

## Chapter 1

### The Impending Establishment of the ASEAN Economic Community (AEC)

— Progress in de facto integration has already been realized

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#### 【Key Points】

- To achieve economic prosperity in the 21<sup>st</sup> century and compete with the rise of China and India, member states of the Association of Southeast Asian Nations (ASEAN) have been implementing necessary measures in accordance with a schedule that aims to establish the ASEAN Economic Community (AEC) by the end of 2015. While measures such as elimination of tariffs are proceeding smoothly, others – such as non-tariff barriers – are not moving forward.
- Trade in goods and services, direct investment, and the mobility of the skilled and unskilled labor force within the ASEAN region have increased greatly and regional economic integration is developing. Once the non-tariff barriers are reduced or eliminated, transportation infrastructures are developed, and the AEC is established, these trends will intensify and regional economic integration will develop further.
- The Japanese government can contribute to the establishment of the AEC through economic cooperation in various areas, starting with the development of transportation infrastructure and human resources. In order to seize the business opportunities that would be created by the AEC, Japanese companies should not only actively obtain and use local information, but should also consider cooperating with local companies that are becoming more competitive.

Difference in GDP Per Capita (USD)

1993			2000			2013		
Country	GDP Per Capita	Scale Factor	Country	GDP Per Capita	Scale Factor	Country	GDP Per Capita	Scale Factor
Vietnam	189	1.0	Cambodia	299	1.0	Cambodia	1,008	1.0
Cambodia	251	1.3	Laos	321	1.1	Laos	1,646	1.6
Laos	287	1.5	Vietnam	433	1.4	Vietnam	1,911	1.9
The Philippines	817	4.3	Indonesia	790	2.6	The Philippines	2,765	2.7
Indonesia	840	4.4	The Philippines	1,043	3.5	Indonesia	3,475	3.4
Thailand	2,153	11.4	Thailand	1,969	6.6	Thailand	5,779	5.7
Malaysia	3,395	17.9	Malaysia	4,005	13.4	Malaysia	10,514	10.4
Brunei	14,681	77.6	Brunei	18,087	60.5	Brunei	38,563	38.3
Singapore	18,302	96.7	Singapore	23,793	79.6	Singapore	55,182	54.8

Note: No information is available regarding Myanmar, so it is not included in the list.

Source: World Bank, World Development Indicators online.

## 1. Foreword

ASEAN's goal is to establish the ASEAN Economic Community (AEC) by the end of 2015. The AEC is being created to take advantage of the following key factors: (1) a single market and production base, (2) a highly competitive economic region, (3) a region of equitable economic development, and (4) a region fully integrated into the global economy. With the establishment of the AEC, ASEAN's presence in East Asia and in the world will be strengthened and will attract attention from foreign companies as a new place to run their businesses. With about a year left until the AEC is built, how much are the ASEAN economies mutually dependent and integrated? With regard to the AEC, the focus tends to be on institutional issues such as the elimination of tariffs and non-tariff barriers, liberalization policies on investments, trade in services, and movement of the people. However, this report will measure and evaluate the level of integration of the ASEAN economies based on various statistics and specific cases. Furthermore, it will examine the challenges for further integration and the business opportunities for foreign investors.

The Japan Center for Economic Research has analyzed strategies for foreign companies in ASEAN countries in a report titled "ASEAN Economy and Corporate Strategies" (2012). It also analyzed the structural problems in ASEAN countries in a report titled "The ASEAN Economy and the Middle-Income Trap" (2013). This study is part three of the ASEAN research.

## 2. Economic conditions of the ASEAN countries

### 2.1 Economic growth after the 1990s and future economic outlook

In the 1990s, the Philippines and Brunei were the slow-growth economies among the original six ASEAN members (ASEAN 6),<sup>1</sup> with an average annual growth rate at the 2% level. However, the average annual growth rates of Indonesia, Malaysia, Singapore, and Thailand were steady at above 4% (table 1). Malaysia and Singapore recorded particularly robust growth that exceeded an average annual growth rate of 7%. A factor for high growth for these countries was the liberalization of both trade and direct investment, which led to a large expansion in both exports and inward direct investment. The inward direct investment by multinational companies enabled efficient production and distribution by incorporating the ASEAN 6 into the production and distribution network (also known as the global

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<sup>1</sup> Original ASEAN members (ASEAN 6) refers to countries that joined ASEAN from the beginning until the 1980s: Indonesia, Malaysia, the Philippines, Singapore, Thailand (the five countries are founding members of ASEAN), and Brunei (1984). Countries that joined ASEAN in the 1990s – Vietnam (1995), Myanmar and Laos (1997), and Cambodia (1999) – are referred to as new members.

supply chain) that connects East Asian countries (such as Japan, China, the Republic of Korea, and Taiwan) with countries such as the United States and Europe. Meanwhile, by joining this production and distribution network, the ASEAN 6 were able to grow economically through the expansion of production, employment, and export, and through the transfer of technology.

The ASEAN 6 hugely suffered from the Asian Financial Crisis of 1997 and growth of the member states sharply dropped in 1998. However, the economies recovered by 1999 and through the early years of the 21<sup>st</sup> century – until the Global Financial Crisis of 2008 – they experienced steady growth. Economic growth fell in 2009 due to the Global Financial Crisis, but it recovered in 2010. The Global Financial Crisis damaged the economy of the United States, where the crisis originated, and the economies of Europe to which the crisis spread. These economic damages brought about a serious recession in Japan as well. However, compared to the negative effects experienced by the developed countries, the impact on the ASEAN 6 was relatively minor. The reason for this is not only due to the expansionary fiscal and monetary policies that the ASEAN 6 took as a response to the crisis, but also the cautious attitude that the financial institutions and companies took toward investment before the crisis hit in light of the lessons learned from the Asian Financial Crisis.

From 2010 to about 2012, the ASEAN 6 recorded high growth due to the recovery from the Global Financial Crisis of 2008. However, in 2013, the ASEAN 6 adopted austerity measures to combat the increasing budget deficits and inflation resulting from the expansionary macroeconomic policy. Due to these policies, the ASEAN 6 saw low economic growth in 2013. Furthermore, the economies of the ASEAN 6's major export destinations, such as China and other developed countries, became stagnant, which led to a decrease in exports and slowed down the economic growth of the ASEAN 6. In addition to these conditions, economic activity is weakening in Thailand because of political turmoil. While many of the countries of the ASEAN 6 are experiencing low economic growth, the Philippines are experiencing high growth due to strong consumption supported by remittances sent by Filipino workers who work overseas.

In comparison to the ASEAN 6, the new members of ASEAN – Cambodia, Laos, Myanmar, and Vietnam – have had high levels of economic growth since 1990. A factor that contributed to this high growth is the shift in these countries from socialist planned economies to market economies in the 1980s. By joining ASEAN in the 1990s, these countries opened their economies to foreign business, which greatly expanded their trade and inward direct investment. The new members of ASEAN were not impacted as much by the Asian Financial Crisis or the Global Financial Crisis of 2008, and their economies

continued to grow. However, since 2010, the economies of the new members of ASEAN have also become sluggish because of the prolonged economic stagnation in developed countries and the low economic growth of major trade partners such as China and the ASEAN 6.

Table 1 GDP Growth of ASEAN Member States (%)

	Actual Values					Estimated Values	
	1990-2000	2000-2010	2011	2012	2013	2014	2015
Brunei	2.2	1.4	3.4	0.9	-1.8	1.1	1.2
Cambodia	7.4	8.0	7.1	7.3	7.2	7.0	7.3
Indonesia	4.2	5.2	6.5	6.3	5.8	5.3	5.8
Laos	6.2	7.1	7.8	7.9	7.9	7.3	7.4
Malaysia	7.1	4.6	5.2	5.6	4.7	5.7	5.3
Myanmar	7.2	12.0	5.9	7.3	7.5	7.8	7.8
The Philippines	2.9	4.8	3.7	6.8	7.2	6.2	6.4
Singapore	7.1	5.6	6.1	2.5	3.9	3.5	3.9
Thailand	4.5	4.3	0.1	6.5	2.9	1.6	4.5
Vietnam	7.6	6.6	5.9	5.2	5.4	5.5	5.7

Note: Growth between 1990 and 2010 was calculated using the World Bank's WDI. Cambodia's growth is from 1993 to 2000.

Myanmar's growth (2000 to 2010) was calculated using the ADB Key Indicators.

Values from 2011 to 2015 are from the ADB, Asian Development Outlook 2014 Update.

Note: Values for 2014 and 2015 are estimated values from the ADB.

Table 1 shows the predicted growth values of 2015 as estimated by the Asian Development Bank in 2014. When looking at the countries of ASEAN as a whole, GDP is estimated to increase from 4.6% in 2014 to 5.3% in 2015. Malaysia is the only country within the ASEAN member states that is estimated to experience a decrease in growth and, for the rest of the nine countries, growth rate is expected to increase.

The driving forces for the increase in ASEAN's GDP growth rate are Indonesia and Thailand, which are first and second largest economies in ASEAN. Under a new president, Indonesia's investment environment is expected to improve through reforms. As a result, inward investment is expected to expand and economy is projected to grow. Meanwhile, political turmoil in Thailand is expected to calm down, which will restart public works that had been on hold, and capital investment is expected to expand. These factors are predicted to result in increased economic growth. The decrease in economic growth that is estimated for Malaysia is mainly due to the austerity measures implemented as a response to inflation. Increased investment under stable economic conditions will

preserve momentum for increased economic growth in the rest of the ASEAN countries (except Indonesia, Thailand, and Malaysia). However, downside risk factors include China’s slowdown in economic growth; Indonesia, Malaysia, Vietnam’s surge in inflation due to cutting subsidies; and monetary and fiscal austerity measures.

## 2.2 Diversity in ASEAN economies

Many ASEAN members share a common factor in that compared to other countries, they have experienced relatively high growth. Meanwhile, ASEAN members are different from each other in various aspects of the economy and there is a diversity of economies within the ASEAN members (table 2).

Table 2 Basic Economic Indicators for ASEAN, Japan, China, the Republic of Korea, and India (2013)

	Population (1 million people)	Area (10 thousand square kilometers)	GDP (1 billion USD)	GDP per capita (USD)
Brunei	0.4	0.5	16.1	38,563
Cambodia	15.1	17.7	15.2	1,008
Indonesia	249.9	181.2	868.3	3,475
Laos	6.8	23.1	11.1	1,646
Malaysia	29.7	32.9	312.4	10,514
Myanmar	53.3	65.3		
The Philippines	98.4	29.8	272.0	2,765
Singapore	5.4	0.1	297.9	55,182
Thailand	67.0	51.1	387.3	5,779
Vietnam	89.7	31.0	171.4	1,911
ASEAN	615.7	432.6	2,351.9	4,182
China	1,357.4	938.8	9,240.3	6,807
Japan	127.3	36.5	4,901.5	38,492
Republic of Korea	50.2	9.7	1,304.6	25,977
India	1,252.1	297.3	1,876.8	1,499
World	7,124.5	12,973.4	74,909.8	10,514

Source: World Bank, World Development Indicators online.

Indonesia has the largest population with approximately 250 million people, while Brunei has the smallest population with approximately 400 thousand people. This is about 1/600<sup>th</sup> of the population of Indonesia. Beside Indonesia, ASEAN countries with more than 50 million people include the Philippines, Vietnam, Thailand, and Myanmar. On the other hand, other than Brunei, the countries with a population of 10 million or less are Laos and Singapore. As a reference, the combined population of the ASEAN member states is approximately 600 million, which is about five times the population of Japan and about half the population of China or India.

There is also a huge difference in land area among the ASEAN countries. Similar to population, Indonesia’s land area is overwhelmingly large compared to the other ASEAN countries. Singapore, a city-state, has the smallest land area, which is about 1/2500<sup>th</sup> of

Indonesia's land area. Following Indonesia, Myanmar and Thailand both have large land areas, but even so, their land area is about a third of Indonesia's. Similar to Singapore, Brunei has an extremely small land area. In general, agriculture is a dominant industry in countries with large land areas. The combined land area of ASEAN is about half the size of China and about 1.5 times that of India.

There are huge differences among ASEAN countries in terms of the size of their economies as measured by gross domestic product (GDP) in US dollars. Indonesia has the largest economy with a GDP of approximately \$870 billion. Meanwhile, Laos has the smallest economy with a GDP of approximately \$11 billion, which is about 1/80<sup>th</sup> of Indonesia's GDP.<sup>2</sup> Though their GDP is much smaller than Indonesia's, Thailand, Malaysia, Singapore and the Philippines follow Indonesia with GDPs ranging from approximately \$300 to \$400 billion. Cambodia and Brunei have small economies similar to Laos and the GDP of these countries are approximately \$15 billion each. The GDP of ASEAN as a whole is approximately \$2.35 trillion, which is a quarter of China's GDP and 1.25 times India's GDP.

Large gaps in the GDP per capita of the ASEAN countries can also be seen. Singapore has the largest GDP per capita with \$55,000 (US dollars). This number is higher than Japan's GDP per capita by almost \$17,000. On the other hand, Cambodia has the lowest GDP per capita within the ASEAN countries with approximately \$1,000. The World Bank classifies countries around the world by GDP per capita into high-income economies (\$12,616 or more), upper-middle-income economies (\$4,086 to \$12,615), lower-middle-income economies (\$1,036 to \$4,085), and low-income economies (\$1,035 or less).<sup>3</sup> According to this scale, Singapore and Brunei are high-income economies; Malaysia and Thailand are upper-middle-income economies; Indonesia, the Philippines, Vietnam, and Laos are low-middle-income economies; and Cambodia is a low-income economy. The average GDP per capita of the ASEAN nations is approximately \$4,200, which is much lower than China's GDP per capita of \$6,800; however, it is much higher than India's GDP per capita of \$1,500.

This huge variation in GDP per capita among the ASEAN nations could create social and political instability among the member states. On the other hand, the formation of production networks, which contributed significantly to ASEAN's high economic growth, was made possible by wide gaps in wages among ASEAN countries. In the East Asian production network that includes ASEAN (which will be later analyzed), it is

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<sup>2</sup> Myanmar is not included in the analysis in this section as statistics on Myanmar's GDP is not among the World Development Indicators published by the World Bank.

<sup>3</sup> To be exact, not GDP but Gross National Income (GNI) is used.

possible to efficiently produce a product that requires multiple parts by assigning different parts (which are produced with varying levels of technology) to a country or a region that can most efficiently produce that specific part, and gather these parts through trade for assembly. Specifically, parts that require advanced technology to produce are manufactured in high-income economies that have skilled engineers, while processes such as assembly that require more basic technology are carried out in low-income economies where there are abundant low-wage workers. In ASEAN, high-income economies such as Singapore have many engineers and researchers; therefore, they are assigned the processes of development of products and parts, and the formation of business strategies. On the other hand, countries such as Vietnam – where there are many low-wage workers – are assigned the process of assembling the final product.

Up until now, the focus has been on the wide differences in GDP per capita between the ASEAN countries. However, the gaps in GDP and GDP per capita are decreasing (table 3 and 4). With regard to GDP, the difference between the highest and the lowest was 119 times higher in 1953, but it decreased to 95 times higher in 2000 and only 78 times higher in 2013. The differences in GDP per capita are also shrinking. For instance, the difference between the highest and the lowest GDP per capita was 97 times higher in 1993, but decreased to 80 times higher in 2000 and only 55 times higher in 2013. The decrease in the GDP and GDP per capita gaps show that low-income and lower-middle-income economies are catching up to upper-middle-income and high-income countries in terms of economic development.

Table 3 Difference in GDP (1 billion USD)

1993			2000			2013		
Country	GDP	Scale Factor	Country	GDP	Scale Factor	Country	GDP	Scale Factor
Laos	1.3	1.0	Laos	1.7	1.0	Laos	11.1	1.0
Cambodia	2.5	1.9	Cambodia	3.7	2.1	Cambodia	15.2	1.4
Brunei	4.1	3.1	Brunei	6.0	3.5	Brunei	16.1	1.4
Vietnam	13.2	9.9	Vietnam	33.6	19.4	Vietnam	171.4	15.4
The Philippines	54.4	40.9	The Philippines	81.0	46.8	The Philippines	272.0	24.4
Singapore	60.6	45.7	Malaysia	93.8	54.2	Singapore	297.9	26.7
Malaysia	66.9	50.4	Singapore	95.8	55.4	Malaysia	312.4	28.0
Thailand	125.0	94.2	Thailand	122.7	70.9	Thailand	387.3	34.8
Indonesia	158.0	119.0	Indonesia	165.0	95.3	Indonesia	868.3	77.9

Note: No information is available regarding Myanmar, so it is not included in the list.

Source: World Bank, World Development Indicators online.

Table 4 Difference in GDP Per Capita (USD)

1993			2000			2013		
Country	GDP Per Capita	Scale Factor	Country	GDP Per Capita	Scale Factor	Country	GDP Per Capita	Scale Factor
Vietnam	189	1.0	Cambodia	299	1.0	Cambodia	1,008	1.0
Cambodia	251	1.3	Laos	321	1.1	Laos	1,646	1.6
Laos	287	1.5	Vietnam	433	1.4	Vietnam	1,911	1.9
The Philippines	817	4.3	Indonesia	790	2.6	The Philippines	2,765	2.7
Indonesia	840	4.4	The Philippines	1,043	3.5	Indonesia	3,475	3.4
Thailand	2,153	11.4	Thailand	1,969	6.6	Thailand	5,779	5.7
Malaysia	3,395	17.9	Malaysia	4,005	13.4	Malaysia	10,514	10.4
Brunei	14,681	77.6	Brunei	18,087	60.5	Brunei	38,563	38.3
Singapore	18,302	96.7	Singapore	23,793	79.6	Singapore	55,182	54.8

Note: No information is available regarding Myanmar, so it is not included in the list.

Source: World Bank, World Development Indicators online.

### 2.3 The challenges of the ASEAN nations

From an economic perspective, the ASEAN member states have developed relatively smoothly. But in order to maintain and gain momentum for steady development, the countries must effectively handle various challenges. The main challenges to the ASEAN member states will be listed in this section. The challenges for Singapore and Brunei, which are high-income economies, are the maintenance and expansion of economic dynamism as wages increase and a low birth rate and an aging population both progress. Singapore and Brunei have to build economic structures and systems that can support the expansion of social welfare programs, as medical costs and social security costs rise as their aging populations grow. A key solution for this problem is to improve productivity; however, it is not easy to increase productivity in economies where the service sector occupies a large portion of the economic activity.

A shared challenge among Indonesia, Malaysia, the Philippines, Thailand, and Vietnam, which are middle-income economies, is to escape the “middle-income trap.” The expression refers to a situation in which countries are able to grow from low-income to middle-income level by overcoming poverty issues, but fail to maintain the high growth necessary to graduate to high-income economies. The term was first used in 2007 in a report by the World Bank titled “An East Asian Renaissance.”<sup>4</sup> One important factor that enabled these countries to develop economically is the integration of these countries into a production network that was formed by multinational companies. In order to develop their economies further and become high-income economies, these countries need to improve their roles in the production network from low value-added production to high value-added

<sup>4</sup> The Japan Center for Economic Research analyzed the issue of the middle-income trap in the ASEAN member states in 2013.

production. The solution for this issue is to train people with a high-level of knowledge and skills.

The biggest challenge for Cambodia, Laos, and Myanmar, who are in the initial stage of development compared to other ASEAN countries, is to participate in the production network that largely contributes to the countries' economic growth. At this stage, these countries are starting to participate in the production network with textiles, but participation in the production network for machinery industries such as electronic parts is limited. The participation in production networks will increase trade and investment and enable the transfer of technology, which in turn promotes economic growth. Development of infrastructure and human resources are also important for participating in production networks.

Major challenges for the ASEAN member states were discussed in this section by dividing the ASEAN countries into three groups. But, a common challenge for all countries must also be addressed. The most serious issue is the rise in domestic income inequality. Growing income inequality brings about political and social instability and prevents smooth economic activities. At the same time, if countries implement excessive leveling off of income in order to narrow the gap between the rich and the poor, it can result in low morale, the emigration of workers out of the country, and an overall decline in economic activity. These competing factors make income inequality an extremely difficult problem to solve. Furthermore, there are issues associated with the environment and urban concentration as the economies develop. The ASEAN Economic Community (AEC) plans to deal with the various economic issues of the ASEAN member states not on an individual country level, but as a whole, cooperative unit. The next section reviews the significance of the AEC.

### **3. Path to establishing the AEC and its significance**

#### **3.1 Regional cooperation among the ASEAN member states**

In 1967, ASEAN was founded by five Southeast Asian nations: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. The political motive behind the founding of ASEAN was to resolve the intra-regional disputes that were erupting at the time.<sup>5</sup> ASEAN contributed to the political stability of the region through dispute resolution, and since 1976, it has actively called for regional economic cooperation among its member states.<sup>6</sup> ASEAN's initial projects reflected the import substitution policy, an economic

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<sup>5</sup> See Yamakage (2011) on ASEAN.

<sup>6</sup> See Shimizu (2013) on ASEAN's regional cooperation.

development strategy that was preferred by many of the ASEAN members at the time. Specifically, with the aim of achieving economies of scale within the ASEAN region, schemes such as the ASEAN Industrial Projects (AIP) in 1976, the Preferential Trading Arrangements (PTA) in 1977, and the ASEAN Industrial Cooperation (AIC) in 1981 were implemented. AIP facilitated large projects through joint investments from each country, while the AIC formed projects in which private companies from at least four countries cooperated in the production of specific industrial products and a preferential tariff was applied to these products. PTA was a preferential tariff system targeting AIP and AIC products and the aim was to endorse AIP and AIC projects. These economic cooperation projects were implemented with the aim of industrial development within the ASEAN region; however, the result was inconclusive as conflicts between countries erupted as they were taking import substitution industrialization policies. Under these conditions, the ASEAN Industrial Joint Ventures (AIJV) was implemented in 1983, in which the participation conditions were eased. Since there were no changes in countries' policies of industrialization through import substitution, the result was poor.

The joint industrial development projects by the ASEAN member states did not result in a huge success as expected. However, in light of the lessons learned from these projects, joint projects were implemented, including the Brand-to-Brand Complementation (BBC) in 1988, and in 1996, the ASEAN Industrial Cooperation (AICO), an improved and expanded version of the BBC. The BBC and the AICO brought about a steady success. The BBC was a scheme in which preferential tariffs lower than the most favored nation tariff, were applied to automobile parts, in order to promote the concentrated production of automobile parts and the creation of complementary production systems within the ASEAN region. AICO was a scheme in which the BBC was improved and expanded. More specifically, the target areas were expanded to include not only automobiles but also household appliances, and the conditions of preferential tariffs were eased.

An important agreement that shifted ASEAN's economic integration into high gear was the ASEAN Free Trade Area (AFTA) that aimed to expand intra-regional trade. AFTA entered into force in 1993 and under the Common Effective Preferential Tariff (CEPT) Agreement, it required that tariff rates levied on applicable products traded within the region be reduced to 0-5% within 15 years, by 2008. The factors that urged the establishment of the AFTA were the active development of regional economic integration worldwide and the rise of the Chinese economy. Since China had been achieving steady economic development since the reform and open policy of 1979, it had attracted a large number of direct investments from foreign countries, which contributed to its economic development. The ASEAN member states felt a sense of urgency under these circumstances

and promoted market integration through the implementation of the AFTA and anticipated direct investment from abroad.

After this, in order to compete against China, (which was attracting investors with their high growth), the intra-regional tariff reduction was advanced ahead of schedule. Furthermore, since Vietnam, Laos, Myanmar, and Cambodia joined ASEAN, the date for the tariff elimination was set to be 2010 for the members of the original AFTA and 2015 for the new members. In 2010, the ASEAN Trade in Goods Agreement (ATIGA) was entered into force. This agreement included stipulations that were more comprehensive and detailed than that of the CEPT Agreement. With the aim of intra-regional expansion of trade in services and direct investment, the ASEAN Framework Agreement on Services (AFAS) was signed and entered into force in 1995 and the ASEAN Investment Area (AIA) was signed and entered into force in 1998.

In 1996, on the 30<sup>th</sup> anniversary of ASEAN and on the edge of the 21<sup>st</sup> century, the first informal ASEAN summit was held. While the environment surrounding ASEAN was changing with issues such as the rise of China, a vision plan for 2020 was agreed upon at the first informal summit. At the second informal ASEAN summit, held in 1997 in the midst of serious economic downturn caused by the Asian Financial Crisis, the ASEAN Vision 2020 was adopted. The ASEAN Vision 2020 highlights the importance of economic integration for regional development. In 1998, the Hanoi Plan of Action (a six-year timeframe from 1999 to 2004) was adopted. The Hanoi Plan of Action was the first in a series of action plans for the ASEAN Vision 2020. In the plan, enhancing greater economic integration was listed as a major item.

### **3.2 The emergence of the AEC plan and its significance**

The regional economic cooperation among the ASEAN members entered a new stage in the form of the ASEAN Economic Community (AEC), which was outlined in the Declaration of ASEAN Concord II (Bali Concord II) at the 9<sup>th</sup> ASEAN Summit held in Bali, 2003.<sup>7</sup> The Bali Concord II laid out the establishment of the ASEAN Community by 2020<sup>8</sup> comprising three pillars: the ASEAN Economic Community (AEC), the ASEAN Political-Security Community (APSC), and the ASEAN Socio-Cultural Community (ASCC). In 2004, at the 10<sup>th</sup> ASEAN Summit held in Vientiane, the capital of Laos, the Vientiane Action Program was adopted. This action program served as a roadmap for establishing the ASEAN Community. Actions related to the AEC include the acceleration of the integration process toward a single market and production base, and the integration

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<sup>7</sup> The (First) Declaration of ASEAN Concord was signed in Bali in 1976.

<sup>8</sup> In 2007, the goal of establishing the ASEAN Community was moved up to 2015.

of 11 priority sectors (agro-based products, automotives, electronics, etc.) by the end of 2010. The AEC is anticipated to shift ASEAN into a region with a free flow of goods, services, investments, skills and capital, and to also bring economic prosperity to the region.

At the 13<sup>th</sup> ASEAN Summit in 2007, the ASEAN Charter was signed and it entered into force in 2008. The ASEAN Charter serves as a strong foundation in realizing the ASEAN Community by providing legal status as a regional institution. It also codifies the ASEAN goals, rules, and values. At the same summit, leaders adopted the AEC Blueprint. The AEC Blueprint lays out four pillars (a single market and production base, a competitive economic region, equitable economic development, and integration into the global economy), 17 core elements,<sup>9</sup> and 77 measures. The four pillars clarified the aim and significance of the AEC. Establishing a single market and production base will allow ASEAN member states to have an advantage over China and India in the competition to attract the direct investment necessary for economic growth and this will promote ASEAN's economic growth. Building a competitive economic region will contribute to attracting direct investment, and furthermore, encouraging competition between companies will increase consumer benefits. Achieving equitable economic development is necessary for not only bringing economic, social, and political stability to the region by reducing the huge development gap between ASEAN member states that currently exists, but it is also necessary to push forward economic integration. In terms of integration into the global economy, it is important to push forward intra-regional and extra-regional integration simultaneously in order for ASEAN's economy to flourish as economic activities globalize. In particular, forming close relationships with other entities within the global production network will greatly contribute to economic growth.

In order to ensure the implementation of the AEC Blueprint, the ASEAN Secretariat established a monitoring mechanism in 2008 called the AEC Scorecard to evaluate the progress of various AEC measures in each country. It is reported that the implementation rate of prioritized AEC deliverables was 82.1% at the end of 2013. Furthermore, in order to supplement and reinforce the plans for hard infrastructure that was insufficient in the AEC Blueprint, the Master Plan on ASEAN Connectivity was adopted at the 17<sup>th</sup> ASEAN Summit in 2010. The Master Plan on ASEAN Connectivity aims to

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<sup>9</sup> The 17 core elements are: a single market and production base (1. Free flow of goods, 2. Free flow of services, 3. Free flow of investment, 4. Free flow of capital, 5. Free flow of skilled labor, 6. Priority Integration Sectors, 7. Food, Agriculture, and Forestry); a competitive economic region (1. Competition policy, 2. Consumer protection, 3. Intellectual property rights, 4. Infrastructure development, 5. Taxation, 6. E-commerce); equitable economic development (1. SME development, 2. Initiative for ASEAN integration); and integration into the global economy (1. Coherent approach toward external economic relations, 2. Enhanced participation in global supply networks).

strengthen: (1) physical connectivity, (2) institutional connectivity, and (3) people-to-people connectivity. Specifically, items under (1) physical connectivity include development of hard infrastructure, such as transportation, information and communications technology (ICT), and energy. Items under (2) institutional connectivity include the development of soft infrastructure, such as trade liberalization and facilitation, investment and services liberalization and facilitation, regional transportation agreements, cross-border procedures, and capacity building programs. Lastly, items under (3) people-to-people connectivity include the facilitation of mobility of the people through education, culture, and tourism.

Many observers think that establishing the AEC by the end of 2015 is, at this time, unlikely, but ASEAN's move toward economic integration will continue after 2015. In November 2014, at the 25<sup>th</sup> ASEAN Summit held in Nay Pyi Taw, the capital of Myanmar, the Nay Pyi Taw Declaration on the ASEAN Community's Post-2015 Vision was announced and agreed upon. The Declaration outlines what AEC should be as well as challenges facing the ASEAN member states.<sup>10</sup> The AEC for 2016-2025 should aim to establish an integrated and highly cohesive economy, a competitive, innovative and dynamic ASEAN, a resilient, inclusive and people-oriented, people-centered ASEAN, enhanced sectoral integration and cooperation, and a global ASEAN.

#### **4. Recommendations**

About a year remains until the ASEAN Economic Community (AEC) is established. Twenty years have passed since ASEAN decided to move toward regional economic integration under the framework of the ASEAN Free Trade Area (AFTA), which entered into force at the beginning of the 1990s and aimed to liberalize trade in goods within the ASEAN region. There were many pessimistic views on the AFTA as the economic cooperation programs at the ASEAN regional level implemented until then had ended in failure. Many people thought that the AFTA would also result in no reduction or elimination of intra-regional tariffs, which were the goals, even though the framework was built. However, contrary to all expectations, the AFTA not only reduced and eliminated tariffs ahead of schedule, but also built a framework in which not only goods but also services, investment, and skilled labor in the ASEAN region would flow freely. The culmination of these measures is the AEC. This report will review the implementation

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<sup>10</sup> ASEAN Secretariat

<[http://www.asean.org/images/pdf/2014\\_upload/Nay%20Pyi%20Taw%20Declaration%20on%20the%20ASEAN%20Communitys%20Post%202015%20Vision%20w.annex.pdf](http://www.asean.org/images/pdf/2014_upload/Nay%20Pyi%20Taw%20Declaration%20on%20the%20ASEAN%20Communitys%20Post%202015%20Vision%20w.annex.pdf)>

status of policies and measures for achieving the AEC and evaluate the level of progress of ASEAN's regional economic integration by analyzing the mobility situation in the region in terms of goods, services, investment, skilled laborers, and unskilled laborers (which are not included in the AEC). The results show that intra-regional mobility has expanded for goods, services, investment, skilled laborers, and unskilled laborers. However, there are cases in which intra-regional mobility has not sufficiently developed as some measures included in the AEC Blueprint (which was created to monitor the progress toward the AEC) are not being implemented. In light of these results, the following recommendations are presented to the ASEAN member states, the Japanese government, and Japanese companies.

ASEAN member states must consistently and swiftly implement the items included in the AEC Blueprint in order to complete the AEC and achieve the goal of market integration. Items that are particularly important are the elimination of non-tariff barriers, the facilitation of trade, the liberalization and facilitation of trade in services and investment, the free movement of skilled labor, and the development of transportation infrastructure.

Currently, the information on ASEAN's progress as a whole on the AEC Blueprint is publicly available, but it is important to announce sectoral and country-by-country progress. Furthermore, it is necessary to swiftly lay out and announce the AEC Post-2015 Vision and a new blueprint that would serve as guidelines of the AEC after 2015. Effective outlining of an action plan is essential, but in that process, ASEAN should incorporate requests of the private sector including foreign companies such as Japanese companies. Moreover, ASEAN should establish a cooperative relationship with international institutions such as the Asian Development Bank (ADB) and the Economic Research Institute for ASEAN and East Asia (ERIA), and exchange opinions and information with these organizations.

At the moment, unskilled labor is not included in the AEC Blueprint, but in order to achieve market integration, it is necessary to secure a high-quality labor force that includes unskilled laborers. In other words, establishing a sound labor market is essential and for this reason, it is necessary to outline and put into effect an agreement that is legally binding with regard to the protection and promotion of rights of immigrant workers that are currently under discussion.

The Japanese government should take into account not only the importance of ASEAN's production base and market, but also its geopolitical importance. Japan should strengthen the various cooperation measures that are already taking place toward the establishment of the AEC, which will contribute to the development and the growth of the

ASEAN economy. Specifically, it is important to cooperate in areas such as the development of transportation infrastructure and human resources that will be discussed in this report. The Japanese government is also expected to effectively communicate the requests of the Japanese companies that are actively operating on a large scale in the ASEAN region to the ASEAN Secretariat and governments of the ASEAN member states, and to ensure that those requests are being reflected in the policies. Specific measures include requesting that ASEAN member states clarify whether or not Japanese companies operating in the ASEAN region would be included in the ASEAN companies that can enjoy the benefits from the liberalization of trade in services and investment of the AEC. Another measure is to demand that ASEAN member states listen to requests of the Japanese companies in creating the new blueprint.

Recommendations for business strategies in the ASEAN region must be made to Japanese companies. With the establishment of the AEC, ASEAN will gain attraction not only as a production base but also as a market. Due to this, competition with both foreign companies and with local companies within the ASEAN region is expected to intensify. In order for Japanese companies to effectively operate under these extreme competitive environments, the Japanese companies must be familiar with the new rules under the AEC. Therefore, it would be useful if Japanese companies obtained latest information through exchanges with Japanese government agencies such as The Japan External Trade Organization (JETRO), private financial institutions, and consulting firms, and accurately communicate the information to their management. Meanwhile, either on their own, through the Chamber of Commerce and Industry, or through industry associations, Japanese companies should make an active effort in notifying the Japanese government and local governments of the ASEAN their requests for improving business environment. It is also important for Japanese companies to localize in various aspects. For instance, by cooperating with local ASEAN companies that are knowledgeable in the business situations of the ASEAN member states, Japanese companies are more likely to succeed in the ASEAN region. Local procurement of human resources will also be an advantage for Japanese companies that are experiencing difficulty in securing workers in Japan due to a declining birthrate and an aging population. Furthermore, if there are opportunities for local employees to be promoted, Japanese companies will be able to secure skilled employees. This will largely contribute to the efficient management of not only the local subsidiaries but also of the head office in Japan.

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