is always an important contributor to economic growth. Development of information infrastructure is also seen to help sustain regional economic growth and competitiveness. Energy and mining are other possible areas for cooperation. As ASEAN accelerates its economic integration efforts, greater investment will be needed particularly in the development of regional infrastructure. Putting in place innovative financing schemes to attract greater private sector involvement is thus important.

- ✓ *B5. Taxation*

ASEAN needs to complete the network of bilateral agreements on avoidance of double taxation among all Member Countries by 2010, to the extent possible.

- ✓ *B6. E-commerce*

This pillar serves to lay the policy and legal infrastructure for electronic commerce and enable on-line trade in goods (e-commerce) within ASEAN through the implementation of the e-ASEAN Framework Agreement and based on common reference frameworks.

To achieve the objective of competitive economic region, all ASEAN economies shall promulgate a competition law by 2015 to ensure a healthy and fair competition environment. On that basis, ASEAN member states will establish a mechanism for coordination and cooperation among ASEAN competition authorities to enforce competition laws and policies in ASEAN region.

More specifically, the main objectives are the following:

- to adopt the best practices for introducing competition policy, to set up an Action Plan for reinforcing intellectual Property Rights, to improve infrastructure and to comply with Road Safety Requirements, to implement the ASEAN Framework Agreement on Multimodal Transport that was signed in 2005, as well as the ASEAN Framework Agreement on the Facilitation of Goods in Transit (AFAFGIT) in compliance with the Master Plan on ASEAN connectivity;
- to complete the network of bilateral agreements on avoidance of double taxation ;
- to adopt a harmonised legal infrastructure for E-Commerce.

2.2.3. Pillar C: equitable economic development.

This pillar focuses on the development of Small and Medium Enterprises (SMEs) and the initiative for ASEAN Integration (IAI). On this pillar, the identified sectors are food, agriculture and forestry and more especially on improving food security.

✓ *C1. SME Development*

The development of the small and medium-sized enterprises (SMEs) is necessary for the equitable development through mitigating market dominance by foreign MNCs and large SOEs, and to foster local entrepreneurship, innovation and employment creation. The main targets for equitable economic development rely on SME Development seeks to strengthen the implementation of technical assistance and capability building programmes for public and private sectors needing assistance in some ASEAN countries through the IAI.

✓ *C2. ASEAN Integration*

The IAI was launched in November 2000, before the 12th ASEAN Summit of 2007 and the elaboration of the Blueprint in order to narrow the development gap between ASEAN countries and also between ASEAN and other parts of the world.

Hence, its objective is to serve a platform for identifying and implementing technical assistance and capacity building programs targeted at CLMV.

2.2.4. Pillar D: integration with the Global economy.

ASEAN operates in an increasingly global environment, with interdependent markets and globalised industries. In order to enable ASEAN businesses to compete internationally, to make ASEAN a more dynamic and stronger segment of the global supply chain and to ensure that the internal market remains attractive for foreign investment, it is crucial for ASEAN to look beyond the borders of AEC. External rules and regulations must increasingly be taken into account when developing policies related to AEC.

This pillar has one main target: External Economic Relations and Participation in Global Supply Networks. Regional economic integration for East Asia is progressed in a gradual and phased manner (building-block approach). The final goal is to have a coherent approach towards external economic relations: ASEAN shall work towards maintaining “ASEAN Centrality” in its external economic relations, including, but not limited to, its negotiations for FTAs and comprehensive economic partnership (CEPs) agreements. This shall be done by reviewing FTA/CEP commitments vis-à-vis ASEAN’s internal integration commitments, and establishing a system for enhanced coordination, and possibly arriving at common approaches and/or positions in ASEAN's external economic relations and in regional and multilateral forums. *Second*, ASEAN shall also enhance participation in global supply networks by continuing the adoption of international best practices and standards in production and distribution, where possible, and developing a comprehensive package of technical assistance for the less developed ASEAN Member Countries to upgrade their industrial capability and productivity to enhance their participation in regional and global integration initiatives.

2.3. The other blueprints

AEC is only a milestone to cement ASEAN's regional centrality. ASEAN countries want to further deepen their integration in order to become a Borderless Economic Community by 2030. As expressed by the conclusion of a study from the ADBI, "*ASEAN 2030 Toward a Borderless Economic Community*[36]" the region seeks, by 2030, to become Resilient, Inclusive, Competitive, and Harmonious (indeed a "RICH" ASEAN).

Therefore, two other Blueprints - the ASEAN Socio-Cultural Community (ASCC)[37] and the ASEAN Political Security Community (APSC)[38], plus the 2nd IAI Workplan - were adopted by the ASEAN leaders at the 14th ASEAN Summit on 1 March 2009 in Cha-am/Hua Hin (Thailand). The ASCC Blueprint is focused on nurturing the human, cultural and natural resources for sustained development in a harmonious and people-oriented ASEAN and the APSC Blueprint aims to ensure that countries in the region live at peace with one another and with the world in a just, democratic and harmonious environment.

The AEC, the ASCC, the ASPC, and the IAI are expected to work in tandem in establishing the ASEAN Vision 2020.

36 ADBI (2012).
37 For an in-depth assessment of the Blueprint for the ASCC we refer to Von Feigenblatt (2012).
38 Dealing with conflict is the heart of the ASEAN's original mission and purpose. For a concise, though thoughtful, analysis of the evolution of the ASEAN's role in regional integration and fostering regional dialogue, its present challenges and its goal of building an effective Political-Security Community in the near future see, among the others, Caballero-Anthony (2012) and Von Feigenblatt (2012), and the wide literature referred to therein.

3. PROGRESS TOWARDS THE AEC

3.1. *Implementation Mechanism*

Relevant ASEAN sectoral bodies coordinate the implementation of the programmes and measures envisaged by the Blueprint at the regional level, while AMSs' relevant government agencies are responsible for overseeing the implementation and preparation of detailed action plans at the national level. Finally, partnership arrangements with the private sector, industry associations and the wider community at the regional and national levels are also actively sought where required to ensure participation of all stakeholders in the integration process.

One of the crucial issues of contemporary as well as modern international law concerns the mechanisms for monitoring and guaranteeing compliance with international rules by States to which they are addressed (so-called 'international supervision'). The required actions by AMSs envisaged by the ASEAN are no exception.

International supervision represents a flexible means to prevent disputes. In order to obviate to the renowned deficiencies of the international order in the resolution of conflicts and legal disputes, a new system of inducing compliance with international rules has gradually been pioneered for scrutinizing the behaviour of States parties of specific treaties. International supervision differs from the adjudication in many respects:[39] it shares only some of the features of adjudication and it stands as an essentially "*non-contentieux*" supervision or control. In general, supervisory mechanisms and procedures proved a reasonable and relatively effective means of impelling States to measure up to their international undertakings. As to the modalities through which supervisory is effected, the legal scholarship is unanimous in identifying four principal means, namely:

(1) Examination of periodic reports submitted at set intervals by the State concerned.

(2) Inspection, which is far more effective and penetrating than the assessment of States' reports, where the inquiring body must confine itself to the data provided by the State

39 *First*, the composition of the body in charge of monitoring the implementation of international provisions is normally different from that of judicial bodies, because the supervisory body can also be made up of representatives of States instead of individuals acting in a personal capacity. Moreover, it might happen that overseeing functions are entrusted to more than one organ. In this case, the various bodies often differ in their composition, as one or more are composed of independent individuals, whilst others consist of State officials. *Second*, as a general rule, the initiative for supervisory provision is not left to the aggrieved State. Rather, it can be taken either by the beneficiaries of the international rules (for instance, individuals, groups of individuals, or representatives of the States who directly benefit from the obligations imposed upon the aggrieved State), or even by the supervisory body acting *proprio motu*, that is to say, on its own initiative (such as in the case of anti-corruption monitoring mechanisms). At times there is no need for anybody to initiate the proceedings, for the simple reason that the procedure is a standing and automatic one, involving periodic scrutiny of the behaviour of the States concerned. *Third*, whereas adjudication is triggered after a dispute has arisen, supervision is generally carried out with a view to deterring infringement of international legal standards. In other words, normally supervision is designed to have preventive purposes. *Fourth*, the hearings of judicial bodies are usually public. In contrast, the debates between the contending parties either before an overseeing body or, when the procedure is not continuous in character, the investigative activities of the supervising organ, are run in camera, so as to avoid attracting publicity to possible violations committed by the State under supervision while the investigation is still under way. *Finally*, as a rule, the outcome of the overseeing procedure does not consist in a binding decision. Rather, it takes various forms (such as, for instance, recommendations, reports either public or not, etc.), which, whatever their official label, mainly rely on "*besoin d'honorabilité international*", assumed to be taken into notable consideration by States. It is, in other words, a sensible diplomatic and moral pressure. The underlying idea is that internal and international pressure of public opinion on non-complying States should represent a valid spur to eventual compliance, once States' deviation from international standards is ascertained and made public.

concerned. Investigation on the spot permits international bodies (or, as in the case of the Treaty on Antarctica and other outer space, the other State Parties to the Treaty) to ascertain whether the State concerned respects or disregards the Treaty.

(3) Supervision carried out by means of a contentious procedure, where the Parties to a dispute, or the State under monitoring and the supervisory body, engage in contentious examination of the case.

(4) Adoption of measures aimed at preventing the possible commission of international wrongdoings by a State.

For the effective and successful implementation of the programmes and measures envisage by the Blueprint for the AEC, it is necessary that adequate institutions or mechanisms, resources, capacity and political is accorded to the Community building process, consistently with the cases where international supervising mechanisms work efficiently: the very circumstance that several of the targets identified by the Blueprint will hardly be achieved by 2015 seems to testify that the implementation mechanism's architecture needs to be strengthened significantly.40

At present the implementation mechanism envisaged by the Blueprint is still at an embryonic stage and is shaped as follows:

i) The High Level Task Force (HLTF) on ASEAN Economic Integration provides strategic inputs to the AEM on issues affecting the timely implementation of the Blueprint;

ii) AMSs' relevant sectoral Ministerial bodies are responsible for the implementation of the Blueprint and monitoring of commitments under their respective purview;

iii) The ASEAN Economic Ministers (AEM), as the Ministers-in-Charge of Economic Integration in the Council of ASEAN Economic Community, is accountable for the overall implementation of the Blueprint.

iv) The Secretary-General of ASEAN shall report the progress of AEC to relevant ministerial meetings and the Summit

The ASEAN Secretariat has established a monitoring mechanism called the AEC Scorecard, which reports the progress of implementing the various AEC measures, identifies implementation gaps and challenges in order to track the potential realisation of the AEC by 2015. However, also such instrument needs to be improved: if, on the one hands, it remedies a certain 'transparency gap' of the entire implementation system, on the other, it lacks the necessary powers to stimulate effectively the AMSs to put in place the required actions.

Finally, ASEAN has undertaken various efforts to monitor its implementation. Building upon the AEC Scorecard, this inaugural ASEAN Integration Monitoring report (AIMR) assesses the progress in four AEC-related dimensions: merchandise trade, trade facilitation, services trade and investment. It focuses on policy and market integration outcomes achieved in AMS, as part of the first pillar of the AEC formation process.[41]

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40 See *infra* 4.5.1 and 5.2.1.

41 The report finds that the ASEAN economic integration agenda has already provided important benefits to the Member States by boosting regional trade flows without adversely affecting the global integration agenda. Integration efforts have also helped to improve trade logistics, lower aggregate trade costs and significantly increase regional investment flows. Progress in

However, none of such initiatives is endowed with the needed elements to guarantee effective follow-up actions by AMSs when they fail to fully comply with the actions in the Blueprint.

3.2. General progress of ASEAN

Four phases have been established to implementing the AEC Blueprint: Phase 1 (2008-2009), Phase 2 (2010-2011), Phase 3 (2012-2013) and Phase 4 (2014-2015).

The last scoring report of the ASEAN Secretariat was published in October 2012. A Joint report by the ASEAN Secretariat and the World Bank analysing in detail the results obtained in Pillar one) was published at the end of 2011. These reports point out that ASEAN made significant progress for the two phases under review (2008-2009; 2010-2011). As a whole, 67.5% of targets have been achieved under phase I and II, with Pillar four: "*Integration with the Global economy*", being the best performer and Ppillar one "S*ingle market and production base*" the worst performer. Such results may be explained by two reasons: first, the number of targets is much more important in the first pillar than in the fourth one; second, it seems easier to take decisions related to economic relations with third countries (such as, for instance concluding FTAs with trade partners external to the region), than to pass laws or improve regulations within the region in order to form a real single market and an unique production base and a region characterised by a highly competitive economy, equitable economic development, and full integration into the global economy.

Recent data published by the AEC Scoreboard enable assessment of progress for the first three phases:

- Phase 1 (2008-2009): 92 out of 105 measures have been implemented, which corresponds to an execution rate of 87.6%;
- Phase 2 (2010-2011): 116 out of 172 measures have been implemented, which corresponds to an execution rate of 67.4%;
- Phase 1 (2012-2013): 31 of 44 measures have been implemented, which corresponds to an execution rate of 70.5% (at the date of October 2012).

If we analyse the progress of ASEAN by Pillar[42], it appears that:

- 74.6% of measures for the Pillar 1 (Single market and Production Base) have been implemented;
- 77.3% of measures for the Pillar 2 (Competitive Economic Region) have been implemented;
- 61.1% of measures for the Pillar 3 (Equitable Economic Development) have been implemented;
- 75% of measures for the Pillar 4 (Integration into the Global Economy) have been

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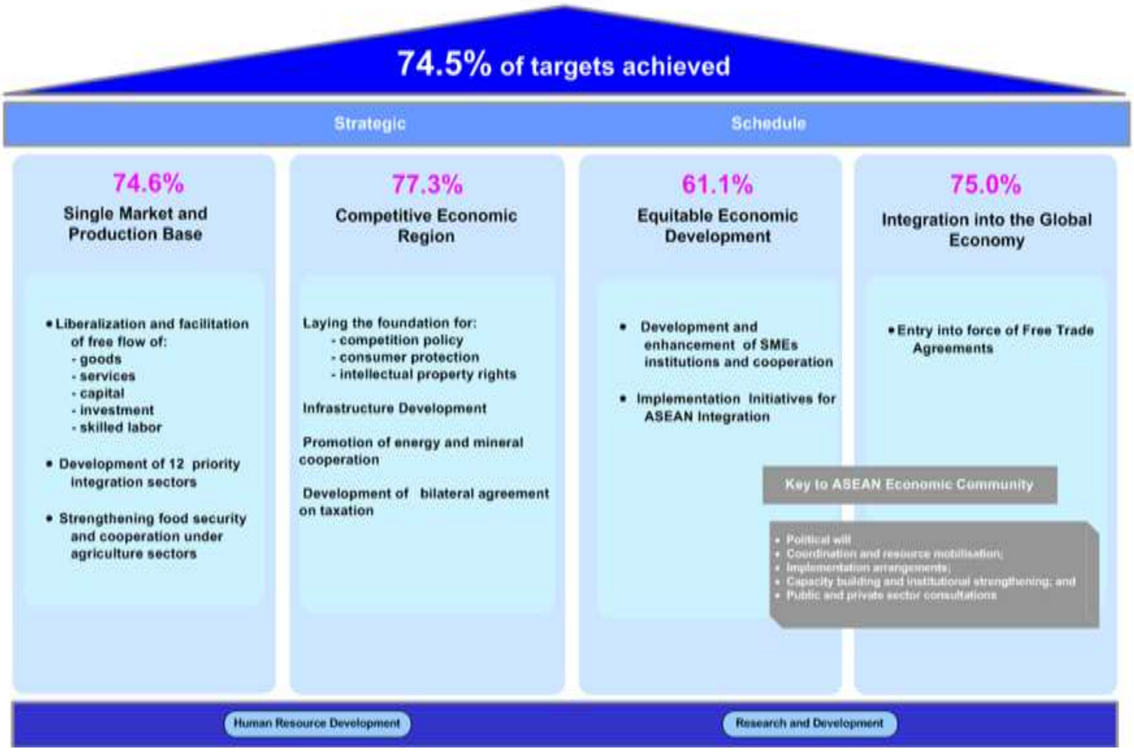
services integration, however, has been modest. It is also clear that the potential gains from further integration in all these spheres remain large. The report highlights important pending challenges to achieving the AEC 2015 goals that lie in implementing the services integration agenda as well as the dangers posed by the use of non-tariff measures. It identifies a number of policy and institutional measures that ASEAN can take to address these issues. For further details see ASEAN Secretariat and World Bank (2013). For another documents which considerably help to define the status of progress of the ASEAN economic integration see ERIA (2013).

42 As of October 2012.

implemented.

Figure 36: Implementation of AEC Scorecard monitoring, Jan. 2008- Oct. 2011



Source: The ASEAN Secretariat (October 2012).

3.3. Vietnam's efforts toward AEC

Overall, Vietnam has been quite successful in terms of degree of fulfilment and liberalization and timely implementation of the set Blueprint for AEC, with some commitments/clauses even being earlier accomplished. For instance, it is noteworthy that many items of current account had been liberalized before the schedule. As another instance, the practice of dual exchange rate structure had no longer existed as Vietnam did this in 1989 (compared to 2007-2008 set forth by the schedule. Similarly, the practice of surrender requirement was abolished in 2004 against the planned 2011-2012 period. The target of "continuing to liberalize, where appropriate and possible, any other items related to current account transactions" will likely be achieved in 2015.

However, as far as Vietnam's efforts toward AEC are analysed in detail with regards to the implementation of the different targets and measures, there is an issue of lacking of detailed and recent data ("transparency gap"). Hence, the table below analyses only the implementation of the two first phases envisaged by the Blueprint (i.e.: 2008-2009; 2010-2011).

Table 28 shows that, among the 19 target measures that are identified in the scoreboard, 9 were totally completed, 10 were completed by more than 50% and none was completed by less than 50% in Vietnam.

Table 28: Implementation of AEC scorecard for Vietnam under Phase I and II, 2008-2011

Pillars	Targets	Vietnam	ASEAN
Single market and production base	Free Flow of Goods	>50%	<50%
	Free Flow of Services	>50%	<50%
	Free Flow of Investment	>50%	<50%

	Freer Flow of Capital	100%	100%
	Free Flow of Skilled Labor	100%	100%
	Priority Integration Sectors	>50%	100%
	Food, Agriculture and Forestry	>50%	<50%
Competitive economic region	Competition Policy	100%	100%
	Consumer Protection	>50%	>50%
	Intellectual Property Rights	100%	>50%
	Transport	>50%	>50%
	Energy	>50%	<50%
	Mineral	100%	100%
	ICT	100%	100%
	Taxation	100%	<50%
	E-commerce	100%	100%
Equitable economic development	SME Development	>50%	>50%
	Initiative for ASEAN Integration (IAI)	>50%	>50%
Integration with global economy	External Economic Relations	>50%	>50%

Source: AEC Scoreboard – ASEAN Secretariat.

More specifically, Vietnam performed better than the other ASEAN countries, implementing 21 reforms up to 2013, and the highest number in East Asia Pacific. Vietnam outperformed in the first two pillars, and went at the same path for the last two pillars.

AEC Scorecard reports that the shortfall was mainly caused by delays in ratification of signed ASEAN-wide agreements and their integration into national laws, as well as delays in the implementation of specific initiatives. However, it is difficult to know exactly what actions of the Blueprint have and have not been implemented in Vietnam because the ASEAN Secretariat does not provide such information in detail.

The analysis of Vietnam's position respect to the four pillars provided below is only partial and is drawn upon different sources of information. The very necessity of assessing precisely the efforts and actions required by each AMS to achieve the targets identified for the AEC is the main reason why we strongly suggest that the ASEAN Secretariat together with the AMSs should implement a more effective and transparent monitoring (and follow-up) mechanism: at present such operation is not possible by relying only with the information provided by the Scoreboard and other related initiatives.

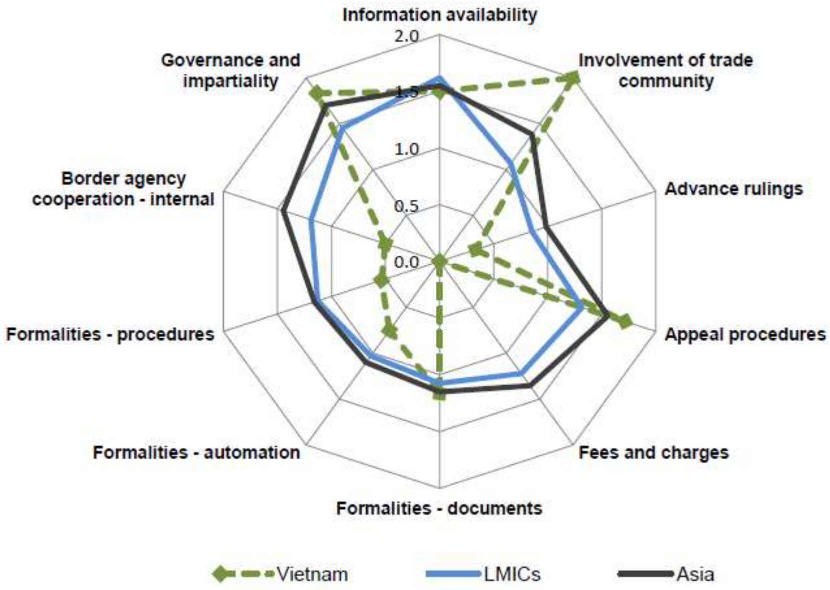
A. Single market and production base

✓ *A1. Free flows of goods and trade facilitation*

AEC targets, but essentially bilateral trade and regional FTAs put pressures in freeing trade in goods via comprehensive tariff reduction. In Vietnam, about 90% of tariff lines is suppressed by 2015, and most of the remaining lines will decrease to 0% by 2018[43].

When it comes to trade facilitation, Vietnam performed well and better than the regional peers in the areas of governance and impartiality, involvement of trade community, appeal procedures and document formalities.

Figure 37: Trade facilitation performance of Vietnam, 2013



Source: OECD

Note: The index goes from 0 = worst performance to 2 = best performance. LMICs stands for lower middle income countries. No reliable information is available for Vietnam on the indicator of external border agency cooperation.

Regarding NSW, Vietnam is in an advanced stage of development towards a full implementation by 2015, covering about half of all import and exports by this time.

It seems to be on an equal footing in the area of information availability, but significantly lagging behind in the areas of advance rulings, fees and charges, formalities automation and procedures, as well internal border agency control.

As Figure 37 suggests, Vietnam has made a significant progress in some areas (e.g. governance and impartiality; involvement of trade community; appeal procedures; and documentation, but is still significantly deficient in others (e.g. fees and charges or border agency cooperation).

National Single Window

Vietnam has made it efforts in developing the National Single Window (NSW) since 2005. The implementation of NSW has been deeply and widely focused during the last three years. The initial achievement of NSW's first piloting period is the technical connection between three core governmental agencies, namely the Ministry of Finance (General Department of Customs), the Ministry of Transport and the Ministry of Industry and Trade on 26 February 2014.

43 CIEM (2013).

With the success of the first piloting period on the NSW, three core governmental agencies have been technically connected. A total of 18 procedures are chosen for included in the NSW after a long time for coordination on the simplification and harmonization of procedures. The first three core governmental agencies have also come to an agreement of selection of data and format for transmission to the NSW. It is planned that three other core governmental agencies, namely Ministry of Agriculture and Rural Development, Ministry of Health and Ministry of Natural Resource and Environment, will also be connected to NSW by the end of this year. With such connection in the second stage of piloting, another 43 administrative procedures will be simplified. Recently, there has a proposal on allowing Vietnam Chamber of Commerce and Industry to participate in the NSW with regards to granting C/O procedure.

The technical infrastructure of NSW is being implemented, comprising of main functions such as front-end systems for traders, for manifest submission, for good declaration, for payment of duties, taxes and fees. The functionality of integrated risk management, electronic connectivity and international data exchange has been planned and underway. According to a report by the General Department of Customs, more investment for expanding of NSW Customs Portal has been recently put in place, in order to unify the administrative procedures, technical plans and working schedule with various stakeholders.

In spite of the above mentioned significant development, the implementation of NSW/ASW has some following key challenges:

- The involvement of various stakeholders (governmental agencies) in the NSW/ASW has become a challenge in coordinating the implementation of the comprehensive systems, and sometimes created a lag in time schedule;
- The difference/gap in applying ICT among OGAs; the synchronous participation of related OGAs;
- The willingness of related government agencies;
- There has been some concern of the business community, including (i) although procedures are electronized, paper documents still exist; (ii) there has been inconsistency/difference in the requirement of submitting documents from difference customs ports; and (iii) enterprises are time consuming because of slow coordination between customs offices and port authorities.
- Technical infrastructure is still poor and less advanced.

<u>Custom modernization</u>

The Government has issued the first initiatives of piloting e-customs at Hai Phong Customs Office under Decision No. 149/2005 on 20 June 2005. With such experiences, the pilot of e-customs has been expanded to 19 other provinces in 2009. The last three years has witnessed a rapid and significant reforms in customs modernization. On the one hand, it shows stronger political willingness in response to the requirement of economic integration and implementation of regional and international commitments. On the other hand, it reaffirms the support from the international donors (such as Japanese Government, the World Bank, etc.).

The biggest achievement is the officially adoption and implementation of VNACCS/VSIC which has been funded by Japan. VNACCS/VSIC comprises of automatic and electronic components of e-declaration, e-manifest, e-invoice, e-payment, e-C/O, selectivity, risk management, release and clearance and supervision and control. According to the Customs Office of Vietnam, by the end of June, the main results of having e-customs procedures include the followings:

- Application of e-customs at 85% (165/174) customs office in the country;
- A total of 49.7 thousand (96%) of total export-import enterprises participating in the e-

customs, increasing by 16.6% compared to 2012;

- Reducing the “paper” work: A total of 5.4 million customs declaration has been made under e-mechanism, accounting for 93.2% of the total declaration, increasing by 25.9%;
- Reducing time for releasing/clearance of goods (only 5-10 minutes for green channel);
- Selectivity: Green (61.6%), Yellow (27.6%) and Red (10.8%);
- Reducing cost of compliance (32.11%) through the simplification of 42 procedures, elimination of 3 procedures;
- Regular consultations between business community (including foreign-invested enterprises) and customs offices have been conducted so that to provide regulatory framework for enterprises, having responses from business community on the application and other bottlenecks to operation as well as providing feedbacks from customs offices.
- More investment in technical infrastructure and informatics technology;

However, there are still some bottlenecks in the implementation of custom modernization, including:

- The existing inconsistence and desynchronized in the policies and regulatory framework, particularly in licensing framework, quarantine and administrative procedures, standards and conformance, etc.
- The application of some functionality and the upgrading of information technology systems is still at the low pace as compared to its requirement of modernization;
- The standardization of data for integrating risk management and selectivity is still limited;
- The automatic level in implementing e-customs procedures has been constrained because of the lack of information standards and data format among participated government agencies.

Trade repository

There should be more work to done to trade repository because the it has not yet reached to consensus among the ASEAN Member States on the structure, coordination and connection of National Trade Repository as well as ASEAN Trade Repository. The Government of Vietnam has taken the first step in preparing for the National Trade Repository. Still, since there has been no national trade repository so far, Vietnam’s problem was to await the decision on agreed structure of Trade Repository at both national and ASEAN levels to ensure follow-up consistency. This problem is strikingly different from that in other ASEAN countries (such as Singapore) which already has their only Trade Repository and may incur adjustment costs if their system differs from the regionally agreed one.

✓ *A2. Services liberalization*

Vietnam has followed a decent path in facilitating the freer flow of services, which is regarded as one of the core elements to achieve a single market and production base. It is soon expected that there is substantially no restriction to ASEAN service suppliers in providing services.

On foreign ownership restrictions, in general and to WTO commitments, foreign investors can establish new 100% foreign-owned companies in Vietnam; however, under current regulations the remaining cap is at 49%, or even lower. In services sector such as insurance, telecommunication, tourism (for travel agencies, tour operators and tourist guides), and maritime, the maximum capital contribution for foreign partners is 49%. In the banking and financial sector, except securities companies, it is regulated in Decree 01/2014 of the Government regulating the buying of shares in Vietnamese credit institutions by foreign investors that:

- The proportion of a foreign individual ownership is maximum 5% of total charter capital;
- The ownership of a foreign organization is maximum 15% of total charter capital (except some following cases)
- The ownership of a strategic foreign partner cannot exceed 20% of charter capital;
- The ownership of a foreign investor and his/her relatives cannot exceed 20% of charter capital;
- Total ownership of foreign investors can no exceed 30% of charter capital of Vietnamese commercial bank.
- In some special cases for the restructuring of weak and difficult credit institutions, and ensuring the security of its system, the ownership shares can exceed the above-mentioned proportion under the decision of the Prime Minister.

There still exists difference in operation between domestic and foreign investors in market access, process of granting an investment license, tax incentives, and capital contribution. In the banking and insurance sector, the licensing framework seem higher and stricter for foreign-invested banks and insurance companies, particularly of total assets, minimum capital, shareholders, and years of operation. In the maritime sector, there has experienced entry restriction to domestic private on pilotage towing and tying services, entry restriction to foreigners on internal waterway, port operation, container station, freight-forwarding and pilotage towing and tying; only sea-shipping is allowed for foreigners.

✓ *A3. Free flow of Investment*

Bearing in mind that the target of "Assess and identify rules for liberalization for freer flows of portfolio investments, particularly in debts and equity" by 2008-2009 remained incomplete as the AEC Blueprint "allows AMSs (including Vietnam) to use adequate safeguard against potential macroeconomic instability and systemic risk that may arise from the liberalization process, including the right to adopt necessary measures to ensure macroeconomic stability" is possibly not achieved. Similarly, other targets related to the portfolio investment liberalization are also hardly attained given the global crisis and domestic financial instability and economic slowdown. Nevertheless, this performance cannot be regarded as failure, because of ambiguous nature of the schedule. The ASEAN Central Bank Governors, as mentioned above, agreed on the end-goal of financial integration, which recognizes that: (a) each AMS has its own initial conditions; and (b) each AMS may define its own milestones and timelines to achieve the common end goal of financial integration. Some members may be able to achieve the end goal earlier, while some may follow later depending on its own conditions.

AEC convergence targets, but also FTAs initiatives, have facilitated the creation of production networks and eased the FDI inflows. As previously pointed out, Vietnam has been denoted as a large net recipient of FDIs (see Figure 17), only after Singapore and Cambodia. These investments are been increasingly focused on real estate projects and labour-intensive activities and should now be diversified.

Vietnam's environment has become more and more transparent and friendly for companies of the different ownerships, and to a certain extent, more favourable for foreign-own financial institutions, in the context of the increasing foreign presence in almost all markets, scope of activities, and equity participation. Notably, Vietnam allows 49% foreign stake in securities companies and investment funds and management funds within 5 years shortly after WTO accession, much shorter than 10 years in the case of China, where the financial system has been more capable, developed and sophisticated (Le Xuan Sang 2003).

The SOCBs and some other financial spin-offs (say, securities companies, investment funds derived from SOCBs and SOEs) have, indeed, been granted some kinds of privileges but the later tend to decrease significantly. As a result, the market and ownership shares of the state-owned financial institutions have been declining. It is important to note that the increasing foreign presence did not entail the shrinking/crowding out and/or bankruptcy of domestic rivals as it was warning at the beginning of the opening up domestic markets and before WTO/FTAs accession or as it has created negative consequences happened with some other economies.

However, in the committed period of the blueprint, these countries fail to assess and identify rules for liberalization for freer flows of portfolio investments, particularly in debts and equity; and to progressively liberalize, where appropriate and possible, the rules identified for other types of flows, particularly and long-term foreign borrowing and lending (Appendix 1). With greater volatility in global financial markets and financial stability, prolonged slowdown in domestic economic growth in recent years, Vietnam's and other AMSs' governments are understandably reluctant to commit to free flow of capital, with the threat to domestic financial volatility. Furthermore, proposals for financial integration have taken a back-seat since the outbreak of public debt crisis in many members of the euro zone. The implementation of initiatives in other areas has been also slow until very recently. The implementation of the financial services liberalization commitments has been also limited. In addition, regional integration of capital markets has been constrained by the large differences in the levels of the different financial systems' development and in the observance of regulatory standards, capital controls, fragmented infrastructure, and insufficient coordination and monitoring mechanisms. Bearing in mind that another important factor for the slow progress is a trade-off between (the benefits of) risk sharing, on the one hand, and (the increased danger of) financial contagion risk, on the other hand, a far more prudential approach to financial integration in the countries of AEC is recommendable. Notwithstanding the above, some commitments/agreements are progressing, namely the ASEAN+3 cooperative arrangements of regional financial surveillance (AMRO), the multilateralized Chiang Mai Initiative (CMIM), and the Asian Bond Market Initiative (ABMI) that were not existing the target measures of the AEC Blueprint.

- ✓ *A3. Freer flow of Capital*

There have been no violations of the scheduled commitments in opening up of financial sector for foreign and non-state investors. As for implementation of commitments in financial liberalization, Vietnam fully implemented 6 measures in both phase 1 (2008-9) and 2 (2010-11) of the criterion headed "free flow of capital" (ASEAN Secretariat 2012).

With regards to macroeconomic policies, in principles, Vietnam has liberalized its current account for residents and non-residents under Decree 70/2014 of the Government on 17 July 2014. There is no restriction on capital inflow, however, there is some restriction on capital outflow, including:

- The maximum amount of cash carrying is USD 5,000 or VND 15,000,000. If the amount is above USD 5,000 or VND 15,000,000, the person should declare to customs (for entry) or get the approval of SBV or authorized credit institution (for exit).
- Foreign-invested enterprises or foreign investors need to open a foreign currency account in an allowed credit institution, and can buy foreign currency and transfer abroad within 30 days of the buying.

In opening up the banking sector, a number of policies have been promulgated, comprising of two new versions of Law on Credit Institutions in 2010 and Law on SBV in 2010, and many other under-law guiding documents. At this moment, the legal framework has still not yet been sufficient enough and need further review and amendment. The scope of banking activities offered to foreign credit institutions is practically the same with domestic institutions, except for market limitations on accepting deposits in VND in the first 5 years of opening. Moreover, there have been recently some stricter requirements in licensing criterion for foreign banks rather than domestic banks. Therefore, although the number of foreign branches and 100% foreign owned banks is increasing, the market shares accounted has been around a modest number of 12% in 2011.[44]The purchase of shares in domestic commercial banks is entitled, for foreign banks, to have collectively 30% and individual not more than 15% of charter capital.

In the securities sector, a more relaxation can be seen in the applicable legal documents for foreign securities suppliers to have representative offices and joint venture with foreign participation capped at less than 49%. However, it is necessary to promulgate a guiding document on the organization and commercial operation of branches and 100% foreign owned securities service suppliers. In a short word, the legal framework still lacks detailed regulations, just mainly focus on domestic securities market.

Financial liberalization may emerge with trade-off effect, particularly in being affected by external fluctuation and volatility. During 2006-2010, the development indicators of stock market yield volatility; reserve vulnerability indicator shows that inadequate foreign exchange reserves and the current level of external debt of Vietnam have made the country fragile to adverse shocks. Institutional efficiency has not been enhanced yet, let alone exacerbated (asset quality with rising concerns over bad debts) and transparency/disclosure of information is not upheld properly.

- ✓ *A5. Free movement of skilled labour*

Vietnam has made all preparations to open the labour market in 2015. The ASEAN Committee on the Implementation of the ASEAN Declaration on the Protection and Promotion of the Rights of Migrant Workers was established on July 13th 2007. The Agreement on the Movement of Natural Persons (AAMNP) was signed on 19 November 2012 in Cambodia.

Additionally, Vietnam has ratified, or plans to ratify, several international conventions on employment, job services, wages and vocational training. Existing laws governing the inflow or outflow of workers is applied after 2015 unless new agreements are made within the bloc. Trung believes that Vietnam is shaping a healthy and transparent labour market to lure the best domestic and foreign talent.

Rather importantly, ASEAN integration by 2015 is just around the corner. With such fast approaching deadline, businesses, workers and those representing them in the ten AMSs need to get prepared for the free flow of goods and services as well as the unavoidable movement of labour and the challenges facing labour market integration: the relevant differences in education, expertise and skills for several professionals among the people from the ten AMSs may worsen the employment rates and conditions for nationals of the ASEAN’s less advanced economies. Taking such issue in due considerations means to establish functioning welfare systems, which, among the other things, can effectively support programs of training, requalification and specialization for people who otherwise may become more vulnerable after economic integration of the area.

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[44] Mai Thu Hien (2013).

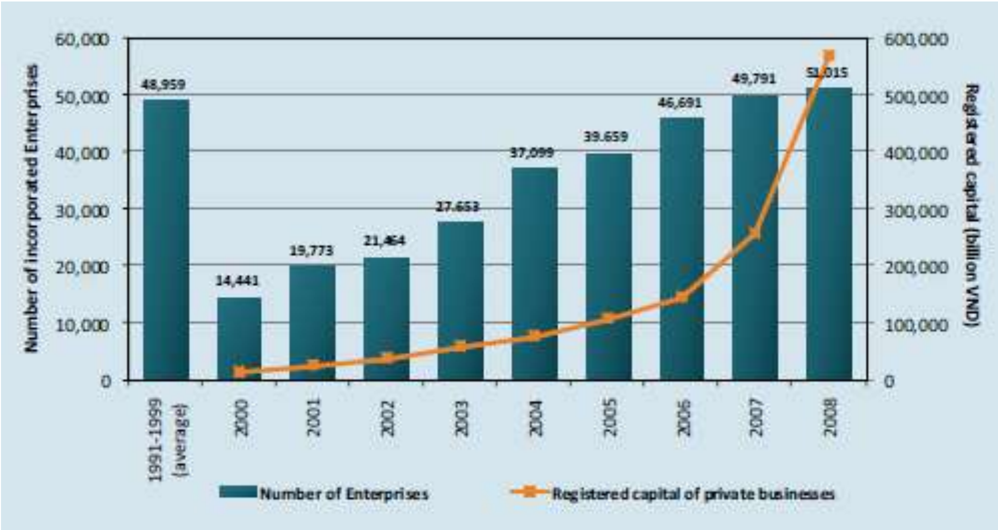
B. Competitive economic region

- ✓ *B1. Competition Policy*

Vietnam was under increasing pressure to build a transparent legal framework, not only to follow its engagements towards AEC, but also because it was involved in the process of negotiating accession to international trade/economic organizations like the APEC or the WTO, in liaise with an internationally established competition policy.

Thus, Vietnam established anti-competitive acts or monopolies in some specific areas that were regulated by separate and scattered provisions in a number of pieces of legislation such as the Ordinance on Price, the Ordinance on Telecommunications, the Law on Credit Institutions, Commercial Law, Electricity Law, etc. Nevertheless, till 2004, implementation of the regulations so far failed to attain full effectiveness, partly due to lack of a complete and consistent legal framework, lack of state management competency on competition and monopoly control, lack of sanctions, defective enforcement system, etc.

Figure 38: Newly incorporated private enterprises in Vietnam, 1991-2008

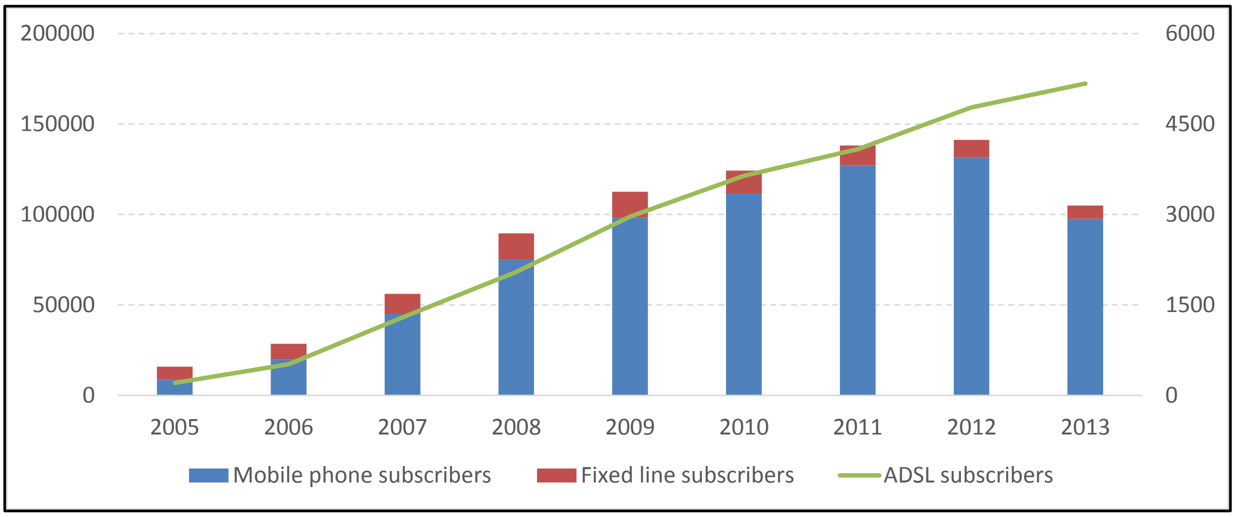


In such context, the Competition Law was approved by the National Assembly on November 9, 2004 and came into force on July 1, 2005. The national competition authority was also established under the Ministry of Trade (currently the Ministry of Industry and Trade) to ensure a level playing field for both local and foreign enterprises operating in Vietnam. At the same time, other Laws such as Enterprise Law, Investment Law (both in 2005) reduced discrimitory treatment against private enterprises (including FDI enterprises) relative to SOEs.

Figure 38 exhibits the total number of enterprises in Vietnam and the registered capital of private businesses. As it can be seen, both expanded after 2000, when the Law simplified business registration procedures and allowed companies in all sectors in the country to function under the same framework of governance.

Post and telecommunication represent the sectors with most dramatic increase in competition. The number of suppliers in these services sectors went up considerably. In mobile network, for example, Vietnamese customers started to see presence of more providers such as Viettel, Gmobile, etc., apart from the traditional ones under Vietnam Post and Telecommunication Group (namely Vinaphone and Mobiphone). This led to sharp fall of fees for using mobile services, thereby popularizing the use of mobile phones and related services throughout the country. Similar developments were also witnessed in courier services, data services, etc. Accordingly, the coverage of phony and Internet services was expanded (Figure 39).

Figure 39: Number of subscribers to telephone and ADSL services, 2005-2013



Source: GSO.

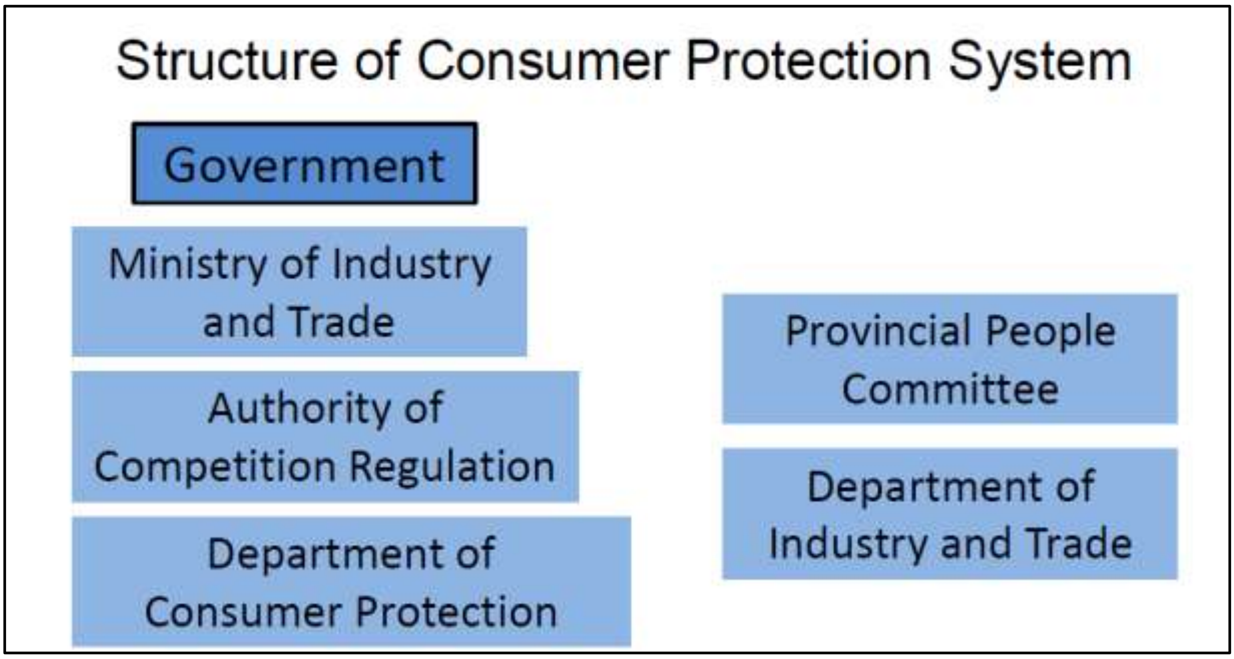
More actions have been undertaken with respect to anti-competitive practices. In 2011, Vietnam Competition Authority (VCA) reportedly pre-examined 10 cases and initiated official investigations into two cases. This shows bolder action compared to 2006 when only five pre-examinations were conducted without any official investigation. However, fostering competition remains a challenge in Vietnam. The improvement so far in the regulatory framework and institutional capacity of VCA is yet to suffice. Till 2012, only 2 cases on anti-competitive practices had resulted in monetary sanctions. There were argubaly other concerns about anti-competitive practices (such as price fixing agreements) of major State business groups under the authority of various Ministries, but VCA appears to lack adequate capacity to investigate these cases.

More importantly, the question of equal treatment between the domestic private enterprises, SOEs and FDI enterprises is receiving more attention. SOEs still enjoy certain advantages in terms of accessing capital, land, information as well as business opportunity. Meanwhile, in a bid to attract more FDI, the Government is granting more preferential treatment (including fiscal incentives) for foreign-invested enterprises relative to domestic enterprises. This somehow weakens the competitiveness of domestic private enterprises relative to both SOEs and FDI counterparts.

- ✓ *B2. Consumer protection*

Vietnam had the Law of Consumer Protection approved in 2010. The Law then came into effect in July 2011. Subsequently, the Government issued Decree No. 99/2011/ND-CP detailing the Law of Consumer Protection. The Prime Minister also issued Decision No. 02/2012 on the list of key products and services which must follow the stipulated forms of contracts. The Decision also identifies the list of 9 essential products for which registration is required to ensure maximal consumer protection.

Figure 40: Structure of Consumer Protection System



Source: Nguyen Minh Thang (2013).

Vietnam already has a network of agencies to protect consumers. The Ministry of Industry and Trade is mandated on issues of consumer protection at the Central level; the VCA provides supports to the Minister of Industry and Trade in the tasks related to consumer protection. The provincial People's Committees are in charge of consumer protection in their respective localities, assigning tasks to the Departments of Industry and Trade. The district People's Committees are responsible for consumer protection in their districts.

Various sector-specific regulations also serve to protect consumers' rights and benefits in the corresponding sectors. The horizontal ones include the regulations on quality and standards. Other sectoral laws also incorporate provisions related to consumer protections. As an example, consumer protection in telecommunication sector is provided for by the Law on Telecommunication and related Decrees (No. 25/2011/ND-CP and No. 83/2011/ND-CP), Law on Technical Regulation and Standard (with specific Regulations and Standards in Telecommunication), and Decision 02/2012/QD-TTg of the Prime Minister.

Thousands of cases related to consumer right violations have been received and resolved. In 2013, 90,279 cases were reported, of which 25,869 were resolved. These cases were largely in the aspects of food safety, measurement, IPR, advertisement, etc. The main products where the cases took place comprised of foodstuff, electronics, cosmetics, etc.

Nevertheless, consumer protection still suffers from several drawbacks. On the one hand, the Association for Consumer Protection is authorized to file the claim on behalf of the consumer, but the fee has to be paid by the Association itself. Resource constraints then undermined the operation of the Association. On the other hand, depending on the actual situation, the district People's committees may assign the task of consumer protection to different divisions.

- ✓ *B3. IPR*

Vietnam has strengthened domestic legal framework on IPR protection. The country has joined and ratified several international agreements on IPR protection. The Law on IPR in 2005 provides for the protection of three major IPRs, namely: copyrights and related rights, industrial property rights; rights in plant varieties.

Efforts to enhance IPR protection have brought about some recent achievements. The software piracy rate declined from 92% in 2004 to 81% in 2013, and is projected to fall to 60% in 2018.[45] After years of imposing only administrative fines, Vietnam now decided to handle software piracy cases through the courts, which serves as a major deterrent to piracy.

However, the enforcement of regulations on IPR protection remains a concern. Counterfeit goods remain prevalent. Vietnamese enterprises are still seen to "*routinely copy trademarks, patents, copyrighted works, propriety knowledge and technology, architectural designs and pharmaceutical data and tests*"[46] from other local and foreign firms. As such, Vietnam constantly receives requests related to improving IPR protection from its partners, especially during negotiation of ambitious FTAs (such as TPP, Vietnam-EU FTA, etc.)

✓ *B4. Infrastructure Development.*

Vietnam has signed the following agreements:

- ASEAN Framework Agreement on the Facilitation of Goods in Transit (AFAFGIT)
- ASEAN Multilateral Agreement on Air Services (AMAAS);
- ASEAN Multilateral Agreement on the Full Liberalization of Air Freight Services (AMAFLAS);
- ASEAN Framework Agreement on Multimodal Transport (AFAMT);
- ASEAN Multilateral Agreement on the Full Liberalisation of Passenger Air Services (AMAFLPAS);
- ASEAN Framework Agreement on the Facilitation of Inter-State Transport (AFAFIST).

ASEAN adopted in October 2010 a "Master Plan on ASEAN Connectivity" with targets set from 2010 to 2015 to accomplish "physical, institutional and people-to-people connectivity" (did Vietnam also adopted this plan? If yes when?)

Under ASEAN–X formula, ASEAN has performed well toward the establishment of the ASEAN Single Aviation Market (ASAM).

Vietnam has also signed the agreements under the Roadmap for Integration of Air Travel Sector (RIATS) and their protocols in May 2009.

C. Equitable economic development

✓ *C1. Development of Small and Medium Enterprises (SMEs)*

Vietnam has paid increasing attention to the development of SMEs. It was only until 2001 that the Government issued the first Decree to promote the development of SMEs, with clear

[45] According to the Business Software Alliance (see Hoang Phi 2013)
[46] MacDonald, M. (2013, p.1).

classification of such enterprises. During 2001-2010, however, few concrete policy measures were specifically targeted the SMEs. It was only since 2012 that, during time of economic downturn, the Government specifically identified SMEs as a group for policy supports (such as tax exemption and/or reduction). At the same time, the development of SMEs is increasingly aligned with the policy to facilitate industrial cluster development.

Box 1: Critical factors for the design and implementation of cluster policy in Vietnam

Some recent studies have summarized the key factors for successful design and implementation of cluster policy in Vietnam. *First,* the policy targets should be properly selected and reasonably justified, focusing on some clusters only. In this process, the Government should identify the already existing clusters and the potential "seeds", so as to deliver appropriate dosage of policy support. As mentioned earlier, policy support may work best and be most cost-effective in initial phases of cluster development.

Second, the design and implementation of cluster policy should avoid too much institutional complexity. While the cluster development policy may exhibit complications due to involvement of various policy instruments in different possible roadmaps, the institutions involved should not be too complex in order to ensure transparency and enforceability.

Third, the promotion of clusters should be closely associated with development of supporting industries. Specifically, development of supporting industries, above all local SMEs, is an important component of industrial cluster policy.

Fourth, reinforcing the innovation system and educational infrastructure is critical to the viable development of industrial clusters. As previously mentioned, innovation, education and training constitute important supporting institutions to cluster development. While there is yet to be any concrete evidence of poor innovation and education services leading to cluster failure, better provision of such services certainly facilitate intra-cluster business activities and linkages.

Fifth, one should refrain from thinking that Silicon Valley serves as the only model for cluster development. Specifically, cluster development may be viable in the industries other than the high-tech ones. In fact, there is a strong case for supporting knowledge creation and transfer also in traditional sectors – from agro-industry and food processing to furniture, textile and garments and other light manufacturing – or sectors dominated by FDIs. Motorbike, mechanical and electronics industries constitute notable examples of successful clusters where Vietnam has a clear and visible comparative advantage.

Sixth, cluster policy may not work out properly in the restraint of the voice of the business sector. In fact, the policy should incorporate reasonable substance of consultation with the business community, aiming to address their needs and issues while harmonizing the micro interest with broader objectives of cluster development.

Finally, improving the business environment should be considered as a pillar for cluster development. For instance, cluster policy may be embedded in SME development so as to promote the networking and linkages of critical importance to the SMEs in Vietnam.

Source: Extract from Vo Tri Thanh and Sothea Oum (2014).

✓ *C2. Initiative for ASEAN Integration (IAI)*

Vo (2012) surveyed responses on the effectiveness of the IAI and came to the following conclusions. *First,* CLMV countries (including Vietnam) have positive perception of the IAI programs and projects, as they are relevant to development needs and priorities of CLMV. However, better outcomes would have been realized if the IAI work-plans had been better designed and implemented and there had been better financial adequacy. *Second,* the IAI program areas and/or projects contribute either moderately or substantially to narrowing development gaps. Criticisms of the IAI programs focus on the inappropriateness of using a common template for CLMV, some projects are too ambitious in terms of financial resources and time available, the role of the World Bank and ADB as donors would be necessary; and IAI needs to pay more attention to institution building.

D. Integration with the Global economy.

The effort to integrate the regional economy began in 1995 when Vietnam became a member of ASEAN, and was followed by APEC in 1998. Vietnam then participated in various ASEAN-plus FTAs such as those with China and Korea. Thanks to bold and comprehensive reforms and liberalization efforts, Vietnam became member of the WTO in 2007. Even after the WTO accession, the country went on to negotiate and/or implement other ambitious FTAs such as ASEAN-Japan Comprehensive Economic Partnership, ASEAN-Australia-New Zealand FTA, ASEAN-India FTA, TPP, Vietnam-EU FTA, RCEP, Vietnam-Korea FTA, etc.

Table 29: Summary of Key Integration Milestones of Vietnam

Milestones	***Membership***	***Status***
AFTA	10 ASEAN member countries	Signed in 1992 (ASEAN-6); Vietnam participated in 1995; the remaining countries participated the following years.
Vietnam - US BTA	Vietnam and the United States	Signed in 2000 and implemented in 2001.
ASEAN – China FTA	10 ASEAN countries and China	Signed in 2004
ASEAN – Korea FTA	10 ASEAN countries and Korea	Signed in 2006; only Thailand signed in 2009
WTO	Became the 150th member	Accession in 2007
ASEAN – Japan	10 ASEAN countries and Japan	Signed in 2008
Vietnam - Japan	Vietnam and Japan	Signed in 2008
ASEAN - India	10 ASEAN countries and India	Signed in 2009
ASEAN -Australia- New Zealand	10 ASEAN countries and Australia, New Zealand	Signed in 2009
Vietnam - Chile	Vietnam and Chile	Signed in 2011
Trans- Pacific Partnership (TPP)	12 economies in the Asia-Pacific region	Negotiation in progress
Vietnam – European Union (EU)	Vietnam and the European Union	Negotiation in progress
Regional Comprehensive Economic Partnership (RCEP) (ASEAN+6)	10 ASEAN countries, China, Japan, Korea, India, Australia, New Zealand	Negotiation in progress
Vietnam - Korea	Vietnam and Korea	Negotiation in progress
Vietnam - Customs Union	Vietnam and Russia-Belarus-Kazakhstan	Negotiation in progress

Note: ASEAN-6 countries including: Brunei, Indonesia, Malaysia, the Phillipines, Singapore and Thailand.
Source: CIEM (2013) and updated by the authors.

In particular, Vietnam moves toward trade liberalization with the European Union (EU) with negotiations on an FTA beginning in June 2012 and that should be finalised by early 2015. This reflects the attempts to foster closer trade and investment ties with the region – which has been among the early signatories of bilateral trade agreement with Vietnam (in 1992).

*

* *

In conclusion, in spite of the positive results presented by the ASEAN scoreboard, which put Vietnam in the first position for implementing measures - some of them being anticipated - it appears that regulatory reform is still a very slow process in Vietnam. As a note, the ongoing dialogue with the EU, including the conclusion of a bilateral FTA, also covers issues such as regulatory reforms.

3.4. SWOT analysis about Vietnam Position

3.4.1. Strengths

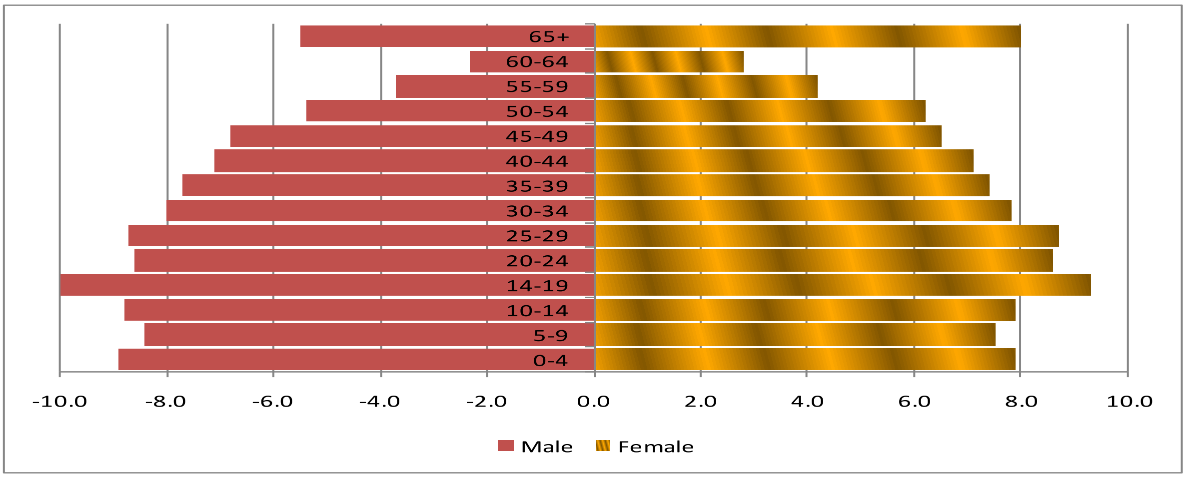
✓ *Socio-political stability*

Vietnam has a stable socio-political environment, as reflected by the significant confidence of the business community and the people who generally participate in and share the benefits from national economic growth (Vo Tri Thanh and Nguyen Anh Duong 2013). This stability ensures a favourable context for investment and business activities, thereby contributing substantially to long-term growth. As discussed previously, FDI and private investment increased continuously with important contribution to socio-economic progress, which was partly facilitated by the relative stability in the socio-political environment. As such stability prevails, further mobilization of resources for development may enjoy continuing ease.

✓ *Young population and growing middle class*

Vietnam has a fairly young and growing population, expanding middle class, a relatively skilled and low-cost workforce, a good location and political stability. In the ASEAN region, Vietnam pays the lowest average wage, only after Cambodia, hence offering competitive cost location (World Bank, 2013). In addition, the middle class is emerging, which induce significant changes in consumption behavior.

Figure 41: Vietnam's demographic structure by age group, as of 01/04/2010



Source: GSO (2011).

✓ *Robust economic growth, high employment rate and social progress*

As highlighted in part II of the study, Vietnam has succeeded in maintaining a reasonably high and continuous growth. In addition, the Vietnam benefits from high employment rate and has lately harmonized economic growth, social progress and equality. In other words, economic growth in the country has been quite inclusive.

- ✓ *Strategic geographic position and large production base*

The country has also a large production base of foreign factories, which is a favourable ground for diversification. The coastal line of 3,444 km, ranking 32nd out of 156 countries bordering with the sea, creates enormous potential for developing maritime transport and merchandise trade. Besides, Vietnam is part of South East Asia and East Asia, the dynamic regions with favourable substances for growth and development such as deepening development cooperation, high saving rate, and development of regional production network.

- ✓ *Solid financial institutions*

Domestic financial institutions have a strong knowledge of local markets and customers' habits and orientations. Liberalization of financial services has also been promoted in line with the commitments under the WTO and ASEAN Framework Agreement on Services. Since 2005-2006, Vietnam has also promoted development of the domestic suppliers of financial-banking services. Reforms of the banking sectors and financial soundness are on-going, which may contribute to enhanced efficiency of economic activities in the region.

- ✓ *FDI and induced engagement in regional production network*

Like the entire ASEAN region, Vietnam benefits from large inflow of FDIs. Over the years of 2010-2013, the amount of FDI reached between USD 10.5 billion and USD 11.5 billion, which has been considered as a sign of confirmed investors' confidence in Vietnam. The country ranked third in the ASEAN region in view of the implemented capital of FDI in 2012, after Singapore and Cambodia.

The contribution of FDI has been rising over time with pre-crisis peaks, but also maintaining level of about 5% of GDP thereafter. The FDI enterprises accounted for a major share in Vietnam's trade, reaching almost two-thirds in recent years. At the same time, via their spillover impacts (backward and forward linkages, competition, technology transfer), FDI helped Vietnam to engage more deeply in the regional production network.[47]

- ✓ *Progressively open trade and investment regimes*

The efforts made by the Government of Vietnam to access the WTO are a relevant basis to take good advantage from the AEC. Continuing liberalization efforts under ambitious agreements such as Trans-Pacific Partnership, Regional Comprehensive Economic Partnership, Vietnam-EU FTA, Vietnam-Korea FTA, etc. may broaden the economic opportunities as well as pressures for competitiveness-enhancing reforms. As it is widely known, economies that are already open and globalized will benefit less from economic integration while economies that are closed will face painful adjustments from trade and investment liberalization but will enjoy efficiency gains: due to its late accession to WTO, Vietnam has already undertaken most of the required reforms for economic integration and, hence, undergone the related painful adjustments. However, since such reforms and the very accession to WTO are rather recent, the Vietnamese economy is still likely to have good margins for enjoying efficiency gains of further economic integration. The gains are potentially larger given the simultaneous negotiation and/or implementation of various trade deals. Nonetheless, the magnitude of such

[47] See Tran Binh Minh et al. (2011), CIEM (2013).

gains is conditional upon how Vietnam harmonizes its commitments under various integration arrangement.

3.4.2. Weaknesses

✓ *Shortage of institutional adequacy*

The decision-making capability remains far from sufficiency for developing a market-based economy, alongside weak information system. Besides, Vietnam lacks experience in managing economic development, and the business environment fails to be sufficiently enabling to innovation and entrepreneurial activities. Coordination and cooperation of macroeconomic policies have been less than fully effective, as showcased by the macroeconomic performance in recent years. The incentive for effective policy formulation and implementation was also constrained by the inadequate monitoring system, particularly regarding the financial system.

✓ *Underdevelopment of infrastructures*

Vietnam's infrastructure system remains underdeveloped, despite huge investment. Infrastructure services and utilities are too expensive and even restrictive to economic activities. The issue gets even more serious in urban areas, where high population density and migrants are popular. The underdeveloped infrastructure system also led to higher services link costs. This weakness could be attributed to the lack of financial resources, poor project preparation, weak contractors and lengthy construction process. Meanwhile, proper mechanism for inducing private investment in infrastructure fails to be enforced.

✓ *Insufficient quality of human resources*

Vietnam's human resources are still of insufficient quality (and even skill-reflecting qualifications). The education and training system no longer meets practical demand, yet proper and feasible directions for improvement stay unidentified. Simultaneously, the link with foreign institutions and overseas trained people has been relatively weak.

✓ *Lack of competitiveness and dynamic efficiency*

Vietnam lost ground in several areas of the Global Competitiveness Index, including labour market efficiency (56th, down by 5) and financial market development (93rd, down by 5).

Another area of concern is technological readiness (Vietnam's ranking is 102nd in the GCI down four in comparison with the previous year). Although new technologies are spreading among the population, Vietnam is lagging behind the region in terms of the percentage of firms with internationally recognized quality certifications and Vietnamese businesses are particularly slow to adopt the latest technologies for their business use (128th in the GCI), thus forfeiting significant productivity gains through technological transfer. Such situation has been intensified by the absence of a regional strategy and the scarcity of national ones to promote private sector investment in research and development.

Also the presence of too many SOEs and government-linked companies affects Vietnam's competiveness and the efficiency of the Vietnamese internal market SOEs may be highly important to smooth running of society and are sometimes propped up with cash infusions in times of crisis to help to surmount situations that would bankrupt a normal privately owned business. In addition, they can work well in some areas (e.g. infrastructure) and badly in others (e.g. consumer goods) and it is also possible for them to boost growth at one stage of development and impede it at another: therefore, their viability always depends on the wider context. However, there is striking evidence that, in most of cases, state-owned companies are not only less innovative, but also less productive than their private competitors. In addition, there exists the risk that political interference – a common deadly disease of SOEs – emerges, impeding the proper management and functioning of such entities. In short, an economic sector, which is too pervaded by SOEs, runs the material risk to be far less efficient and innovative than one where the presence of such companies is properly counter-balanced by the private actors.

Despite some studies suggest that the AEC benefits are expected to accrue among the less developed members of AEC, which includes Vietnam, these findings are debatable, as the implementation capacity of those countries is still weak. In short, Vietnamese undertakings, and SMEs in particular, are not well placed to face increased competitiveness in the industrial sector.

- ✓ *Eroding financial system*

As far as domestic financial institutions are concerned, a first weakness can be pointed out in over-granting of licenses for some types of financial institutions. First, income of Vietnamese banks from non-credit interest (14%) is much lower than the corresponding figures in other countries: 21% in China, 36% in Thailand, 33% in Australia and 40% in Singapore, respectively (VPBS 2014). Second, the domestic banks' capacity in governance, technology renovation and application is still poor. These factors put the domestic banks in a disadvantageous position over foreign competitors in the context of further financial liberalization and integration.

Another weakness can be observed in micro-prudential sustainability. Most banks in Vietnam records to achieve a minimum Capital Adequacy Ratio (CAR) of 9%48, which is rather low compared to the average CAR of APEC at 13.1% or Asian emerging countries at 12.3%.

Furthermore, the delayed application of Basel II and III is not a sole fault of the banks. Another, persistent weakness of Vietnamese banking sector is the high ratio of Non-Performing Loans (NPLs) in recent years, which reflects to a certain extent the poor administration of the SBV. NPLs is ranging about 6-13%, depending on methods of accounting. It is noteworthy that this proportion of NPLs is highest for state-owned commercial banks (54%, as of Sep. 2012) and lowest for foreign invested credit entities (5%) and that the NPLs are largely related to SOEs (70%).

A third weakness of the Vietnamese financial institutions is maturity mismatch, i.e. long-term lending is financed with short-term deposit. However, the problem of maturity mismatch can be mitigated as a short maturity of part of deposits is usually extended (VPBS 2013).

- ✓ *Insufficient domestic regulatory reforms*

In 2012, Vietnam ranked 76th on the rule of law indicator. This weak score reflects the fact that, from outside, Vietnam's legal environment is seen as being archaic. Domestic regulations are still perceived by investors as burdensome, with the number of procedures to be compliant with and delay in time.

Regulations affecting services in particular for professional and transport services remain relatively more cumbersome or restrictive than other countries.

Another example of institutional weakness can be seen in the Ordinance of Foreign Exchange.

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48 Except for Eximbank and Techcombank, having a CAR of more than 12%, the corresponding ratio of other banks ranges from 8% to 11%

This legal document was promulgated in 2005 and came into effect in 2006. Hence, some provisions became out-dated, inconsistent and unadjusted to the other related legal documents, which have already been revised to meet new circumstances and/or to comply with international commitments.

Weaknesses can also be seen in the lack of effective sanctions related to competition policy, consumer protection and intellectual property rights, prohibiting proper enforcements of legislation. Enforcement agencies of IPRs in the country have found it difficult to keep up with recent rapid changes to the related legal framework, and administrative enforcement is complicated by the large number of bodies involved.

3.4.3. Opportunities

- ✓ *More intra-trade in the ASEAN*

ASEAN is a fast growing economy, increasing the competitiveness of the overall economy and the region is an important market for Vietnam, which accounts for between 15% and 20% of its overall trade, still below its potential.

The fact that more than 99 percent of tariff of six ASEAN countries (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) is scheduled to be eliminated in 2015 may help Vietnamese firms, as customers of Vietnamese banks, to gain more benefit from the Agreement and to promote Vietnam's exports to other ASEAN markets.

A study by ERIA (2012), which assumes elimination of all tariffs and significant improvement in trade facilitation, actually finds that the largest benefits will accrue for Vietnam and the other less developed countries of ASEAN, given that they still have some room to reduce tariffs. However, the further reduction of tariffs will likely impinge on trade volume only marginally. On the other hand, some larger benefits are expected of Vietnam's FTAs with EU, Japan, Korea, Australia and New Zealand (so, outside ASEAN),

Other studies pointed out that harmonizing standards across member countries would also enable a transfer of best practices, and, hence, improve trading facilitation (in particular, the customs administration).

- ✓ *Improving competitiveness and attracting FDI*

According to various studies, AEC is more perceived as a single market, hence being attractive for foreign investors, especially for large multi-national companies (especially multi-plant) that may establish different phases of the value chain in different countries but still operating on one market and fully enjoying the benefits of free movement of goods, services, capital and labour. MNCs, therefore, would fully exploit the chance for ASEAN to develop a regional IPN and, hence, reduce transportation and transaction costs, while benefit from significant economies of scale and scope at, at same time, make use of each location's advantages to boost productivity and cut costs, when bolstering investment and technological transfer.

Low wages and productivity will offer competitive cost locations for MNCs at different stages of the value chain. Labour experts and national officials agree that the gains is far greater than the losses, especially for Vietnam and the Bangkok-based ILO office states that, as Vietnam's wages are neither the highest nor the lowest in ASEAN, there is a movement of workers both into and out of the country.

As Vietnam is low at the wage ladder in the region, it may face skilled workers outflow. On the other hand, specialized workers coming from other ASEAN countries may compete with local specialist. Nevertheless, this situation represents more an opportunity than a threat, because comparable situations (e.g., the context of the EU) tend to show that skilled workers move more easily than non-skilled workers, except when the later can expect much higher payments or increased social protection when they move out of their own country. Thus, the free flow of skilled labour may be an opportunity for Vietnam, given the scarcity of skilled workforce in the local economy. A potential inflow of skilled workers may elevate the competitive and productive capacity over the medium-long run. Skilled people from other AMSs is flowing into Vietnam, providing many more opportunities in trade, investment and employment, new knowledge and advanced technology and hence improving the productive capacity and reinforcing the economy dynamism. Skilled labourers from Vietnam will also have a wider variety of choices, according to the Ministry of Labour, Invalids and Social Affairs. However, in order to mitigate the likely adverse consequences (mainly in terms of higher unemployment) of such movement and increased competition on the national workers in the short term, it is essential for Vietnam to develop its welfare system and adequate State programmes of training and professional (re-) qualification. This is an area where State intervention is crucial and cannot be delegated to the private actors' initiative, since the private sector lacks of concrete incentives to undertake and carry out such activities. The risk of raising unemployment of nationals gets higher due to the lack of harmonized policies and standards to manage mobility of skilled and unskilled labour.

FDI coming from developed countries may also help local enterprises to better face their difficulties in production and business and to increase competitiveness by seizing the transfer of high-tech skills and know-how.

- ✓ *Improving financial system*

As far as the Vietnamese financial system is concerned, the AEC can help achieving integrated financial and capital markets through financial services liberalization and capital account liberalization. In turn, this can benefit the country's through increased scale and liquidity of domestic market, wider choice of instruments to manage the company's capital structures, increased ability to issue long term, local currency denominated debt to allow for a better matching of returns and liabilities of firms (relief of double mismatch), increased risk sharing potential, and increased attractiveness of Vietnam as an investment destination.

Financial service liberalization may provide opportunities to Vietnamese financial institutions, particular banks, to further penetrate ASEAN banking markets (Vietnamese banks are now operating in Laos, Cambodia and Singapore) and to seek for (strategic) assets/partners.

Despite having a modest market shares in the banking sector in recent years, the foreign–invested banking sector can fight successfully for a larger share of credit market cakes over the medium and long term. There has been evident of such potential since 2013, when the foreigners sought more active and successful in M&As and better gaining non-credit-interest incomes. Advantages in capital, technology, risk management skills, and so on add more impetus/synergy for foreign banks to crowd out the domestic banks in the domestic markets.

- ✓ *Enhancing macro-economic stability*

AEC will further support the achieved macro-stability in the region and will foster the work on larger initiatives, like Financial Stability Dialogue or a Fiscal Pact (also in the light of the recent bad experience of the EU and the Eurozone and the small success of the first Chiang Mai Initiative).

ASEAN mechanisms is increased and will enable ASEAN to participate in wider regional initiatives (e.g. ASEAN Financial Stability Dialogue) and in a regional dialogue focused on sustainability in a wide array of different areas (fiscal, environment, socio-protection, workers' rights, etc.).

Stronger financial co-operation initiatives within the ASEAN context will enable to further strengthen AMSs macroeconomic resilience.

- ✓ *Reinforcing institutional mechanisms*

For AMSs (plus China, Japan, South Korea), the establishment of institutional mechanisms and arrangements for economic and financial co-operation will reinforce the region's capacity to respond to wide-scale crises and enhance surveillance capability to prevent such crises from erupting in the region, exemplified by the CMIM.

As for AMSs' financial institutions' development, the promoting of (virtually) automatic mutual recognition regimes for investment funds, expedited review frameworks (including the use of harmonized ASEAN disclosure and approval) for secondary listings of primary offerings of securities, and the operationalization of the ASEAN linkages including back office linkage would provide a robust starting point for an integrated ASEAN capital market (Lee, 2012).

- ✓ *ASEAN-related opportunities*

There exist some significant opportunities that Vietnam shares with the other AMSs and stem directly from its membership to the ASEAN and, more specifically, to its participation to the AEC.

First, a source of considerable opportunities is represented by the ASEAN strategic location with huge market potential in neighbouring economies. In turn, such potential is also facilitated by the well-rooted historical and cultural links throughout Asia; strong economic links with ASEAN+1 FTA markets in Australia, New Zealand, China, India, Japan and the Republic of Korea; potential development of region-wide FTA with China, Japan, the Republic of Korea, India, Australia and New Zealand (RCEP); deep manufacturing and technology links with Northeast Asia; financial cooperation with PRC–Japan–Republic of Korea in reserve pooling through the CMIM; and surveillance through ASEAN+3 Macroeconomic Research Office (AMRO).

Second, ASEAN is in the middle of the fast growing, largest growth corridor in the world today, spanning from Northeast Asia through the ASEAN region and onto India. East Asia is also in the throes of a major economic transformation. The fast economic growth of China and its emergence as an export powerhouse especially in labour intensive manufactures has one important result, which will likely lead to further economic restructuring and transformation in East Asia. Specifically, China's hitherto huge "labour surplus reserve" has largely gone and in its place is a huge and growing middle class. In addition, China is moving headlong into skilled labour intensive industries, including major expansions in tertiary education and sharp rise in R&D expenditures. Thus, China's real wages can be expected to spike up more substantially while the growth of China's middle class would mean more solid growth in domestic consumption and imports of goods and tradable services. The ASEAN region will likely be impacted by these developments. Already, the flow of FDIs into Cambodia and Vietnam is partly attributable to the rise in labour costs in China's south-eastern provinces. Recent newspaper reports also suggest that ASEAN countries especially Vietnam, Indonesia, Thailand and the Philippines are likely major beneficiaries of the FDI spillovers arising from the spike up in real wages in China. At the same time, China's surging middle class offers opportunities for profitable market niching by ASEAN firms especially in the light of the ASEAN-China FTA. Similarly, China's fast growing and huge middle class and Northeast Asia's ageing but well off population offer tremendous growth opportunities for tourism, healthcare and wellness service industries where ASEAN countries have strong comparative advantage.

Third, East Asia's robust growth and dynamism would lead to large and growing demand for more income elastic products (e.g., tropical fruits, design based garments and furniture) and industrial materials (e.g., minerals, biofuels, rubber) where a number of ASEAN countries have comparative advantage. ASEAN region is also a significant world player in electronics, with strong presence of MNCs and a number of home-grown firms. If ASEAN upgrades alongside China's fast improvement in the industry as well as Japan and NIEs technological advances, East Asia remains the global production hub for the industry.

Fourth, the creation of an economic community between the AMSs has the potential of increase energy, water and food production and could play a pro-active role in responding to supply crisis of such key assets. Similarly, through AEC, the AMSs could develop regional hubs in health, educations, logistics, financial services and tourism.

3.4.4. Threats

✓ *Increased competition*

More competition brought in by AEC in Vietnam may be detrimental for some dominating industries such as garment industry, as these industries operating low in the value chain may exhibit further cost pressures and throw employees even lower at the income ladder (and potentially into poverty). Opportunities for Vietnam are illustrated above and seem predominant, but not all studies agree. A study made with a CGE model, assumed the complete elimination of tariffs and NTBs, the liberalization of five service sectors, AEC-induced changes in FDI and a 5% reduction in trade costs and concluded that Vietnam would be the last country to take benefit of from the economic community (2.8% of baseline GDP), with Singapore being the most advantaged (9.7% of baseline GDP).[49] This apparently puts Vietnam in an unpleasant position, suggesting that the more developed economies within ASEAN are those which may get the most out of the AEC. Indeed, the more developed economies of ASEAN are expected to exhibit a 26-38% increase in per capita GDP induced by the competition policy. Such situation is also exacerbated by the absence of an effective regional fund to redistribute resources among ASEAN members.

Vietnam may not be able to take advantage of the geographical proximity of big and less-demanding markets such as China and India to boost up its exports (Hai and Porter, 2010).

Demand for high-skill labour will likely grow faster than supply, while demand for low-skill labour will remain weak. Rising inequality is also creating tensions in many countries along with corruption, political instability, poor governance and a lack of sufficient investment in infrastructure.

The free flow of skilled labour may be also a disadvantage for Vietnam. According to Torres' study, it may create an opportunity for skilled Vietnamese to search for better opportunities (in terms of higher wages) in other AEC members (Malaysia, Indonesia, Thailand, Myanmar, Cambodia, Singapore, Laos, Philippines and Brunei) where they will receive higher pay for their abilities, and, more particularly, in the more developed ones like Singapore and Malaysia that have already created decent environment for such workers.

✓ *Rise of the China and India overshadow ASEAN and AMS' relevance*

The potential of AEC for Vietnam and the other AMSs may be impaired by the rise of China and India.

49 According to the results of a CGE model of the AEC built by Plummer and Chia (2009).

The significant improvement in the capacity of China in skilled labour intensive industries will pose further pressures on the concerned industries in such countries like Vietnam, Malaysia, Philippines, and Thailand. China's fast and dynamic transformation presents tremendous competitiveness challenges to ASEAN industries and firms in third- country and domestic markets across a wide range of industries.[50] Indeed, some model simulations suggest that China would significantly crowd out ASEAN exports in most Western and other non-East Asian economies by 2020 if China liberalizes unilaterally and ASEAN does not follow suit and adjust accordingly (Roland-Holst, 2002).

India is also growing fast and ASEAN-India trade has been surging at a fast clip in recent years, although the level of trade is still relatively small compared to the ASEAN-China trade. India does not appear to be a compelling constraint to ASEAN's exports to third markets at the moment. And as India grows fast and its middle class increases substantially, the potential for possible complementarily between ASEAN countries and India would likely increase also.

There is one important aspect where both China and India pose a challenge to ASEAN: both countries are large countries with huge domestic markets; in contrast, ASEAN consists of 10 countries with varying priorities, policies and institutions. Thus, potentials for economies of scale are better realized in the two large countries as compared to ASEAN unless there is greater connectivity, efficient facilitation, and more common regulatory framework in the ASEAN.51

- ✓ *Risk of falling in the "middle income trap"*

Like most of the ASEAN member countries and many countries in Asia, after several years of rapid growth, Vietnam has advanced towards the middle-class status. The risk of being unable to move from a low-cost to a high-value economy, making it difficult for the country to compete in export markets with both lower-cost producers and high-income countries (finding itself still behind the advanced economies in higher-value products) is getting higher. Momentum for reforms remains modest, whilst the role of productivity in economic growth shows little positive improvement in recent years.

- ✓ *Regional-specific and ASEAN-related threats*

Not only may Vietnam and the other AMSs benefit from opportunities related to their geographic location, but they also have to cope with threats originating from the same position and the peculiar features of the Asian region, namely: political–security conflicts in Asian region arising from unresolved intra- and extra-regional territorial disputes and ethnic conflicts; vulnerability of export-dependent economies to external shocks from US and Europe; loss of the centrality in the geopolitical context due to the rise of the PRC and India; lack of effective regional cooperation on climate change, water-energy-food security, and disaster management (drought, floods, earthquakes, volcanic eruptions).

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50 Thus, for example, the drop in the global trade shares of Malaysia and the Philippines during the 2000s can be attributed in part to the dramatic rise of China's global share (from 3.3% in 1990 to 19.9% in 2008) in electrical and electronics equipment, a major export item of both countries especially of the Philippines.

51 Arguably, ASEAN's drive towards a single market and production base under the AEC can be liken to mimic China and India, since an ASEAN population of around 600 million is a pretty large market by itself. The more open, integrated and connected the AMSs are among themselves as well as with the rest of East Asia and beyond, the better would the ASEAN region be able to respond both to the challenges and the opportunities of the two huge countries, East Asia overall, and the rest of the world.

Other threats derive from the current configuration of ASEAN: erosion of advantages in the export-driven growth model followed so far; excessive focus on intraregional competition and lack of internal cohesion to formulate a long-term regional development strategy; absence of unified ASEAN representation of members' interests in global forums; weak linkages between ASEAN and sub-regional cooperation initiatives and programs; obsolete institutional governance and weak monitoring and implementation mechanism.

- ✓ *Weak ASEAN institutional capacity*

The threats posed by ASEAN's poor institutional capacity deserve further considerations. Implementation of regulations against their enactment by law may remain weak, posing potential problems in building more competitive economies within a larger community, as well problems of faster harmonization of standards across AMS. Strengthening ASEAN and endowing it with more resources could overcome the issue: ASEAN is a very lean organization (Komori 2009; Severino, 2007). The Secretariat is understaffed and has very limited resources. Funds are normally allocated on ad hoc basis for certain projects or special meetings. This means that most resources stay in the hands of the member states rather than on the organization itself. Furthermore, the ASEAN's reigning dispute management system is based on avoidance[52] and consensus building, which is surprisingly informal and protracted: even though it raised the long term stability of the organization, its cohesiveness, and greatly strengthen preventive diplomacy, it causes relevant costs due to lack of decisive action in tackling short and midterm threats and also in the operationalization of agreed policy goals by AMSs (like, for instance, the creation of AEC by 2015).

The weak institutional structure, which currently characterises the ASEAN, seems definitely inadequate for coping with the considerable governance issues of the region and fostering the regulatory reforms which are essential for the creation of the economic community: on the one hand, it has no specific competence and lack of sufficient dedicated resources to strengthen public governance.in the region (*i.e.* to promote the rule of law, contract enforcement, implementation and enforcement of transparent rules, and strengthen national civil services); on the other, it lacks of effective mechanisms, adequate funds and capabilities to introduce the necessary governance regulatory reforms and international best practices, by, *inter alia*, adopting a wide region competition policy and legal framework, a harmonised consumer law, harmonizing ASEAN governance standards and practices, and an ASEAN Competition Authorities and a network between the National Competition Authorities (NCAs) of the ASEAN member countries. The issue attains more importance as ASEAN is embarking on various cooperation framework (ASEAN+1, ASEAN+3, ASEAN+6, etc.) with complex web of arrangements/commitments which gives rise to the need for improved coordination capacity.

3.5. Remaining challenges

Given the wide-ranging and complex issues involved in economic and financial liberalization and integration, and the need for more deliberate and cautious approaches, many challenges remain and it appears relatively clearly that the fulfilment of the goal of full economic and

52 Avoidance refers to conflict management procedures leading to the filtering out of certain kinds of disputes or to other more subtle methods of avoidance such as the channelling of certain issues to powerless secondary committees and the subsequent delay and final ignorance of the findings.

financial integration in the ASEAN lies beyond 2015.

3.5.1. Central role of ASEAN in regional (East Asian) economic integration

✓ *Managing Macroeconomic and Financial Stability*

ASEAN countries need to bolster internal cohesion to effectively cooperate in determining the strategic direction of existing and future institutions. Members must also enhance institutional effectiveness and capability by expanding resources and through peer-group review of national policies. To improve macroeconomic policy coordination and ensure financial stability, an ASEAN Financial Stability Dialogue—composed of finance ministers, central bank governors, financial supervisors, and market regulators — should be established. Active dialogue with the private sector and coordination with the recently expanded ASEAN+3 Finance Ministers' and Central Bank Governors Meeting should be encouraged.

Closer regional cooperation on macroeconomic policies, particularly exchange rate and fiscal policies, would benefit member countries. As ASEAN economic interdependence deepens, policymakers must avoid the possibility of fiscal crisis contagion, which could jeopardize overall macroeconomic stability. Regular assessments of member countries' fiscal sustainability by an independent institution — such as AMRO or a multilateral financial institution like ADB or the International Monetary Fund—could begin collaboration in fiscal policy management. Assessment results could initially be reported to the ASEAN Financial Stability Dialogue, eventually leading to a regional Compact on Fiscal Sustainability, which would define tolerable levels of fiscal deficit and public debt ratios.

Excessive exchange rate volatility is harmful to a functioning AEC — with its single market and production base. Volatility limits economic transactions, increases costs of cross-border business, and reduces the benefits of regional production networks. A flexible coordination mechanism can maintain fairly stable exchange rates between regional currencies in times of stability, while providing greater flexibility in times of stress — for example, when countries are hit by sudden foreign exchange liquidity shortages or balance of payments shocks.

✓ *Promoting Economic Convergence and Equitable Growth*

Narrowing the development gap within and across ASEAN economies is a critical step for deepening economic integration. At the same time, ASEAN has strived to include provisions related to development cooperation, especially targeting the reduction of intra-regional development gap, in its FTAs with East Asian partners. Over the past two decades, CLMV countries have steadily caught up with the more advanced ASEAN economies: the ratio of average per-capita GDP of the ASEAN-6 to CLMV countries declined from over 11 times in 1990 to about 4 times in 2010. If 2030 per-capita GDP growth aspirations are met, the ratio would further fall to about 3 times. Growth potential in CLMV countries is enormous, given their natural resources, a young and growing population, and their strategic position linking China with India (more generally East Asia with South Asia). CLMV countries need to build a solid macroeconomic policy framework to ensure stability and development. Progress toward equitable economic growth and closer integration depends on the speed and quality of CLMV convergence toward the ASEAN average over a wide range of development indicators. Closer coordination of ASEAN-6 initiatives for helping overall CLMV development and channelling external assistance from development partners to support the Framework for Equitable Economic Development (adopted at the 19th ASEAN Summit) — and to the Initiative for ASEAN Integration—will greatly improve economic convergence.

The creation of an ASEAN Convergence Fund through voluntary contributions would be a more direct route to bridging the development divide—not only between countries but also within them. Substantial enlargement of the existing ASEAN Development Fund would be one way to develop a new fund promoting intraregional convergence. However, the only way to make such fund effective is to hire qualified professionals to administer it. Priority projects to be considered under the fund would be those reducing intraregional disparities, including through sub-regional initiatives.

- ✓ *Regulations and national willingness*

AEC does not cover the crucial issue of regulation of unskilled and illegal migration (which is nevertheless addressed – although in insufficiently adequate terms - in the Annex for ASEAN Security Community Plan of Action). Regulation of illegal migration and migration of unskilled workers is much more pressing than the free flow of skilled labour. Given the tremendous political and security consequences and deriving social instability, the Vietnam's government should not delay the domestic reforms in this domain that are more essential for the country than the free flow of skilled labour. Introducing an integrated system of freer, yet managed, unskilled labour movement across borders — while continuing the AEC commitment to free movement of skilled labour—is an important policy initiative in moving toward a borderless economic community. Large numbers of unskilled workers already cross borders in response to demand and supply gaps in ASEAN labour markets. However, such movements often remain undocumented, create unwarranted discrimination and social tension, and exacerbate inequalities. Proper regional management can reduce tensions, narrow inequalities, and promote overall ASEAN development.

ASEAN still faces several internal challenges related to non-tariff barriers, sticky labour laws, lack of infrastructure and huge development gaps among members. More particularly, the reluctance of authorities to change their legal apparatus in the area of NTBs in order to be compliant with regional cooperation and product standards remains a considerable challenge to make AEC a real integrated market. Trans-boundary transport arrangements can also be held hostage to political disputes or pressures.

Financial liberalization and integration will likely foster capital transactions, but risk management is yet to be accomplished: particularly, inspection procedures, supervision mechanisms, prudential requirements and mechanisms of collaboration among ministries and state regulators should be put in place and or ameliorated consistently. Such new issues represent significant threats for the Vietnam's banking and financial sector in particular.

- ✓ *Attracting FDI*

The long-term objective of the ASEAN is to become a RICH region, but the short-term target is still focused on creating an integrated market and attracting FDI. In 2013, ASEAN got 22.4% of total FDI, with Singapore, Malaysia and Thailand being key investors. The challenge to increase this figure remains high in a global scenario of fierce competition to attract FDI. Specifically, Vietnam and certain countries in the region are competing aggressively in terms of fiscal incentive, procedural relaxation, etc. to attract FDI. Such a competition may, however, incorporate a substance of race to the bottom.

The link between trade and investment, particularly through FDI, has been extensively discussed in the literature: even if ASEAN is lowering its tariffs to increase intra-ASEAN trade, it will not obtain the potential benefits of trade liberalisation with greater investment unless supported by a broader enabling environment. Therefore, delays in ratifying important relevant agreements contribute to a loss of the momentum in integration, and these delays need to be addressed. On the other hand, the potential for impact of the intra-ASEAN trade as well the other trade agreements on the FDI inflows may be undervalued.

- ✓ *Lack of supranational bodies*

In the long run, ASEAN aims to become a "RICH" *Resilient, Inclusive, Competitive, and*

Harmonious region by 2030, which means the quest for peace and security, economic prosperity and social security, safeguarding of national independence, preservation of the competitiveness and preservation of the environment. To reach goals that are partly similar to those defined by the European Union, ASEAN has chosen the "ASEAN Way", which is characterised by the absence/weakness of supra-national institutions.

The challenge faced by ASEAN lies in whether the region is able to reach the goals defined in the RICH vision without following a "binding way" of integration, when it comes to sensitive issues such as financial integration, total freedom of workers within ASEAN, etc.

While, for instance, the European Union has put these issues at a level of supra-national co-operation, ASEAN relies on inter-governmental co-operation and choose not to put in place any instruments that enable a supra-national mechanism of enforcement for the commitments undertaken at the international level: the region has decided to pursue integration without hampering individual sovereignty of member states and it even seems that ASEAN countries do not aspire to create a supra-national body. This path quite resembles the intergovernmental system, which initially dominated the co-operation between the founding members of the original European Communities. History has proved that the establishment and protection of the internal market and closer economic integration required overcoming such inter-governmental form of co-operation in the vast majority of the fields of common interest.

Different ways can be followed to reach this goal. Among others, one way is to extend the "ASEAN way" to other countries in the region and to increase economic cooperation in order to reinforce economic stability and resilience. Another way is to follow the European model in order to reach a more integrated ASEAN.

The "ASEAN Way" has led to the absence of supranational bodies that would assume the role of enforcing regional regulations in national legislations. As already highlighted in the present study, the ASEAN member countries have relied on non-ASEAN sources of law to support their regional economic integration into the AEC, and arguably benefited from the previous experience and outcomes of other regional areas like the EU. ASEAN needs to look towards rule-based principles for economic integration. At present, relevant ASEAN sectoral bodies coordinate the implementation of the programmes and measures envisaged by the Blueprint at the regional level, while AMSs' relevant government agencies are responsible for overseeing the implementation and preparation of more detailed action plans at the national level. Finally, partnership arrangements with the private sector, industry associations and the wider community at the regional and national levels are also actively sought where required to ensure participation of all stakeholders in the integration process. For the creation of the AEC, such bodies activities remain under the supervision of a weak and embryonic implementation mechanism, which relies, on the one hand, on the coordination between the HLTF on ASEAN Economic Integration, the ASEAN Secretariat; the AEMs, AMSs' relevant sectoral Ministerial bodies, and, on the other, upon the AEC Scorecard (with its already illustrated shortcomings). Finally, the absence of a supranational court, before which bringing possible disputes on the implementation of the Blueprint and the present ASEAN's dispute management system, based on the costly principles of avoidance and consensus building, impede decisive actions in the operationalization of agreed policy goals by AMSs, like the creation of AEC by 2015.

The present institutional framework has also led to create more and more complex situations, such as the possibility of concluding all FTAs at the national, regional and plurilateral levels, described by many analysts as a "spaghetti bowl". According to Vo Tri Thanh (2011), the complexity of various FTA commitments and their ambiguous impacts on ASEAN member countries could hinder the ASEAN's consensual move towards deeper integration."[53]

Another consequence of the approach at issue is that national regulatory institutions have not followed the drastic changes in business practices and technologies that emerged in the ASEAN supranational context over the last decades. More particularly, labour market institutions did not adapt regulations quickly enough, causing significant distortions between laws and the necessities of real business.

The creation of supranational bodies seems be an option that has not been retained by AMSs, but that challenge remains nevertheless unaddressed: for the effective and successful implementation of the programmes and measures envisage by the Blueprint for the AEC, adequate institutions and mechanisms, ample resources and technical capacity shall be accorded to the Community building process, consistently with the cases where international supervision and follow-up mechanisms work efficiently.

- ✓ *Region-wide competition policy and creation of an ASEAN Competition Authority*

The construction of a single market (first pillar of the AEC) and a highly competitive economic region (second pillar of the AEC) cannot be maintained without the implementation of a regional ASEAN Competition law and the creation of an ASEAN Competition Authority in charge of enforcing it together with the AMSs' NCAs acting as peripheral enforcers (like the EU Commission and the EU Member States' NCAs). Free internal market can hardly survive and/or be nurtured if the partitioning of its segments within States can be replaced by private actors. From another angle, competition law has the primary function of prohibiting commercial practices that damage the operation of markets and promote activities that yield economic benefit in terms of efficiency. A good competition policy can ensure sound implementation of the AEC Blueprint and strengthen the international competitive position of ASEAN firms.

In the new context, more ambitious FTAs involving countries in the ASEAN region incorporate the commitments towards enhancing fair and neutrality of competition. Examples of such FTAs include, but are not limited to, the Trans-Pacific Partnership, FTA with the EU, etc.

Therefore, ASEAN governments should adopt a region-wide competition policy, or at least its legal framework, to avoid unfair competition across national markets, especially for attracting FDI or implementing FTAs with non-ASEAN members.

Along with the design and implementation of a competition policy and institutions, the 'culture of competition' has yet to emerge in some AMSs, who traditionally favour cartel arrangements, state over-intervention, and the protection of national champions.

- ✓ *Nurturing Natural Resources and Sustaining the Environment*

Achieving a harmonious ASEAN requires countries to an environmentally sustainable development, given limited resource availability. Although natural resources are abundant in

53 Vo Tri Thanh (2011).

Southeast Asia, meeting the inappropriately managed consumption needs of growing populations may imply that such resources are depleting rapidly. Those transformed into energy unavoidably result in pollution. Policymakers must respond by designing and implementing "green growth" strategies for economic development. Without immediate, decisive action, by 2030 ASEAN's river quality, for example, will have seriously deteriorated and drinking water will likely be in short supply. Air quality, especially in fast growing urban areas — estimates suggest 50% of ASEAN's population will live in cities by 2030 — will decline below acceptable levels.

This challenge has both national and regional dimensions. An ASEAN Ministerial Meeting on the Environment (AMME) — started in 1981 as part of the ASCC—introduced in 2010 a Blueprint comprising 10 priority areas to protect the environment. Over the years, AMME has adopted agreements and strategic plans to lower carbon emissions, reduce greenhouse gases, manage water resources, and lower transboundary haze pollution. While ASEAN- level resolutions are non-binding at the national level, policymakers from member countries should proactively introduce long-term development plans that reflect decisions taken by ASEAN agencies and adopt an overall approach for mainstreaming green growth. They should also support "green products," which can provide new impetus for joint-development of niche high-value added sectors and the adoption of common standards across the ASEAN region.

✓ *Forging a Competitive and Innovative Region*

Large variations in global competitive rankings among ASEAN members need to be narrowed. Policies promoting competitiveness must be crafted nationally, given the different contexts and needs of individual countries.[54] At the same time, regionally coordinated efforts should be made to reduce intra-ASEAN gap in development capacity and competitiveness. To complement national efforts, ASEAN countries should consider establishing an ASEAN Competitiveness Institute — or something similar — to promote adoption of a region-wide innovation strategy, and construct a framework for a regional research and development (R&D) policy. Accelerating technology diffusion and absorption in key areas with large spillovers to the rest of the economy should be one policy goal. Exploiting synergies with science, R&D, and innovation in biotechnology and nanotechnology could make ASEAN a leader in emerging market niches.

A concrete initiative in developing a borderless economic community could be the creation of an ASEAN brand—a Made-in-ASEAN product label, which should be facilitated by the existence of 'region-specific' ROO. For this purpose, a dedicated regional agency for certification and application of proper standards could be established. It could have a multiplier effect not only on industrial development, but also in terms of strengthening firms' and individuals' ASEAN identity.[55]

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54 For countries such as Indonesia, Philippines, and Thailand, for example, incremental innovation should remain the priority over the next two decades. Malaysia is on the verge of innovating on its own, whereas Singapore's challenge is to strengthen is relatively well-established indigenous innovation capability. The situation of the Cambodia, Laos and Vietnam is even more peculiar due to their different phase in economic development and political contexts.

55 Furthermore, AMSs should also exploit their comparative advantage in tropical agriculture and value chain, in parts and components related to regional production and distribution networks, and in services such as tourism. Here, establishing an ASEAN Tourism Council could help design and coordinate a variety of regional, multi-country tourism packages—from ecotourism to art and culture-related excursions. Such a Council should be introduced alongside adoption of a single ASEAN Visa for tourists, which has been under discussion for quite some time and should be in place well before 2030.

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ASEAN efforts to establish their own economic community come under the challenges of new arising issues. At this stage, the geo-political and geo-economic powers in the world and in the region are undergoing a “transition period” of reallocation/redistribution. The newly emerging economies, particularly the BRICS, are having a greater voice in the aftermath of the global financial crisis and economic restructuring. The major trade and investment partners of ASEAN member countries are also experiencing drastic changes. Besides, each member country and the ASEAN as a whole can not exempt themselves from the so-called “spaghetti-bowl” syndrome of various regional/bilateral FTAs which embody huge inconsistency of the rules of origin (ROO) and the depth of investment and services liberalization. New trans-national and non-traditional securities issues, such as energy security, food security, etc., are also confronting the region. Without sufficient well-coordinated efforts at both regional and country levels, the ASEAN can hardly improve the fundamentals for AEC on time.

3.5.2. Vietnam’s position regarding the AEC

- ✓ *Macroeconomic policy and finance*

The microeconomic foundation of Vietnam’s economy and prosperity remains fragile. Vietnam’s GCI performance is weakened once sustainability measures are considered. According to the Global Competitiveness Index in 2013-2014, the country ranks no higher than 57th in any of the pillars except the market size pillar (36th). According to a World Bank report (2013), the efforts to stimulate the economy through tax breaks and accommodative monetary policy have faced diminishing returns, while raising fiscal deficits and creating new contingent liabilities. In fact, growth rate has been below 7% for six consecutive years.

Without accelerating structural reforms, especially in the banking and SOE sectors, Vietnam faces the risk of a prolonged period of slow growth and the exclusive strength of domestic banks could be undermined on the long run. The efforts since 2011 have contributed to significantly stabilized macroeconomic environment. Nonetheless, few attempts were made to fundamentally address the major imbalances underlying the macroeconomic instability during 2007-2010, such as reliance of exports on imports, investment-savings gap and induced improvement of future production capacity. Management of capital flows presents another concern as it depends upon absorptive capacity of the domestic economy and policies to deal with such flows (such as exchange rate, sterilization,[56] etc.).

The above risk may be further magnified since the financial liberalization and integration are progressing. In fact, Vietnam has gradually liberalized various items under the current and capital accounts. Room for further liberalization, however, remains with such items as outward investment, portfolio investment, etc. At the same time, the regional financial integration process is on-going, with various initiatives such as Asian Bond Market Initiative, Chiang Mai Initiative Multilaterization, Asian Bond Fund, Asian Infrastructure Investment Bank, etc. Coordination of macroeconomic policies alongside reforms of financial market fundamentals thus become important prerequisites.

[56] The failure to effective sterilize money supply upon purchase of USD during 2007-2008 led to rapid increase in total liquidity and, thus, inflationary pressures (see Vo Tri Thanh and Nguyen Anh Duong 2009).

- ✓ *Competitiveness and FDI attraction*

With its labour force structure, similar to China and South Korea, Vietnam will need to take a full advantage of its golden population structure, before its greying emerges over the next two decades. But Vietnamese SMEs face several challenges, including limited access to finance, technology, appropriately skilled labour, severe competition from SOEs and MNCs, as well SMEs from the surrounding: Japan, China and the Republic of Korea, weak entrepreneurial and management skills and difficulties in coping with AEC market standards.

As far as the magnitude of domestic value added is concerned, the challenges are the upgrading from the import of capital goods and the spillovers from foreign-owned activities to local companies. Foreign factories in Vietnam use cheap labour to produce for their own global value chains and have shallow roots in the domestic economy. Cheap labour was, however, partly traded off with relatively low labour productivity and/or high costs of labour trainings. Still, Vietnam's level of education are low in comparison of those offered by other ASEAN countries such as Singapore, Thailand, Indonesia or Malaysia. According to Hai and Porter (2010), much remains to be done in regard to improving the quality standards of the manufacturing and service operations in the country. According to the World Bank's Enterprise Surveys, only 11.4% of the firms met this criterion in 2005 versus 22.4% for the region. Hence, one of the country main challenges is to provide the same level of qualifications as other ASEAN members' countries, such as Thailand in transport and health care or Singapore in financial services etc.

In a related aspect, the regional production network involving ASEAN member countries (including Vietnam) is increasingly deepened. Share of intermediate goods in regional trade activities has gone up. In other countries, this larger share was driven partly by the presence of FDI enterprises that possess wide network of suppliers and customers. In Vietnam, however, the presence of such enterprises, even mega ones, fails to help upgrade the economy's position in the regional production network. This failure was attributed to the lack of local enterprises' capacity to enhance linkages with FDI enterprises. At the national level, this failure implies weak position of Vietnam in the regional production network. Ultimately, Vietnam's efforts to compete for FDI may not work out in terms of inclusiveness of local enterprises and gross value added from domestic sources.

Services liberalization also presents a significant challenge for both AEC and Vietnam itself (and at the same time the biggest opportunity). The growing economy of Vietnam will surely create more demand for services, while the supply will not be likely to match, because it is limited to a certain category of workers, such as doctors of medicine, dentists, nurses, engineers, architects, accountants, surveyors and tourism professionals. Finance, communications, information technology, and transport will also need inputs for high-end manufacturing sectors in order to increase their competitiveness and overall productivity. In this regard, the shortage of highly-skilled labourers and the extreme shortage of Vietnamese speaking foreign languages is a big concern for the country. Without mastering English, it will difficult to access new knowledge, which is a barrier to further regional integration.

How to effectively balance employment creation and efficiency on the one hand with employment protection and decent working conditions on the other hand is a challenge that does not seem sufficiently well addressed in the AEC Blueprint, as well as in Vietnam's policy framework.

- ✓ *Regulations and Business Climate*

First, regulations are assessed as lax and not well enforced in Vietnam, an attitude that is also reflected in the country's low level of commitment to international treaties.

Problems of cross ownership/investment have emerged recently and are seen as a "new generation” of risk in Vietnamese financial system that should not be neglected. As a legacy of the bank–based financial market, the cross ownership creates additional systematic risk, masks the real risk of banks and may create imprudent lending practice.

With the above-analysed risks, Vietnam’s banking sector is all the more vulnerable because degree of application of advanced standards is low (about 60% supervision measures is those of Basel 1) and the supervision approach is outdated (largely compliance supervision is applied rather than using risk-based approach). If Vietnamese institutional capacity would not improve accordingly, a financial crisis could happen and widespread, being particularly harmful for safety and efficient development of the financial system in Vietnam.

Another challenge is the insufficient perception of Vietnamese companies – the important customers of domestic banks – about opportunities and challenges of the AEC fulfilment. A survey of Vietnam Chamber of Commerce and Industry (VCCI) reveals that as much as 80% of local enterprises have little information about interests and challenges available for them in the ASEAN market.

- ✓ *Social progress*

Another challenge for the Government of Vietnam is to maintain the low levels of poverty and inequality that have been achieved after 27 years of Doi Moi. Presently, the country lacks access to healthcare services, faces insufficient social mobility and large segments of its population are in vulnerable employment. In the last Global Competitiveness report, Vietnam ranked 70 regarding this component and its score of 3.93 decreased in comparison from the previous study. In another aspect, the weak level of social protection of workers and the outsourcing arrangements that were made more and more frequently put pressures on wages and increased tension between employers and workers. Although this aspect should be better dealt with in the agenda towards ASEAN Socio-Cultural Community, it remains essential to allow and facilitate more economic participation of people, as well as social and business communities in order to converge towards a more sustainable development.

- ✓ *Environment*

Vietnam also encounters challenge in promoting further compliance with environmental laws and regulations. It seems that some standards are viewed as too difficult by the Vietnamese government to comply with. Nevertheless, in the last the Global Competitiveness report, Vietnam’s score of 3.73 also decreased in that area in comparison from the previous study.

The rapid industrialization of the country is having a strong negative impact on the environment, including air and water pollution (not fully measured by this framework). In turn, pollution of air and water altogether may put the country’s long-term competitiveness and the living conditions of the citizens in jeopardy if more sustainable processes are not adopted.

Today, 7 millions of people are dying every year in the world because of air pollution and more than 4 million of them are originating from South East Asia. In this region, Vietnam is one of the countries that suffer the most of this phenomena, because of high level of particulate matter concentration and CO2 emission in cities like Hanoi and Ho Chi Minh.

The pressure on water resources and fish stocks is also relatively high in Vietnam. The rapid industrialization of the country had a strong negative impact on the environment, including air and water pollution and the phenomena does not diminish, which may the living conditions of the citizens in a very bad trends (and consequently the country’s long-term competitiveness and) if sustainable measures are not adopted.

The Government’s efforts are presently focused on reducing carbon emissions by 20%, reduction in poverty by 20%, and increase in growth by 20%, but still no efficient policy is put in place to reach these targets and environmental regulations are not well enforced in Vietnam, which is also reflected by the fact that in the country's is not very much inclined in signing to international treaties in this domain.

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In summary, Vietnam is making material progresses in almost all pillars of the AEC. In particular, the efforts to deepen regional and international economic integration become more vivid, as the country actively engages itself in the negotiation and implementation of various ambitious FTAs. Domestic preparations in terms of regulatory framework and building infrastructures also received wide attention. Still, the room for improvement remains. More importantly, the consistency between ASEAN integration and domestic preparations seems to be less than sufficient.

With a view towards the AEC, Vietnam has the current strengths of golden demographic structure, robust economic growth, high employment and social progress, strategic geographical position, large production base, solid financial institutions, FDI-induced engagement in regional production network, and progressively open trade and investment regime.

As it weaknesses, Vietnam suffers from the shortage of institutional adequacy, underdevelopment of infrastructures, inadequate human resources, lack of competitiveness and dynamic efficiency, eroding financial system, and slow paces of domestic regulatory reforms.

The AEC also increases opportunities for Vietnam, particularly in terms of intra-regional trade, improving competitiveness and attracting FDI, improving financial system, enhancing macroeconomic stability, reinforcing institutional systems and other ASEAN-specific ones.

Engagement in the AEC and the rise of China and India also hardens the competition for Vietnam. In this process, Vietnam may risk falling into the middle income trap. Other threats also lie in the regional-specific and ASEAN-related issues, such as political-security conflicts in the region, territorial disputes, etc.

4. POLICY RECOMMENDATIONS

The past experience with attempts toward an ASEAN also presents significant implications. Most importantly, it may be hard to achieve an AEC in economics terms. As argued by Lloyd (2005), with the definition of a single market as one in which the Law of One Price must hold in all goods, services and factor markets, the progress towards ASEAN economic integration has been limited and far from an ASEAN single market which would be imaged.

Even if a "true" single market can not be realized, it is crucial to make a breakthrough to ASEAN economic integration by the agreed time frame. More importantly, one should ask whether ASEAN as a whole can really have a sense of economic community by 2015. That is, the essential ingredients of such an economic community should be established by 2015, despite the fact that these ingredients altogether may fail to constitute ASEAN economic community as a "true" single market. This can help retain and even strengthen the momentum for further integration of ASEAN.

More specifically, these essential ingredients should first include effective commitments enforcements, reflected by the realization *"from action to decisive actions"*, rather than just "*from vision to action"*. Besides, ASEAN cooperation should be further enhanced, in a way that facilitates and strengthens connectivity through regional infrastructure development and service-link cost reduction. For the AEC to function by the people and for the people, it should also allow for active participation of the people, and social and business communities.

ASEAN economies, as a group, have signed multiple FTAs with non ASEAN countries such as China, Japan, Korea, India and Australia/New Zealand. There is now an interest in forming a larger regional agreement, for a couple of reasons.

The first interest is that the gains from integration are greater across wider areas with deeper coverage (there is also an interest in deepening the commitments to integration). The second interest is that there is a concern that the proliferation of trade agreements adds to the costs of decision-making in international business.

Hence, a new wider economic agreement could be constructed in a new set of negotiations. The track that seems to be preferred by ASEAN is to build up from the "ASEAN+" agreements into a new "ASEAN++" structure.

There are advantages in this approach, given the degree of common membership of the agreements under consideration. There is, however, also a significant risk that any attempt to adopt a "top-down" approach based on a new region-wide agreement could add yet another agreement to the existing "noodle bowl" and make things more and more difficult to handle, given the difficulty of reaching agreement across the larger number of participants. In this regard emerges the need for better management, coordination and enforcement of commitments in the integration roadmap.

Experiences of the EU show that the presence of supranational bodies such as the European Commission, the European Parliament and the European Court of Justice is essential. In fact, such a presence characterises the EU as a unique supranational organization. As known wide and far, the Union is a "sui generis" actor of international law, combining both intergovernmental and supranational features. More remarkably the EU law is a (self-contained) system of International Law with unique 'supranational features', namely the concessions of sovereign powers by Member States through the founding treaties, the establishment of a set independent rules through those treaties and the derivative acts; an Independent and compulsory system of adjudication which is in charge of settle disputes between member states, between the EU institutions and member states, and between the institutions themselves.

Meanwhile, only Committees have been established in ASEAN to enforce targets defined in the AEC Blueprint and these committees are not entailed with supra-national power. The question is therefore to know whether the "*European way*" would be applicable to ASEAN. Alternatively, to put more broadly, one should ask if there is another way to look after in case the "*ASEAN Way*" would not be efficient enough to cope with future challenges.

When comparing the functioning for ASEAN and the EU, history has demonstrated that some similar mechanisms could benefit both types of organisations, notwithstanding the type of functioning that has been chosen. For example, ASEAN-EU collaboration in higher education sustained by a programme performed between 2000 and 2006, called the "ASEAN-EU University Network Programme (AUNP)" was a stimulus for the creation of a consortium of European universities, equivalent to the ASEAN University Network established in 1995. Another similarity stems from the ASEAN Charter, endorsed in December 2008, that gave birth to a Committee of Permanent Representatives (CPR) similar to the EU's "*Comité des Representants Permanents*" (COREPER). ASEAN and the EU also cooperate in larger fora such as Asia-Europe Meeting (ASEM). It is necessary to popularize such cooperation, resting on the principles of shared benefits and fair division of responsibility.

There are other examples of different regional integration in the world, such SADC, which utilizes a "regional compliance model" based on political criteria, even if some examples in Africa such as ECOWAS or WAEMU may not be convincing enough to be a source of inspiration.

For the very cultural traditions and peculiar economic context and (state of development) of its members, the ASEAN still needs to maintain a level of flexibility, which does not seem compatible with a highly structured supranational administration like that of the EU. Furthermore, the EU's uniquely modus operandi and deep difference in terms of economic integration between the two areas lead to exclude the possibility that the EU functioning can be replicated by ASEAN simply by institutional mimesis. However, some experiences of the EU can represent good empirical lectures for the AMSs in the run up for the creation of the AEC. We devote some further considerations on such issues in Annex 4 to the present study. Still, it is important that such flexibility is bound by the accountability, credibility and enforceability of commitments.

4.1. *Horizontal recommendations*

As analysed above, given the wide-ranging and complex issues involved in reaching an AEC by the end of 2015 and the need for more deliberate and prudent approach, it appears clearly that the fulfilment of the goal of financial integration in many members of ASEAN, including Vietnam lies beyond 2015.

In order to fulfil the goal of safety efficient financial liberalization and integration under the AEC framework, the following horizontal measures are proposed.

4.1.1. Prioritization of AEC's agenda and definition of clear integration vision

The ASEAN Leaders stressed, in the Phnom Penh Declaration on ASEAN, the need to "set priority activities and concrete key measures to address the challenges and obstacles in realizing the [AEC]" (ASEAN Secretariat, 2012). As already mentioned, the agenda for AEC has proved to be over-ambitious for 2015: Realizing the potentials of AEC and given the limited resources and time to 2015, seizing the moment for ASEAN entails prioritization of AEC measures and policy actions.[57] For instance, the ERIA's MTR report of 2012 proposes that ASEAN gives particular emphasis on the implementation towards 2015 of AEC measures that are the central and foundational elements of ASEAN economic integration and connectivity, and at the same time pushing further ASEAN's integration with the rest of East Asia. In addition, ASEAN continues its strong policy emphasis on narrowing development gaps in the ASEAN's regional integration strategy.

Accordingly, the priority AEC measures for implementation in the run up to 2015 should be the following:

i) tariff elimination (virtually done in ASEAN-6);

ii) addressing NTBs or NTMs with large NTB effects,

iii) trade facilitation;

iv) services liberalization;

v) investment liberalization and facilitation;

vi) transport facilitation;

vii) completion of RCEP negotiations as well as enhancing IAI effectiveness;

viii) and promoting further development of SMEs.[58]

Although these are the AEC measures with the heaviest burden for the success of AEC 2015, their implementation are to be continued, deepened and expanded in scope in terms of policy actions beyond 2015 (e.g., for RCEP, the implementation can be expected to be after 2015 even if the negotiations were completed well before 2015). Furthermore, the entire area lacks of a clear integration vision beyond 2015, which is similarly to be defined promptly. At this stage, only a Report by ERIA (2014) is dedicated exclusively to the agenda towards AEC beyond 2015. These include work items towards building: (i) An integrated and highly contestable ASEAN; (ii) Competitive and dynamic ASEAN; (iii) Inclusive and resilient ASEAN; (iv) Global ASEAN; and (v) Building regulatory foundation for a responsive ASEAN.

Finally, also improving coordination with external development partners requires better promulgation of ASEAN priorities and strategies —and better inclusion in projects and programs of bilateral and multilateral donor agencies. For implementation of the Master Plan for ASEAN Connectivity (MPAC), Vo Tri Thanh (2013) makes the following recommendations:

i. ASEAN should work together with China, Japan and Korea (CJK) to have a broader framework of East Asian integration and cooperation schemes. The institutionalized integration in East Asia cannot succeed without the strengthening of ASEAN integration. In turn, ASEAN integration could not succeed if the development gap among member countries continue to widen. In line with this, CJK and ASEAN should establish regular "East Asia dialogue forums" for building regional mutual trust/credibility and a new development paradigm, including the coordination of

57 See ERIA (2012).
58 See ERIA (2012).

cooperation and assistance programs.

ii. ASEAN should mobilize further support of CJK to the process of building AEC and implementation of ASEAN connectivity, especially in developing and realizing capacity building programs for Cambodia, Lao PDR, Myanmar and Vietnam.

iii. Regarding physical connectivity, CJK may join in and lead the process of improving the regional master plan of connectivity. This process should take into full account the connection between ASEAN and CJK as well as national strategies in terms of developing infrastructure, especially the networks of national primary and secondary transportation, corridor towns, and industrial zones. China may lead the development of North-South corridors, similar responsibility over West-East corridors is assumed by Japan, while Korea may have greater focus on the secondary networks to support those corridors. CJK should all be involved in the development of sea and airlines transport. At the same time, the CJK - depending on their interest and capacity – may coordinate among themselves (perhaps with the coordination of ASEAN) and extend support/assistance to the preparation of feasibility studies for all projects, which must incorporate comprehensive assessments of the socio-economic and environmental impacts.

iv. ASEAN should work further with CJK in mobilizing resources and formulating/enforcing institutions for implementation. The existing schemes such as ABMI, ABF, and ASEAN stock market link, ASEAN Infrastructure Fund, and those of CJK or having CJK engagements should be improved and utilized more effectively. Another line of efforts is to strengthen private sector engagement.

4.1.2. Improving supervision and follow-up mechanism

ASEAN needs to pay greater attention to member countries' domestic politics and to put in place, if not supranational bodies, at least more efficient mechanism to push ASEAN countries implementing necessary reforms in a more rapid way than today.

The AEC Scorecard has demonstrated its importance to follow up the effective implementation of the AEC Blueprint, but it remains too general to be useful to both the general public and technicians. In order for ASEAN to become a RICH region, it would be important for ASEAN to share quality information with its people, and among member countries.

The Scoreboard should be more detailed, more transparent and readily available for private sector use. It should also be able to clearly translate an agreement's benefits, such as those relating to reduced costs and prices in the region. These issues need more awareness and require the active participation of all those concerned in the process, including the region's business community.

Presently, the AEC Scorecard also lacks a degree of usefulness because it does not account for the reasons for its own delays. For example, ASEAN took more than two years to ratify the ASEAN Comprehensive Investment Agreement, which is viewed as one of the seeds for integration and is expected to enhance investment flows in the region.

In addition, the ASEAN Secretariat Scorecard should be less consensual and better explain the reasons when delays arises. It should propose specific actions when it faces reluctance of the AMS to reach in due time the targets specified in the Blueprint.

The ASEAN Secretariat should enhance its supervision efficiency and effectiveness in various areas and not only for the AEC follow-up. For instance. The poor quality of financial supervision has been proved to be a core reason of any financial crisis and instability. The financial surveillance system in Vietnam is institution-based modelled and is to date obsolete. To enhance quality of financial supervision, it is crucial to strengthen the compliance approach, meanwhile, preparing to remove on risk-based one based on a number of macro/microprudential indicators/ratios, particularly quantitative model, for instance Early Warning System (EWS), Stress Test (ST) and Value at Risk (VaR) Models.

If an enhanced Scoreboard may be a viable option for a more transparent and useful supervision for the AEC, it may be insufficient for a prompt and effective follow-up of international commitments by the AMSs: this is why we claim that ASEAN needs to look towards rule-based principles for economic integration and that the creation of supranational bodies seems be an option that has not been retained by AMSs, but that challenge remains nevertheless unaddressed. For the effective and successful implementation of the programmes and measures envisage by the Blueprint for the AEC, adequate institutions and mechanisms, ample resources, technical capacity and political shall be accorded to the Community building process, consistently with the cases where international supervision and follow-up mechanisms work efficiently.

4.1.3. Strengthening the institutional architecture

Considering the absence of an effective and more institutionalized implementation system for the creation of the AEC leads to a far more general point: reinforcing ASEAN's institutional base is increasingly urgent —given the need to properly manage increased economic interdependence with other ASEAN members, with other Asian countries, and with the rest of the world. Improving the effectiveness and efficiency of the regional bureaucracy and ASEAN institutional governance are also important for ensuring proper functioning of a borderless economic community. ASEAN should use its perceived "centrality" in ASIA to assume a more active role when participating in international events (G20 and similar forums). Members should entrust the ASEAN Chair and Secretary General with authority to articulate internally agreed regional agendas in international meetings, especially when only a few ASEAN members — if any — are invited as participants.

Moreover, with the Secretariat playing a coordinating role, ASEAN should reform its institutional architecture by forming new functional institutions decentralized across the region, based on individual country interest and capacity to host them. More active participation in defining the regional agenda would also provide a better sense of community, promoting the sodality of nations, and boost ASEAN's identity at the grassroots level. ASEAN already has centres and regional bodies in energy and food security, biodiversity, communicable diseases, and financial surveillance. In light of the urgency to deal together with the 'environmental issue' and to promote the tertiary sector in most of the AMSs, areas for future development include natural disaster management, human and drug trafficking, services (tourism), education (tertiary and vocational education), and issues related to the environment and climate change, among others. The creation of an ASEAN Competition Authority in charge of enforcing competition law together with the ASMs' NCAs acting as peripheral enforces is also crucial for the building up and maintenance of a single market and a highly competitive economic region. Early attempts toward regulatory cooperation should be enhanced.

ASEAN member countries should also establish a stronger Secretariat in order to enable such body to better perform its mandated responsibilities—by enhancing its legal capability to attain trust, confidence, and respect in enforcing ASEAN agreements and commitments. Members need to invest more human and financial resources in the Secretariat. At the same time, the resources should be managed by the Secretariat with greater autonomy, rather than being pre-allocated to certain AMS-specific projects.

Realizing the AEC's aspirations also requires reassessing some of ASEAN's basic principles, as the association today, different from 45 years ago, needs to promote regional cooperation in a globalized world. In particular, ASEAN needs an "efficiency reform" by introducing more formal rules and adopting a more flexible decision-making system — to govern more intensive integration and extensive external relationships: despite its undeniable benefits in terms of enhanced stability and cohesion of the region consensus building is too costly and can severely impair the implementation of agreed policies by AMSs. Therefore, while consensus decision-making should remain as ASEAN's governing principle enshrined in its Charter, flexibility should be introduced to allow decisions on operational matters (which do not affect fundamental issues). This will avoid inefficiencies from unnecessary bureaucratic processes delaying simple decisions on day-to-day matters.

To recap, a stronger Secretariat, decision-making "efficiency reforms," and funding contributions are important steps to create a robust and effective regional bureaucracy. The Secretariat can be more effective in coordinating its activities and functions with countries' national agencies and with external development partners.

The recently established Committee of Permanent Representatives (CPR) should play an increasingly important role in providing a more effective interface between the Secretariat and the AMSs, and in forging a new ASEAN approach to regional bureaucracy. An effective and dynamic CPR can greatly improve ASEAN in providing regional public goods by identifying efficient mechanisms for regional cooperation and strengthening the institutional base. As the CPR becomes fully integrated in a well-functioning ASEAN, member countries will easily realize that the costs of non-cooperation are in fact very high.

Finally, even though such reform goes well beyond a mere institutional revision or update, ASEAN members should consider whether introducing a judicial body to settle their dispute once the AEC is established. The example of the Court of Justice and General Tribunal of the EU and the fundamental role they played in the construction and consolidation of the EU internal market is most telling.[59] It is true that given the tremendous difference between the ASEAN and European contexts, any attempt of institutional mimesis by the ASEAN is simply not possible. Similarly, most of notions crystallized in the 'case law' of the Luxembourg-based Courts (e.g. the notion of 'measure of equivalent effect to a quantitative restriction') are already implicitly included in the required actions for the AEC different targets. However, interpretation and application of law and complex legal notions is a dynamic work, which requires to be carried out by bodies who deeply understand the political, social, and economic context of the specific jurisdiction at issue. Therefore, it may be foreseen that in future also the AEC will benefit from the work of such kind of institution.

4.1.4. Reinforcing regulations

Vietnam is pressing ahead with the privatization of SOEs and the liberalization of the banking sector, which could offer new opportunities for SMEs, but the country need more appropriate regulations. For instance, the investor protection could be significantly improved. The Enterprise Law triggered the boom of new enterprises as well the capital invested in private business, but further reforms remained needed to spur the growth of the private business sector.

For instance, potential benefit can be expected from adopting measures such as the structural and cohesion funds of the EU. Some talks advanced in this direction (ADBI, 2012).

In the financial domain, as the capital account is liberalized further, Vietnam is placed under

59 This holds true also with reference of other judicial or quasi-judicial bodies created in the context of other plurilateral or multilateral organizations.

increasing pressure to pursue sound macroeconomic policies. To ensure long-term sustainability, there should be removed/mitigated key factors of macroeconomic instability and poor competitiveness such as overreliance on the prolonged monetary expansion, inefficient public investment, and lack of a system of solid supporting industries.

The global and Asian financial crises have shown that countries pursuing sound macroeconomic policies would be better able to prevent an asset bubble from occurring when there is a surge in capital inflows (ERIA 2013). Such countries have been more resilient to speculative attacks and managed more effectively the adverse impact of a sudden flight of capital.

Designing efficient, sound macroeconomic policies, include price stability, fiscal discipline, prudent external debt management, a flexible exchange rate, and transparency in the conduct of monetary and exchange rate policies is of critical importance to mitigate vulnerability to a sudden reversal of capital.

The ministries and line authorities in each AMS should closely coordinate in formulating, justifying and implementing such policies, especially monetary and fiscal policies.

4.1.5. Strengthening institutional environment and governance within AMSs

In order to further improve its competitiveness, ASEAN countries, and more particularly Vietnam, should continue to strengthen their institutional environment. Yet, policy implementation and use are both critical factors for a nation or a region to achieve its strategic goals as they raise the confidence of concerned parties and potential investors. Indeed, in many developing countries, the existence of various policies does not necessarily imply that they have been fully implemented or that they are in use.

As it is recommended to avoid reaching a full economic integration before countries having been harmonized fiscally, in order to avoid budget deficit and increase inequalities, this necessary implies that the institutional environment has been reinforced first in order to put this environment in place.

In a rather general definition good governance implies transparent rules and regulations and the adoption of effective ways to manage institutions, which are as important as growth for economic development and social progress. Therefore, improving governance is a key enabling factor for development and for achieving a RICH ASEAN.

Over time, as ASEAN grows and its citizens become richer and better educated, they will likely demand better governance, and governance standards will likely improve. Yet in the absence of good governance structures it is very difficult for private sector institutions to flourish and for social progress to keep up with economic growth. Improving the effectiveness of existing institutions could be the point of departure. World Bank indicators suggest there is an urgent need in several ASEAN countries to strengthen public governance. In particular, it is important to introduce regulatory institutions that are transparent, rule-bound, and work toward improving the economic welfare for all, rather than serving particular interests.

The success of institutional reform depends upon the strength and independence of the civil service and to safeguard it from the risk of capture. ASEAN governments need to undertake concerted efforts to train and develop an efficient and independent civil service. A civil service the primary mandate of which is advising governments on measures to improve economic welfare without sacrificing long-term development goals. In the context of such reforms, ASEAN governments should also undertake those necessary adopt a region-wide competition policy, and to co-ordinate the national competition policies as far as possible.

4.2. Specific recommendations for Vietnam

From Vietnam's perspective, effective and deeper integration within ASEAN framework has proved, and will continue to be beneficial. Therefore, the country should remain fundamentally committed to this process. Moreover, the country will be proactive in undertaking measures to ensure that further ASEAN integration is smooth, not only for itself but for other ASEAN member countries as well. Being a country with intermediate development level, Vietnam has a lot in common with the more advanced economies and the less advanced ones in the ASEAN. Therefore, the country can serve as a good "bridge" for a better mutual understanding between the newer and older members in the ASEAN. The realization of the current room for further meaningful ASEAN integration should rest crucially on this.

Policies to promote more effective economic integration

First, Vietnam should deepen reform-enabling integration commitments under various FTAs, including existing and future ones. These include the TPP, RCEP, VN-EU FTA, etc. and other ASEAN FTAs, not to mention the WTO framework. In addition, the commitment to reduction of tariff and non-tariff barriers should be implemented for effective integration and trade liberalization. This will further enhance confidence of foreign investors on the business and investment environment in Vietnam, especially with regard to transparency of change. As evidenced in recent studies (such as Vo Tri Thanh and Nguyen Anh Duong 2014, CIEM 2013), trade and investment liberalization may make way for further expansion of Vietnam's trade activities, thereby inducing further FDI inflows to the country.

Second, Vietnam should further improve absorptive capacity of FDI. Specifically, attempts should be made to facilitate positive spillover effects of FDI and increase the domestic enterprises' absorptive capability of such effects. This will be transformed into larger production capacity, thereby restricting adverse impacts on macroeconomic and financial variables. Instead of encouraging FDI to some certain industries, it is advisable to stipulate the list of foreign-investment-prohibited industries, and allow investment in the others.[60] Further equitization of SOEs should be promoted, while better market access in some industries, which are mainly dominated by SOEs, should be provided to foreign-invested enterprises and non-State domestic enterprises. This will generate competitive pressures to all enterprises and minimize the protection level in some favoured industries. The aim of these measures is to reduce the concentration of FDI in some import-substitution industries, to attract FDI inflows to all industries, thereby generating spillover effects to domestic enterprises as well as the economy.

In particular, attraction of FDI should be accompanied by measures to legitimately support domestic enterprises in enhancing linkages with FDI counterparts. This will enable Vietnam to upgrade its position in the regional production network, whilst ensuring that the local enterprises can better participate in and take advantage of opportunities from the emerging regional value chains. Harmonization of efforts toward effective integration in ASEAN value chains and other FTA-induced value chains (such as APEC, RCEP, etc.) is also essential, though ASEAN value chains should retain core importance.

The policies should aim further at developing SMEs, and support these enterprises in establishing intra-industry production linkages with other FDI counterparts. The Government's

[60] See Nguyen at al. (2005).

assistance is also necessary in improving the capacity of those SMEs, so that they can benefit from the diffusion of new technology. The commonly used measures are to provide information, at zero or very small costs, to the SMEs; to organize the meetings for direct discussion between enterprises; to organize training classes for the staff in those firms.

Similarly, the R&D capacity of domestic firms should be upgraded, so as to improve the absorptive capability of new technology and to promote technology transfer. This can be done via government-funded programme for specialist exchange between research institutes, universities, etc. and enterprises, or via research on new products, new industries where the participants share the sponsorship and benefits. Along this line should come the efforts to quickly increase the rate of trained labours in the economy, particularly in domestic enterprises, to improve the absorptive capability of new scientific and technological advances.

Third, Vietnam needs to further improve the absorptive capacity of ODA. Most of the ODA now are loans with concessional interest rate and provisions. However, the benefits of such concessions will be undermined if the projects are slowly implemented or not in line with the prescribed objectives. Coordination of such ODA projects presents another dimension of improving absorptive capacity, acknowledging that replications of such projects leading to each project being underutilized.

Fourth, the scope and objectives of trade policy should be improved. Trade policies should focus on both penetrating product markets and participating in value chains, instead of sole access to foreign markets. Export-oriented production relies more and more on imported inputs and technology. Therefore, import policy plays a very important role in driving technological innovation and implementation of best practices on upgrading human resources, management skill and modern institutions.

Finally, Vietnam should actively cooperate with other countries in the region to cope with common financial and monetary risks at regional level. In this process, Vietnam should learn experiences from other countries in the region for more active prevention of financial and monetary risks. Several regional frameworks have been identified and gradually phased in, such as ABMI, CMM, etc. The role of regional institutions such as AMRO continues to be appreciated. Still, this cooperation remains new and needs to be further concretized in the future.

Policies to strengthen macroeconomic stability

Vietnam should strive to further strengthen macroeconomic stability. This will help align inflationary expectation, whilst avoiding distortion of price signals to resource allocation. In doing so, the country should make fundamental changes in the management of macroeconomic policies, including monetary policy; fiscal policy, including public investment; trade policy. In particular, improving the conditions for adopting an inflation-targeting framework may be an important agenda. This also requires further efforts to strengthen the financial system and financial market, ultimately creating strong foundations for more effective implementation of monetary policy.

As previously underlined, the deeper financial liberalization and integration will put Vietnamese financial institutions under greater financial exposure. Given the weaknesses of the institutions, particularly JSCBs, it is important to help them improve soundness and efficiency through accelerating the process of recapitalization, restructuring (i.e. M&A), resolving NPLs and applying good/appropriate international standards and practices. Financial policies should be designed to promote prudent risk management, supported by a strong capital base, strict disclosure requirements, and well-designed liquidity management. In addition, it is crucial to crack down on illegal and unregulated practices such as shadow banking practice of financial firms and commercial banks and to force some securities companies to separate their account from the investors' account and upgrade financial capability and governance.

Vietnam is not able to adopt the floating exchange rate regime yet. Otherwise the induced impacts of capital inflows will become more complicated, which challenges the policymaking process. To facilitate FDI inflows, exchange rate should contribute to effective and sustainable increase of trade (especially exports). In the future, the exchange rate policy should aim at: (i) maintaining competitiveness of Vietnam's products in international markets with thorough considerations of exchange rate and REER; (ii) strengthening market confidence in the policy itself; and (iii) creating a sufficient room for exchange rate fluctuations in order to increase the flexibility of monetary policy and strengthening exchange rate's roles in providing market-based signals. The capacity of SBV is the key factor in formulating and making appropriate policy decisions. Vietnam should further liberalize interest rate to affect exchange rate, though care should be taken to avoid adverse impacts on FDI inflows.

Vietnam should also develop and enforce strict principles to fundamentally avoid the excessive expansion of public investment which may have further crowding-out effect on private investment (even FDI). At this stage, the room for expanding public investment is relatively scarce due to pressures on public debt and budget deficit. However, this presents an opportunity to focus more on enhancing efficiency of public investment, rather than just on increasing resources for such investment.

In a related aspect, Vietnam should strengthen the management of public debts and discipline of government bonds. Intertemporal approach should be incorporated in such a management attempt, considering that efficient management in the current stage would result in more available resources for future consumption and investment. The Law on Public Investment Management in 2014 serves as a crucial move in this direction. Still, it needs to be concretized and enforced via timely guidelines and regulations, such as medium-term investment framework, coordination of investment projects, etc.

Finally, it would be necessary to strengthen the capability and autonomy for the SBV. The process of deeper financial integration and liberalization implies a more volatile in volume, direction, magnitude of capital, trade and investments inflows and outflows and creates an enhanced interaction among the flow and uncertainties in the world markets. The new, more complicated environment requires more professional, sophisticated policy making, particularly for monetary policies. As such, the autonomy of the SBV should be consolidated to effectively design, justify and implement the monetary policy aiming to ensure macroeconomic stability, build up a safety, efficient and resilient banking sector and reallocate capital efficiently.

<u>Policies to ensure effective capital account liberalization</u>

Management of total liquidity should fit in line with the patterns of capital flows. This is a crucial condition given that Vietnam also wants to retain the crawling peg exchange rate regime. As the experience in 2007-2008 shows, failure to manage total liquidity in the presence of massive capital inflows would result in excessive inflationary pressure. This management needs to be complemented by the development of open market and further operations in such a market. In addition, the long-term bond market needs to be strengthened, so that both the Government and private companies can have more alternatives to accessing capital.

International economic integration requires Vietnam to liberalize its capital account, especially the management of portfolio investment. However, given the current development of its financial system, Vietnam should set this as the objective for the long run. Liberalizing the capital account should proceed gradually in the most prudent manner to prevent unfavorable impacts on its financial and macroeconomic stability. This also requires long-term reforms of banking system and financial market.

For the sake of achieving a high degree of capital account openness while preserving adequate financial stability, it is important for Vietnam to revise existing and/or introduce new measures of capital flow management, such as: (i) requiring cross-border flows to be effected through authorized domestic intermediaries; lengthen the maturity of short-term capital inflows through central bank certificates (SBIs); reduce short-term external borrowing and reduce currency mismatches in bank balance sheets central bank; (ii) consistent stance toward de-dollarization; (iii) require routine *ex post* reporting; and (iv) impose prudential regulations aimed at domestic institutions, such as tighter loan-loss provisions and capital requirements (e.g., with respect to external lending).

With its experience and technical assistance, the EU may help Vietnam in formulating an appropriate progressive capital account liberalization policy. In fact, there are no common rules for sequencing the core principles provided by the IMF (see Vo Tri Thanh and Le Xuan Sang 2004) advice that Vietnam should pursue macroeconomic policies and structural reforms that promote financial sector stability, in correlation with gradually liberalizing the capital account when preconditions are met.

In addition, Vietnam should, together with other AEC members, agree on the definition of a crisis and affirm the right of a member country to introduce an emergency measure in the event of a crisis. Such emergency measures might include an administrative suspension of (certain types of) normal capital flows, temporary capital inflow controls, and exit levies.

The EU may also assist Vietnam in designing appropriate safeguard measures. As mentioned previously, it is both unreasonable and unrealistic to expect that all ASEAN countries will have achieved capital account liberalization by 2015. As such, Vietnam's capital account liberalization is an ongoing process over the coming years that needs appropriate support and accompanying process.

Still, Vietnam needs a more concrete framework and roadmap to improve the convertibility of the national currency. At the domestic level, this requires bolder efforts and higher priority to address dollarization. Controlling and ensuring sustainability of current account deficit and foreign borrowing should also be emphasized.

The EU may support Vietnam and other AMSs in: (i) intensifying regional cooperation on exchange governance, including trading and settlement system alliances and infrastructure, with wider membership to address the problem of fragmented market infrastructure (e.g. materialize the depository links for cross-border settlement and custody upgrade the real-time gross settlement (RTGS) payment systems), (ii) reviewing and harmonizing the payment and settlement system (PSS) with other AMSs in order for them to be connected and integrated after 2015 (e.g. adoption of ISO 20022).

Finally, the EU may bring technical assistance to help Vietnam and other ASMs in amending and supplementing a number of provision in the Ordinance of Foreign Exchange 2005, namely: (i) for current account: supplement provision on mechanism of licensing for export and import activity of foreign currency cash; (ii) for foreign debt management: to tighten regulation on supervision on short term borrowing of resident, particular that for short term speculation and to gain arbitrage (revise, supplement the Article 17 of the Ordinance); (iii) for capital transaction: supplement the Ordinance's regulations on usage of deposit account of non-resident in the Vietnamese territory, guarantee, money transfer made by the court decision; payment of collateral among resident and non-resident, etc.

<u>Policies related to information dissemination, monitoring and surveillance</u>

First, together with implementing policy measures, Vietnam needs to improve communication to market participants. The contents of such communication may include commitments under AEC, preparation and implementation of commitments, opportunities and related challenges, etc. This will help prevent herd behaviours due to inaccurate information. More importantly, Vietnam should enhance policy credibility through concrete review and accountability. More specifically, the country should consider the trade-off between short-term benefits gained from policy changes in response to the market expectations and long-term losses due to weakened confidence on policies. Any policy adjustment, if truly necessary, should be accompanied with comprehensive and reasonable justifications.

Second, efforts should also be made to develop information system and statistical data in order to produce accurate, evidence-based analysis and forecasts, which helps determine the priorities over high economic growth and macroeconomic stability in certain periods. On the one hand, this will make way for suitable policy instruments. On the other hand, such information system and statistical data serve as important inputs for monitoring and surveillance process over macroeconomic and financial situation. In particular, high frequency data and various leading indicators are necessary to identify and forecast cyclical changes, stress in the foreign exchange and financial markets, etc.

There is a clear need to further harmoniously strengthen the monitoring capacity of ASEAN Secretariat and provide technical assistance to Member States (including Vietnam) in order to improve the monitoring of the AEC Blueprint implementation in each country and to enhance their implementation capacity.

Being one of ASEAN's largest trading partners, EU may assist ASEAN with knowledge and expertise in regional policy-making, especially for economic integration. In particular, sharing of experiences and technical assistance can be targeted to help ASEAN implementing mechanisms and supra-national systems – in case it would be required by the local authorities – and build up the specific capacities of the ASEAN member states, as well as those of the ASEAN Secretariat.

Sectoral policies

Vietnam should aim to take advantage of current special and differential treatments and reserved restraining measures in AEC commitments for related sectors; to provide policy support to domestic enterprises and to channel investment in the sectors of necessity and dynamic comparative advantages for Vietnam. Follow-up resources should be dedicated to monitor and evaluate the uses of those treatments and supports so as to identify and address related impediments.

Vietnam should also focus on formulating and implementing market development strategies in key markets alongside establishing and promoting national brands. At the same time, the country should gradually develop ASEAN-wide distribution network for relevant key export products. In doing so, establishment of business cooperation and linkages with major distributors and retailers is an important direction.

In addition, enhancement of market information and pro-active support to enterprises in terms of market access are critical. Vietnam should build and develop capacity for forecasting global and regional market demand and changes in order to update information for enterprises and producers regarding: prices, supply-demand balance, sale trends, market changes and new requirements of import markets.

Vietnam should improve the legal framework on activities of professional organizations via creating mechanism and supporting the legitimate establishment and development. This should start with the areas of professional services where ASEAN already reached MRAs.

Vietnam should actively negotiate with AMSs to reduce tariff and non-tariff barriers, especially SPS regulations for the purpose of protecting domestic producers rather than for sole epidemic prevention and/or sanitary and phytosanitary quarantine.

Other policies

Improvement of education and training is required for better competitiveness of Vietnamese labour. The legal framework should be further improved to shift labour from unstable employment with low productivity and working conditions to better one. Relevant regulations on labour, employment, minimum wage and flexibility of the labour market should be strengthened.

Vietnam should continue to concentrate on job creation, especially in rural areas. Appropriate and prompt measures are needed to narrow down the share of employment in the informal sector; to encourage creation of jobs and good jobs in FDI and non-State sectors. Public employment program is necessary to support the underemployed labour in agriculture, those losing land due to industrialization and urbanization, laid-off labour due to global financial crisis and economic recession or massive lay-offs. The regulatory framework should incorporate relevant changes to allow for deeper participation in ASEAN labour market (including ratification of international conventions on labour standards).

Vietnam should also develop universal, multi-layer, flexible and efficient social security system, with diversified and efficient social security programs for low-income and adversely affected people. This may help mitigate the adverse impacts of AEC on the disadvantaged groups.

In addition, Vietnam needs to strengthen bilateral and multilateral cooperation with other ASEAN countries for sharing information and experiences and technical cooperation as well as to jointly address global issues such as diseases, natural disasters, and people-caused disasters. This should be in line with the development of master plan for international cooperation in health sector, including strategic directions for investment attraction and targeted investment areas to ensure high ODA efficiency.

Vietnam should deepen efforts to study and issue regulations to prohibit the import goods which are forbidden in ASEAN countries. Those documents should be in line with Vietnam’s situation, ensure national security, protect the environment and consumers as well as increase punishments on violations of environmental regulations. Another direction of effort is to consult and support enterprises in building long-term business strategies in line with environment regulations related to production and consumption, incorporating satisfaction of environment standards as part of business and production cost.

In addition, the recommendations for more effective economic integration made by the CIEM (2013), albeit at wider scope, should be implemented and continuously reviewed.

5. ANNEXES

Appendix 1: AEC Blueprint, 2008-2015

Strategic Approach	**Priority Actions**			
	2008-2009	**2010-2011**	**2012-2013**	**2014-2015**
Freer Flows of Capital Strengthening ASEAN Capital Market Development and Integration				Achieve greater harmonization in capital market standards in ASEAN in the areas of offering rules for debt securities, disclosure requirements and distribution rules Facilitate mutual recognition arrangement or agreement for the cross recognition of qualification and education and experience of market professionals Achieve greater flexibility in language and governing law requirements for securities issuance Enhance withholding tax structure, where possible, to promote the broadening of investor base in ASEAN debt issuance
Allowing greater capital mobility				
The liberalization of capital movements is to be guided by the following principles: 1. Ensuring an orderly capital account liberalization consistent with member countries' national agenda and readiness of the economy. 2. Allowing adequate safeguards against potential macroeconomic instability and systemic risk that may arise from the liberalization process, including the right to adopt necessary measures to ensure macroeconomic stability. 3. Ensuring the benefits of liberalization to be shared by all ASEAN countries.				
Portfolio Investment	2009-2010: Assess and identify rules for liberalization for freer flows of portfolio investments,	→		

Strategic Approach	**Priority Actions**			
	2008-2009	**2010-2011**	**2012-2013**	**2014-2015**
	particularly in debts and equity, which include: + Purchase of domestic debt securities and equity by non-residents Issuance of debt + Issuance of securities and equity by non-residents locally + Repatriation of proceeds arising from portfolio investments +Issuance and/or sale - of debt securities and equity abroad by residents + Purchase of debt securities and equity abroad by residents			
		2011-2013: Progressively liberalize, where appropriate and possible, the rules identified for freer flow of portfolio investments	→	
Other Types of Flows		2011-2012 Assess and identify rules for liberalization of other types of flows, particularly long-term foreign borrowing and lending	→	
			Progressively liberalize, where appropriate and possible, the rules identified for other types of flows, particularly long-term foreign borrowing and lending	
Current Account Transactions	Develop financial market to eliminate, where applicable, the practice of dual exchange rate structure. Relax the limitation on foreign exchange	Further develop financial market to eliminate, where applicable, the practice of dual exchange rate structure	Remove and/ or relax, where appropriate and possible, restrictions on repatriation/	Continue to liberalize, where appropriate and possible, any other items related to current account

Strategic Approach	Priority Actions			
	2008-2009	**2010-2011**	**2012-2013**	**2014-2015**
	purchase and other payments for invisible transactions and current transfers	Adopt Article VIII IMF by ASEAN countries by 2011	surrender requirement	transactions
Facilitation	Draft/amend legal and regulatory framework, where appropriate and possible, to support changes in rules	→	→	→
	Strengthen policy dialogue on prudential regulation and supervision, to assist member countries develop a supportive regulatory framework for orderly liberalisation	→	→	→
	Establish/enhance systems to monitor flows in each member country	→	→	→
	Country collaboration to harmonize, where possible, policies, statistics and infrastructure related to flows	→	→	→
	Share with member countries progress on rules liberalized	→	→	→

Source: Authors' adaptation from the AEC Blueprint.

Appendix 2: Actions required and performed in Vietnam according to the AEC Blueprint

PILLARS	TARGETS	Actions Required	Actions Performed
A. Single Market and Production Base	**A1.Goods**	Conduct scheduled study and assessment related with implementation of ROO and country assessment on trade facilitation	ASEAN Trade in 1.Goods Agreement (ATIGA)
		Establish ASEAN Customs Transit System	
		Finalise the MRA for Prepared Food Stuff and Automotive	ASEAN Integrated Food Security Framework* (AIFS)
		Implement measures under ASEAN Single Window	ASEAN Single Window* (ASW)
		Modernise tariff classification, customs valuation, and customs techniques (i.e. Implement ASEAN Cargo Processing Model, ASEAN Customs Declaration Documents, Pre-arrival Clearance for customs clearance and cargo release)	
		Promote mutual assistance on customs	
	A2.Services	Finalise commitments under 8th Package and schedule the sectors to be liberalised up to 2012	
		Schedule PIS sectors that meet the required higher foreign equity participation levels in subsequent AFAS package ; Completion of the 7th package of trade in 2.Services liberalisation commitments	ASEAN Framework Agreement on Services (AFAS)
	A3.Investment	Entry into Force of the ASEAN Comprehensive Investment Agreement (ACIA); Endorse the ACIA Reservation Lists	ASEAN Comprehensive Investment Agreement

PILLARS	TARGETS	Actions Required	Actions Performed
		Implement the ASEAN Interconnection Projects Complete the Network of Bilateral Agreements on Avoidance of Double Taxation among all AMSs	
		Subsume all measures under the ASEAN Investment Agreement (AIA) Temporary Exclusion Lists and Sensitive	
	A4.Capital	Expedite ratification of the 5th Package of Commitments on Financial Services	Chiang Mai Initiative (CMI) and Chiang Mai Initiative Mutualisation (CMIM)
	A5.Skills	Finalise negotiation of Movement of Natural Persons (MNP) Agreement	ASEAN Agreement on the Movement of Natural Persons (AAMNP)
	A6. PIS	Identify sector-specific projects or initiatives through regular dialogues or consultation with stakeholders, particularly the private sector	
	A7. FAF	Align the National GAP programme with ASEAN GAP	ASEAN Cooperation in Food, Agriculture, and Forestry* (FAF)
		Develop Guidelines on Compartmentalisation of Livestock Production	ASEAN Cooperation in Food, Agriculture, and Forestry* (FAF)
		Harmonise Quarantine and Inspection Procedures	ASEAN Cooperation in Food, Agriculture, and Forestry* (FAF)
B. Competitive Economic Region	**B1. Competition Policy**	Finalise the ASEAN Medical Device Directive Agreement	ASEAN Experts Group on Competition*
	B3.Intellectual Property	Completion of studies carried out in collaboration with dialogue partners and follow-up activities	Intellectual Property Rights Action Plan* (IPR)

PILLARS	TARGETS	Actions Required	Actions Performed
	B4. Infrastructure Development	Lists under the ASEAN Comprehensive Investment Agreement (ACIA) upon entry into force of the ACIA	ASEAN Tourism Strategic Plan* (ATSP)
		Complete the activities scheduled under ASEAN Single Shipping Market	
		Conclude Protocol 6 (railway borders and interchange Stations) under the ASEAN Framework Agreement on Facilitation of 1.Goods in Transit	
		Develop a comprehensive website on the ASEAN Cross Border Consumer Redress	ASEAN Power Grid* and Trans ASEAN Gas Pipeline* (APN and TAGP)
		Enact the necessary domestic legislations to effect the ASEAN Framework Agreement on Multimodal Transport	ASEAN Framework Agreement on Multimodal Transport (AFAMT)
		Expedite ratification of the agreement and its protocols ; Entry into Force of the Agreement and its Protocols 1 and 2 of ASEAN Multilateral Agreement on the Full Liberalisation of Air Freight 2.Services (MAAFS)	ASEAN Multilateral Agreement on Air Services (AMAAS) ; ASEAN Multilateral Agreement on the Full Liberalization of Air Freight Services (AMAFLAS)
		Finalise and ratify protocols ; Entry into Force of the Protocols 1, 2, 7 and 9 of ASEAN Framework Agreement on the Facilitation of 1.Goods in Transit (AFAFGIT)	ASEAN Framework Agreement on the Facilitation of Goods in Transit (AFAFGIT)
			ASEAN Framework Agreement on the Facilitation of Inter-State Transport (AFAFIST)
		Ratify the ASEAN Framework Agreement on Inter-State Transport	

PILLARS	TARGETS	Actions Required	Actions Performed
		Ratify the ASEAN Multilateral Agreement on Full Liberalisation of Passenger Air 2.Services	ASEAN Multilateral Agreement on the Full Liberalisation of Passenger Air Services (AMAFLPAS)
	B5. Taxation	Complete the network of bilateral agreements on avoidance of double taxation among all Member Countries by 2010, to the extent possible.	
	B6. E-Commerce	Adoption of the best practices and guidelines of regulations and/or standards based on a common framework;	Mutual Recognition Arrangements in Services (MRAs)
	B2. Consumer Protection	Establish the ASEAN Coordinating Committee on Consumer Protection (ACCCP)	
C. Equitable Economic Development	**C1. SME Development**	Establish a comprehensive SME Service Centre at national level	
		Establish the SME Financial Facilities at national level	
		Harmonise ASEAN Harmonized Electricity and Electronic Equipment Regulatory Regime to the listed standards and to complete agreed conformity assessment procedures for regulated EEE	ASEAN Policy Blueprint for SME Development* (SMEs)
		Implement the common Curriculum for Entrepreneurship in all ASEAN Member States	
		Implementation of the ASEAN Policy Blueprint for SME Development 2004-2014	
	C2. ASEAN Integration	Complete the list of proposed activities under IAI	

PILLARS	TARGETS	Actions Required	Actions Performed
		Conduct activities in support of investment promotion and facilitation as scheduled	Initiatives for ASEAN Integration (IAI) and narrowing the Development Gap
		Identifying and implementing technical assistance and capacity building programmes for both public and private sectors in ASEAN Member Countries	
		Promote best practices in SME development, including SME financing.	
D. Full Integration into the Global Economy	**D1. External Economic Relations and Participation in Global Supply Networks**	Development of Free Trade Agreements	ASEAN-Australia-New Zealand Free Trade Area (AANZFTA)
			ASEAN-China Free Trade Area (ACFTA)
			ASEAN-India Free Trade Area (AIFTA)
			ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEPA)
			ASEAN-Korea Free Trade Agreement (AKFTA)
			Regional Comprehensive Economic Partnership (RCEP)**
		Finalise ASEAN-India 2.Services and investment negotiations	
		Implement the ASEAN-Japan Comprehensive Economic Partnership by all Member States	

Appendix 3: Regulatory reform in banking and securities sectors

Sector	Legal document
Banking sector	The Laws, Ordinances and regulations relating directly or indirectly to banking services as modified and supplemented include: Before WTO accession Bankruptcy Law, passed on 15/06/2004 and came into effect on 15/10/2004 (replacing Bankruptcy Law in 1993)/ Commerce Law, passed on 14/06/2005 and came into effect on 01/01/2006, Civil Law passed on 14/06/2005 and came into effect on 01/01/2006. Enterprise Law, passed on 19/11/2005 and came into effect on 01/07/2006; Contract Buying Law, proved on 29/11/2005 and came into effect from 01/04/2006. Law on Negotiable Instruments ratified on 29/11/2005 and came into effect on 01/07/2006 (replacing Ordinance on Bill of Exchange in 1999); Ordinance on Foreign Exchange which was approved on 13/12/2005 and came into enforcement on 01/06/2006; Other important legal documents were issued which aim at directly adjusting the activity of banks and credit institutions, including: Decision no. 1096/2004/QD-NHNN on 06/09/2004 of Governor of State Bank of Vietnam on factoring activity of credit institutions; Decision no. 1452/2004/QD-NHNN on 10/11/2004 on foreign exchange of credit institutions allowed to trade in foreign exchange; Decision no. 351/2004/QD-NHNN on 07/04/2004 of the Governor of State Bank of Vietnam on monetary agency Decision no. 475/2005/QD-NHNN on 19/04/2005 and Decision 03/2007/QD-NHNN on 19/1/2007 of the Governor of State Bank of Vietnam on ensuring safety in the whole operation of Credit Institutions. Decree no. 22/2006/ND-CP enforced on 28/02/2006 of the Government about organizations and operations of foreign bank branches, joint venture banks, banks with 100% foreign capitals, representative office of foreign credit institutions in Vietnam; Decree 141/2006/ND-CP on enforcing the legal capital of credit institution. + Decree No.26/2006/ND-CP officially enforced the establishment of foreign entry in domestic banking sector After WTO accession Vietnam's Government and State Bank have taken some actions regarding this issue. In particular: Decision no. 40/2007/QD-NHNN dated 02/11/2007, promulgating a Regulation on licensing the establishment and operation of non-stock banking credit institutions. Decision no. 01/2008/QD-NHNN dated 09/01/2008, on opening and terminating operation of branches, representative offices of non-banking credit institutions. On 03/12/2008, Governor of State Bank passed Decision no. 2951/QD-NHNN on adjusting the compulsory reservation rate for credit institutions. Decision no. 34/2008/QD-NHNN dated 05/12/2008 on modifying and supplementing several articles of regulations on the safety rate in the operation of credit institutions, along with Decision no. 457/2005/QD-NHNN on 19/04/2005 and Decision no. 03/2007/QD-NHNN on 19/01/2007 of the Governor of State Bank. Decision no. 457 and Decision no.03 indicated some problems that needed to be dealt with immediately to create favourable conditions for credit institutions to develop safely, stably and healthily within international standards and practices.

	Decree No.81/2008/ND-CP, article 8 specifying 10 billion USD as the required charter capital for parent company to conduct business in Vietnam for foreign financial leasing companies; Decree 95/2008/ND-CP amended article 8, Decree No.16/2001/ND-CP related to the licensing criterion for foreign suppliers; Decision 83/2009/QD-TTg on rights and obligations of bank regulatory commission at SBV; Decree No. 01/2014/ND-CP on January 3 on purchase of shares of Vietnamese credit institutions by foreign investors.
Securities sector	+ The Securities Law No.70/2006/QH11 and the Amending and Supplementing Securities Law No.62/2010/QH12. + Decree No. 14/2007/ND-CP and the Amending and Supplementing Decree No.84/2010/ND-CP. + Official Letter no. 1210/NHNN-CNH61 on 7/2/2007 gives instructions to be received by VND deposit branches and they are to follow the same route as in Vietnam's commitments generally. So this was introduced to apply directly to the State Bank of Vietnam. + Decision No.124/2008/QD-BTC provides the legal background as well as specifies the licensing 2013 procedures for foreign participation in the form of representative offices + Decision No.55/2009/QD-TTg, article 3 allows for the equity contribution and restricts to 49%, which is appropriate with WTO commitments. + Decision 121/2008/QD-BTC + Decree No.69/2007/ND-CP on foreign investors buying stocks of Vietnam trade banks, + Circular No.226/2010/TT-BTC, in 2011, + Decision No.112/2009/TT-TTg specifies the organization, responsibilities and authorities of SSC and + Decision 127/2008/QD-BTC specifies the securities market surveillance.

Source: Doan Le Mai (2013), Nguyen Hong Van (2009), and authors' update and revision.

61 Legal document no. 1210/NHNN-CNH61 on 7/2/2007 of State Bank of Vietnam sent to branches of foreign banks in Vietnam with instructions to receive by VND.

Appendix 4: Market Communities and Institutional Architectures: Is the European Union a good Template for the ASEAN?

- ***Economic Development and Trade Integration supported by Institutional Reforms and Rules-based Governance Mechanisms***

Within ASEAN substantial economic cooperation has been achieved in the "ASEAN" way, not through rules and regulations, but through discussion and consultation, and consensus (relations-based governance). What is particularly distinctive about ASEAN is the way it is integrating. The so-called 'ASEAN Way' is based on the principles of non-interference, informality, minimal institutionalization, consultation and consensus, non-use of force and non-confrontation. However, it has been stated that ASEAN must move away from these "relationship-based" governance mechanisms to ones that are more "rules-based" and "market-driven".[62] This echoes the existing literature on legalization.[63] With economic expansion in the region and closer economic cooperation among the members of ASEAN, international trade and investment in the region are increasingly becoming subject to international regulation by a rules-based system, with a rules-based framework evolving to regulate economic relations *inter se*. AMSs have been moving slowly towards developing a rules-based framework for economic cooperation among themselves, which has culminated in the ASEAN Charter: at the 12th ASEAN Summit in January 2007, the leaders agreed to hasten the establishment of the AEC by 2015 and to transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and free flow of capital. Hence, on November 2007, the ASEAN leaders adopted the ASEAN Economic Blueprint at the 13th ASEAN Summit in Singapore. The signing at the 13th ASEAN Summit in Singapore in 2007 of both the ASEAN Charter and the Declaration of the AEC Blueprint was a significant step in achieving economic integration. Of particular importance was a commitment to move away from the 'soft-law' approach of the past towards an adherence to rules-based systems for effective compliance and implementation of economic commitments. [64]

62 Severino (1999).There have been at least twenty Summits among the ASEAN countries. They adopted about twenty basic legal documents. All these are dedicated to realizing the ambitious goal of the ASEAN countries to be developed.

63 "Legalization" as a concept in the literature on international relations was developed by scholars to explain "the use and consequences of law in international politics." See Goldstein et al. (2000, p. 385 *et seq*). According to the authors, legalization refers to characteristics that institutions may possess. The elements of their concept of legalization are obligation, precision, and delegation. "Obligation" refers to international actors being legally bound by legal rules and procedures, whether international or domestic. Such legal rules and procedures impose obligations that are distinct from obligations resulting from coercion, comity, and morality. "Precision" means that these rules and procedures define rights and obligations in unambiguous ways." That is, the scope of reasonably interpreting them is narrow. In Thomas Franck's parlance, this means that such rules are determinate. Finally, "delegation" relates to the grant of authority to third parties (such as courts, arbitrators, and administrative bodies) to interpret and apply rules during dispute settlement, and also to make further rules.' Dispute resolution mechanisms are highly legalized when parties agree on the basis of clear and generally applicable rules-to be bound by the decisions of these third parties. They are less legalized when political bargaining goes on, and parties are not bound to accept the determinations of third-party adjudication. See K. W. Abbott et al. (2000).

64 The ASEAN Economic Ministers Meeting (AEM) held in August 2006 in Kuala Lumpur, Malaysia, agreed to develop "a single and coherent blueprint for advancing the AEC by identifying the characteristics and elements of the AEC by 2015 consistent with the Bali Concord II with clear targets and timelines for implementation of various measures as well as pre-agreed flexibilities to accommodate the interests of all ASEAN Member Countries. At the 12th ASEAN Summit in January

The AEC would form a large and diverse economic entity by end 2015. The AEC areas of cooperation include human resources development and capacity building, recognition of professional qualifications, closer consultation on macroeconomic and financial policies, trade financing measures, enhanced infrastructure and communications connectivity, development of electronic transactions through e-ASEAN, integrating industries across the region to promote regional sourcing and enhancing private sector involvement for the building of the AEC. The AEC Blueprint outlines actions and measures and time lines for completion by the 2015 deadline.

However, as extensively evidenced above, by mid-2014 only a partial implementation had been achieved. While tariff elimination had largely been on schedule, there are difficulties with removal of non-tariff barriers (NTBs) and services and investment liberalization. In summary, the AEC has come a long way, but it has fallen short of the high standard and time frame it has set for itself. ASEAN has to find the political will and management capability to fulfil all goals in the AEC Blueprint – arguably, by prioritizing the more urgent and shortly achievable - and embark on further liberalization, rationalization, and integration to seize the opportunities and successfully meet the economic challenges of the 21st century. Moreover, the economic integration of ASEAN is not only about the development of a Single Market, but also about the development of Integrated Production Network (IPN).

To achieve the main AEC blueprint’s objectives fully and face the complex process of economic challenges of the 21st century, ASCs should carefully consider a process of institutional reform and enhancement of the Association’s architecture itself: ASEAN has been so far effective in the capacity envisioned at its creation, as it successfully promotes peaceful relations within the region diminishes the effect of outside forces in the states while concurrently promoting the economic development of all its nations. However, to further its progress and maintain relevancy in today's world, ASEAN must form a court or similar institutions to deal with the increasingly complex and contentious matters facing the region. Noticeably, in 2007 it was also adopted the so-called ASEAN Charter. The Charter adopted by AMSs is drafted in the form of a treaty, and will serve as a sort of constitution of ASEAN. It was intended to instil a greater incorporation of rules and formality into the regional bloc's operations. ASEAN members wanted the Charter to help in regional integration in the three pillars of political-security, economic, and socio cultural matters. The Charter of ASEAN has been hailed as a legal instrument that would integrate the ten constituent members as a community and a regional organization. The Charter aims at transforming ASEAN from an institution that fosters purely political relationships into one that fosters compliance by member countries to their promises and obligations. The Charter confers legal personality on ASEAN, by providing ASEAN, as separate from the member states, with juridical personality and legal standing,65 and emphasises that ASEAN is a "rules-based" organisation with a

2007, the Leaders affirmed their strong commitment to accelerate the establishment of an ASEAN Community by 2015 as envisioned in the ASEAN Vision 2020 and the ASEAN Concord II, and signed the Cebu Declaration on the Acceleration of the Establishment of an ASEAN Community by 2015. In particular, the Leaders agreed to hasten the establishment of the ASEAN Economic Community by 2015 and to transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and freer flow of capital.

65 The ASEAN Charter formally accords ASEAN legal personality as a full-fledged inter-governmental organisation, moving it from its previous state as a loosely-organised regional entity (and therefore making ASEAN a subject of

dispute settlement/compliance mechanism, and strengthens ASEAN's institutions. In an Asian context, the credibility of ASEAN is, arguably, at stake. Other major actors are posing economic challenges in the region, and the ability of ASEAN to harness the collective economic and political resources of its member states is being tested as never before. Optimistically, the Charter provides opportunities for action, and it is a document that can be adapted and amended in the light of new circumstances.

It is also worth recalling that the ASEAN member states (AMSs) have relied on non-ASEAN sources of law to support their regional economic integration into the AEC. Finally, economic integration between the AMSs has arguably benefited from the previous experience and outcomes of other regional areas and, above all, the EU. Whether the EU is an appropriate template for ASEAN, or, whether, given the apparently unique circumstances of European integration and Southeast Asian regionalism, analogies between the two are counterproductive, is a rather complex issue. What is crystal-clear is that the EU's uniquely *modus operandi*, peculiar regional context and deep economic integration cannot be replicated by ASEAN simply by institutional mimesis.

Serious efforts toward a deeper economic integration among the ASEAN members started only in 1992. Initial obstacles included the widespread pursuit of import substitution policies of industrialization, the small extent of intra-ASEAN trade, and the wide differences in economic size, development level, and industrial competence giving rise to widely divergent perceptions of benefits and costs of integration. The challenges of globalization, slow recovery from the Asian financial crisis, and the economic rise of the People's Republic of China (PRC) and India further pressured ASEAN into deep integration in 2003 with the formation of the ASEAN Economic Community (AEC): in October 2003, ASEAN decided to establish the AEC by 2020 but advance it to 2015 in January 2007 (with a longer time line of 2018–2020 for CLMV). The AEC is a highly ambitious effort at deep integration, which includes factors of production as well as a dispute settlement mechanism. It represents the realization of the end goal of economic integration as espoused in the Vision 2020, which is based on a convergence of interests of AMSs to deepen and broaden economic integration through existing and new initiatives with clear timelines[66]. In establishing the AEC, AMSs act in accordance to the principles of an open, outward-looking, inclusive, and market-driven economy consistent with multilateral rules as well as adherence to rules-based systems for effective compliance and implementation of economic commitments. The AEC envisages the following key characteristics: (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy. Such characteristics are plainly inter-related and mutually reinforcing. At the same time, the AEC addresses also the development divide

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international law in its own right).

66 Economies that are complementary at the outset of economic integration face less resistance since there would be limited competition among them, while economies that are in competition at the outset would face more resistance, as economic restructuring would be painful. However, the gains from economic integration would also be larger with improved economic efficiency from reforms and resource reallocations. Likewise, economies that are already open and globalized will benefit less from economic integration while economies that are closed will face painful adjustments from trade and investment liberalization but will enjoy efficiency gains.

and accelerate integration of the CLMV through the Initiative for ASEAN Integration and other regional initiatives. Other areas of cooperation are also to be incorporated such as human resources development and capacity building; recognition of professional qualifications; closer consultation on macroeconomic and financial policies; trade financing measures; enhanced infrastructure and communications connectivity; development of electronic transactions through e-ASEAN; integrating industries across the region to promote regional sourcing; and enhancing private sector involvement for the building of the AEC.

The AEC's goals are formidable and extremely challenging. One of the crucial issues is whether the existing intuitional framework can adequately underpin the required reforms. The present Annex compares the institutional and decision-making structures of the ASEAN with those of the EU. It asks whether the EU is an appropriate template for the ASEAN or whether, given the apparently unique circumstances of European integration and Southeast Asian regionalism, analogies between the two are counterproductive. First, the EU's evolution is briefly outlined by illustrating the economic context of its evolution and the peculiar motives featuring the accession of its different members; second, ASEAN's institutional architecture is set in the context of the ASEAN Charter's innovations that most invite comparison with the EU; and third, the two organizations are compared by assessing the intersection between setting ambitious, but realistic, goals for ASEAN's greater integration and adopting structures that might be inappropriate to ASEAN.

The central questions are again raised of how far ASEAN can go towards creating a polity of nations in its region and whether the EU can, or should, be a template for integration within ASEAN.[67] We address such questions here; in particular, we examine the essential spirit of political integration in the EU, which, uniquely, synthesizes the discrete interests of Member States, on the one hand, and the common 'European' interest, on the other, through a supranational organization. Such synthesis, therefore, provides a litmus test comparison for ASEAN: what would need to change in ASEAN for a similar development to occur? And what has changed so far? Given that some EU's institutions do not find any reason for being transplanted within the ASEAN and will not be emulated (*e.g.* a unique currency, the Euro, and a central bank, the European Central Bank and the European System of Central Banks, in charge of the monetary policy on exclusionary basis), which EU's institutions can arguably complete the current institutional structure for the AEC's objectives being achieved?

Our argument proceeds in three steps. First, we outline the distinguishing features which underpinned the main passages of the EU's institutional development from its essentially economic origins and rationale as a 'common market' to its current status as a 'union' embracing also political and security objectives. Second, we examine ASEAN's institutional architecture and, in particular, discuss the implications of those innovations in the ASEAN Charter that appear to invite comparison with the EU's policy-making process. Third, we

67 As the ASEAN Charter and the Lisbon Treaty are now functioning, the time is opportune to compare two major regional organizations attempting to make a leap towards a new plateau of integration. Comparison is justified also because the ASEAN Charter included some decision-making structures whose format and nomenclature are modelled on those of the EU (Jetschke and Murray, 2012). A similar approach is followed by the insightful study of Murray and Moxon-Browne (2013).

compare the two regional organizations by assessing whether or not ASEAN can develop also by importing some institutional solutions from the EU and whether such operation can be confined within a 'zone of discretion' between setting ambitious but realistic goals for ASEAN's greater regional integration, and adopting ambitious structures that might be inappropriate to ASEAN and that could, paradoxically, impair the region's economic integration.

- ***The Unique Context of the EU's Institutional Development: an Important Caveat for Institutional Mimesis***

Murray and Moxon-Browne (2013: 524 *et seq.*) highlights the caveats and risks of comparing ASEAN with the EU: "(t)he 'new regionalism' studies have at times played down the idea of the EU providing a template for regional projects outside of Europe (Acharya and Johnston, 2007; Warleigh-Lack and Rosamond, 2010). Instead of the legalism, elaborate institutional framework and distinctive supranational characteristics of the EU, 'new regionalism' posits a broader range of modalities, largely setting aside the neo-functionalist and neo-realist theoretical canons of European integration. In particular, as the EU has become more preoccupied with its own governance, its crises in the Eurozone and unemployment more broadly and its popular legitimation, the gap between itself and regionalism projects in the rest of the world has widened (Beeson, 2011; Mahbubani, 2008, 2011). Many other regional projects can claim an institutional structure that is still vestigial and, therefore, any concerns about 'constitutionalizing' their systems of regional governance would be premature and could even be regarded as European 'integration snobbery' (Murray, 2010). Yet, however we may distinguish between the EU experience and regional integration instances in other parts of the world, the EU has remained the focus of much scholarly exchange (Murray, 2010; Schmitter and Kim, 2008). Explicitly, the conclusion is often reached that due to Europe's unique constellation of factors – economic, political, historical – that experience or 'model' is simply not appropriate for non-European contexts and their specific economic, political and historical experiences (Acharya and Johnston, 2007; Murray, 2008; Stanley Foundation, 2008). Implicitly, without any overt reference to the EU, regional integration schemes in non-European settings have often been measured against a tacitly acknowledged 'gold standard' set by the EU and are found to be deficient. Due to entirely different socio-economic and politico-historical contexts, the European experience is simply not relevant. Yet there has been recognition that new regionalism and EU studies share research agendas and cross-pollinate regarding process, norms and practices (Acharya and Johnston, 2007; Murray, 2010; Warleigh-Lack and Rosamond, 2010). At the same time, there remains an absence of micro-level comparisons, of how individual institutions or committees work within regional bodies, and how they might influence each other, and this article seeks to redress this lacuna."

Starting from such considerations, we turn to our own central theme: to what extent are ASEAN and the EU, respectively, developing into similar polities? Such question is raised not only against a familiar background of regionalism, but more immediately regarding the EU's role as a global and normative actor: we may suggest "a global regional standard setter". Among its peculiar features, a key characteristic of the EU is its ability to influence other regional organizations and processes, by inducing its regional integration schemes in other parts of the globe. This 'power by example' is arguably a core component of the EU's normative role in a global context (Murray and Moxon-Browne, 2013: 525). As stressed by Jetschke and Murray (2012) such influence is so strong to urge other regional projects, such as ASEAN, to borrow institutional templates from the EU and apply them in rather dissimilar economic, social and political contexts.

As a matter of fact, the EU's progress made towards a polity is unique. Today, the EU represents a an exceptional case of a supranational organization featured by a long-established and smoothly operating policy-making process in which governments play their part alongside interest groups, regional representations, political parties, civil society and public opinion. Within the EU the decision-making transcends state borders and operates at discrete levels of authority, for example, in the multi-level governance system (Hooghe and Marks, 2001) guaranteed by the fundamental principle of subsidiarity established in Article 5 of the Treaty on the European Union (TEU) complemented by the principles of conferral and proportionality.68 Such an approach is also grounded a relatively high level of institutionalization so that formal channels of decision-making by independent experts are normally privileged over informal meetings between politically committed power brokers: the central role of the European Commission is paradigmatic of that dynamics. Although the informality may sometimes provide rapid solutions, the formal decision-making initiated by independent experts arguably provides greater predictability and consistency. This contrast is mirrored in the divergent experiences of the EU and ASEAN.

Creating institutions, however, is relatively simple: the political significance and the effectiveness attached to these institutions (that is to say, the role they are called upon to play and the means available to achieve their objectives) is another cup of tea. In this respect, several commentators argue that the EU is well-endowed with a plethora of institutions, most of which are not only accorded some significance by national governments with whom they interact, but also excessively constrain these governments in formulating and implementing policies at the regional level, frequently flowing into dangerous over-regulation. Such criticism has been voiced more decisively in the context current economic crisis, towards which the EU's institutions would have acted ineffectively and, sometimes, through policies, which had already proved to exacerbate the negative economic scenario. In ASEAN, as in other regional organizations, like the Southern Common Market (MERCOSUR), the African Union (AU) and partly the North American Free Trade Agreement (NAFTA), institutions have sometimes been created according to what appears to be a European model, but the anticipated osmosis whereby these new institutions might be imbued with significance comparable to their EU analogues does not materialize (Murray and Moxon-Browne, 2013).69 Accordingly to some (Wong, 2012), in the case of ASEAN, it is imperative to avoid

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68 As widely known, the principle of subsidiarity is fundamental to the functioning of the European Union (EU), and more specifically to European decision-making. In particular, the principle determines when the EU is competent to legislate, and contributes to decisions being taken as closely as possible to the citizen. It appears alongside two other principles that are also considered to be essential to European decision-making: the principles of conferral and of proportionality, to which it is complementary. In essence, the principle of subsidiarity aims at determining the level of intervention that is most relevant in the areas of competences shared between the EU and the Member States. This may concern action at European, national or local levels. In all cases, the EU may only intervene if it is able to act more effectively than Member States. The principle of subsidiarity also aims at bringing the EU and its citizens closer by guaranteeing that action is taken at local level where it proves to be necessary. However, the principle of subsidiarity does not mean that action must always be taken at the level that is closest to the citizen. The Protocol on the application of the principles of subsidiarity and proportionality also defines the implementation of the principle of subsidiarity. In addition, the Treaty of Lisbon has considerably strengthened the principle of subsidiarity by introducing several control mechanisms in order to monitor its application. The Protocol on the application of the principles of subsidiarity and proportionality lays down three criteria aimed at establishing the desirability of intervention at European level, namely whether the action have transnational aspects that cannot be resolved by Member States; whether a national action or an absence of action be contrary to the requirements of the Treaty; and, finally, whether, the action at European level has clear advantages. For a detailed analysis, see, *ex multis*, Chalmers et al. (2014).

69 See, for instance, the excellent studies published in *Journal of European Integration*, Vol. 32, No. 6, 2010.

mistakes made in the EU. Arguably, it is more balanced to argue that ASEAN should avoid some of the EU's inconsistencies and deficiencies and, at the same time, should learn some of the important lessons given by the EU's long-established institutional experience in order to complete the AEC and, possibly, strengthen its own integration in different fields. For instance, ASEAN members should consider whether introducing a judicial body to settle their dispute once the AEC is established. The example of the Court of Justice and General Tribunal of the EU and the fundamental role they played in the construction and consolidation of the EU internal market is most telling.70 It is true that most of the notions crystallized in the 'case law' of the Luxembourg-based Courts (e.g. the notion of 'measure of equivalent effect to a quantitative restriction') are already implicitly included in the required actions for the AEC different targets. However, the interpretation and application of law and complex legal notions is a dynamic work, which requires to be carried out by bodies that deeply understand the political, social, and economic context of the specific jurisdiction at issue. From an economic angle, other EU's initiatives, which at first may seem of minor relevance, could represent good practice to draw for ASEAN: the Phare programme,[71] one of the pre-accession instruments financed by the EU to assist the applicant countries of Central and Eastern Europe in their preparations for joining the Union, represents an excellent example of how to reduce the economic and institutional gaps between the different members of the same intergovernmental regional organizations supporting the less advanced - in case of ASEAN, Cambodia, Lao PDR, Myanmar and Vietnam (CMLV) – or those which are gradually move to a market-driven economic system. Minding such gaps is plainly an essential pre-condition to realize a common market beneficial to all the participants. From yet another perspective, no single market can be maintained without the implementation of a regional competition law and the creation of a central competition authority in charge of enforcing such law together with the member States' National Competition Authorities (NCAs) acting as peripheral enforces. No such law and authority exist in the ASEAN context.

- ***Reflecting upon the Origins: Is the European Context Sui Generis?***

In assessing whether the EU's institutional structure can, or should, be a good model for ASEAN in the process from its initial legal informalism towards a more "rules-based" and "market-driven" governance mechanism and transformation from an institution that fosters mainly political relationships into one that fosters compliance by member countries to their promises and obligations, we should first consider a key question that lies at the heart of European integration theory discourse, that is to say that of the EU's uniqueness. Is the EU *sui generis,* or a unique experiment as its publicists proclaim, and its development made possible by a unique economic and socio-political context? Such questions trespass on attempts to theorize about integration in comparative regional contexts and inquiries into the economic foundations of the EU and the strategic considerations of the different Member states to participate to the European project. As rightly argued by Murray and Moxon-Browne, (2013: 526): "the potential transferability of the EU experience depends on whether factors specific to (originally) western Europe are essential prerequisites for the integration process or

70 This holds true also with reference of other judicial or quasi-judicial bodies created in the context of other plurilateral or multilateral organizations.
71 See *infra* section 6.5.

whether integration could proceed elsewhere based on a different set of factors." This argument requires us to identify factors that are necessary or sufficient for political and further economic integration to take place. It is relatively simple to identify factors that have guaranteed the success of European integration. Yet, it is a different matter to say whether these or analogous elements would be the necessary requirements for regional integration to proceed elsewhere towards a level of intensity similar to that of the EU. What makes the question all the more difficult is that regionalism initiatives in other places have achieved neither the economic success achieved in Europe – at least until the last decade currently overshadowed by the Eurozone crisis, nor the EU institutional progress.

As argued elsewhere, "if the emergence of a polity in the EU is attributable solely to factors that are uniquely present in Europe, the chances of its transferability to ASEAN, even as a tentative template, seems remote" (Murray and Moxon-Browne, 2013: 527). Therefore, in order to assess whether it is possible and feasible for ASEAN to adopt a EU-like institutional architecture, it is preliminarily necessary to ask whether EU economic and political integration has been dependent on conditions that are uniquely present in Europe. Different themes are pertinent here. First, some trace the roots of integration in Western Europe to the 'inadequacy of the state' (Wallace and Wallace, 2000, p. 47), which differs from ways in which the state might be seen as inadequate in some ASEAN countries. As prosperity and extensive welfare states developed in Western Europe, the single States found themselves under pressure to perform their quintessential functions of providing welfare and security to an extent that was increasing exponentially and which lay far beyond their capacity to deliver. In other words, "an expectations–capability gap had arisen due largely to notions of a Westphalian state system needing to confront an increasingly post-Westphalian world order, resulting in a reliance on transnational co-operation. In this way, states drew strength from each other and prolonged their own survival" (Murray and Moxon-Browne, 2013: 527).72

Second, factors specific to Western Europe may account for the progress of a new institutional experience in such region. Historical experiences of major conflicts created a strong desire to devise collective security arrangements (supported and activated by the United States, unlike the hub and spokes approach in Asia): the terrible twentieth-century experience of two World Wars, fought mainly on European territory, provided the necessary impetus to seek alternative ways of political survival, coexistence, and even cooperation. Without such conflicts and the consequent urge to secure peace and stability through appropriate institutions, the original European Communities' institutions would have not been created. While individual States pursued contrasting solutions to their own security ranging from neutrality to military alliances, behind these divergent security postures lay a neat balance often based on geopolitics: the creation of a European Coal and Steel Community (ECSC) in 1951, by which two strategically important industry sectors of rival nations like France and Germany were pooled, was the pragmatic answer to the need of stronger stability. In addition, "Europe was unique in its overlapping confluence of high population density and numerous national borders, although there are parallels in Asia now" (Murray and Moxon-

72 As Milward (2000) argues, the State was rescued from its own demise by the novel mechanisms of European integration. The security concern was exacerbated by the cold war (until 1990) and thereafter by more diffuse threats such as terrorism, environmental degradation, cross-border trafficking and ethnic conflict. By the 1990s a modus vivendi had evolved whereby the EU took care of some sectors of policy-making while the nation-state retained control over others.

Browne, 2013: 527). Jealously protected concepts of national sovereignty, and historic rivalry between some of its founding members, sometimes hardened by conflict, made functional co-operation a prerequisite to overcome the challenge of geographical proximity. Much of the success of the EU is attributable in part to the fewer impediments to regionalism facing the more homogeneous European continent, as well as the fact that the original members had stronger economies than constituent members of several other regional organizations, (for instance, their ASEAN counterparts). Another distinguishing feature of the European construction stems from the diversity of its members' economies, which characterised the organization from its very origins. This holds true both for the original six member states and for the latecomers:73 The chance of positively exploiting the economic diversity of the European States has been at the basis of the idea of economic integration as developmental engine for decades. Such diversity – which is not limited to the economic sphere - is one of defining features of the EU, as the EU's motto 'Unity in diversity' testifies. With the introduction of the introduction of the Euro the need of more homogeneity has emerged and the priority now is to find effective ways to reconcile diversity and homogeneity of the member States. Although characterised by different features, the ASEAN States do not seem to be as diverse as the European States have traditionally been, at least as far as their economy is concerned. Moreover, a commitment to market-based economy, liberal democracy and a certain protection of welfare State, became a badge of Europe's identity, dividing it from the communist East and, then, providing the means for a later 'return to Europe' of the countries of Eastern Europe.74 EU social policy acknowledges that citizens needs protection from the cross-border implications of economic integration and, at least before the burst of Eurozone crisis, this has been an undisputable tenet of the European rhetoric.

Again from an economic angle, unlike the vast majority of the ASEAN members, the EU countries are in the decay phase of the technology curve, whereas developing countries benefit from more margins in that respect. That was the case at the origins of the European Communities, when member States could grow more substantially and their co-operation was based mainly on intergovernmental methods. To develop new technologies EU countries should arguably exploit their synergies, also by establishing a European space for innovation, a European system of IPRs protection (overcoming national privileges), and a strong integrating research system.75

Fourth, until very recently, a characterising element of the European integration was the leadership of a sort of directorate made up of France and Germany, occasionally completed by other large countries (especially, the United Kingdom and Italy). With the economic decline of France,76 such leadership is now held by Germany alone, even though it is not so strong to

73 The crisis of the Eurozone has exacerbated such diversity, mainly between the so-called North and South of Europe. The illustration of the economies of the EU member states goes evidently beyond the scope of the present work. For an insightful outline of the economies of Europe see Neal (2007).

74 Notions of the 'welfare state', although differently interpreted across the continent, take as their starting point an assumption that the state (or society) has a duty to protect the individual 'from the cradle to the grave' from the wilder excesses of the market. Europe is not unique in espousing the concept of a welfare system, but it is perhaps the defining characteristic of European society (Canonica and Padoan, 2014, pp. 71 and ff.; Neal, 2007, p. 143 and ff.; Moxon-Browne, 1997, p. 30).

75 Canonica and Padaon (2014), pp. 74-5.

76 According to the IMF, the spread between the German GDP (3593 billion of Euro in 2013) and that of France (2739

impose its favoured solutions for the whole Union, as a truly hegemonic power could do (Canonica and Padoan, 2014: 99). Even though the differences among developed and developing economies are plain, none of the ASEAN Member States (AMSs) plays a similar role.

And finally, despite its imperfections, the EU citizenship mirrors a value-laden consensus that does not exist in other regional organizations. This is granted by the Lisbon Treaty to all those who are citizens of one of the Member States of the EU.77 There was no mention of the citizenship in the initial EC Treaty; it was only established in the Treaty of Maastricht of 1992, after the Spanish Government submitted a proposal entitled ‘The Road to European Citizenship’ in September 1990 at the Intergovernmental Conference on Political Union that preceded the adoption of the Treaty on European Union. Although the significance and implications of EU citizenship are still debated and its relevance sometimes not well publicized, EU law and the Court of Justice provide a transnational framework for the protection of many citizens’ rights, unmatched elsewhere, by setting a transnational legal device which has allowed EU citizens to enjoy a wide array of fundamental human rights and liberties in States different from theirs of origin (Chalmers et al., 2014, pp. 471 ff.; Margiotta, 2014, pp. 65 and ff).

To conclude the point, all the above mentioned elements characterises the EU as a modern political phenomenon that has risen out of the peculiar social, historical and economic context of its members States in the 20th century. Such context has created a highly institutionalised political system, which is unique in comparison to all others, and, arguably is the most notable feature of the region.78 Although it has traits that bear resemblance to the political systems of federal states as well as intergovernmental organisations (IGOs), it remains one of a kind, *sui generis*, as a political system, a ‘supranational’ organization,79 that, among the other things, has executive power in that the bodies that make up its decision making process, the European Commission, the Council of Ministers, and the European Parliament, legislate laws and measures that significantly influence all member states; is based on a high degree of sovereignty pooled by Member States in central institutions; works by means of the majoritarian voting system which is utilized for several policy decisions; by redistributive cohesion policies; and by normative assumptions of the EU’s role in the world. Remarkably, the EU’s deliberations result in binding legislation, unlike those of ASEAN. These measures cover economic and environmental matters, as well as those of foreign policy, defence and security policy.80 The EU is also characterized by a multi-level governance which relies on

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billion of euro in 2013) is definitely greater than that between the latter and the Italian one (2068 billion of euro in 2013). See http://www.imf.org/external/data.htm.

77 Cfr. Art. 20 of the Treaty on the Functoning of the European Union (TFEU).

78 The EU is highly institutionalized, distributing the power granted to it by the member states between the European Council (main legislature), Commission (the ‘guardian of the Treaties’, which represent the interests of the EU as a whole), Parliament (sharing legislative power) and Court of Justice (interpreting and upholding EU law

79 There have been several attempts to define the notion of a ‘supranational’ – as opposed to a weaker ‘international’ or ‘intergovernmental’ –organization. The prevailing view nowadays prefers to identify a number of characteristic elements, the combined existence of which should allow one to speak of a ‘supranational’ organization. These elements include, most notably, majority voting in decision-making institutions with the power to bind outvoted Members, a system of obligatory dispute settlement, the direct effect and supremacy of EU law in/over national law, and the existence of ‘own resources’ of the organization.

80 The extent of the EU’s executive power is illustrated by the fact that “some scholars estimate that the EU sets over 80 per

action taken at a whole series of levels (local, regional, national, supranational), without diminishing the so-called ‘authority of EU law’, being an autonomous legal order which limits national sovereignty. The EU single market is often referred to as the most successful common market in the world. This has been achieved by the removal of barriers to trade as well as other economic initiatives such as regulation concerning competition.81 The Single European Market initiative, specifically the Cohesion policy, reflects a federal system further in that it provides financial assistance to the EU’s less economically developed members. This distribution of resources reflects a centralized system that is also typical of federal political systems.82 Finally, the introduction of a single currency across the majority of countries in the Eurozone highlights further the extent to which economic integration is present in the EU, although the poor outcomes of the policies adopted to tackle the economic crisis started in 2007 denotes how fragile the European construction, and, especially, its single currency, still is. The failure to the introduce the so-called ‘Eurobonds’ (*i.e.* debt instruments with different principal, maturity and interest rate attached, whereby an investor loans a certain amount of money to the Eurozone bloc altogether, which then forwards the money to individual governments) for the firm opposition of Germany,83 the scarce financial resources allocated to the European Stability Mechanism (ESM),84 the Banking Union’s embryonic state,85 and the harsh debates on the so called ‘Fiscal Compact’, are all symptoms of the same disease: the lack of a truly shared vision on how to further the European integration and cope with the current economic and social challenges. The very fact that the mere announcement of a properly European economic tool - the Outright Monetary Transaction (OMT)86- by the President of the European Central Bank (ECB) calmed down the financial turmoil at the peak of the European sovereign debt crisis sent a clear messages as to the way to follow in the next future. Despite the travails of the EU and its common currency, it is fair to state that the level

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cent of rules governing [economic matters] in member states’ markets.” (Hix 2005).

81 To a certain extent, the progress towards making a Single European Market over the last fifty years has been similar to the initial economic unification of federal states such as Germany in the 19th Century; standards are established and tolls and tariffs are reduced or removed completely. This creation of standards is similar to Europe today: with the European Union regulating all products produced within each member state to a certain level so as to fully implement the Single Market initiative.

82 For more detailed information see: http://ec.europa.eu/regional_policy/what/future/index_en.cfm

83 For a preliminary assessment of the pros and cons of such instrument see Claessens et al. (2012); De Grauwe and Moesen (2009); Delpla and Von Weizsäcker (2011); EU Commission (2011); Soros and Sinn (2013); Juncker and Tremonti (2010); Muellbauer (2012).

84 Cfr. the EFSF official website - http://www.efsf.europa.eu and the ESM official website - http://www.esm.europa.eu. See also Tridimas (2011).

85 Cfr. Pillar 1: www.eba.europa.eu/regulationandpolicy/singlerulebook; Pillar 2: www.eba.europa.eu/regulationandpolicy/supervisoryreviewandevaluationsrepandpillar2//activitylist/NRWsAs5hcSDu/more;jsessionid=B2E958CA937983B16F73ED2463C34518; Pillar 3:www.eba.europa.eu/regulationandpolicy/transparencyandpillar3//topicdocuments/m5cbuvPOTdmW/morewww.europa.eu/rapid/pressrelease_MEMO14294_en.htm?locale=en; on its advantages and disadvantages see Interview with Mario Nava:www.affaritaliani.it/economia/unionebancariaeuronava17042014.html;Federico Fubini on banking union: www.rassegna.esteri.it/EcoTiffPilot/Default.aspx?FN=D:%5CEco%5CImg%5C2BZ8%5C2BZ8GAP?.TIF&MF=1&SV=Rassegna%20Stampa&PD=1; “Does Europe need a banking union?” debatingeurope.eu: www.debatingeurope.eu/2012/12/13/doeseuropeneedabankingunion/#.U4HT4F5w8f0; Manifesto by German, Swiss and Austrian economists for a banking union done properly: www.economistsview.typepad.com/economistsview/2012/07/insupportofaeuropeanbankinguniondoneproperlyamanifestobyeconomistsingermanyaustriaan.html; Breuss (2013).

86 The OMT is a program of the European Central Bank under which the bank makes purchases ("outright transactions") in secondary, sovereign bond markets, under certain conditions, of bonds issued by Eurozone member-states.

of economic integration within the EU in the absence of the same level of political integration highlights the extent to which the EU is a unique political system. Such evolution is probably the most notable peculiarity of the EU.

- ***ASEAN's Institutional Progress***

We turn to assess the features of ASEAN countries that support or militate against regional integration, either economically or politically and, thereafter, the principles and philosophy behind ASEAN's institutional development.

Starting from the AMS's main features, they are rather different in terms of territory, political regimes - ranging from authoritarian to democratizing - variation of geographical dispersal from large landmasses to islands, and levels of economic development and prosperity that potentially impairs the possibility of a united body. There is a relatively low level of economic interdependence and inter-regional trade, when compared to the EU. There exist contrasts in terms of religion, civic and political culture. Collaborative strategies towards FDIs and trade policies coexist with competition among the ASEAN counties. On the contrary, what really distinguish the ASEAN economy from that of EU is that the economic integration of ASEAN is not only about the development of a Single Market, but also about the development of Integrated Production Network (IPN):87 while the creation of the European Single Market indirectly created the environment for new networks of businesses and production, in Asia, counter-intuitively, these networks already exist despite some trade barriers.88 International and regional production networks are market-driven and involve the breaking up of production processes into fragmented segments that can be carried out in different cross-border locations and eventually coordinated for assembly into final products. Production networks make use of each location's advantages to boost productivity and cut costs, while bolstering investment and technological transfer. The East Asian fragmentation of manufacturing production and export appears as follows: the PRC, Japan, and the Republic of Korea are home countries for production networks, with the PRC increasingly functioning as the major assembly base (factory of the world). The ASEAN countries of Malaysia, Philippines, Singapore, and Thailand encourage inflows of MNCs' investments, successfully absorb new production technologies and develop local supporting industries, and became

87 An integrated production network (IPN) is a network of enterprises that have chosen to link their production based upon cost-effectiveness to the extent that standing outside the network becomes no longer viable. The IPN can be horizontal or vertical. When an IPN becomes transnational, it faces several challenges. The main challenge beyond the cost of transport and logistics planning is ensuring that the rules applicable to each actor in the network remain predictable and certain. When the IPN operates in countries where the rule of law is weaker, guarantees against arbitrary intervention and discrimination become more critical for the continued effective functioning of the IPN. Ewing-Chow (2013, p. 284) even contends that "the absence of a significantly large internal market at present (although it is predicted to grow over the next few decades), the main driver of ASEAN economic integration is not market integration, but rather production integration by way of the integrated production network (...)".

88 Rather than changing the general environment to allow a climate for such networks, Asian businesses took advantage of the less-than-transparent discretion provided to policy makers of all levels in many Asian countries, and instead obtained specific solutions to the trade barriers they faced. Since the 1960s, subject to the changing players and gravitational forces, much of the intra-Asia trade has been about the trade of components as part of a production chain of 'Factory Asia'- with each state being part of a process that culminates in a final product for export to developed countries. ASEAN, because of its low labour cost and high raw material endowment, has always been the hub of such a "Factory Asia" network. Unrestricted regional trade has been an important building block for the region's economic strength, and consequently disruptions-whether political or administrative-put this competitiveness at risk.

major exporters of machinery parts and components.89 The success of these ASEAN economies led to a second wave of production networks to Indonesia and CLMV, as they are able to absorb the relocation of labour intensive segments and enter international markets requiring only a limited range of skills.90 Like the EU, ASEAN is characterized by historical experiences of major conflicts that created a strong desire by Indonesia, Malaysia, Singapore, the Philippines and Thailand to form a regional body in 1967, with the objectives to accelerate economic growth, social progress and cultural development and, crucially, to manage intra-regional conflicts. However, different from Western Europe, different perspectives of regional identity and hegemonic power were endorsed on the part of the United States, which favoured a bilateral over a multilateral path in Asia and so did not support ASEAN or an Asian-style NATO treaty organization (Hemmer and Katzenstein, 2002).

Coming to the ASEAN's institutional evolution, it is worth stressing that the origins of the Association denote different intents than that of the European construction: the ASEAN Declaration of 1967 was quite different from the Treaty of Rome.91 It did not commit member countries to regional economic integration; the new organization was simply asked to facilitate cooperation on social, cultural and economic matters, and, importantly, to promote peace. Secondly, in comparison with the highly institutionalised EU, the main institution of ASEAN, the Secretariat, merely advises negotiations and discussions that take place between the member states in their own name. Thirdly, key ASEAN principles such as consensus, preventive diplomacy, avoidance, unanimity in decision-making, non-interference in domestic affairs and rejection of supranationalism have all combined to render ASEAN regionalism distinctive, and in its own way, *sui generis* (*ex multis*, von Feigenblatt, 2012; Roberts, 2013; Murray and Moxon-Browne, 2013). The procedural use of consensus building and preventive

89 Initially there was limited trade among the Southeast Asian countries (except with Singapore which functions as the regional entrepôt), since they exported similar natural resource products (such as rubber, palm oil, and metals) due to similar natural endowments and labour-intensive manufactures due to similar low technological capability. Hence they competed with each other for markets in the developed countries. With the rise of production networks in the region since the late 1980s and consequent rapid growth in intra-industry trade in parts and components, economic complementarity in manufactures developed among the ASEAN economies.

90 As widely known he development of production networks has been facilitated by FTAs that encourage inward FDI by multinational corporations (MNCs). Factors in the rapid growth of production networks in East Asia include the following: First, wide regional differences in wage and labour productivity levels, resulting in different competitive cost locations for different parts of the value chain. Second, ASEAN countries increasingly adopted outward oriented development strategies resulting in trade and investment liberalization unilaterally and regionally under the FTAs. Third, cross-border trade flows were facilitated by improvements in customs administration and availability of efficient trade infrastructure and logistics that result in lower production and logistics costs. Production networks are usually found in industries with long value chains, such as electronics and electrical machinery, automotive, and textiles and garments.

91 ASEAN was created at a time when the communist threat to existing governments was severe. The desire to combat communism furnished the cement that initially held these disparate nations together. Peace among ASEAN members also was high on the initial priority list, and with ample reason. ASEAN's creation followed closely upon the "*Konfrontasi*" conflict in the early 1960s between Malaysia, Singapore and Indonesia, which nearly led to armed conflict; ASEAN created a neutral forum where leaders could discuss their differences. ASEAN also helped to broker the conflict between Malaysia and the Philippines over the Sabah region in Borneo; diplomatic relations were restored between the two countries in 1969. In 1971, all ASEAN members were able to sign a declaration of peace and neutrality. As Stephenson (1994, p. 440) rightly remarks: "(i)n the context of distrust and nationalism that characterized the 1960s and most of the 1970s, the first years of ASEAN's existence saw little progress towards intraregional liberalization. Instead, the ASEAN members addressed political conflicts among themselves and worked out common approaches to two deadly and prolonged wars in the Southeast Asian region, the Vietnam and Cambodian conflicts."

diplomacy are still dominant within the Association (von Feigenblatt, 2012; Roberts, 2013).92 Within ASEAN substantial economic cooperation has been achieved in the "ASEAN way", not through rules and regulations, but through discussion and consultation, and consensus (relations-based governance).93 The so-called "ASEAN Way" contributed to the early success of the regional grouping, as it focused heavily on building confidence and trust among neighbours rather than legalistic structures and styles. There was a policy of non-intervention in domestic affairs, there was no hegemon, the ASEAN Secretariat was kept small so that there was minimal discomfort with supranationality, and cooperation and integration was pursued not according to any pre-decided blueprint but at a pace that all members would be comfortable with.94 Such 'relation-based' or 'soft' regionalism renders EU procedures of decision-making at best unworkable, and at worst illusory.

The notion of ASEAN as a 'serious regional player' (Ong, 2007) and a driver of regional security dialogue is plain in the ASEAN Regional Forum (ARF) - the only Asia-Pacific wide forum for consultations and dialogue on political and security issues that involves other interested players, such as the United States, the EU and Australia - which signed a decisive move from confidence building to 'preventive diplomacy'.95 Notably, in 2007 it was adopted the so-called ASEAN Charter. The Charter adopted by AMSs was intended to instil a greater incorporation of rules and formality into the regional bloc's operations. ASEAN members wanted the Charter to foster regional integration in the three pillars of political-security, economic, and socio cultural matters. The Charter of the ASEAN has been hailed as a legal instrument that would integrate the ten constituent members as a community and a regional organization. Ostensibly, the Charter has three strategic thrusts in support of the vision of the ASEAN Community. The first is to formalize ASEAN as an institution while streamlining its

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92 Critics object that the ASEAN Way's emphasis on consultation, consensus, and non-interference forces the organization to adopt only those policies, which satisfy the "lowest common denominator." According to Leviter (2010), however, these critics are correct that decision-making by consensus requires members to see eye to eye before ASEAN can move forward on an issue, but these principles emerged to ensure stability in a historically tumultuous region.

93A governance structure is necessary in order for every economic entity to engage in economic cooperation. A system of governance may be categorised as either relations-based or rules-based. Relations-based governance represents an informal approach to international relations, placing greater reliance on informality and the relationship between the parties to the negotiations. Such mechanism relies on the personal relationship of the actors to establish the parameters of their cooperation; agreements are based on the mutual relations of the actors, and depend on knowledge of and familiarity with each other. Formality is avoided, and the maintenance of good relations is relied on for the "enforcement" of commitments. More in detail, the "ASEAN Way" refers to several principles, which collectively prevent organizational change and can be reduced to two essential components. First, it emphasizes decision-making through informal consultation among diplomats, which facilitates group consensus at official meetings. Second, it is a series of six behavioural principles set forth in the 1976 Treaty of Amity and Cooperation: (1) respect for state sovereignty; (2) freedom from external interference; (3) non-interference in internal affairs; (4) peaceful dispute settlement; (5) renunciation of the use of force; and (6) cooperation. Of these, member states particularly emphasize non-interference in each other's internal affairs. In recent years, the principle of non-interference has been invoked by instruments of regional integration, as well as by the member states themselves, in order to assert the primacy of domestic interests above regional interests. See, e.g., ASEAN Vision 2020, Dec. 15, 1997, available at http:// www.aseansec.org/1814.htm ("We envision the Treaty of Amity and Cooperation in Southeast Asia functioning fully as a binding code of conduct for our governments . . ."); Bali Concord II, (reaffirming ASEAN's commitment to the TAC and non-interference).

94 Islam (2012) noted that the ASEAN Secretariat has 75 professional staff, making it a challenge to support or drive forward the integration process.

95 For a comprehensive illustration of the ARF, its origins, activities, strategic importance and forces that hold it back we refer the reader to Severino (2009) ff. Here suffice it to remind that there have been countervailing forces (for example, the potentially hegemonic role of China and the growing strength of India externally) that tended to thwart the Forum's ambitions.

decision-making processes. Secondly, the Charter seeks to strengthen ASEAN institutions. Thirdly, it seeks to establish mechanisms to monitor compliance and settle disputes. The Charter aims at transforming ASEAN from an institution that fosters purely political relationships into one that fosters compliance by member countries to their promises and obligations.96 In an Asian context, the credibility of ASEAN is, arguably, at stake. Other major actors are posing economic challenges in the region, and the ability of ASEAN to harness the collective economic and political resources of its member states is being tested as never before. Optimistically, the Charter provides opportunities for action, and it is a document that can be adapted and amended in the light of new circumstances. 97 Aw (2009,

96 Hailed by some as a constitution for the grouping of ten member countries, the Charter has been expected by some to move ASEAN to a higher stage and be something of a constitutional moment, after which previous norms and practices will change. The ASEAN leaders at the signing stated that they celebrated the signing of the ASEAN Charter as a historic milestone for ASEAN, representing our common vision and commitment to the development of an ASEAN Community as a region of lasting peace, stability, sustained economic growth, shared prosperity and social progress. On the drafting of the Charter, as recounted by the High Level Panel and other officials, see Koh et al. (2009). Others, both inside and outside the region, have criticized the Charter as being mediocre, toothless and even without any meaning. Cfr., See Wanandi (2007) and Sarkin (2007). For views from outside the region, see Kazmin (2007a) and Kazmin (2007b). Also see Desker (2008). With the Charter, ASEAN is given a legal personality for the first time and this will affect how the organization is viewed in the domestic legislation of its member states. Institutional innovations are intended to enhance regional co-ordination: summits now take place twice a year instead of once; a new ASEAN Co-ordinating Council was established; a Human Rights Body was set up; and a CPR potentially plays a major role in providing both co-ordination and continuity. The CPR is composed of ambassadors accredited to ASEAN in Jakarta. Among their functions are: to ‘support the work of the ASEAN Community Councils’; co-ordinate ASEAN national secretariats; ‘liaise with the Secretary-General of ASEAN’; and ‘facilitate ASEAN co-operation with external partners’ (ASEAN, 2008, Article 12). An overall aim of the Charter is to make ASEAN more of a rules-based organization, although, in the absence of effective compliance mechanisms, it is difficult to imagine that past voluntary, and consensual, modes of decision-making will change overnight. Admittedly, cases of non-compliance will be referred to a summit, although one cannot be too sanguine about this either since the Singapore summit of 2008 suffered the embarrassment of withdrawing an invitation to a United Nations envoy to report on Myanmar in the face of the strident but solitary opposition of Myanmar. The decision to include a human rights body in the Charter was commended, although no provision was made at the time for its functioning, or for selecting its membership, allowing doubts to be entertained about its potential effectiveness, especially given the lack of enforcement mechanisms. Non-governmental organizations remain concerned about the narrow focus of its terms of reference (FIDH, 2009). The generally ‘permissive’ attitude adopted towards Myanmar called into doubt the seriousness with which ASEAN tackles human rights violations, or the capacity to address them, despite evidence of considerable disquiet by some ASEAN members. Recent developments in Myanmar suggest some progress on human rights issues, however tentative. Indeed, the Myanmar Permanent Representative in August 2012 ‘conveyed that the Government of the Republic of the Union of Myanmar is working closely with other ASEAN Member States and on the right course on its democratisation process. (ASEAN, 2012a).

97 It is worth reiterating not only the potentially far-reaching implications of the ASEAN Charter, but also the rather pessimistic atmosphere that surrounded its adoption. First, the original recommendations of the ASEAN Eminent Persons Group (2007) had been watered down and, second, the Singapore summit where the Charter was adopted was preceded by serious riots and examples of government repression in one ASEAN member state: Myanmar. Television pictures allowed these images to receive global publicity. Surprisingly, in view of the rhetoric of revulsion, which followed events in Myanmar, it was not excluded from the summit, which ‘cast a long shadow on ASEAN’s fortieth anniversary celebrations’ (Caballero-Anthony, 2008, p. 75). Indeed, it has been argued that the ‘continued emphasis on non-interference obstructs ASEAN and its member states from responding to regional crises, politically and on human rights grounds’ (Stensland et al., 2012, p. 8). Third, although the language of the Charter, and indeed its very existence, suggest many new commitments, the devil may prove to be in the detail – and the allocation of resources. Fourth, within ASEAN, conflicts are occasionally dealt with by postponing difficult issues, compartmentalizing an issue so that it does not interfere with other areas of cooperation, and quiet diplomacy. With this method of diplomacy, neither ASEAN can never solve the tough issues, nor can it begin to deal with more complex issues. Some criticisms relate specifically to difficulties in Myanmar over human rights that, while long standing, boiled over in the weeks prior to the 2007 Summit: the preceding month, peaceful demonstrations led by monks and civilians occurred in Yangon and other places in Myanmar and were forcefully suppressed by the junta. For a more detailed analysis, see Selth (2008). Another strand of criticism emerges from hopes that the Charter might overhaul the norms and workings of ASEAN more thoroughly so as to ensure a more effective, people-oriented and forward looking organization.

p. 1) characterizes the ASEAN Charter as having some ambitious goals, ‘including turning ASEAN into an EU-style community whose member countries function as a regional bloc and seek a more rigorous role in global affairs’. Moreover, Aw points to challenges for ASEAN relating to the need to respect the principles of non-interference and of consensus. The latter principles constitute the most relevant difference between the EU and ASEAN with regard to sovereignty and the state. The ASEAN’s present dispute management system is based on avoidance[98] and consensus building, which is surprisingly informal and protracted: even though it raised the long term stability of the organization, its cohesiveness, and greatly strengthen preventive diplomacy, it causes relevant costs due to lack of decisive action in tackling short and midterm threats and also in the operationalization of agreed policy goals by AMSs (like, for instance, the creation of AEC by 2015). Even though the establishment of the ASEAN Commission of Human Rights may well constitute a step toward both an intensified form of institutionalization and recognition of the normative aspects of human rights, ASEAN remains distinctively intergovernmental: diplomatic means and consensus building largely prevail. Political will of the individual member states is still crucial. As rightly observed: “(M)uch has been, and can be, achieved through an intergovernmental forum, and ASEAN’s history attests to that. Yet it remains a regional player surrounded by – and linked to – larger and more important players in ASEAN Plus Three (China, South Korea and Japan), and the external hegemon, the United States.”[99]

It is also worth recalling that the AMSs have relied on non-ASEAN sources of law to support their regional economic integration into the AEC. For instance, AMS have used WTO dispute resolution to resolve issues that could have been resolved using the ASEAN Enhanced Dispute Settlement Mechanism. Also, AMSs conducting cross-border inspections have used UN agreements as legal support rather than use the ASEAN Trade in Goods Agreement.[100]

Finally, some suggest that attempts at reform of the global economic institutions, such as Asian representation at the International Monetary Fund (IMF) and G20, reduce the pressure for Asia to build up its own regional institutions (Rathus, 2009, p. 1).

Murray and Moxon-Browne (2013: 529) go on to depict the ASEAN’s institutional development, stating that: “(a)lthough it did not amount to the devising of collective security arrangements, nevertheless ASEAN – and the ASEAN Regional Forum and the East Asia Summit – brought together apparently divergent security postures with concerns firmly based on regional geopolitics, where the United States remains the security guarantor. There is little evidence of transnational support for a welfare state among ASEAN countries, yet the ASEAN Charter seeks to eliminate poverty. Neither is there one, single Asian regional body, but rather a plethora of regional groupings and alliances ranging from ASEAN to the ASEAN Regional Forum, the East Asia Summit, the Asia Pacific Economic Co-operation (APEC)

98 Avoidance refers to conflict management procedures leading to the filtering out of certain kinds of disputes or to other more subtle methods of avoidance such as the channelling of certain issues to powerless secondary committees and the subsequent delay and final ignorance of the findings.

99 Murray and Moxon-Browne (2013: 529)

100 Using non-ASEAN legal instruments to implement ASEAN-level commitments has pros and cons. On the one hand, such practice could undermine the legitimacy of the ASEAN agreements. On other hand, using non-ASEAN legal instruments could give AMSs greater confidence by giving them more experience in dealing with each other, albeit in a non-ASEAN context/manner.

forum and, more recently, the TransPacific Partnership. These are distinguished by either economic or security objectives, but not an overlapping of both.” As it was largely predictable in such a context, notions of transnational citizenship or a nascent regional identity remain muted at best.

As mentioned when illustrating the AEC’s objectives, considerable advances have been made in achieving a single market base, a competitive economic region, equitable economic development and integration with the global economy, although by mid-2014 only a partial implementation had been achieved. Unlike the EU, ASEAN is not a customs union: each country sets its own tariffs on imports from outside the region. While tariff elimination had largely been on schedule, problems remain with removal of non-tariff barriers (NTBs) and services and investment liberalization. In addition, the still partial implementation of the Blueprint has highlighted the incomplete implementation of the single market also from other angles. To date, customs duties on most intra-ASEAN trade have been removed, pledges to remove non-tariff barriers have been made and ‘framework’ agreements on the liberalization of trade in services, investments, interstate transport, and information and communications technology have been made. While the ASEAN’ bodies continue to urge further reforms to make the AEC truly operational across national boundaries within the region, private actors can still easily place artificial barriers to competition and trade among the member states, and nothing similar to a regional competition policy echoes from the official discourses.

Overall, although ASEAN’s institutional development has been characterized by important treaties that establish effectively a code of conduct between its members101 and there are important advances in the AEC, criticisms have persisted that ASEAN is not efficient, or relevant, as long as there is no shared view on its future development and lacks permanent and specific institutions. At the same time, some see a new Asian identity developing and clear efforts to deal with the global economic crisis (for example, Tay, 2009; Pempel, 2005). Other, maintain that “although ASEAN’s development has been halting at times, it is has achieved significant objectives regarding co-operation among Northeast Asian nations” (Murray and Moxon-Browne, 2013: 530), being the first the creation of the ARF, and the second the establishment of ASEAN Plus Three, whereby China, Japan and South Korea meet with ASEAN in a largely collaborative fashion (Tay, 2009). This grouping arrives at agreed positions and stances in the Asia Europe Meeting, and with East Asia Summit participants. The fact that ASEAN has constituted a regional body as the most effective regional interlocutor in the region with the EU since 1980 is also important *per se.*

As stressed above, creating institutions is relatively easy: what truly matters is the political significance attached to these institutions and the role they are called upon to play. The

101 The major agreements are the Zone of Peace, Freedom and Neutrality Declaration of 27 November 1971, whereby the members were committed to ‘exert efforts to secure the recognition of and respect for Southeast Asia as a Zone of Peace, Freedom and Neutrality, free from any manner of interference by outside powers’ and to seek to broaden co-operation to contribute to strength, solidarity and a closer relationship. The second is the Declaration of ASEAN Concord of 24 February 1976, which sought to develop political co-operation through summits; the peaceful settling of intra-regional disputes; extradition agreements; and the harmonization of views and positions. The third, signed on the same day as the second, is the important Treaty of Amity and Co-operation in Southeast Asia, outlining the central principles of mutual respect for one another’s sovereignty; non-interference in internal affairs; the peaceful settlement of intra-regional disputes; and effective co-operation. The Southeast Asia Nuclear Weapons-Free Zone agreement of 15 December 1995 provides for a Commission and Executive Committee.

current financial crisis on a global scale appears to provide a fruitful context for the recognition of the political significance of leadership summits and joint commitments: the above referred European developments in the matters of the ESM and the Fiscal Compact, along with the shortcomings in creating ‘Eurobonds’ and allocating sufficient resources to the Banking Union are telling examples of this story. A good example of effective and sound political cooperation from the ASEAN side is represented by the creation, in the aftermaths of the following the 1996–97 Asian financial crisis, of the Chiang Mai currency swap initiative, which established a network of bilateral agreements to swap and repurchase central bank reserves among ASEAN Plus Three countries, ‘stimulated by the system of EMU in Europe (...) but framed within non-Western norms’ (Gilson, 2004, p. 197).102 Yet, the weak ASEAN institutional capacity poses potential problems in building more competitive economies within a larger community, as well problems of faster harmonization of standards across AEC and, more in general, to the all the Association’s goals. Implementation of regulations against their enactment by law may remain weak. ASEAN is a very lean organization (Komori 2009; Severino, 2007). The Secretariat is understaffed and has very limited re-sources. Funds are normally allocated on ad hoc basis for certain projects or special meetings. This means that most resources stay in the hands of the member states rather than on the organization itself. Unlike the EU, the ASEAN does not have its own budget. Furthermore, as already stressed, the ASEAN’s present dispute management system based on avoidance and consensus building, causes relevant costs due to lack of decisive action in tackling short and midterm threats and also in the operationalization of agreed policy goals by AMSs.

The less ‘legalistic’ fashion, in which ASEAN integration has progressed,[103] called “ASEAN Way”, has led to the absence of supranational bodies that would have the role to enforce regional regulations in national legislations. Even where some institutions have been created and deadlines are approaching, the framework is still weak. For instance, relevant ASEAN sectoral bodies coordinate the implementation of the programs and measures envisaged by the Blueprint at the regional level, while AMSs’ relevant government agencies are responsible for overseeing the implementation and preparation of more detailed action plans at the national level. Also, partnership arrangements with the private sector, industry associations and the wider community at the regional and national levels are also actively sought where required to ensure participation of all stakeholders in the integration process. For the creation of the AEC, such bodies’ activities remain under the supervision of a weak and embryonic implementation mechanism, which relies, on the one hand, on the coordination between the High Level Task Force (HLTF) on ASEAN Economic Integration on ASEAN Economic Integration, the ASEAN Secretariat; the ASEAN Economic Ministers (AEMs), AMSs’ relevant sectoral Ministerial bodies, and, on the other, upon the AEC Scorecard. Finally, the absence of a supranational court, before which bringing possible disputes on the implementation of the Blueprint and the present ASEAN’s dispute management system, based on the costly principles of avoidance and consensus building, impede decisive actions in the operationalization of agreed policy goals by AMSs, like the creation of AEC by 2015.

102 However, although the Chiang Mai Initiative was extended in 2008 into the Chiang Mai Initiative Multilateralization to be used as a form of currency protection in times of crisis, it remains as yet untried.
103 See Fuller (2012)

The present institutional structure has also led to create more and more complex situations, such as concluding all FTAs both at the national and regional level, described by many analysts as a "spaghetti bowl". According to Vo Tri Thanh, the complexity of various FTA commitments and their ambiguous impacts on ASEAN member countries could hinder the ASEAN's consensual move towards deeper integration."104 Another consequence of the approach at issue is that national regulatory institutions have not followed the strong changes in business practices and technologies that emerged in the ASEAN supranational context over the last decades. More particularly, labour market institutions did not adapt regulations quickly enough, causing significant distortions between laws and the necessities of real business.

The creation of adequate supranational bodies seems be an option that has not been retained by ASMs, but that challenge remains nevertheless unaddressed: above all for the effective and successful implementation of the programs and measures envisaged by the Blueprint for the AEC, adequate institutions and mechanisms, ample resources, technical capacity and strong political endorsement shall be accorded to the Community building process, consistently with the cases where international supervision and follow-up mechanisms work effectively.

- ***Institutional Comparisons and the 'Zone of Discretion'***

The history of ASEAN is of an intergovernmental organization of States motivated by the desire for peace, stability, mutual support and economic co-operation and featured by the governments' fame for their strict adherence to the principle of non-interference in the internal affairs of other States. ASEAN elites regularly invoke their mantra of 'non-interference' to explain the Association's success as the leading instance of third-world regionalism.105 However, ASEAN analysts often use 'non-interference', consensus building and avoidance, to explain virtually every limitation of the grouping, from its inability to discipline problematic members, to its excessively slow implementation of the AEC and its inaction on transnational security threats. Originally, it was the disruptive potential of the many actual and potential disputes within Southeast Asia that, by 1967, had resulted in a recognition that unless the former five governments established some form of organized dialogue to mitigate competition and future interstate conflicts, then they would either fail or be delayed in their endeavours towards international consolidation, particularly economic development and nation-building. The history of the region suggests a fairly low level of complex integration between the AMSs through the time of the Association's formation. Therefore, the establishment and consolidation of ASEAN necessitated a *modus operandi* where the principles of non-interference, state sovereignty, and consensus-based decision-making were central to what became later known as the 'ASEAN way'. The ASEAN's formative instruments were undemanding, lacked any binding commitments and avoided supranational institutionalization. The conventional analyses argue that the ASEAN way has

104 See Vo Tri Thanh (2011).

105 Despite other disagreements, scholars from all the approaches, which have contended the study of Southeast Asia regionalism (and, above all, realists, on the one hand, and constructivist scholars, on the other), agree on the absolute centrality of the non-interference principle for ASEAN. However, such principle is far from being unproblematic in the region, as the work of Jones (2012) shows. ASEAN''S former secretary-general himself, Rodolfo Severino, insists that the application of non-interference is governed by pragmatic considerations and, accordingly, has not been absolute

subsequently made a significant contribution to regional security and economic development. However, over the following years the implementation of ASEAN agreements has remained (and remains) a problem and the Association may risk maintaining little more than a 'declaratory' reputation should it continue to adhere to the principles of non-interference and consensus-based decision making. However, the Association continues to follow a pattern where consensus has been relatively easier and frequently attained in the economic sphere. For instance, the Economic Blueprint contains far more detail and several more commitments than the ASEAN Socio-Cultural Community Blueprint. A major crossroad may be represented by the ASEAN Charter, intended to advance the Association's regionalist project and address the main challenges by institutionalising and integrating ASEAN politically, economically, and socially.106 The goals of the ASEAN Charter encapsulate the history of ASEAN and the new objectives that it has set itself. As other stress: "(t)he document is therefore a unique combination of the two elements of the zone of discretion discussed (...) – namely setting ambitious but realistic goals for ASEAN's greater integration; and adopting ambitious structures that could well prove to be less than appropriate to ASEAN in terms of short- to medium-term achievements" (Murray and Moxon-Browne, 2013: 531). When first reading the ASEAN Charter, it plainly emerges that it is rather ambitious also within the context of its own goals, which are achievable only if supported by political leadership, adequate institutional architecture, and resources. It then remains to see whether ASEAN's goals are potentially realistic and, in the positive, how the Association's institutions have to evolve to achieve them.107

Park and Wyplosz (2008, p. 135) summarized comparative aspects of European and East Asian regionalism succinctly: their main conclusions can also be applied to Southeast Asia. First, they considered that Europe's regionalism is motivated by a desire for political and economic integration that has no counterpart in East Asia. As widely highlighted in the present work, unlike EU construction institutions of supranational governance, East Asian regionalism has been 'weakly institutionalized'. In addition, they recognized that the existence of transnational or supranational institutions is not sufficient for regional integration to be achieved, as a considerable ceding of sovereignty is essential and, while largely occurred within the EU, this remains the core issue in Southeast Asian regionalism, characterized by non-interference and consensual inter-governmental cooperation. The role of key actors is pivotal – success depends on their courage and commitment. Park and Wyplosz understand that East Asian integration – and as we stressed above in Section 3– is a "multi-polar process in contrast with the alliance of key nations like France and Germany or with a single hegemonic power". The same holds true for ASEAN's regionalism.

What seems undisputed is that the several suggestions and proposals in recent years for an Asian or an Asia Pacific community reflect the desire for ambitious regional bodies, as well as lack of satisfaction with existing architectures.

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106 For an insightful reconstruction of the different phases of ASEAN's regionalism see Roberts (2012, pp. 1).
107 A long-time observer of ASEAN suggests: "We should hope first to see steady implementation in ASEAN's existing plans. Secondly we must expect the organisation to continue to help keep the wider region at peace and to be inclusive, without contention among rising rivals. Thirdly, we can also hope for ASEAN to play a role in shaping Asian responses to the global crisis". (Tay, 2009, p. 1), also recalled by Murray and Moxon-Browne, 2013.

There is much discussion of the EU experience as having relevance in the process of ASEAN's institutional reform, but also general agreement that the EU has not to be regarded as a model or yardstick (for example, Stanley Foundation, 2008; Murray and Moxon-Browne, 2013). The fact that few analysts refer to the ASEAN Charter as the basis for new regional architectures seem to indicate that the Charter is useful for ASEAN itself, but not in a broader context and, that, ASEAN is *sui generis* onto itself (Roberts, 2012; von Feigenblatt, 2012; Murray and Moxon-Browne, 2013).

If, on the one hand, due to the peculiar context that favoured the EU's creation and development and the considerable differences between the two organizations' constituent members, a process of institutional mimesis of ASEAN towards the 'European model' is neither feasible nor desirable, on the other, given the common goal to create (and, then, consolidate) a market community, some aspects of the EU's architecture should be implemented within the ASEAN, after paying the prices of institutional adaptation processes.[108]

As widely known, the former European Communities and the EU have a history of making progress in their integration routes by creating either institutions whose functions allowed them to develop and intensify their cooperation gradually, though increasingly, or by setting deadlines which, although sometimes imperfectly respected, stimulate the European institutions and Member States towards new levels of integration. From such angle, we agree with those who contend that: "ASEAN's adoption of some EU nomenclature for new institutions and processes can be regarded simply as the setting of ambitious goals to create a new dynamism".[109]

Despite problems of perceived legitimacy, recurrent allegations of a "democratic deficit" within the EU,[110] and notwithstanding the paralysis which still seems to affect most of the EU institutions in the context of the Eurozone crisis, the EU still stand as a unique experiment of supranational organization backed also by a general tacit commitment that the public 'ought' has to be involved (lately testified by the attempts at writing a 'European Constitution' failed because of the negative outcome of public consultations in some Member States and by the features of the law-making procedures resulting from the Lisbon Treaty, designed to involve

108 Note that some of such organizational reforms were already discernible in report issued by Eminent Persons Group (EPG), comprising highly distinguished and well-respected citizens from ASEAN Member Countries, with the mandate to examine and provide practical recommendations on the directions and nature of an ASEAN Charter relevant to the ASEAN Community. The purpose of the EPG, as set out in its Terms of Reference, was to: "examine ASEAN in all areas of its cooperation activities, codify and build upon all ASEAN norms, principles, values and goals as contained in ASEAN's milestone agreements, treaties and declarations, as well as undertake a thorough review of the existing ASEAN institutional framework and propose appropriate improvements if so required. It will put forth bold and visionary recommendations on the drafting of an ASEAN Charter, which will serve as the legal and institutional framework for ASEAN, aimed at enabling the building of a strong, prosperous, and caring and sharing ASEAN Community that is cohesive, successful and progressing in the 21st century." Cfr. ASEAN, *Terms of Reference of The Eminent Persons Group (EPG) On the ASEAN Charter*, at para. 3,online: <http:llwww.aseansec.org/18060.htm>.

109 Murray and Oxon Browne (2013: 534) who go on to state: "On the other hand, if the new institutions cannot be operated on the same assumptions as their EU counterparts, there may set in a corrosive sense of frustration and disillusionment – or else a sense of the sui generis Asian way that is based on consensus in incipient institutions. Admittedly, any frustration could well be limited to governmental elites since public awareness of, or involvement in, ASEAN's institutions remains limited, though civil society groups do seek to engage with it more actively in recent years".

110 As to this issue, see the analysis of Corbett (2012, pp. 248 ff).

national parliaments more intensively[111]). In sum, the supranational assumptions underlying the decision-making mechanisms of the EU and its institutions' functioning seem to be incompatible with the ASEAN's carefully preserved inter-governmentalism.

However, now that economic necessities drive public policy in the Southeast Asian region, institutional progress and rule-based mechanisms[112] are increasingly seen as necessary for economic development. With economic expansion in the region and closer economic cooperation among the members of ASEAN, objectives of economic co-operation became more prominent and the need for more of a legal framework to govern these relations grew. Just as the EU historically developed its own, at times troubled, coexistence of intergovernmentalism and supranationalism, so too ASEAN may well develop through the Charter and a stronger institutional framework. The structures proposed in the ASEAN Charter and the efforts put by AMSs to complete the AEC by 2015 invite further thought and pave the way for future comparative research of the evolution of both organization over time, their principles and working methods, their own bodies and their relationships with the other institutions and bodies within the EU and ASEAN, respectively, as well as in terms of inter-regional relations. Our take is that some EU's bodies, which have proved to be essential for the organization's own consolidation and integration among its members, can be equally decisive in the ASEAN's economic advancement once transplanted in the latter region. We examine now the most relevant of them, while noting, however, that some other apparently minor EU's bodies can model the functioning of existing or would be created ASEAN's institutions.[113]

- ***Discussing Institutional Structure of EU as Major Reason for Success: Which Lessons for ASEAN?***

Dispute Settlement and Compliance

One of the key elements of a rules-based system of governance is an effective system for settling disputes that may arise, and ensuring compliance with the rules of the framework. As

111 See Türk (2012).

112 Rules-based governance "relies more on structures and their functions, and is more formal. Rules-based governance relies on the negotiation of rules to regulate the conduct among the parties and formal third party institutions to ensure compliance with the rules". See Davidson (2008). In the context of a rules-based system, rules define the extent to which obligations exist and between whom and how redress is to occur. The aim of rules-based governance is predictability and efficiency. Law plays an important role in rules-based governance. Rules-based governance entails, in part at least, the formation of rules and a means of ensuring compliance with these rules. In the course of economic growth, expansion of trade and investment, as it is currently happening in ASEAN, one may well expect more of a reliance on rules-based governance. See, for instance, Kohona (1985). As the number of economic partners increases, and as the economic activity becomes more complex, it becomes more difficult to interact with partners on the basis of personal knowledge of the partners. Cfr, Dixit (2004); Shuhe (online: East Asian Bureau of Economic Research <http://ideas.repec.org/p/eab/govern/209.html). Note that, while clearly stating in Art. 2 the founding principle that ASEAN and its Member States shall act in accordance with the "adherence to multilateral trade rules and ASEAN's rules-based regimes for effective implementation of economic commitments and progressive reduction towards elimination of all barriers to regional economic integration, in a market-driven economy", the Charter does not set out what these "rules-based regimes" are, and one is left to the considerations of interpreters to determine what the parameters of this "rules-based regime" might be.

113 In this sense, it is rather interesting the comparison proposed by Murray and Moxon-Browne (2013, esp. pp. 530-34) between the ASEAN's Committee of Permanent Representatives (CPR) and the ASEAN widely accepted in both academic and policy-making circles that the EU's Committee of Permanent Representatives (Coreper), which would make more apparent than other major bodies the EU's uniqueness.

noted by Davidson (2008: 220) within ASEAN, there has been some problem with some member-countries back-tracking on their AFTA commitments, or being reluctant to follow through on arrangements." Today, the focus of most nations today in Southeast Asia is economic advancement. ASEAN must accommodate this collective goal and refocus its functioning to achieve economic regional development. Accordingly, the success of the EU can be a model for ASEAN, insofar as some EU's bodies have effectively contribute to the economic advancement of its members. Although regionalism in Europe is not much older than in Asia, the EU has successfully created a powerful trading entity on the world stage. The success of the EU – and, above all, the success of EU in achieving common market - would not have been possible without the predictability of the system provided by the former European Court of Justice (ECJ; now Court of Justice)114: non-member trading partners and investors are able to rely on predictable transactions because the Luxembourg-based courts' dispute settlement flushes out inconsistencies in EU policy; through the Court's interpretation and preliminary ruling, EU law is applied in the same way in all EU countries; legal disputes between EU governments and EU institutions are settled before the Court with binding rulings; finally, individuals, companies or organisations can also bring cases before the Court if they feel their rights have been infringed by an EU institution. Moreover, the unity of the EU legal system and the uniform application of EU law has repeatedly been held by the Court of Justice to require that EU law "normally be given an autonomous and uniform interpretation throughout the European Union."115 In turn, this has proved essential also for the consolidation of the so-called authority of EU Law.

In order to continue to effect change in the economic arena, and to foster development in other areas of concern in the region, it is essential that AMSs concede some of their sovereignty to the organization and put more trust in the Association ASEAN:116 despite the institutional changes introduced with the ASEAN Charter, ASEAN still lacks any substantial authority to act on its own and a specific body to do so (like the EU Commission). As a consequence, individual states' positions and attitudes become the main determinants when setting the agenda of the regional body. However, this does not suffice to attract more FDIs and foster the economic integration, ASEAN nations must provide a reliable investment based on clear legal commitments to friendly cooperation and a credible compliance system. AFTA and the adoption of the ASEAN Charter were important first steps in this process, but further integration with institutional controls and actual stability are vital to continued regional success. Creating an ASEAN Court of Justice, among other institutional reforms, would

114 The Court of Justice is to ensure that EU law is observed in the interpretation and application of the Treaties. It comprises three courts; the Court of Justice, the General Court and the European Civil Service Tribunal. Among the other functions, the Court of Justice claims an exclusive responsibility to declare EU measures invalid and to provide authoritative interpretations of EU Law, which bind courts and other administrative actors across the Union.

115 Case C-281/09 *Commission v Spain,* Judgment of 24 November 2011, para. 42.

116 While, preventive diplomacy and promises of working cooperatively may be enough for AMSs to interact to grant peace to, the business world requires a more tangible guarantee of reliability. Today, progress in the region mainly depends on the mindset of each of the ten member states and their willingness to compromise for the joint goal of regional solidarity. Modern business cannot rely merely on rhetoric and the promise of reliable collaboration. If the future of ASEAN lies in furthering the economic prosperity of member states, ASEAN must1 be willing to deal in this realm by more predictable methods. Arguably, as it stands, businesses, which avoid investments perceived as too risky, will be unlikely to invest in Southeast Asia under ASEAN protection alone: multinational businesses expressed desire for legal certainty and transparent monitoring mechanisms and an effective compliance system.

provide the reliability economic actors require to feel more comfortable to invest in the region more substantially and grant the Association international legitimacy. A court with jurisdiction over internal issues and, especially, over the AEC once established would further integrate the region ensuring the effect of the legal commitments undertaken by AMSs for the creation of the internal market.

The move to a more rules-oriented approach in ASEAN is evident in the provisions in the Charter for dispute settlement and compliance. Is such novelty sufficient to assure the legal stability and certainty required for the functioning and consolidation of the AEC? To answer to such question, we must assess the ASEAN Charter's provisions establishing the dispute settlement system. The ASEAN Charter is expected to start a process of greater legal certainty. This means if there are problems, if disputes arise, AMSs will invoke proper legal provisions to resolve them in a more definitive and certain way. This "... would stiffen some of the softer aspect of ASEAN, like our agreement on trade liberalisation. So we are going to institute a dispute settlement mechanism. It's no point making agreements if we don't abide by these agreements or we do not take these agreements seriously."117 To say it differently, the Charter is designed to put in place a system of compliance monitoring and, most importantly, a system of compulsory dispute-settlement for non-compliance that will apply to all ASEAN disputes. Article 22 of the Charter sets out the general principle that "ASEAN shall maintain and establish dispute settlement mechanisms in all fields of ASEAN cooperation". Specifically, Article 25 provides, "[w]here not otherwise specifically provided, appropriate dispute settlement mechanisms, including arbitration, shall be established for disputes which concern the interpretation or application of this Charter and other ASEAN instruments." Furthermore, disputes relating to specific ASEAN instruments are to be settled through the mechanisms and procedures provided for in such instruments; where not otherwise specifically provided, disputes which concern the interpretation or application of ASEAN economic agreements are to be settled in accordance with the ASEAN Protocol on Enhanced Dispute Settlement Mechanism (DSM).118 In this vein, settlement of disputes is transferred from an informal to a formal sphere and provides for third-party disputes resolution. What is more, the introduction of the negative consensus as a decision-making rule meant a significant departure from the ASEAN Way, which is traditionally characterised by consensual decision-making procedures.[119]

117 Singapore's Foreign Affairs Minister George Yeo (2006).

118 Not all ASEAN instruments contain dispute settlement mechanisms; hence the need to establish some sort of mechanism to cover such areas. Otherwise, there would be an obvious lacuna. Thus, Article 25 provides that "appropriate dispute settlement mechanisms, including arbitration, shall be established for disputes which concern the interpretation or application of this Charter and other ASEAN instruments". Cfr. ASEAN Protocol on Enhanced Dispute Settlement Mechanism, in TAPR, Document I.B.7.o(1). Such Protocol bears a strong resemblance to the WTO Dispute Settlement Understanding (DSU) and departs from the ASEAN Way. It provides for appellate review to be conducted by experts that are not associated with any government. The purpose of this, according to then Secretary General Ong is to settle trade and economic disputes through objective assessment instead of bureaucratic negotiation. The Protocol also provides detailed provisions for Surveillance of Implementation of Findings and Recommendations.

119 If consensus is the basis for decision, a "losing" party may be able to block the enforcement of the ruling or, even, an appeal. The WTO Dispute Settlement Mechanism, which takes a more juridical approach and substitute for the previous mechanism under the GATT 1947, has a provision for 'reverse consensus', *i.e.* awards are adopted unless there is a consensus not to adopt. Thus, this make the adoption of awards far more automatic, even though the final say is still in the hands of the WTO DSB. The Protocol on Enhanced Dispute Settlement Mechanism follows this procedure.

Such a move of distancing dispute resolution from diplomacy is a significant step in the direction of legalism. However, the distance from a truly independent judicial body, like the Court of Justice of the EU, is still remarkable. The ASEAN DSM, as designed by the above-mentioned Protocol, has not copied from the EU since the procedure does not feature characteristics of the Court of Justice. To cite the most manifest differences, there is no room for legal disputes between the AMSs' governments and the (few and weak) ASEAN institutions; individuals, companies or organisations cannot bring cases before the DSM if they feel the ASEAN institutions have infringed their rights descending from the ASEAN agreements. It is also worth noting that the Charter itself does not set up any mechanism for resolution of disputes regarding interpretation of the Charter.120 The Enhanced Dispute Settlement Mechanism resembles more the WTO Dispute Settlement System. What is more, it can be compared to and must be interpreted with the provisions in the ASEAN Charter concerning compliance generally. Compliance with the findings, recommendations or decisions resulting from an ASEAN dispute settlement mechanism are to be monitored by the Secretary-General of ASEAN, assisted by the ASEAN Secretariat or any other designated ASEAN body, who shall submit a report to the ASEAN Summit.121 Any Member State affected by non-compliance with the findings, recommendations or decisions resulting from an ASEAN dispute settlement mechanism may refer the matter to the ASEAN Summit for a decision. 122 This may considerably limit the efficacy of the DSMs because the Summit may yield to political contingencies and priorities. Finally, though the Charter has ensured "that economic commitments are legally binding and that non-compliance would result in punitive measures such as trade sanctions", the Charter does not "give [other] existing ASEAN dispute settlement mechanism[s] some much needed 'bite'", as remarked by Hew in the ISEAS report on the Charter.[123] Without establishing of effective sanctions to be applied in case of violations and illicit actions, the risk is that the Charter will result in little more of a *lex simulata*.

The Economic Blueprint and International Supervision

As already remarked the future of ASEAN passes through the economic advancement of the region and integration among its members. It is, therefore, plain that compliance with the AEC Blueprint is essential in the broader scenario of the development of the whole Association.

Relevant ASEAN sectoral bodies coordinate the implementation of the measures envisaged by the Blueprint at the regional level, while AMSs' relevant government agencies are responsible for overseeing the implementation and preparation of more detailed action plans at the national level. In addition, partnership arrangements with the private sector, industry

120 This was deliberate. Arguably, several of the queries regarding interpretation of the Charter will relate to practical problems of implementation rather than disputes between Member States. Where there is a question, Article 51(1) provides that the ASEAN Secretariat shall undertake the task of interpretation. The procedure for reference to the Secretariat is to be determined by the ASEAN Coordinating Council. It is only where a Member State disputes the interpretation made by the Secretariat or proposed by another Member State that reference will be made to the dispute settlement mechanism established under Article 25.

121 Cfr, ASEAN Charter, art. 27, para 1.

122 Cfr, ASEAN Charter, art. 27, para 2.

123 Hew (2005) 33 at 36.

associations and the wider community at the regional and national levels are also actively sought where required to ensure participation of all stakeholders in the integration process.

One of the crucial issues of contemporary international law concerns the mechanisms for monitoring and guaranteeing compliance with international rules by States to which they are addressed, before disputes arise (so-called 'international supervision').[124] The required actions by AMSs envisaged by the ASEAN are no exception. International supervision represents a flexible means to prevent disputes. To obviate to the renowned deficiencies of the international order in the resolution of conflicts and legal disputes, a new system of inducing compliance with international rules has gradually been pioneered for scrutinizing the behaviour of States parties to specific treaties.[125] International supervision differs from the adjudication in many respects:[126] it shares only some of the features of adjudication and it stands as an essentially "*non-contentieux*" supervision or control.[127] In general, supervisory

124 One of the distinguishing features of contemporary international law is that States have gradually realized that, in many spheres, dispute settlement should be replaced by the establishment and running of mechanisms designed to monitor compliance with international legal standards on a permanent or quasi-permanent basis, and, thus prevent or deter as much as possible deviation from those standards.

125 This system essentially reflects a guarantee function of the international legal system. In turn, this function – which represents the mediate goal of the international supervision – aims at preserving the integrity of the legal values of a certain legal system from activities, conduct and facts which may result in shattering this integrity. In the case of international agreements, the above-mentioned guarantee function works through the assessment and the decision on compliance by State parties with international standards – that is, the immediate goal of international supervision. International supervision, however, is not exhausted by the compliance decision for it necessitates, firstly, the knowledge of the object under supervision, and, secondly, the production of legal effects, varying from mere declaration of either conformity or non-conformity or more penetrating interventions of the international organizations concerned.

126 *First,* the composition of the body in charge of monitoring the implementation of international provisions is normally different from that of judicial bodies, because the supervisory body can also be made up of representatives of States instead of individuals acting in a personal capacity. Moreover, it might happen that overseeing functions are entrusted to more than one organ. In this case, the various bodies often differ in their composition, as one or more are composed of independent individuals, whilst others consist of State officials. *Second,* as a general rule, the initiative for supervisory provision is not left to the aggrieved State. Rather, it can be taken either by the beneficiaries of the international rules (for instance, individuals, groups of individuals, or representatives of the States who directly benefit from the obligations imposed upon the aggrieved State), or even by the supervisory body acting *proprio motu*, that is to say, on its own initiative (such as in the case of anti-corruption monitoring mechanisms). At times there is no need for anybody to initiate the proceedings, for the simple reason that the procedure is a standing and automatic one, involving periodic scrutiny of the behaviour of the States concerned. *Third,* whereas adjudication is triggered after a dispute has arisen, supervision is generally carried out with a view to deterring infringement of international legal standards. In other words, normally supervision is designed to have preventive purposes. *Fourth,* the hearings of judicial bodies are usually public. In contrast, the debates between the contending parties either before an overseeing body or, when the procedure is not continuous in character, the investigative activities of the supervising organ, are run in camera, so as to avoid attracting publicity to possible violations committed by the State under supervision while the investigation is still under way. *Finally,* as a rule, the outcome of the overseeing procedure does not consist in a binding decision. Rather, it takes various forms (such as, for instance, recommendations, reports either public or not, etc.), which, whatever their official label, mainly rely on "*besoin d'honorabilité international*", assumed to be taken into notable consideration by States. It is, in other words, a sensible diplomatic and moral pressure. The underlying idea is that internal and international pressure of public opinion on non-complying States should represent a valid spur to eventual compliance, once States' deviation from international standards is ascertained and made public.

127 Cassese (2008) identifies the reasons why international lawmakers resort to this ingenious system for impelling States to abide by international law. He suggests two closely interrelated reasons. *First,* in the aftermath of World War I, States began to rely on international treaties to regulate matters, which until then had remained within their domestic jurisdiction. The evolving international legislation regulating these issues presents one peculiar aspect: it did not impose reciprocal duties, that is to say obligations entailing each Contracting Party being interested in abiding by the rules for fear that other Contracting State might feel free to disregard them as well. On the contrary, the international rules emerging in the aftermath of World War I belonged to that peculiar category of norms which safeguard the interests of entities other than the subjects assuming the rights and obligations at issue (such as, for instance, individuals, groups, populations subject to a mandatory system,

mechanisms and procedures proved a reasonable and relatively effective means of impelling States to measure up to their international undertakings.128 As to the modalities through which supervisory is effected, the legal scholarship is unanimous in identifying four principal means, namely: (1) Examination of periodic reports submitted at set intervals by the State concerned. (2) Inspection, which is far more effective and penetrating than the assessment of States' reports, where the inquiring body must confine itself to the data provided by the State concerned. Investigation on the spot permits international bodies (or, as in the case of the Treaty on Antarctica and other outer space, the other State Parties to the Treaty) to ascertain whether the State concerned respects or disregards the Treaty. (3) Supervision carried out by means of a contentious procedure, where the Parties to a dispute, or the State under monitoring and the supervisory body, engage in contentious examination of the case. (4) Adoption of measures aimed at preventing the possible commission of international wrongdoings by a State.129

For effective and successful implementation of the programs and measures envisaged by the Blueprint for the AEC, it is necessary that adequate institutions or mechanisms, resources, capacity and political is accorded to the Community building process, consistently with the cases where international supervising mechanisms work efficiently: the very circumstance that several of the targets identified by the Blueprint will hardly be achieved by 2015 seems to testify that the implementation mechanism's architecture needs to be strengthened significantly. At present the implementation mechanism envisaged by the Blueprint is still at

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associations of workers and employers, and so forth). *Second*, in such new fields it was not at all easy to establish mechanisms and procedures for ensuring that the new international standards were faithfully observed. According to the Italian legal scholar, resort to adjudication was not feasible on a number of grounds, mainly the circumstance that States, even though they had accepted such original and bold obligations, were reluctant to submit to judicial bodies. What is more, the unique feature of the subject matter made adjudication scarcely appropriate. The non-reciprocal character of the obligations set forth by those rules meant that the infringement of one of them could be passed over silence, in case it was only the Contracting States that had the right to demand compliance. Therefore, it was only logical to confer the right to exact respect for the rules upon the very entities for whose advantage they had been agreed upon. However, a stumbling block remained. It was, indeed, impossible for States to accept the granting of truly *locus standi* before international courts to individuals and groups. As frequently happens in political and social processes a compromise was reached. It allowed individuals or groups of individuals to appeal international bodies that were devoid of any judicial function. Therefore, ingenious monitoring systems were conceived. To make them suitable for States, it was deemed necessary to water down their possible impact on State sovereignty. That is the reason why no binding force was attached to the final assessment of supervisory bodies. Moreover, alongside organs consisting of impartial individuals acting in their own capacity, bodies composed of representatives of States were set up as well. It is almost a pleonasm to stress that the latter bodies are more sensitive to States' interests and needs, and, thus, more inclined to attenuate possible harsh evaluations. At the same time, it was also decided that the sessions and meetings of the monitoring bodies should normally occur in camera, for the manifest rationale of shielding States from public exposure.

128 Not surprisingly, certain of those systems lived on after World War II. By way of example, the ILO mechanisms for monitoring the application of international labour conventions, and the systems for scrutinizing conventions on narcotic drugs exist and are operative. The areas in which supervision is at present most widespread are: (i) treaties and other international standards on human rights; (ii) the peaceful use of atomic energy; (iii) the environment; (iv) the Antarctic and outer space; (v) international economic law; (vi) international and internal armed conflict vi) international cooperation against transnational crimes. The expansion of supervision in such relevant areas bears testimony that it responds to State needs. Moreover, it shows that comprehensive groups of States are prone to supervision, for even those reluctant to accept other international means of investigation do not oppose international monitoring. Needless to add that this openness of States to such a mechanism is mainly due to its inherent flexibility and to the fact the international monitoring bodies do not put the States concerned "in the dock".

129 The most effective form of preventive supervision has been essentially established in the area of the peaceful use of atomic energy and protection of the environment. The peculiar character of the subject matter accounts for the exceptional characteristics of this international scrutiny.

an embryonic stage and is shaped as follows:

v) The High Level Task Force (HLTF) on ASEAN Economic Integration provides strategic inputs to the AEM on issues affecting the timely implementation of the Blueprint;

vi) AMSs' relevant sectoral Ministerial bodies are responsible for the implementation of the Blueprint and monitoring of commitments under their respective purview;

vii) The ASEAN Economic Ministers (AEM), as the Ministers-in-Charge of Economic Integration in the Council of ASEAN Economic Community, is accountable for the overall implementation of the Blueprint.

viii) The Secretary-General of ASEAN shall report the progress of AEC to relevant ministerial meetings and the Summit

The ASEAN Secretariat has established a monitoring mechanism called the AEC Scorecard, which reports the progress of implementing the various AEC measures, identifies implementation gaps and challenges in order to track the potential realisation of the AEC by 2015. However, also such instrument needs to be improved: if, on the one hands, it bridges a certain 'transparency gap' of the entire implementation system, on the other, it lacks the necessary powers to stimulate effectively the AMSs to put in place the required actions. Finally, ASEAN has undertaken various efforts to monitor its implementation. Building upon the AEC Scorecard, the inaugural ASEAN Integration Monitoring report (AIMR) assesses the progress in four AEC-related dimensions: merchandise trade, trade facilitation, services trade and investment. It focuses on policy and market integration outcomes achieved in AMS, as part of the first pillar of the AEC formation process.130 However, none of such initiatives is endowed with the required elements to guarantee effective follow-up actions by AMSs when they fail to fully comply with the actions envisaged by the Blueprint.

Overall, the AEC Scorecard has demonstrated its importance to follow up the effective implementation of the AEC Blueprint, but it remains too general to be useful to both the general public and technicians. In order for ASEAN to become a RICH region, it would be

130 The report is released by the ASEAN Integration Monitoring Office (AIMO) of the ASEAN Secretariat, together with the World Bank - East Asia Pacific Region. The AIMR is the first component of the ASEAN Community Monitoring and Evaluation Program (AECMEP). It is expected to be released annually to provide a regular update on the state of integration in ASEAN. The report is also the outcome of the efforts of the World Bank for assisting the ASEAN Secretariat in strengthening ASEAN's monitoring and analytical capacities as well as of the ASEAN-Australia Development Cooperation Program (AADCP) in supporting the implementation of the AECMEP. The focus of the report is on policy and market integration outcomes achieved in ASEAN Member States (AMS) as part of the Pillar One of the ASEAN Economic Community (AEC) formation process. The aim is to assess progress drawing on evidence from a large range of indicators on policies and outcomes. The AIMR further suggests priorities for future actions for the effective implementation of the AEC 2015 goals. The report provides some important findings and guidance on going forward. The report finds that the ASEAN economic integration agenda has already provided important benefits to the Member States by boosting regional trade flows without adversely affecting the global integration agenda. Integration efforts have also helped to improve trade logistics, lower aggregate trade costs and significantly increase regional investment flows. Progress in services integration, however, has been modest. It is also clear that the potential gains from further integration in all these spheres remain large. The report highlights important pending challenges to achieving the AEC 2015 goals that lie in implementing the services integration agenda as well as the dangers posed by the use of non-tariff measures. It identifies a number of policy and institutional measures that ASEAN can take to address these issues. For further details see ASEAN Secretariat and World Bank (2013). For another documents which considerably help to define the status of progress of the ASEAN economic integration see ERIA (2012).

important for ASEAN to share quality information with its people. The Scoreboard should be more detailed, more transparent and readily available for private sector use. It should also be able to clearly translate an agreement's benefits, such as those relating to reduced costs and prices in the region. Such issues need more awareness and require the active and systemic participation of all those concerned in the process, including the region's business community. Presently, the AEC Scorecard also lacks a degree of usefulness because it does not account for the reasons for its own delays. For example, ASEAN took more than two years to ratify the ASEAN Comprehensive Investment Agreement, which is viewed as one of the seeds for integration and is expected to enhance investment flows in the region. The ASEAN Secretariat Scorecard should also be less consensual. Finally, it should propose specific actions when it faces reluctance of the AMS to reach in due time the targets specified in the Blueprint.

To conclude the point, it is worth stressing that eminent policy-makers and scholars advocate the creation of new mechanisms of international scrutiny also in the EU, with the aim of fostering the necessary economic reforms to cope with the Eurozone crisis and stimulate economic growth.131

Regional Competition Law and Authority

According to McEwin (2013): "(a)ll countries in Southeast Asia are hierarchical and authoritarian to some degree, which has implications for competition. All countries are marked by considerable inequalities in status, wealth, and education. With the exception of Singapore, corruption and cronyism are widespread. Big business in Southeast Asia is mainly dominated by ethnic Chinese families, originally brought in during the 18 and 19th centuries as cheap labor or with skills as traders, tax farmers, miners, and artisans-skills lacking among the indigenous population (who were mainly farmers). To protect against property expropriation, taxes, and limited ability to enforce contracts, they developed their own financial networks and relationships based on family and clan groups-perhaps best described as closed shops that sought to limit competition. At the same time, self-serving political elites awarded monopoly privileges. Nevertheless, economic necessities now drive public policy in this region. While patronage is still important, competition is now increasingly seen as necessary for economic development-but competition upsets traditional monopoly privileges that form the basis of much elite wealth and is resisted politically by governments of all ideological persuasions".[132] Using competition law to improve economic outcomes, if properly enforced, disrupts pre-existing monopoly privileges. Yet, "a clear emphasis on a single goal-promoting economic efficiency-provides greater predictability and certainty and limits the ability of regulators and courts to promote entrenched vested interest group welfare. Competition law goals in Southeast Asia, however, are not all singular. They vary from the single unambiguously economic in Singapore to the broad goals expressed by the very important founding principle of *pancasila* in Indonesia which stresses responsibility to a

131 See, for instance, the recent proposal of the Italian Minister for Economy and Finance and Former OECD Deputy Secretary General and Chief Economist, to anchor the so-called 'Fiscal Compact' to a 'Growth Compact' and assign the Eurogroup or the Economic and Financial Affairs Council (Ecofin) the monitoring of their compliance. Cfr. http://www.ilfattoquotidiano.it/2014/09/07/padoan-sposa-la-linea-draghi-piu-potere-alla-unione-europea-su-riforme/1113030/

132 Cfr. McEwin (2013).

monotheistic God (your choice), respect for humanitarian values of dignity and integrity, national unity and social justice."[133]

As argued above, no single market can be maintained without the implementation of a regional competition law and the creation of a central competition authority in charge of enforcing such law together with the member States' National Competition Authorities (NCAs) acting as peripheral enforces. No such law and authority exist in the ASEAN context. Competition laws vary considerably. While there is some agreement that the European competition law model is the way to go, there is no formal commitment. All countries have agreed to co-operate in competition law enforcement (through the ASEAN Experts Group on Competition at the moment) – but the main cooperation is, again, through informal consultations, technical assistance etc. There are no plans to adopt a EU type supra-national competition law regulator – and it is highly unlikely that this will occur in the foreseeable future.134 Without entering into the considerable debate regarding the economic functions of competition law, we stress that no free internal market can survive, if the partitioning by States can be replaced by the private undertakings. The use of competition policy for the creation and safeguard of the EU internal market is most telling: elimination of barriers to intra-EU movement of goods would have been ineffective, had not EU competition law dealt with private barriers created by undertakings. Originally the purpose of introducing into the EEC Treaty was indeed to complement the internal market rules by preventing businesses from partitioning the internal market and by encouraging competition across borders. The ASEAN should look at such experience and consider how to implement it.

Strengthening the Institutional Architecture

ASEAN still maintains a very loose institutional structure. Although there has been a strengthening of its institutions in recent years, "[t]he "ASEAN Way" of dialogue is still very much entrenched: i.e., *musyawarah* (discussion and consultation), and *mufakat* (consensus).... Hence, the development of an ASEAN Charter could lay the foundation for a more rule-based institutional structure for ASEAN.135 The Charter has strengthened and consolidated ASEAN's institutions, and streamlined ASEAN's cumbersome and uncoordinated organisational structure as well as its decision-making process.136 Starting from the latter, as

133 *Ibidem.*
134 According to McEwin (2014): "The Singaporean competition law, modelled on the EU with changes that reflect Singapore's economic circumstances is widely regarded as a good introduction of competition law (...). Some of the other laws in the region are too complicated for business and judges to understand, while others make presumptions about market power that make little economic sense. However, these deficiencies are recognized (at least privately) and there may be a convergence towards a EU type model in the longer term." As regards the developments of the AMSs' progress in the design and implementation of national competition laws, McEwin observes that: "Several countries are close to finalizing their competition laws in line with their 2015 commitments. I have seen drafts of the competition law of Brunei Darussalam, Lao PDR and Myanmar – all reflect local conditions to some degree, eg., Brunei, being a common law country models theirs on Malaysia and Singapore, the Lao law while initially based on the Thai is now incorporating elements of the Vietnamese. The Philippines plans to adopt an enforcement model that would see responsibility given to the very many existing sectoral regulators. Indonesia is in the process of amending its Law No. 5 of 1999 to overcome some institutional problems that have arisen. Singapore is doing the same. Malaysia with a small staff is taking on many cases. Thailand is also considering making changes (there have been no successful cases since competition law was introduced in 1999 – mainly due to the fact, like Canada in its law of 1889, all penalties are criminal. In all, there is quite a lot happening in a region of 600 million."
135 Hew (2005) 33 at 37.
136 Changes to the ASEAN Institutional Framework, in addition to conferring legal status on ASEAN, include the following. In keeping with the separate legal status of ASEAN, Dialogue Partners and "relevant inter- governmental organizations" may

widely accepted, decision-making is central to any organisation. Realizing the AEC's aspirations also requires reassessing some of ASEAN's basic principles, as the association today, different from 45 years ago, needs to promote regional cooperation in a globalized world — where economic efficiency affects growth and development. In particular, ASEAN needs an "efficiency reform" by introducing more formal rules and adopting a more flexible decision-making system — to govern more intensive integration and extensive external relationships: despite its undeniable benefits in terms of enhanced stability and cohesion of the region consensus building is to costly and can severely impair the implementation of agreed policies by AMSs. Therefore, while consensus decision-making should remain as ASEAN's governing principle enshrined in its Charter, flexibility should be introduced to allow decisions on operational matters (which do not affect fundamental issues). This will avoid inefficiencies from unnecessary bureaucratic processes delaying simple decisions on day-to-day matters. Although the EPG stressed that ASEAN's consensus style of decision making has served ASEAN well, and should be preserved as the guiding principle, they noted that consensus should aid but not impede ASEAN's cohesion and effectiveness, and that ASEAN should consider alternative and flexible decision-making mechanisms.137 Notwithstanding the above, the Charter provides that decision-making will continue to be based principally on consultation and consensus, stating that: 1. As a basic principle, decision-making in ASEAN shall be based on consultation and consensus. 2. Where consensus cannot be achieved, the ASEAN Summit may decide how a specific decision can be made. 3. Nothing in paragraphs 1 and 2 of this Article shall affect the modes of decision- making as contained in the relevant ASEAN legal instruments. 4. In the case of a serious breach of the Charter or non-compliance, the matter shall be referred to the ASEAN Summit for decision.138 Such principle is declined with regard to economic commitments: Article 21 confirms the ASEAN minus X formula as a permanent feature of the ASEAN legal framework. Under the ASEAN minus X formula, a Member State may opt out from certain economic schemes in which it is not yet ready to participate, although it has taken part in determining and approving such economic schemes in the first place. This is an indication of a "softer" approach to legalisation in the ASEAN framework.[139]

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appoint and accredit Ambassadors to ASEAN. (The United States of America was the first Dialogue Partner of ASEAN to appoint an Ambassador to ASEAN). Article 46 of the Charter provides, "[n]on-ASEAN Member States and relevant inter-governmental organisations may appoint and accredit Ambassadors to ASEAN. The ASEAN Foreign Ministers Meeting shall decide on such accreditation." Also, Art. 41 para. 7 of the Charter confers on ASEAN, as an entity, the ability to conduct external relations on behalf of ASEAN. This will have an impact, e.g., on negotiation of "ASEAN" Free Trade Agreements with trading partners outside ASEAN. In this regard, the Secretary-General of ASEAN is empowered to present the views of ASEAN and participate in meetings with external parties. Cfr.,ASEAN Charter, art. 11, para. 2(d). Such legal status will also enable the ASEAN entity to enforce treaties entered into on behalf of its members. Article 41.

137 In this regard, the EPG recommended that "Decision-making by consultation and consensus should be retained for all sensitive important decisions. However, if consensus cannot be achieved, decisions may be taken through voting, subject to rules of procedure determined by the ASEAN Council." Cfr. EPG report , supra note 17 at para. 8. Thus, "while decision-making by consultation and consensus should be kept for all important decisions, majority voting can be used in less sensitive and non-controversial areas." (Ibid. at para. 29. And see further para. 63). The EPG further recommended that the flexible application of "ASEAN minus X" or "2 plus X" formula should be considered, subject to the discretion of the relevant ASEAN Community Councils.

138 Cfr. ASEAN Charter, art. 20.

139 Soft law allows for the possibility of differentiation among parties to an agreement. Parties may agree to a course of action in order to move forward in respect of a certain matter. Closer cooperation among only a number of participants in the framework may be possible, with others joining as they are able/willing. Article 21(2) of the Charter provides, "[i]n the

Considering the absence of an effective and more institutionalized implementation system for the creation of the AEC leads to a far more general point: reinforcing ASEAN's institutional base is increasingly urgent —given the need to properly manage increased economic interdependence with other ASEAN members, with other Asian countries, and with the rest of the world. Improving the effectiveness and efficiency of the regional bureaucracy and ASEAN institutional governance are also important for ensuring proper functioning of a borderless economic community. ASEAN should use its perceived "centrality" in ASIA to assume a more active role when participating in international events (G20 and similar forums). Members should entrust the ASEAN Chair and Secretary General with paragraph 4, states that, "in the conduct of external relations of ASEAN, Member States shall, on the basis of unity and solidarity, coordinate and endeavour to develop a common position and pursue joint actions". This seems to affirm the centrality of ASEAN's putting forward a unified position on external relations, despite the less-than-unified positions espoused by individual Member Countries in multilateral fora/authority to articulate internally agreed regional agendas in international meetings, especially when only a few ASEAN members — if any — are invited as participants.

Moreover, with the Secretariat playing a coordinating role, ASEAN should reform its institutional architecture by forming new functional institutions decentralized across the region, based on individual country interest and capacity to host them. More active participation in defining the regional agenda would also provide a better sense of community, promoting the sodality of nations, and boost ASEAN's identity at the grassroots level. ASEAN already has centres and regional bodies in energy and food security, biodiversity, communicable diseases, and financial surveillance. In light of the urgency to deal together with the 'environmental issue' and to promote the tertiary sector in most of the AMSs, areas for future development include natural disaster management, human and drug trafficking, services (tourism), education (tertiary and vocational education), and issues related to the environment and climate change, among others. The creation of an ASEAN Competition Authority in charge of enforcing competition law together with the ASMs' NCAs acting as peripheral enforces is also crucial for the building up and maintenance of a single market and a highly competitive economic region.

ASEAN member countries should also establish a stronger Secretariat in order to enable such body to better perform its mandated responsibilities—by enhancing its legal capability to attain trust, confidence, and respect in enforcing ASEAN agreements and commitments. Members need to invest more human and financial resources in the Secretariat.

To recap, a stronger Secretariat, decision-making "efficiency reforms," and funding contributions are important steps to create a robust and effective regional bureaucracy. The Secretariat can be more effective in coordinating its activities and functions with countries' national agencies and with external development partners.

The recently established CPR should play an increasingly important role in providing a more

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implementation of economic commitments, a formula for flexible participation, including the ASEAN Minus X formula, may be applied where there is a consensus to do so."

effective interface between the Secretariat and the AMSs, and in forging a new ASEAN approach to regional bureaucracy. An effective and dynamic CPR can greatly improve ASEAN in providing regional public goods by identifying efficient mechanisms for regional cooperation and strengthening the institutional base. As the CPR becomes fully integrated in a well-functioning ASEAN, member countries will easily realize that the costs of non-cooperation are in fact very high.

Regional Cohesion and Internal Market.

Various studies have shown that lowering tariffs is not sufficient to obtain the potential benefits of trade liberalisation that should lead to a greater investment unless a broader enabling environment has been established. Such environment should be featured by minor economic disparities between the members of the internal market. The EU’s regional policy aims to further social cohesion in the process of European integration by reducing the economic disparities among and within EU member states. Inside the EU, regional policy programs have been an increasing part of the budget expenditures over time and continue to have lately grown in importance with the addition of the central and east European countries. “Since the early days of the EU, regional policy has grown in importance, so that today it holds second place as a share of EU total expenditures, after the Common Agriculture Policy” (Lean, 2007: pp. 171 ff.). The so-called Phare Programme represents a rather illustrative of regional cohesion policy.[140] The Phare programme has been established in 1989 by the Council Regulation 3906/89 (EEC), as the EU's pre-accession instrument intended to assist candidate countries of Central and Eastern Europe in their preparations for joining the Union. Today, Phare programme applies to the acceding and candidate countries, and principally involves Institution Building (mainly through twinning projects and service) measures and promotes Economic and Social Cohesion (mainly through supply component). Phare provides funds for institution building support through twinning and technical assistance and for investment support to help applicant countries in their efforts: to strengthen their public administrations and institutions to function effectively inside the EU; to promote convergence with the European Community's extensive legislation and reduce the need for transition periods; to promote economic and social cohesion. According to each country's level of preparation, Phare programmes are implemented under centralised or decentralized management structure. Under the Decentralized Implementation System (DIS), the national implementing authorities are still subject to *ex-ante* control by the local EC Delegation. In a further step, under the Extended Decentralized Implementation System (EDIS), the national implementing authorities are no longer subject to ex-ante control by the local EC Delegation. The financial support provided to the accession process from the Phare Programme was aimed at institution building, for which the EU set a limit of 30% of the allocated funds, and at economic and social cohesion – covering mainly investments – for which it was possible to

140 The Programme of Community aid to the countries of Central and Eastern Europe (Phare) is the main financial instrument of the pre-accession strategy for the Central and Eastern European countries (CEECs) which have applied for membership of the European Union. Since 1994, Phare's tasks have been adapted to the priorities and needs of each CEEC. The revamped Phare programme, with a budget of over EUR 10 billion for the period 2000-2006 (about 1.5 billion per year), has two main priorities, namely institutional and capacity-building and investment financing. Although the Phare programme was originally reserved for the countries of Central and Eastern Europe, it is set to be extended to the applicant countries of the western Balkans. For further information see, the dedicated page in the EU official website, available at:
http://europa.eu/legislation_summaries/enlargement/2004_and_2007_enlargement/e50004_en.htm

draw up to 70% of the funds provided that projects were co-financed at a minimum level of 25%. The financial allocations were conditioned on the fulfilment of the Copenhagen criteria for the accession of associate countries to the EU. A country receiving EU funds through the Phare Programme was also required to ensure a functioning infrastructure.

Overall, the Phare programme, as a pre-accession instrument, has represented the main channel for the European Community's financial and technical cooperation with the countries of Central and Eastern Europe (CEECs) and has been essential for two EU’s priorities: helping the administrations of the candidate countries to acquire the capacity to implement the *Community acquis*. Phare also helps the national and regional administrations, as well as regulatory and supervisory bodies, in the candidate countries to familiarise themselves with Community objectives and procedures; helping the candidate countries to bring their industries and basic infrastructure up to Community standards by mobilising the investment required, particularly in areas where Community rules are increasingly demanding: environment, transport, industry, product quality, working conditions etc.

In light of the disparities between the CMLV and the more advanced AMSs, ASEAN should undertake initiatives similar to the EU’s Phare programme. However, despite that some initiatives have be launched, - such as the establishment of ASEAN Convergence Fund through the enlargement of the ASEAN Development Fund or the creation of ASEAN Competitiveness Institute[141] – ASEAN Members lack a shared view to diminish economic disparities among and within them and to promote own R&D strategy and innovation policy yet coordinated at the regional level.

141 The ASEAN Development Fund shall serve as ASEAN's common pool of financial resources to leverage funding of regional cooperation programmes and projects from Dialogue Partners and other external donors.; to provide seed funding for initial activities of large-scale projects, requiring major financial support from a Dialogue Partner or donor institution; and to provide full funding support to small and short-term projects of a confidential or strategic nature. Cfr. ASEAN, Terms of Reference of the *ASEAN Development Fund*, available at: http://www.asean.org/archive/ADF-TOR.pdf

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