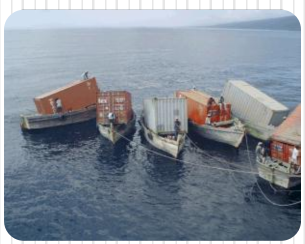
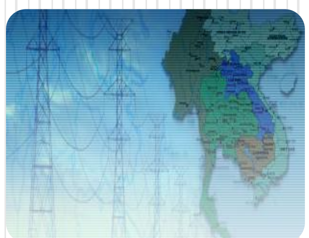
ASEAN – an economic perspective on integration

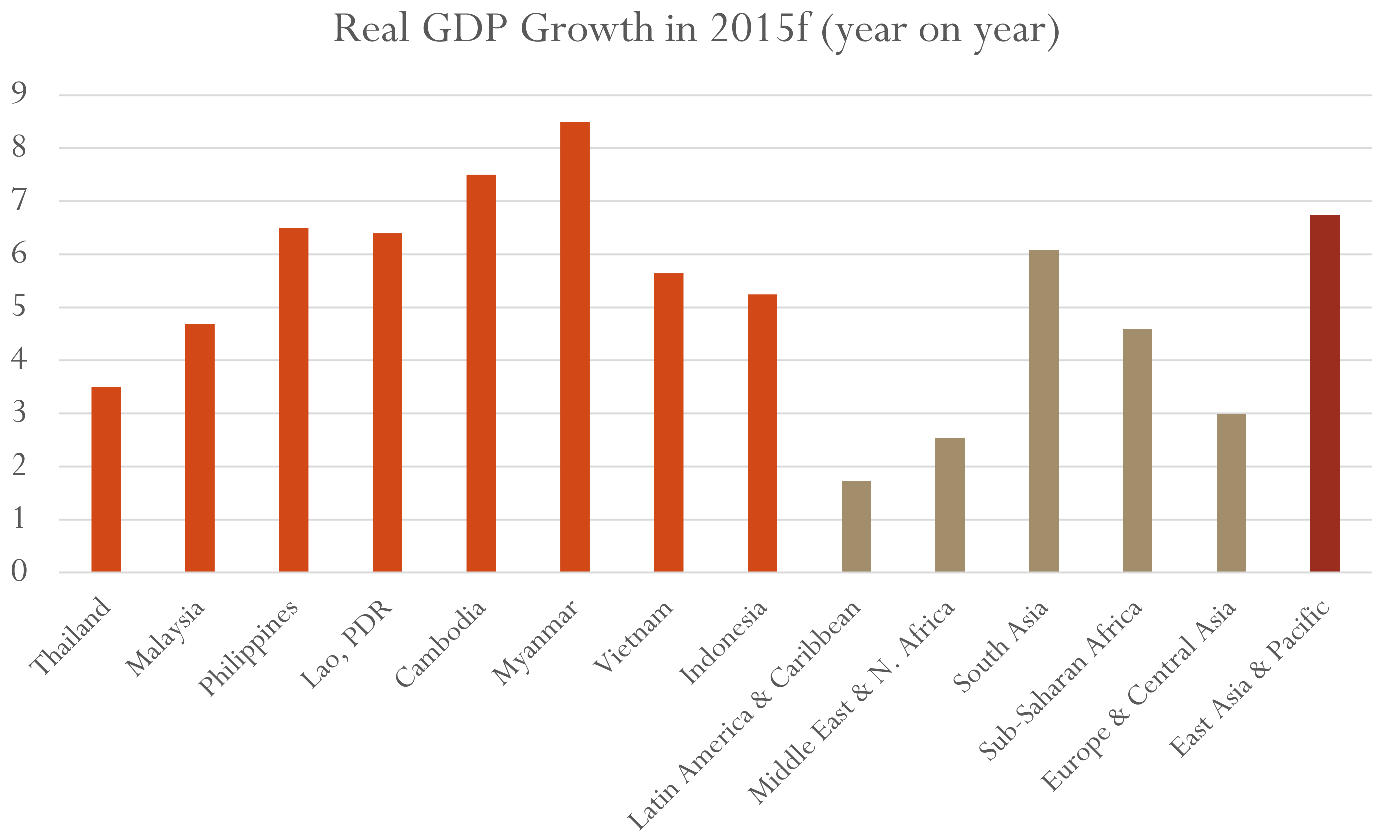

June 2015

Robert Boothe – World Bank

Outline

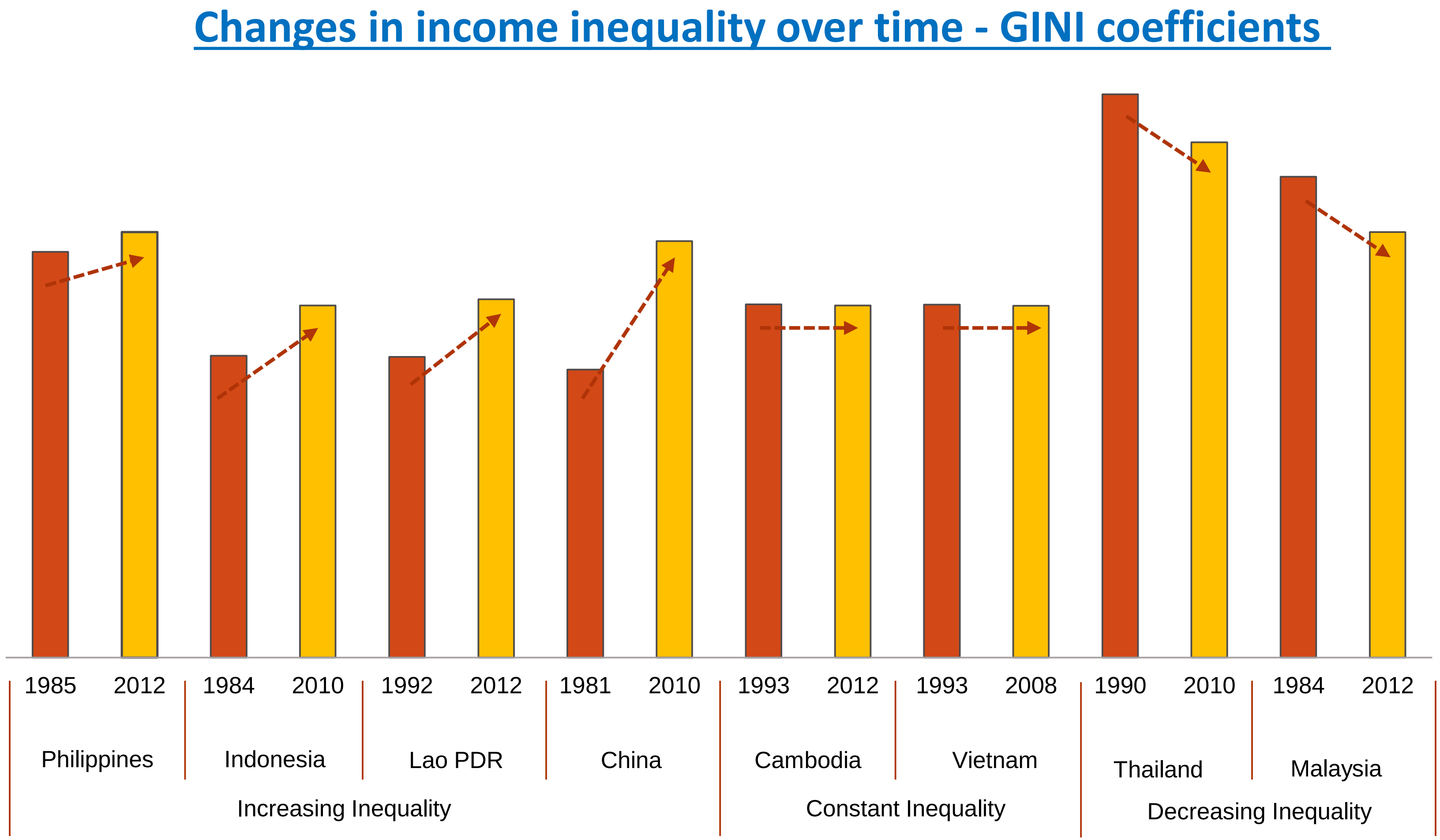
- ASEAN in profile
- What do we mean by regional integration – and why do we care?
- What has the progress been on regional integration – AEC 2015?
- How can ASEAN help solve regional issues to promote growth and development – case study: tax and investment
- Group exercise and discussion

EAP and ASEAN projected to lead world economic growth in 2015



Source: World Bank's Global Economic Prospects, June 2015
Note: EAP= East Asia & Pacific; CLMV= Cambodia, Lao PDR, Myanmar, and Vietnam; SSA= SubSaharan Africa; SAS = South Asia; MENA = Middle East & North Africa; ECA = Eastern Europe & Central Asia; LAC = Latin America & Caribbean
f = forecast

The emerging challenge: Reduce inequality while maintaining/accelerating) growth



Source: World Bank, World Development Indicators

How to maintain growth & reduce inequality and poverty?

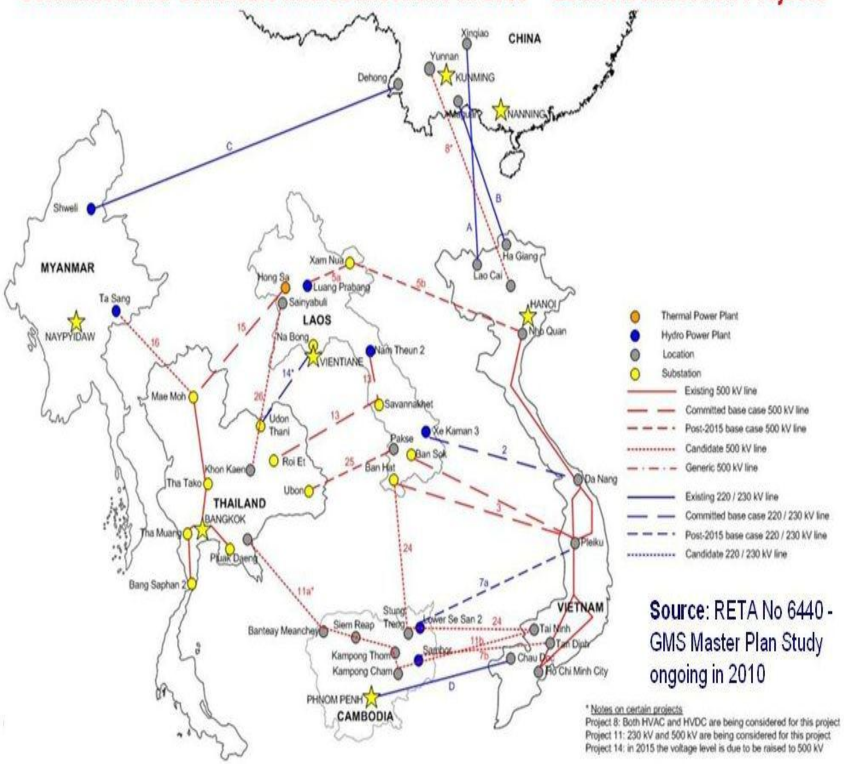
Through Integration, for example

- Promote trade
- Improve infrastructure connectivity

- **Through Inclusion,** for example
  - Quality education – for all
  - Access to finance

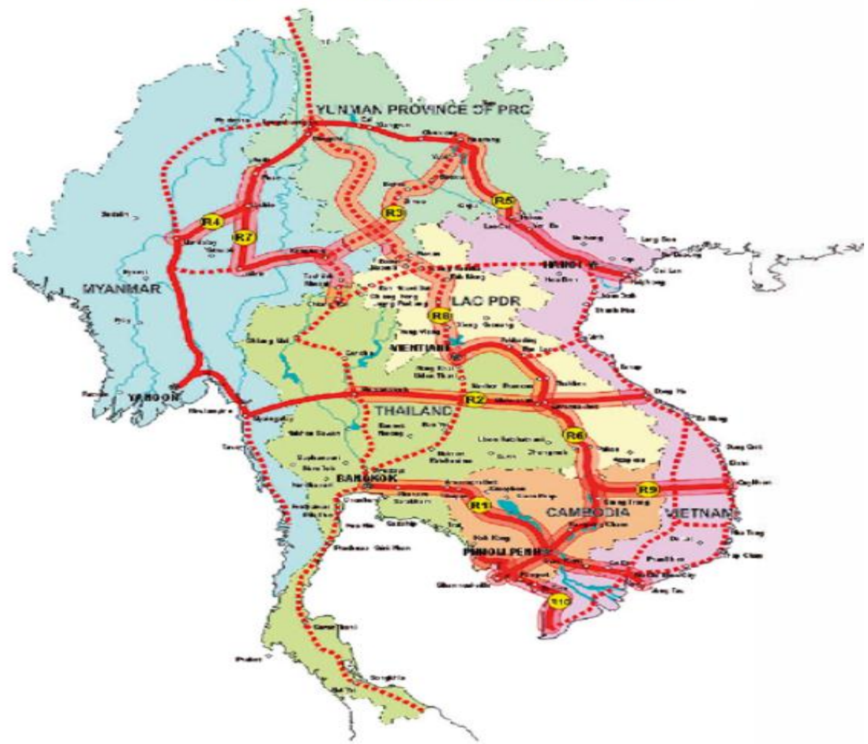
- **Through Jobs,** for example
  - Agriculture productivity
  - Micro, Small & Medium enterprises

Energy and Infrastructure: More roads and power trade?



Source: RETA No 6440 - GMS Master Plan Study ongoing in 2010

ASEAN Highway Network Plan



Source : ASEAN Transport Cooperation Framework Plan

How can ambitious highway and energy trade plans become a reality?

How to increase financing for large energy & infrastructure investments?

Many avenues for financing…..

- Government budgets? , Private sector? Public Private Partnerships?
- International financial institutions such as the Asian Development Bank, World Bank Group, and Asian Infrastructure Investment Bank?

….World Bank Group supports all financing vehicles

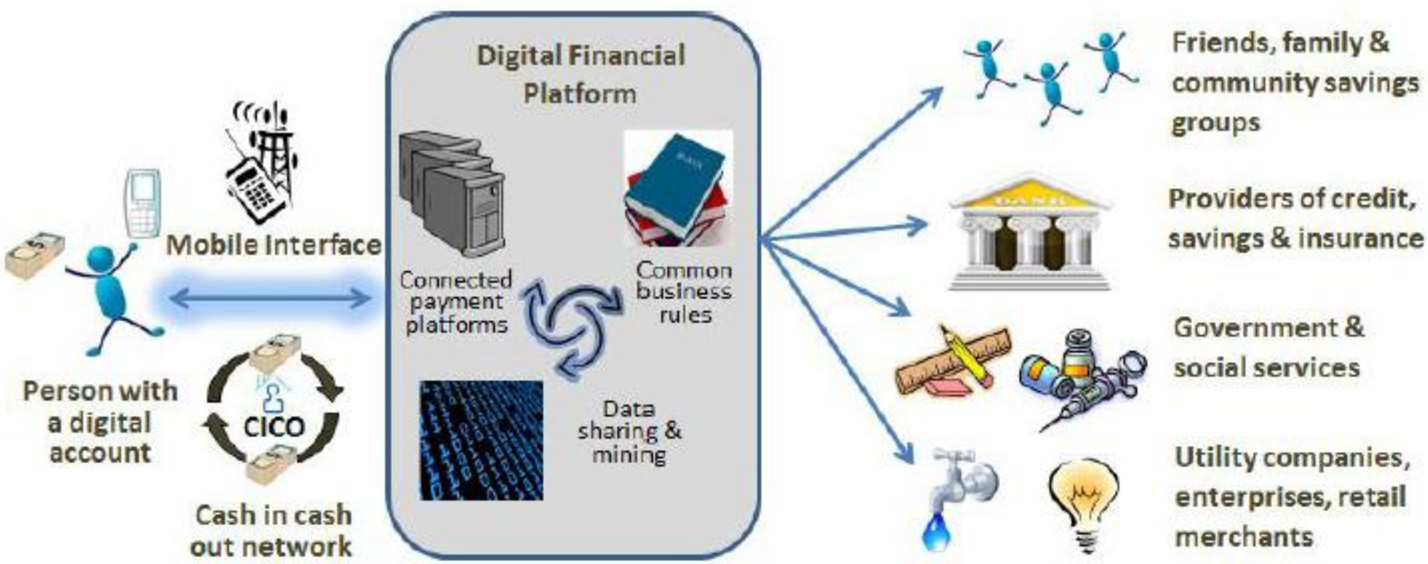
However, important to consider…..

- economic (and financial) cost-benefit screening, so no publicly financed "white elephants".
- competitive sourcing/procurement, so cheapest project sourcing.
- environmental (including climate change) and social sustainability? "responsible" infrastructure and energy investment;
- for trans-boundary projects: bilateral-multilateral political economy and "win-win" contracts for sustainability?

How can we have inclusive development?

- Through providing **quality education** for all

- Promoting **financial inclusion** within and across countries.



How can we generate well paid jobs?

- Through increasing **agriculture productivity**

- **Promoting micro, small & medium enterprises** for broad based job creation

ASEAN Economic Community (AEC) Framework

Target : Greater trade between member countries, mobility between population, and competitiveness

1. Integrated Market and Production Base

- Free flow of goods
- Free flow of investment in services
- Free flow of investment
- Free flow of capital
- Free mobility of <u>skilled</u> labor

2. Increase Competitiveness

- e-ASEAN
- Tax policy
- Competitiveness
- Intellectual Property
- Consumer protection
- Infrastructure invesment

2015

3. Inclusive Development

- Reduce gap between new and old members
- Support SME development

4. Integration with global economy

- Adjust economic policies
- Build production and sale network
- FTAs with countries outside region

AEC has high potential … how to make progress on implementation?

AEC Framework for an Integrated Market and Production Base

Promote & protect investments between ASEAN under National Treatment – Accomplished under investment incentive schemes

tariffs reduced to 0% by 2010 (except CLMV in 2015) - Almost done

Allowing foreign shareholding of up to 70% - Planned, but still work in progress

Promote capital market linkages and development of bond markets and capital accounts liberalization standards – MICs opening, LICs considering options

Mutual Recognition Agreements (MRA) in 7 professional services – details still to be agreed

1. Free flow of goods

Tariffs of ASEAN-6 has been 0% under AFTA since 2010

AFTA	1993	2004	2005	2006	2007	2008	2009	2010	2012	2013	2015
Trade in Goods								ASEAN-6 Tariff 0%			ASEAN-10 Tariff 0%

Normal Track

CLMV

Exceptions

Sensitive List

- Tariffs must be <5%
- Thailand has 4 product lines – cut flowers, dried coconut, potato, coffee beans

Highly Sensitive List

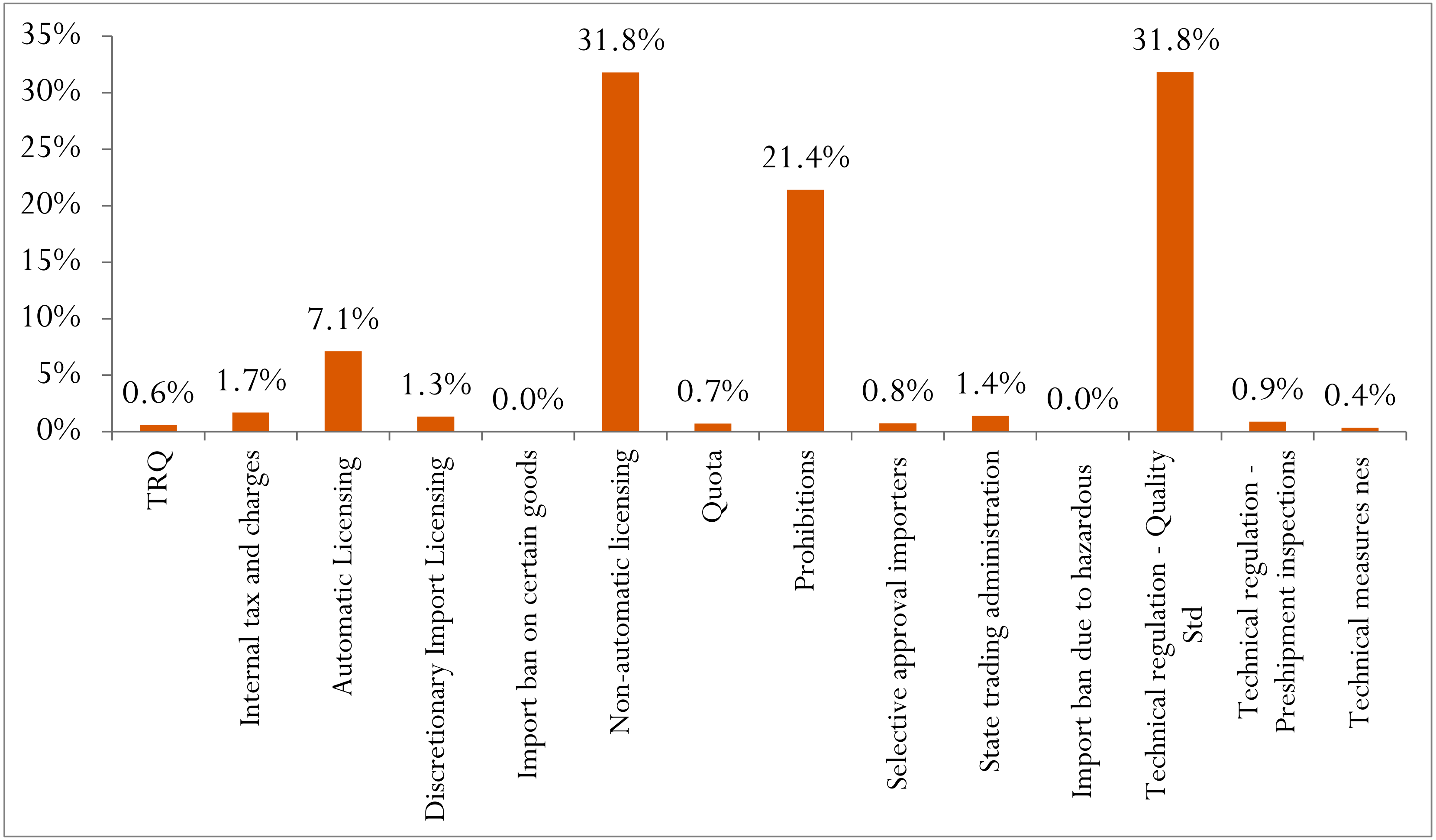
- No tariff reduction required
- Malaysia and Philippines – Rice
- Indonesia – Rice and sugar

ASEAN Trade Facilitation Framework

To reduce Non-tariff barriers such as customs, trade procedures, phytosanitary standards, etc.

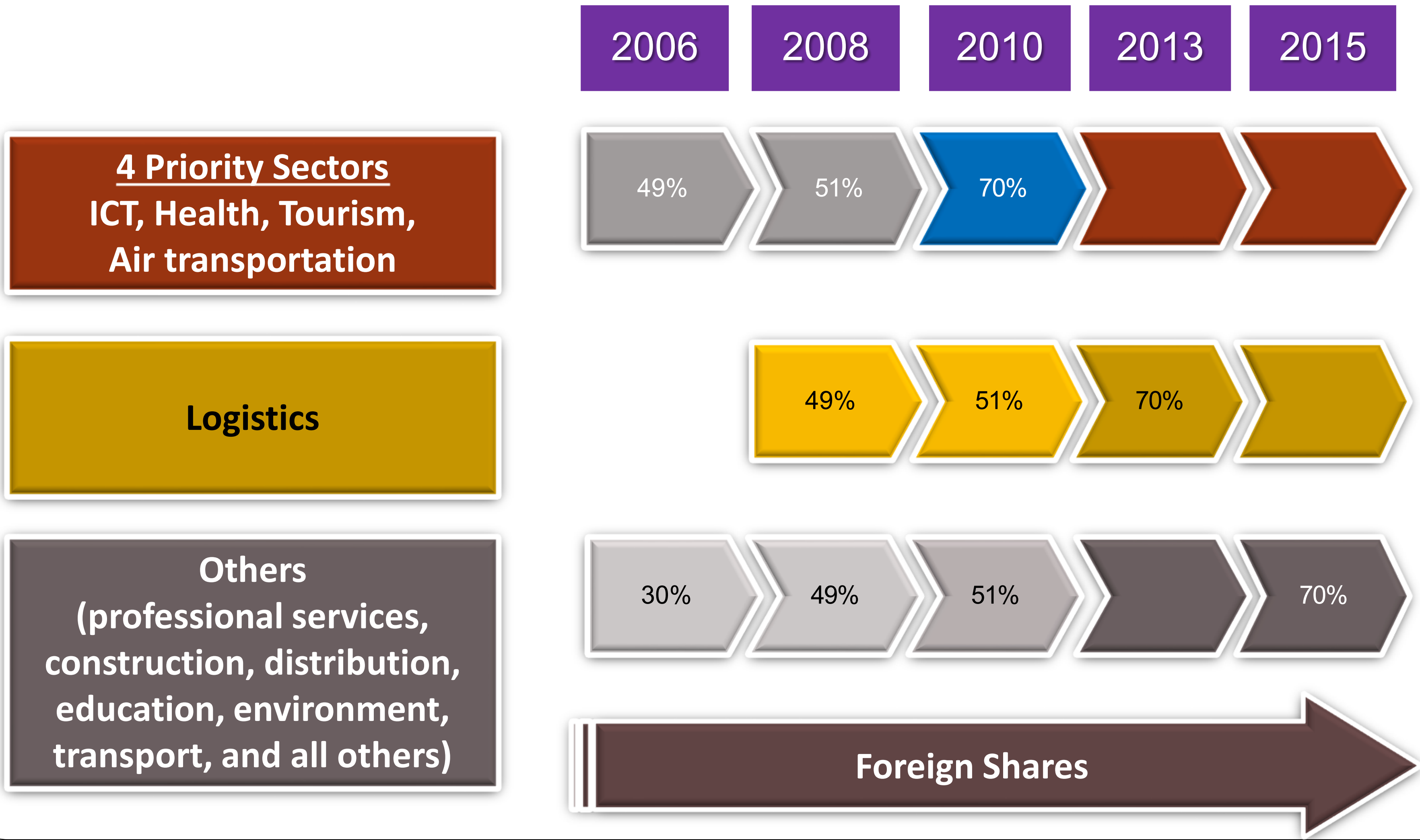
Non-Tariff barriers have prevailed

Percentage of all non-tariff barriers in ASEAN



2. Free flows of investment in services:

Increase foreign shares in service businesses up to 70%



Implementation of AEC milestones are delayed

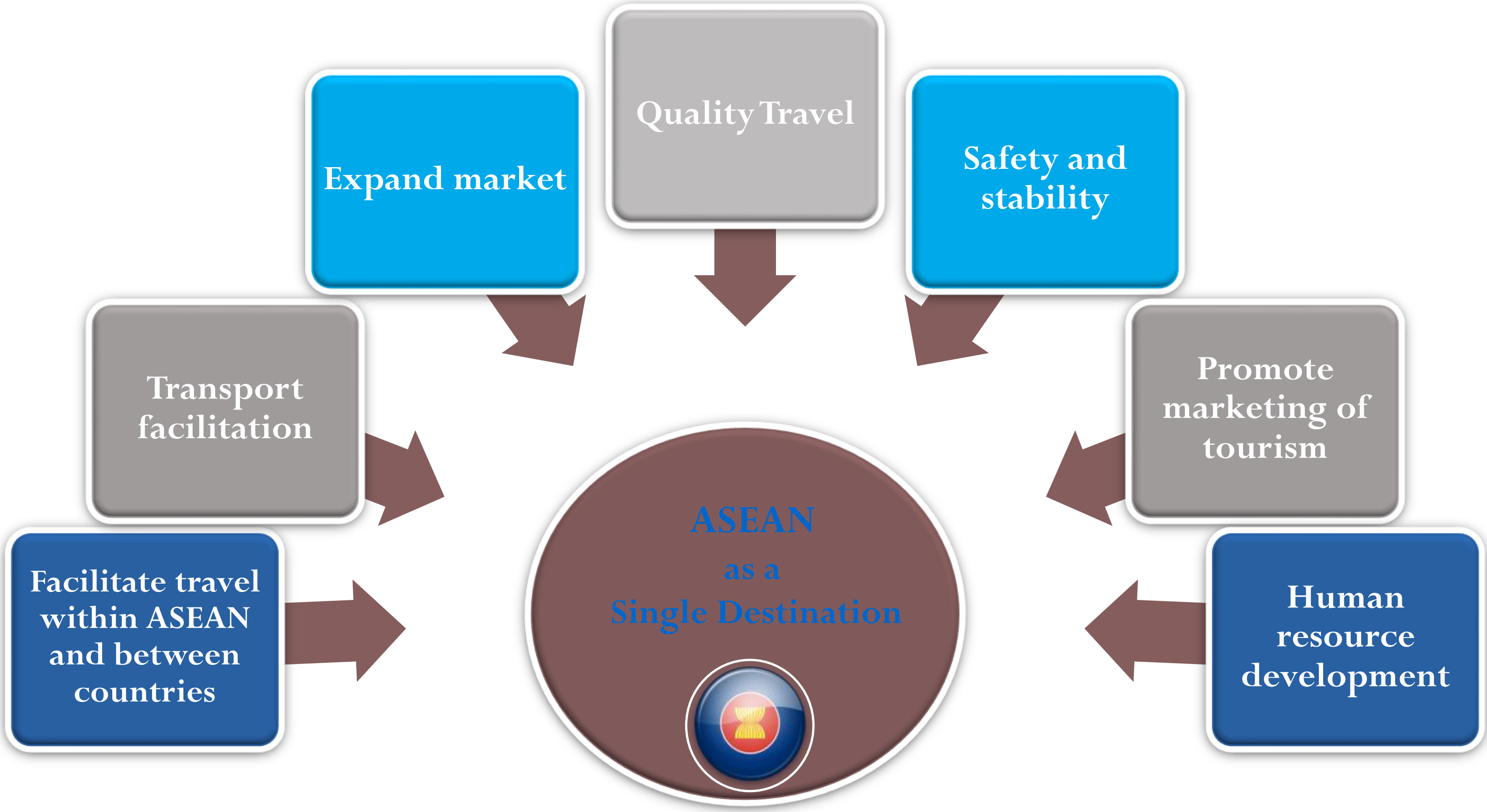
AEC Blueprint established service liberalization goals that need to be implemented through 4 Rounds of negotiations in **ASEAN Framework Agreement on Services (AFAS)** producing 7th – 10th packages

Delayed

Package of Services Commitments	Signed	Modality
1st Package (Round 1)	Dec 1997	Request and offer approach
2nd Package (Round 1)	Dec 1998	Request and offer approach
3rd Package (Round 2)	Dec 2001	Common sub-sectors (if minimum 4 countries => multi-lateralize)
4th Package (Round 3)	Sep 2004	Modified common sub-sectors/ (If minimum 3 countries => multilateralize but ASEAN minus X)*
5th Package (Round 4)	Dec 2006	”
6th Package (Round 4)	Nov 2007	”
7th Package (Round 5)	Feb 2009	Negotiation according to AEC Blueprint
8th Package (Round 5)	Postponed from Aug 2011	”
9th Package	Due to be completed in 2013	”
10th Package	Due to be completed in 2015	Accomplish AEC ultimate goals

2. Free flows of investment in services

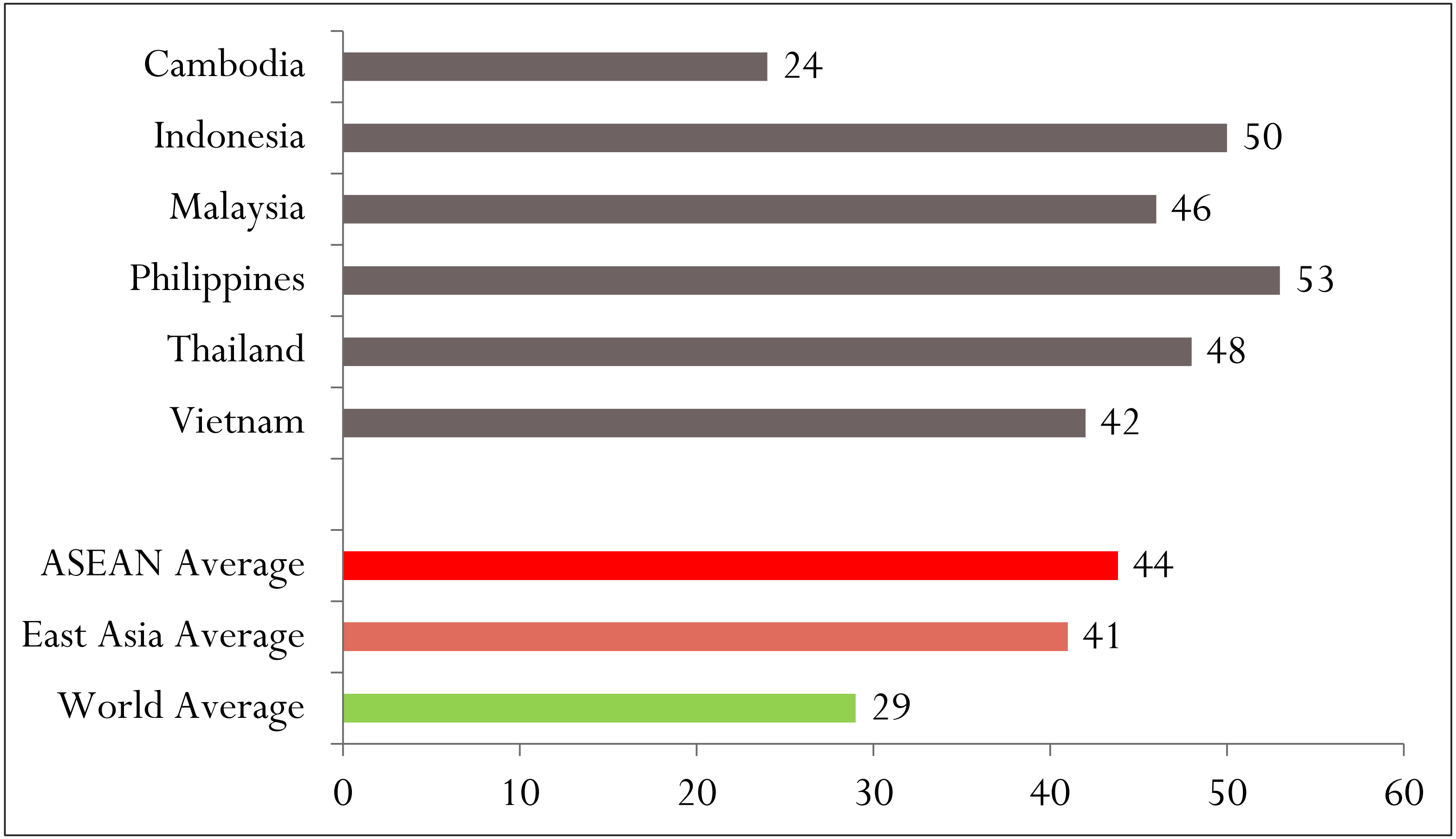
ASEAN Tourism Master Plan 2011-2015 aims to re-structure the tourism markets, promote and develop quality of tourism to create ASEAN Tourism Connectivity Corridors, and support tourism travel of youths



2. Free flows of investment in services

ASEAN remains relatively restrictive in its services trade policies

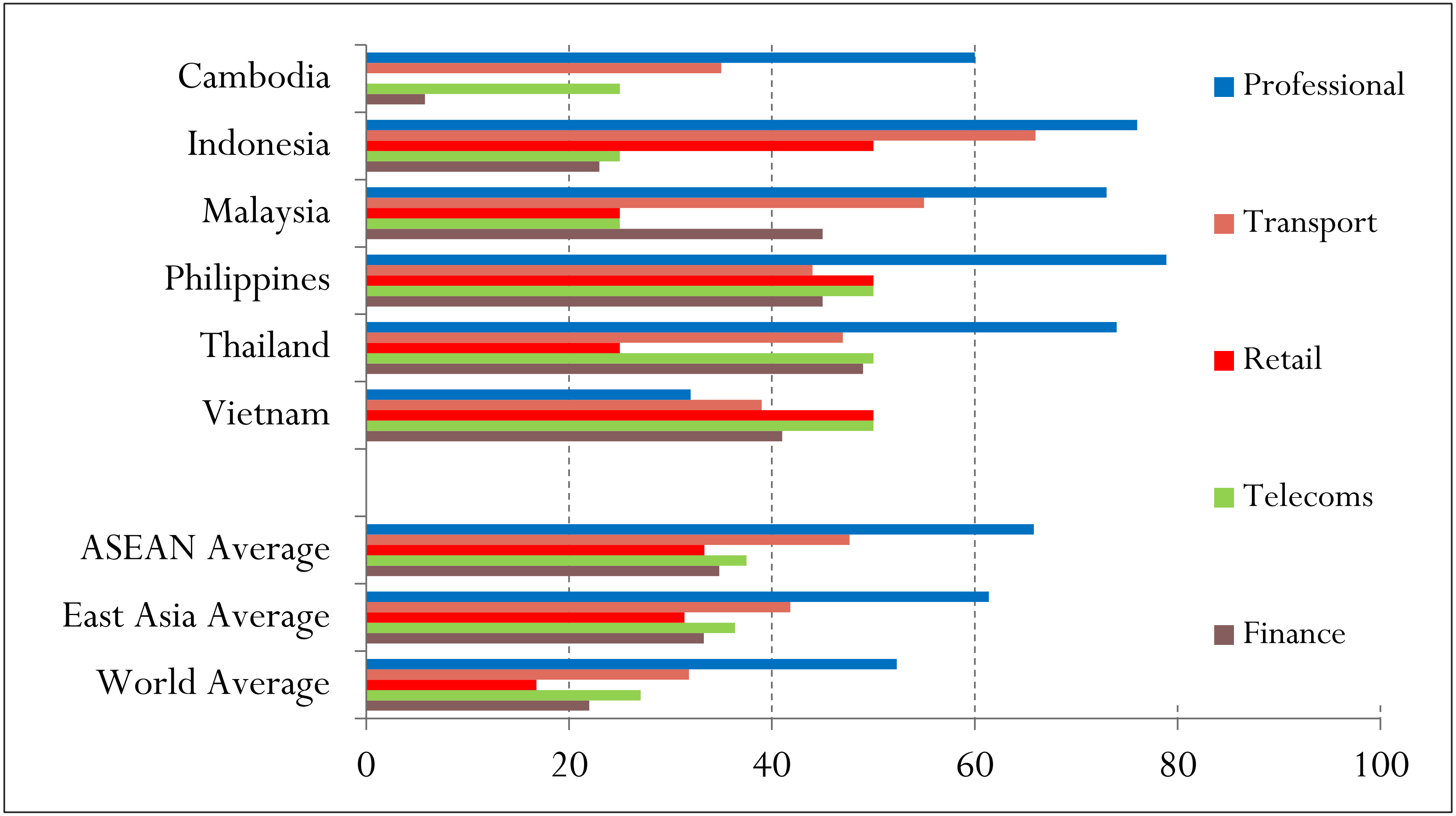
Services Trade Restrictiveness Index (STRI), 2008



Source: ASEAN Integration Monitoring Report (AIMR), 2013

2. Free flows of investment in services

Services Trade Restrictiveness Index (STRI), 2008



Source: ASEAN Integration Monitoring Report (AIMR), 2013

3. Free mobility of skilled labor:
Mutual Recognition Agreements (MRA) of professional services

AEC only applies to 7 professions

2009 | 2010 | 2015

Skilled Labors & Short Term Visits

- Draft MRAs
- Sign MRAs for 7 professions : Engineering, Nursing, Architecture, Surveying, Medical Practitioners, Dental Practitioners, and Accountancy Services
- Exempt visas for Short Term Visits issue ASEAN Business Card
- Facilitation of movement of skilled labor
- Develop curriculum and standards for skilled labor

AEC

3. Free mobility of skilled labor:

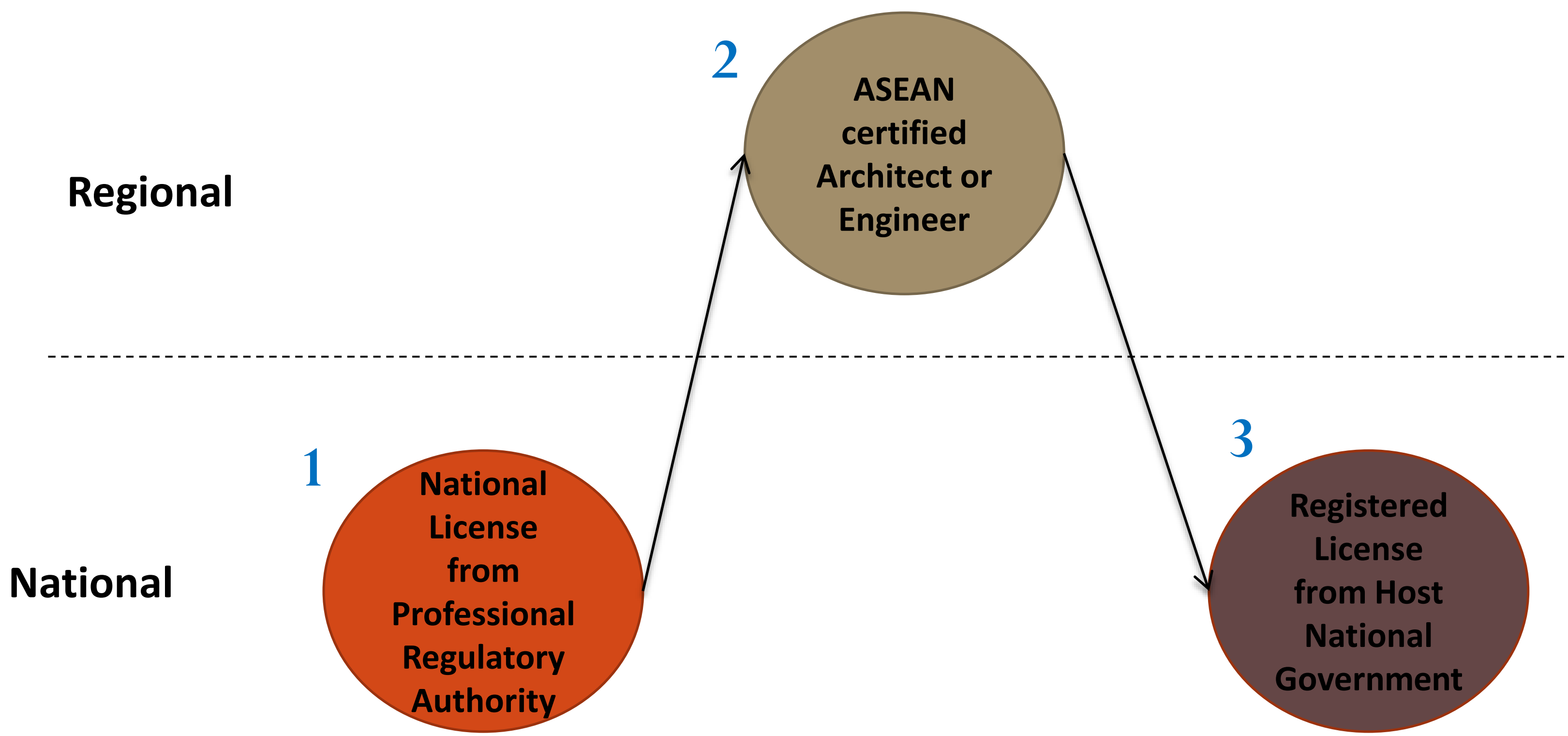
Engineering & Architecture have made most progress on implementation of MRAs

MRA on sector	Detail
Engineering and architecture	Provide recognition for registered ASEAN architects and engineers by providing harmonized standards and qualifications. Member states that would like to participate must notify ASEAN Secretary General (opt in)
Nursing services	Promote exchange of expertise, experience and best practices.
Surveying qualifications	Lay down broad principles and framework for negotiating bilateral and multilateral MRAs
Medical Practitioners, Dental Practitioners, and Accountancy Services	Provide bilateral registration processes. Members that wish to defer implementation must notify ASEAN Secretary General. (opt out)

3. Free mobility of skilled labor

Many behind-the-border barriers still exist

Mobility of Architect and Engineering professionals under AEC



Source: ASEAN Mutual Recognition Arrangement on Architectural and Engineering services (2007)

3. Free mobility of skilled labor

Other ASEAN countries have made headway

Number of Engineers Registered under ASEAN chartered professional engineers (ACPEs)

Country	Numbers of ACPEs
Malaysia	194
Singapore	215
Indonesia	140
Vietnam	113
Thailand	0
Total	**662**

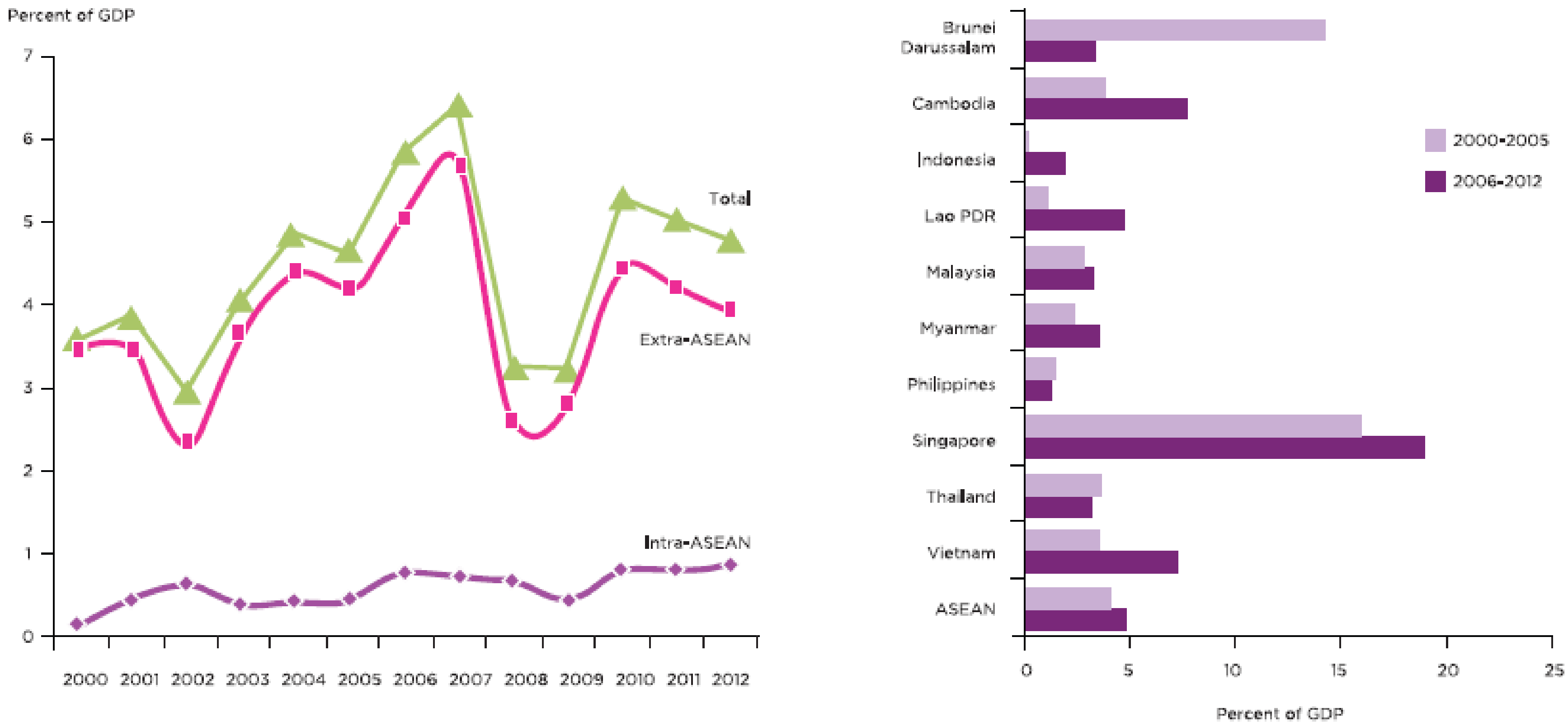
Source: ACPECC website, http://www.acpecc.net
As of June 2015

How does the ASEAN platform help solve issues? Case study – tax and investment

- In practical terms how can ASEAN and AEC help serve to promote our goals of economic growth and development?
- Lets go through a case study together – something happening right now – **tax and investment**
- **Recall ASEAN sub-pillar 2: tax policy and competitiveness**
  - We've talked about regional integration – important goal of regional integration is to increase INVESTMENT
  - What does investment look like right now? What role does tax and investment incentives play? Are there regional issues at stake? How could these be tackled through a platform like ASEAN?

Setting the Stage: Foreign direct investment in the region—room for growth

Net Inflow of Foreign Direct Investment as a percentage of GDP



Source: ASEAN FDI Database

Focus on two challenges: Harmful Tax Competition and International Tax Issues

Harmful tax competition ("the race to the bottom")

- By playing countries against each other to pay lower taxes, investors benefit at the expense of countries' finances
- One vehicle is the provision and application of tax exemptions and incentives

International tax issues that are vehicles for tax evasion and distortions of flows of goods and services (both within and outside the region)

- *Includes transfer mispricing, thin capitalization, application of tax treaties, and profit shifting through cost attribution.*

Drilling down: Harmful tax completion erodes revenue bases and can compromise the investment climate

The tax race to the bottom:

- Evidence shows that countries compete for investment using fiscal incentives (Klemm and Van Parys, 2009)
  - by lowering tax rates outright
  - by providing more attractive tax holidays and other fiscal incentives

Firms take advantage of tax competition by playing one country off of another

  - However, in many cases the final choice is already made regardless of the incentives

'Winning' countries in many cases suffer from the winners curse/buyers remorse, having given up too much

Only a coordinated response could avoid such a race to the bottom (Ex. agree on common minimum criteria, instruments, tax expenditure reviews)

Tax incentives are used more in East Asia than anywhere else in the world

	Number of Countries Surveyed	Tax holiday/ Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	VAT exemption/ reduction	R&D Tax Incentive	Super-deductions	SEZ/ Free Zones/ EPZ/ Freeport	Discretionary process
East Asia and Pacific	12	92%	92%	75%	75%	83%	8%	83%	25%
Eastern Europe and Central Asia	17	71%	29%	18%	94%	29%	0%	94%	41%
Latin America and the Caribbean	24	75%	29%	46%	58%	13%	4%	75%	29%
Middle East and North Africa	15	73%	40%	13%	60%	0%	0%	80%	27%
OECD	33	21%	30%	61%	79%	76%	18%	67%	27%
South Asia	7	100%	43%	71%	100%	29%	57%	71%	14%
Sub-Saharan Africa	30	60%	63%	73%	73%	10%	23%	57%	47%

Source: Sebastian James, (2013), presentation to Central Asian Tax Administrators, November.

Aggressive tax planning: MNE misuse of transfer pricing can erode the tax base and compromise the investment climate

- Globalization and acceleration of movement of goods and services across borders has necessitated rethinking the tools tax authorities need to monitor and adjudicate Multinational Enterprises' transactions.
- Main vehicle for base erosion from these international flows is via misuse of transfer pricing.
- In addition, related issues in which transfer pricing is used include:
  - Thin capitalization
  - Capital flight and illicit flows
  - Inter-relationship with customs valuation
  - Joint ventures - Artificially decreasing profits to reduce amount of JV profits to be shared
  - Foreign exchange controls: circumventing them via transfer pricing.

- These risks can be mitigated through implementation of international tax frameworks to detect aggressive tax planning, along with regional harmonization of principles to tackle the issue to minimize the effects on the ASEAN REGION, and intensifying REGIONAL EXCHANGE of INFORMATION.

Aggressive tax planning: how much is at stake

- **$100 billion** – approximate amount of tax revenue lost by developing countries annually to misuse of transfer pricing from 2002 to 2006 (Hollingshead 2010).

$15.42bn – total transfer pricing adjustments made by the Indian Revenue during the period 2008-2012

$**3.4bn** – payment by GSK to IRS to settle transfer pricing dispute in United States

€160m – tax revenues revealed by Hungarian Tax Administration from transfer pricing in 2012

$110**m** – transfer pricing adjustments made by Vietnamese tax administration by end of 2013

$85m – tax revenues collected by the Kenyan Revenue Authority in y/e 30 June 2013 from transfer pricing

$9.13m - collections from transfer pricing by the Columbian tax administration for 2011-2012

Aggressive tax planning experience in UK 2012 … are MNCs also doing same in ASEAN?

facebook

Estimated UK Earnings: £180M
Estimated pre-tax profit: 21M
UK Tax Paid last yr: 280,000

Estimated UK Earnings: 398M
Estimated pre-tax profit: 60M
UK Tax Paid last yr: 0

Google Deutschland

Estimated UK Earnings: 2,572M
Estimated pre-tax profit: 837M
UK Tax Paid last yr: 3.4M

amazon Join Prime

Estimated UK Earnings: 3,963M
Estimated pre-tax profit: 77M
UK Tax Paid last yr: 1.9M

ebay

Estimated UK Earnings: 802M
Estimated pre-tax profit: 184M
UK Tax Paid last yr: 999,000

Pfizer

Estimated UK Earnings: 1,800M
Estimated pre-tax profit: Loss of 59M
UK Tax Paid last yr: 0

Potential benefits of tax harmonization and regional integration

Minimizing tax competition is expected to lead to:

- Higher revenues due to reduced need to compete on tax incentives
- Potentially higher and more productive investment due to a more transparent and stronger investment climate
- Potential for more regional investment as tax rules are harmonized.

Improved international tax coordination creates further potential for revenue generation through:

Implementing/improving transfer pricing techniques, upgrading capacity to audit international tax issues with regional coordination

Exchange of information regionally builds trust and helps move country towards good practices

Possible steps to consider on the road to harmonization

- Conduct a detailed study on regional tax harmonization with the ASEAN Forum on Taxation: flesh out what this the landscape and issues
- Undertake a stock-take of tax incentives across all ASEAN members: develop a common inventory and determine avenues for harmonization
- Determine policy objectives in dialogue process: what's achievable and what is not
- With the objectives tabled and agreed, the next step could be development and implementation of regional based guiding principles through a structured dialogue process
- Agree on what data and information will be collected and shared
- Share information, identify common problems, and agree on a menu of solutions
- Finally agree on how to facilitate exchange of information in the region and consider a regional approach/mechanism for dispute resolution

Summary

- ASEAN region is extremely dynamic – and has a big role in the global economy!
- We are interested in promoting growth, development and shared prosperity – ASEAN can serve as a powerful platform
- Some key areas for focus:
  - Fostering integration
  - Making growth more inclusive
  - Helping create jobs
- AEC has a number of dimensions to promote integration – with mixed results so far…
- ASEAN has potential to help tackle key issues like tax and investment – what other issues?

Group Activity

- You are an advisor to the Prime Minister of Aseanistan. The Prime Minister has just read an economic brief for the EAP region, which highlights several issues, challenges and opportunities. She wants you to advise her on how these issues could be tackled through a regional platform.
  - Break into 3 groups
  - Discuss for 20 minutes
  - Report back to plenary

The EAP Economic Update

- Growth in developing East Asia and Pacific moderated from 7.2 percent in 2013 to 6.9 percent in 2014, reflecting slowdowns in China and some ASEAN-4 economies.
- Most countries continued to rebuild the fiscal buffers eroded by stimulus spending in the wake of the global financial crisis, but challenges remain.
- The prospect of low world fuel prices means there is a unique opportunity to both remove fuel subsidies and raise energy taxes more broadly; this will reduce inefficiencies and help address fiscal challenges.
- Over the medium term, developing human capital and physical infrastructure is a key priority, including in fuel exporters striving for diversification.
- Countries in the region—both low- and middle-income—face significant long-term fiscal challenges, as demographic trends and social pressures lead to rising social security and health expenditure.
- Increasing competitiveness in services through further regional integration will be necessary for ASEAN economies to sustain growth in the long run.

Topics for discussion

- Group 1: Growing demand for physical and human capital
- Group 2: Demographic and social changes putting upward pressure on social security and health expenditures
- Group 3: Economies in the region need better integration and investment in services

- Discuss – 30 minutes

THANK YOU

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