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*Progress of Economic
Integration in the ASEAN and
Countermeasures taken by
Japanese Corporate Enterprises*

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Summary

1. Since the mid-1980s, the Association of Southeast Asian Nations (ASEAN) has continued to expand its trade (in terms of value) as well as the percentage of trade within the ASEAN region. Furthermore, empirical analysis using the trade intensity index, the trade supplementation index and gravity model confirms not only the quantitative expansion of trade but also the intensification of intra-regional economic relations. While intra-regional integration intensified along with the construction and progress of supply chains in the ASEAN region, the movement to eliminate intra-regional tariffs toward the formation of the ASEAN Free Trade Area (AFTA) may have served as a driver. However, the results also suggest that intra-regional integration since the late 2000s has not progressed as much as in the past.
2. The ASEAN is currently engaged in initiatives to form the ASEAN Economic Community (AEC) to step up the liberalization of intra-regional trade and investment. In contrast to the dramatic progress achieved in the reduction and elimination of intra-regional tariffs among the ASEAN6 (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand), the elimination of non-tariff barriers and liberalization in the services sector is still lagging. Even though it appears difficult to achieve all the goals in the action plan set forth by the ASEAN by the end of 2015 which is the target for establishment of the AEC, the ASEAN should continue to strive for achievement of the goals even after 2016 and raise the level of institutional integration.
3. In the course of the elimination of intra-regional tariffs accompanying the formation of the AFTA, Japanese corporate enterprises have stepped up their intra-regional procurement by utilizing preferential tariffs and the realignment of the production sites from a medium-term perspective. Industrial sectors such as the automotive sector have upgraded their

system for the mutual supply of production items among intra-regional production sites while keeping their existing production sites intact. In contrast, the electronics/electrical machinery sector has streamlined their production sites in a bid to consolidate their items of production.

4. Among the four additional members (Cambodia, Laos, Myanmar and Vietnam, referred to below as the “CLMV”) of the ASEAN, intra-regional tariffs will be eliminated by 2018 at the latest. In response to this change, companies which possess production sites in these four countries will need to decide whether to maintain or eliminate the sites and resort to imports from other countries within the region. Furthermore, the ASEAN will progress toward greater integration not only on an institutional level but also in terms of physical connectivity through the improvement of roads and infrastructure. Under these circumstances, management strategies based upon a “plane-based” (the entire ASEAN region) approach rather than a “point-based” (country level) approach, will possess greater importance.

1. Introduction

Even though East Asia still does not possess a definite institutional framework like that of the European Union (EU) or the North American Free Trade Agreement (NAFTA), it enjoys a considerable degree of actual economic integration. In fact, a system for the division of labor has been formed mainly among Japanese companies, serving to stimulate intra-regional trade. In view of these conditions, East Asia has been described as an area of advanced economic integration in real terms which lags in institutional integration.

The progress of institutional integration will lead to a higher

degree of economic integration. In East Asia, the ASEAN is a region which has engaged in institutional integration from a relative early period. In 1993, the ASEAN started to engage in the formation of the ASEAN Free Trade Area (AFTA), and intra-regional tariffs were eliminated in the six initial member countries (Singapore, Brunei, Indonesia, Thailand, Malaysia and the Philippines, the “ASEAN6”) in 2010. Furthermore, the ASEAN is striving to form the ASEAN Economic Community (AEC) by eliminating not only tariffs but also non-tariff barriers and liberalizing investment in service areas.

In this paper, we shall examine the degree of ASEAN’s economic integration in terms of both (1) actual conditions, and (2) institutional framework. In addition, this paper will also look at how Japanese companies dealt with the progress of economic integration and how they should cope in the future.

This paper is constructed as follows. In **Section 2**, we shall conduct a survey on the initiatives toward the establishment of the AFTA which started in 1993. In view of these initiatives, we shall examine the economic relations among the countries of the ASEAN by looking at their trade statistics in **Section 3**. A look at ASEAN’s endeavors toward the launch of the AEC in 2015 will enable us to gain an understanding of the current degree of institutional integration and provide a future outlook in **Section 4**. In **Section 5**, we shall survey how Japanese companies responded to the progress of economic integration in the ASEAN. **Section 6** will summarize the discussions up to **Section 5** and examine the business developments of Japanese companies in view of the progress of the AEC.

2. ASEAN economic integration: an examination of its progress from an institutional perspective

(1) 1993: commencement of the reduction of intra-regional tariffs toward the formation of AFTA

The ASEAN was established in 1967 as a security framework against the spread of communism in Indochina. However, its position changed, triggered by the US withdrawal from Vietnam in 1975 and Vietnam's unification in 1976. It gradually shifted in character to an organization for economic cooperation since the adoption of the "Declaration of ASEAN Concord" at the ASEAN Summit in 1976. Industrial cooperation projects such as the ASEAN Industrial Cooperation Scheme and the ASEAN Industrial Joint Venture are some of the actual initiatives in this direction.

In the early 1990s, the movement toward regional integration gathered momentum around the world such as the unification of the European market and the formation of NAFTA in contrast to the stagnation of the Uruguay Round trade negotiations. Given these developments, the ASEAN – being a union of countries with small economic scales – embarked in initiatives to create a free trade market to rival other free trade areas. This was the AFTA.

The AFTA was formally decided upon at the 1992 ASEAN Summit held in Singapore, to be established in the 15-year period from 1993 to 2008. Since the commencement of initiatives to create the AFTA, the ASEAN grew from six member states (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand, the "ASEAN6") to 10 members with the addition of four additional members including Cambodia, Laos, Myanmar and Vietnam (the "CLMV"), with a target to form a free trade area among the 10 members of the ASEAN.

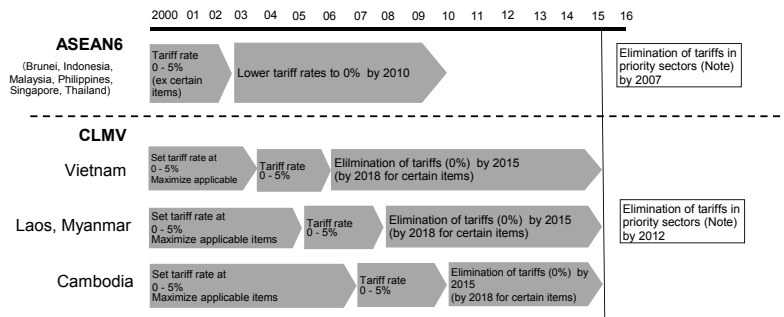
In the formation of the AFTA, the Common Effective Preferential Tariff (CEPT) scheme is a program to reduce tariff rates within the area, of which further details are as follows.

In the AFTA, virtually all industrial products and agricultural goods produced within the ASEAN were subject to the reduction of tariff rates. However, an across-the-board reduction of tariffs would be a challenging task for the ASEAN which is a developing area. Hence, the members were allowed to place items they wish to protect for the time being in the Temporary Exclusion List (TEL) (note 1), placing all other items in the Inclusion List (IL). While a low common preferential tariff is to be applied on items in the IL, the members were required to lower the tariff rate to 0–5% within a certain period of time. Moreover, the members were also required to shift items in the TEL to the IL and to reduce tariff rates to 0–5% by 2008 which was the initial deadline (note 2).

(2) Elimination of virtually all tariffs among the ASEAN6 by 2010, achieving the formation of AFTA

At the time of commencement of initiatives to form the AFTA, the members were not necessarily positive toward the reduction of tariff rates which would place their domestic industrial sectors in a

Chart 1: AFTA Tariff Reduction Schedule



Note: "Priority sectors" refer to 11 sectors including the automotive, electronics, IT, aviation, lumber, agriculture, fisheries, tourism, rubber, textiles/apparel, and healthcare sectors.

Source: Ministry of Economy, Trade and Industry, *White Paper on International Economy and Trade 2008*

severe environment.

However, a sense of crisis started to mount among the countries of the ASEAN regarding the loss of investment necessary for growth due to dramatic changes in the external environment such as the Asian Financial Crisis in 1997 and the rise of China as a competitor in the attraction of foreign investment. The ASEAN started to take a proactive stance toward the liberalization of trade from the perspective of maintaining its attractiveness for foreign investment.

The ASEAN6 succeeded in achieving the target of reducing tariff rates on almost all items in the IL to 0–5% in 2003 – five years earlier than the initial target of 2008 (note 3). The ASEAN pursued a path toward further trade liberalization (**Chart 1**), eliminating intra-regional tariffs on all the 11 priority sectors by 2007, and eliminating 99.7% of tariffs on an itemized basis in the ASEAN6 by 2010.

Amid the rise in activity toward the formation of free trade agreements (FTA) in East Asia from the 2000s onward, the ASEAN took a step ahead toward the reduction of tariffs. While Japan has concluded economic partnership agreements (EPA) and free trade agreements (FTA) with 13 countries/regions thus far, note that these have only achieved a liberalization rate of 90%. In comparison, the AFTA – which as an FTA among developed countries – deserves commendation for its high liberalization rate.

3. The progress of economic integration in the ASEAN: an examination in light of actual conditions

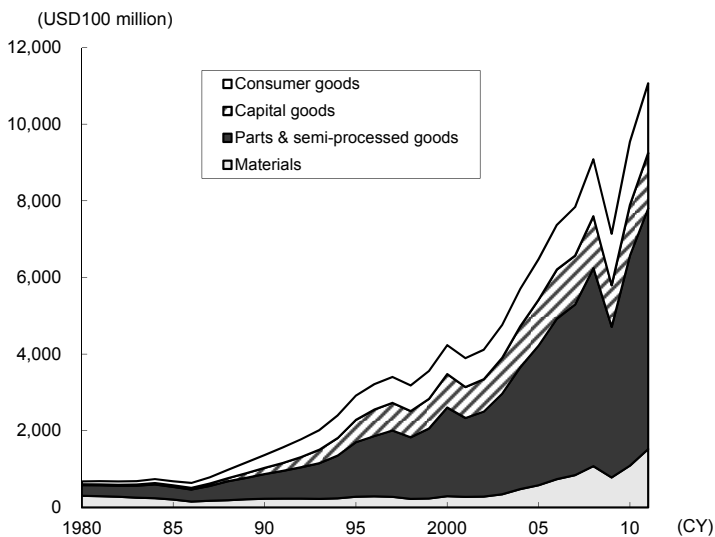
In this section, we shall ascertain the actual state of progress of economic ties in the ASEAN through the endeavors toward formation of the AFTA in the foregoing section.

(1) Intra-regional trade in the ASEAN expanded mainly in intermediate goods

Trends in ASEAN exports indicate that exports expanded with the exception of periods such as the Asian Financial Crisis and the Global Financial Crisis (**Chart 2**). A closer look in terms of usage of goods reveals that the increase of intermediate goods such as parts and semi-processed goods pushed up total trade from the mid-1990s.

In the background to the expansion of ASEAN's exports (mainly of intermediate goods) is the formation and development of supply chains throughout a wide area of East Asia. East Asia, including the ASEAN, envelopes a varied range of countries such as Japan, South Korea and Taiwan which possess advantages in technology and countries such as China and the ASEAN which possess low-cost labor. In a bid to maximize the advantages of each of these

Chart 2: ASEAN export value (breakdown by usage of goods)



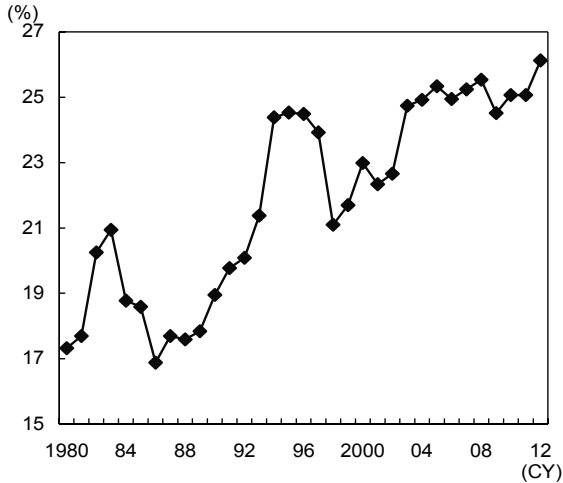
Source: RIETI, *RIETI-TID 2012*.

countries, production processes were segmentalized in manufacturing sectors such as electronics and electrical machinery, leading to the exchange of parts among production sites dispersed throughout the region. Hence, supply chains were formed throughout East Asia, resulting in the expansion of trade in intermediate goods among production sites.

Amid these developments, the percentage of intra-regional trade rose in the ASEAN. **Chart 3** depicts the ratio of intra-regional trade (exports to the ASEAN/value of total exports). The ratio of intra-regional trade has been rising since the 1980s (note 4). Despite a decline during certain periods such as the Asian Financial Crisis, the ratio has risen to approximately 26% since 2004 (note 5).

The rise of the intra-regional trade ratio in the ASEAN stems most likely from the rise in trade of intermediate goods such as parts and semi-processed goods within the region along with the

Chart 3: Intra-regional trade ratio in the ASEAN



Note: Intra-regional trade ratio = value of ASEAN exports/ASEAN exports to the world

Source: IMF, *Direction of Trade Statistics*.

reduction of tariffs for the formation of the AFTA. Indeed, a look at **Chart 4**, showing intra-regional trade in terms of goods, indicates the rise in share of parts and semi-processed goods, particularly from the mid-2000s.

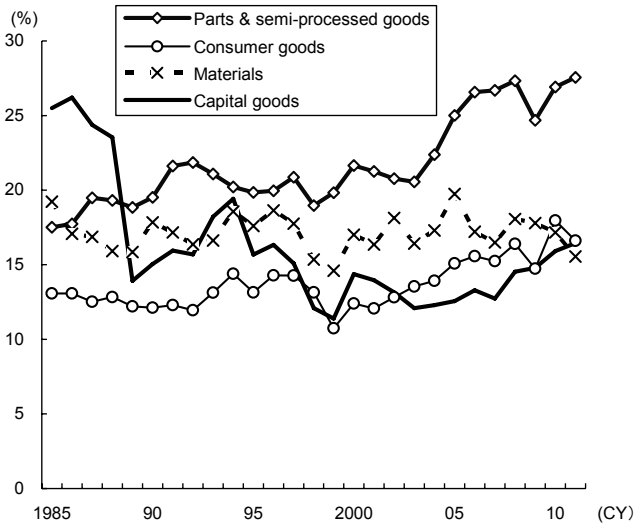
(2) Trade intensity rises in the ASEAN

We infer that economic ties between countries within the ASEAN are rising on a medium to long-term perspective, mainly reflecting the movement to eliminate tariffs of intermediate goods in the ASEAN region due to the AFTA. To verify this point, we shall resort to (1) the trade intensity index, (2) the coefficient on trade complementarity, and (3) empirical analysis using the gravity model.

a. The trade intensity index

Firstly, we shall look at the change in the trade intensity index which gauges the intensity of trade between two countries (**Chart 5**).

Chart 4: Intra-regional trade ratio (by goods)



Source: RIETI, *RIETI-TID 2012*.

The change between 2000 and 2005 indicates that trade intensity is rising among many countries of the ASEAN and hence that intra-regional trade ties are growing stronger. At the same time, ASEAN's trade intensity with China and Japan is also strengthening, suggesting that trade within East Asia is intensifying due to the construction of wide supply chains in East Asia including the ASEAN.

Chart 5: Trends in the trade intensity index

[2000]									
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	China	US	Japan
Indonesia		2.46	2.44	5.00	1.70	2.37	126.00	0.70	3.90
Malaysia	2.48		3.25	8.71	3.73	1.98	0.87	1.06	2.19
Philippines	0.91	2.80		3.87	3.25	0.80	0.49	1.54	2.47
Singapore	15.51	14.07	4.54		4.38	6.18	1.10	0.89	1.27
Thailand	3.69	3.17	2.90	4.12		4.95	1.15	1.10	2.48
Vietnam	3.27	2.22	6.11	2.90	2.65		3.00	0.26	2.79
ASEAN	1.58	5.84	6.25	3.91	2.95	3.73	1.09	0.82	2.24
[2005]									
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	China	US	Japan
Indonesia		3.83	3.27	5.45	2.63	2.39	1.37	0.75	4.70
Malaysia	3.07		2.77	9.31	5.40	2.48	1.16	1.28	2.09
Philippines	1.50	5.70		3.91	2.85	2.28	1.75	1.17	3.90
Singapore	12.55	12.66	3.60		4.13	5.81	1.52	0.68	1.22
Thailand	4.67	5.01	3.66	4.13		6.43	1.46	1.00	3.04
Vietnam	1.88	3.03	5.05	3.52	2.67		1.76	1.18	2.99
ASEAN	6.25	6.33	3.16	3.87	3.59	4.20	1.42	0.93	2.48
[2010]									
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	China	US	Japan
Indonesia		5.37	5.49	4.17	2.33	2.21	1.06	0.69	3.51
Malaysia	3.11		4.26	6.41	4.29	3.19	1.34	0.72	2.25
Philippines	0.96	2.46		6.84	2.80	1.99	1.19	1.12	3.27
Singapore	10.33	10.77	5.55		2.90	3.75	1.11	0.49	1.00
Thailand	4.18	4.95	6.89	2.23		5.05	1.18	0.79	2.26
Vietnam	2.26	2.71	6.66	1.46	1.36		1.12	1.55	2.38
ASEAN	5.15	5.78	5.77	2.75	2.43	3.37	1.17	0.69	2.08
[2012]									
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	China	US	Japan
Indonesia		4.99	3.61	4.76	2.86	1.69	1.35	0.67	3.61
Malaysia	3.90		2.68	7.28	4.31	2.57	1.56	0.73	2.54
Philippines	1.42	1.65		4.94	3.85	1.61	1.41	1.21	4.33
Singapore	9.30	10.36	2.86		3.12	3.57	1.28	0.47	1.05
Thailand	4.30	4.56	3.92	2.49		3.99	1.39	0.84	2.33
Vietnam	1.87	3.41	3.12	1.13	2.09		1.33	1.50	2.69
ASEAN	4.73	5.29	2.97	2.92	2.95	2.85	1.36	0.74	2.32

- Notes: 1. The trade intensity index (based upon exports) is calculated as follows:

$$\frac{\text{Value of exports from Country } i \text{ to Country } j}{\text{total value of Country } i \text{'s exports}} \div \frac{\text{value of exports from the world to Country } j}{\text{total value of the world's exports}}$$

2. Shading indicates an increase from 2000.

Source: IMF, *Direction of Trade Statistics*.

However, both the periods from 2005 to 2010 and 2010 to 2012 indicate that it fails to show a clear rise in trade intensity in the ASEAN despite slight variations from country to country. In particular, the change between 2010 and 2012 after the Global Financial Crisis shows the intensification of ties with countries outside of the ASEAN such as China, Japan and the US.

b. The coefficient on trade complementarity

Next, we will look at the coefficient on trade complementarity which measures the degree of complementarity in trade between two countries (**Chart 6**). Given the use of detailed item-based data, we limited the countries to the ASEAN6 (Thailand, Malaysia, Singapore, the Philippines, Indonesia and Vietnam).

A look at the trade complementarity coefficient reveals a rise of the coefficient from 1990 to 2005, showing that the complementarity of trade is rising in the ASEAN.

Chart 6: Trends in the coefficient on trade complementarity

	1990	1995	2000	2005	2010	2012
HS1992	48.6	53.0	59.1	62.6	61.4	61.5
HS1996			58.1	62.5	61.7	61.3
HS2002				65.8	62.0	61.8

- Notes:
- The coefficient on trade complementarity was calculated as follows:

$$C_{ij} = 100 - \frac{\sum (|m_{ik} - X_{ij}|)}{2}$$
 mik : Import share (in total import) of Country k's item i
 Xij : export share (in total import) of Country j's item i
 - The "HS Code", referring to the "Harmonized Commodity Description and Coding System" (hereinafter, "HS"), is a coding system for the unification of the names and classifications of international trade items. The HS classification is revised from time to time, revised in the past in 1992, 1996, 2002, 2007 and 2012. The notations "HS1992", "HS1996", and "HS2002" refer to the calculations by classifications according to standards of 1992, 1996, and 2002.

Source: UN Comtrade.

However, the complementarity coefficient has not risen from 2005 to the present, suggesting the possibility that trade complementarity has not necessarily risen in recent years.

c. Empirical analysis using the gravity model

We conducted estimates using the gravity model (note 6) to ascertain whether the ASEAN is creating more intra-regional trade than other trade areas. The gravity model is an estimation model used frequently to examine the factors determining bilateral trade. Among the main explanatory variables are economic size, income level, and distance between the two countries. Theoretically, the larger or higher the economic size and income level and the nearer the distance between two countries, it is assumed that trade activity between the two countries is higher. In this paper, we shall add the ASEAN dummy variable (ASEAN membership by both of the countries engaged in trade takes on a value of 1 while the absence of membership in the ASEAN takes on a variable of 0) to the foregoing variables to measure the impact of ASEAN's regional characteristic upon the volume of trade. By doing so, we shall examine the extent to which the developments toward economic integration in the ASEAN are having an impact upon the creation of trade.

The gravity model takes the form of:

$$\begin{aligned} \ln T_{ij} = & \alpha + \beta_1 \ln (GDP_i GDP_j) \\ & + \beta_2 \ln (GDPPC_i GDPPC_j) + \beta_3 \ln (Dist_{ij}) \\ & + \beta_4 Border_{ij} + \beta_5 Language_{ij} + \beta_6 ASEAN_{ij} \\ & + \beta_7 EU_{ij} + \beta_8 NAFTA_{ij} + \varepsilon_{ij} \end{aligned}$$

Where each of the variables is as follows:

T_{ij} : value of trade between the two countries

$GDP_i GDP_j$: the product of GDP

$GDPPC_i GDPPC_j$: the product of per-capita GDP

$Dist_{ij}$: the distance between two countries

$Border_{ij}$: dummy variable to indicate the absence or presence of a common border between two countries

- Language_{ij}* : dummy variable to indicate the absence or presence of a common language
- ASEAN_{ij}* : dummy variable to indicate the absence or presence of ASEAN membership
- EU_{ij}* : dummy variable to indicate the absence or presence of EU membership
- NAFTA_{ij}* : dummy variable to indicate the absence or presence of NAFTA membership

While the sample group includes approximately 200 countries on which trade data is available, there are lapses for certain years in some countries. Moreover, in cases where two countries do not possess trade relations, such are deleted from the sample (note 7). The estimation period is a cross section of the following five years: 1990, 2000, 2005, 2010, 2012 (note 8).

As a result of estimation, we found that from 1990 onward, the ASEAN dummy was positively significant on a consistent basis, and more or less about the same in terms of proximity in distance and absolute values (**Chart 7**). These results suggest that the initiatives toward ASEAN's economic integration such as the AFTA are stimulating intra-regional trade.

Nevertheless, the trends in the coefficient of the ASEAN dummy from 2005 onward indicates that ASEAN's regional effect is not rising along with the passage of time.

As shown above, all three analytical tools, namely the trade intensity index, the trade complementarity coefficient, and the gravity model, indicate the steady rise of economic integration in the ASEAN from 1990 to around 2005. On the other hand, it also suggests that ASEAN's integration is not progressing as much as it did in the past from mid-2000. The intra-regional trade ratio has more or less flattened out after rising to around 26% in the first half of the 2000s (**Chart 3**).

Some of the plausible factors are 1. the rise of exports to developed countries due in part to the strength of the overall global economy centering upon the US, 2. the increase of China-bound

exports due to the full-fledged rise of China as the final destination of exports following China's accession to the World Trade Organization (WTO).

However, despite the intensification of intra-regional trade among the ASEAN6 due mainly to the reduction of tariffs under the AFTA, it is possible that its trade creation effect is declining marginally due to the fact that the process of tariff reduction has almost been completed. In order to achieve a further unification of the ASEAN, it would be necessary to eliminate intra-regional tariffs among the CLMV. Moreover, there should be initiatives not only in the area of tariffs but also toward institutional unification such as the reduction/elimination of non-tariff barriers and the development of infrastructure transversing the ASEAN.

In the next section, we shall examine the initiatives for the progress of unification of the ASEAN.

Chart 7: Results of estimation by the gravity model

	1990		2000		2005	
	Coefficient	Standard error	Coefficient	Standard error	Coefficient	Standard error
GDP	0.93 ***	0.01	1.03 ***	0.01	1.06 ***	0.01
GDP per capita	0.15 ***	0.01	0.07 ***	0.01	0.05 ***	0.01
Distance	-1.22 ***	0.03	-1.32 ***	0.02	-1.32 ***	0.03
Dummy of absence or presence of a common border	0.73 ***	0.13	1.16 ***	0.12	1.15 ***	0.12
Dummy of absence or presence of a common language	0.77 ***	0.05	0.85 ***	0.05	1.19 ***	0.05
ASEAN dummy	1.08 ***	0.28	1.37 ***	0.29	1.51 ***	0.31
NAFTA dummy	-0.32 ***	0.11	-0.29 ***	0.11	-0.25 **	0.12
EU dummy	-0.52 ***	0.13	0.06	0.10	0.00	0.12
Constant	-9.69 ***	0.29	-9.99 ***	0.24	-10.95 ***	0.26

	2010		2012	
	Coefficient	Standard error	Coefficient	Standard error
GDP	1.04 ***	0.01	1.03 ***	0.01
GDP per capita	0.05 ***	0.01	0.07 ***	0.01
Distance	-1.24 ***	0.02	-1.29 ***	0.03
Dummy of absence or presence of a common border	1.13 ***	0.12	1.15 ***	0.13
Dummy of absence or presence of a common language	1.11 ***	0.05	1.14 ***	0.05
ASEAN dummy	1.12 ***	0.28	1.10 ***	0.29
NAFTA dummy	0.11	0.12	0.12	0.12
EU dummy	0.51 ***	0.11	0.50 ***	0.11
Constant	-11.7 ***	0.26	-11.79 ***	0.27

Notes: 1. *** indicates significance at the 1% level.
 ** indicates significance at the 10% level.
 2. Data extended using "CEPII gravity dataset".

Source: Made by MHIRI based upon CEPII and others.

4. Initiatives toward the formation of an ASEAN economic community

(1) The nature of the ASEAN economic community and action plan for its formation (AEC Blueprint)

As in Section 2, the ASEAN engaged in initiatives for the formation of the AFTA and achieved its target of reducing intra-regional tariffs among the ASEAN6 to 0–5% in 2003. Having achieved its initial goal, the ASEAN declared its intent to establish a community in the Declaration of ASEAN Concord II (Bali Concord II) in October 2003. The ASEAN Concord II sets forth the formation of the ASEAN Community comprised of the ASEAN Security Community (ASC), the ASEAN Economic Community (AEC) and the ASEAN Socio-Cultural Community (ASCC).

Although the core of the AEC is the AFTA, the AEC goes

Chart 8: Strategic Schedule of the AEC Blueprint

Strategic Schedules	Core Elements
① Single market and production base	<ul style="list-style-type: none"> • Free flow of goods • Free flow of services • Free flow of investment • Freer flow of capital • Free flow of skilled labor • Priority integration sectors • Food, agriculture and forestry
② Competitive economic region	<ul style="list-style-type: none"> • Competition policy • Consumer protection • Intellectual property rights • Infrastructure development • Tax system • Electronic commerce
③ Equitable economic development	<ul style="list-style-type: none"> • Small and Medium Enterprises (SMEs) • Initiative for ASEAN integration
④ Integration into the global economy	<ul style="list-style-type: none"> • External economic relations • Participation on global supply network

Source: ASEAN Secretariat, *AEC Blueprint*.

beyond a free trade area and also strives for economic integration including the facilitation of trade, free flow of services, the free flow and facilitation of investment, conformity with standards, and mutual certification.

Under the initial schedule, the AEC was to be established by 2020. However, it was agreed at the ASEAN Summit in January 2007 that the AEC would be established in 2015 – five years earlier than initially scheduled – in light of circumstances such as the progress of globalization and the rise of peripheral emerging economies such as India (note 9). Furthermore, the ASEAN Economic Community (AEC) Blueprint to serve as the master plan for establishment of the AEC was adopted at the ASEAN Summit in November 2007.

The AEC Blueprint sets forth four Strategic Schedules (**Chart 8**). They are 1. single market and production base, 2. competitive economic region, 3. equitable economic development, and 4. integration into the global economy. According to the Strategic Schedules, there are comprehensive roadmaps including 17 “core elements” and 176 “priority actions”. These are to be undertaken during the period from 2008 to 2015 in four phases set every two years.

Although the AEC will eliminate all tariffs within the region as a general rule, extra-regional tariffs are left to the discretion of each country since the AEC is not a customs tariff union (note 10). Note also that services trade and investment will still be subject to certain restrictions and will not be liberalized completely. Furthermore, the mobility of persons was limited only to skilled labor. As such, the economic integration sought by the AEC is not a tight community such as the EU but rather seeks a level of integration similar to economic partnership agreements (EPA) concluded by countries such as Japan (**Chart 9**).

We shall look at the progress of the liberalization of the flow of goods and the liberalization of investment in services.

(2) Initiatives for the further reduction and elimination of intra-regional tariffs and expansion of preferential tariffs

Although the ASEAN has more or less succeeded in the elimination of intra-regional tariffs in the ASEAN6, intra-regional tariffs are scheduled for elimination among the CLMV in 2015.

Furthermore, the ASEAN Trade in Goods Agreement (ATIGA) was concluded in 2009. This agreement is an amendment of the Common Effective Preferential Tariff Scheme (CEPT) under the AFTA, which integrates the initiatives which were added since 1993. To be more exact, it is a comprehensive agreement spanning a broad range of issues including rules of origin, elimination of non-tariff barriers, trade facilitation, customs, criteria and scorecard, and

Chart 9: Comparison of the AEC with the EU and EPA

	AEC	EU	EPA
Elimination of tariffs	○	○	○
Elimination of non-tariff barriers	○	○	△
Trade facilitation	○	○	○
Extra-regional common tariff	×	○	×
Mutual certification	△	○	○
Liberalization of trade in services	○	○	○
Liberalization of investment	○	○	○
Movement of natural persons	△	○	△
Protection of intellectual property rights	○	○	○
Opening of government procurement	×	○	△
Competition policy	△	○	△
Intra-regional cooperation	○	○	○
Common currency	×	○	×

Notes: ○ : indicates that the matter is covered, △ : indicates that the matter is covered albeit on a limited basis, or that its 100% achievement is difficult, × : indicates that the matter is not covered.

Source: Made by MHRl based upon Ishikawa, Shimizu and Sukegawa (2013).

provides a legal framework for the promotion of the liberalization and facilitation of the free flow of goods.

a. The reduction and elimination of intra-regional tariffs

Chart 10 provides the state of reduction and elimination of tariffs in the member countries of the ASEAN. In the ASEAN6, tariffs on 60,712 out of 61,202 namely 99.2% of all items have been eliminated as of February 2013.

Chart 11 provides a list of items with tariff rates of 0–5%. For Malaysia, items in this list include fruit such as bananas and pineapples. In the Philippines, meats such as pork, and corn are included in the list. In Thailand, the list includes cut flowers and flower buds, and potatoes. On the other hand, items with tariff rates

Chart 10: The reduction and elimination of intra-regional tariffs under the AFTA among the countries of the ASEAN

	Total no. of items	Tariff rate 0%	Share (%)	Tariff rate over 0%			
				Up to 5%	Over 5%	Others	
Brunei	9,916	9,844	99.3	72	0	-	72
Indonesia	10,012	9,899	98.9	113	0	17	96
Malaysia	12,337	12,182	98.7	155	60	13	82
Philippines	9,821	9,685	98.6	136	74	35	27
Singapore	9,558	9,558	100	0	0	-	-
Thailand	9,558	9,544	99.9	14	14	-	-
ASEAN6	61,202	60,712	99.2	490	148	65	277
Cambodia	8,300	3,327	40.1	4,973	4,833	140	-
Laos	9,558	7,525	78.7	2,033	1,585	361	87
Myanmar	9,558	7,614	79.7	1,944	1,884	-	60
Vietnam	9,558	6,905	72.2	2,663	2,365	98	190
CLMV	36,974	25,371	68.6	11,603	10,667	599	337
ASEAN10	98,176	86,083	87.7	12,093	10,815	664	614

Notes: 1. "Others" refer to items which are not indicated in the AFTA preferential tariffs. Items with tariff rates over 5% refer to those items which were incorporated into the Inclusion List (IL) from the General Exception List (GEL), Sensitive List (SL), Highly Sensitive List (HSL).

2. AHTN2012 Version. The AHTN2007 with respect to Cambodia.

Source: ASEAN Secretariat (February 2013).

over 5% are limited to rice (Indonesia, Malaysia, Philippines) and sugar (Indonesia, Philippines). As indicated above, tariffs still exist in certain agricultural products but are mostly eliminated for industrial products among the ASEAN6. This allows us to deduce that the ASEAN region provides an environment which facilitates the free flow of parts and semi-processed goods.

In contrast, among the CLMV, tariffs have been eliminated on 25,371 items out of 36,974 items (68.6% of the items) (**Chart 10**).

Chart 11: Items with tariffs under the AFTA among the ASEAN6

HS Code	Item	Brunei		Indonesia		Malaysia		Philippines		Thailand	
		No. of items	Tariff rate	No. of items	Tariff rate	No. of items	Tariff rate	No. of items	Tariff rate	No. of items	Tariff rate
0103	swine, live							4	5%		
0105	chickens, ducks, geese, turkeys, and guineas, live							6	5%		
0203	meat of swine (pork), fresh, chilled or frozen							20	5%		
0207	meat & ed ofal of poultry, fresh, chill or frozen							36	5%		
0603	cut flowers & buds for bouquet etc., prepared									6	5%
0701	potatoes (except sweet potatoes), fresh or chilled									2	5%
0714	cassava arrowroot etc fresh or dry, sago pith							6	5%		
0803	bananas and plantains, fresh or dried					6	5%				
0804	dates, figs, pineapples, avocados etc. fr or dried					4	5%				
0807	melons and papayas, fresh					4	5%				
0810	fruit nesoi, fresh					9	5%				
0901	coffee, coffee husks etc, substitutes with coffee									5	5%
1005	corn (maize)							2	5%		
1006	rice			10	30%	12	20%	19	40%		
1203	copra									1	5%
1302	veg saps & extracts; pectates etc: agar-agar etc.	2	MFN								
1701	cane or beet sugar & chem pure sucrose, solid form			5	25%			16	18%		
2106	food preparations nesoi			7	MFN						
2203	beer made from malt	2	MFN	2	MFN	4	GE				
2204	wine of fresh grapes, grape must nesoi	13	MFN	13	MFN	13	GE				
2205	vermouth & other wine of fresh grapes spec flavored	4	MFN	4	MFN	4	GE				
2206	fermented beverages nesoi (cider, berry, mead etc)	6	MFN	6	MFN	10	GE				
2207	ethyl alcohol, undenat. n/un 80% alc, alcohol, denat	1	MFN								
2208	ethyl alcohol, undenat. and 80% alc, spirit bev etc	16	MFN								
2401	tobacco, unmanufactured, tobacco refuse										
2402	cigars, cigarettes etc., of tobacco or substitutes										
2403	tobacco & tobacco subst mfrs nesoi, tob proces etc										
2639	vegetable alkaloid			4	MFN						
3006	pharmaceutical goods (specified sterile prod etc.)			2	MFN						
3302	odoriferous mixtures as raw materials for industry			2	MFN						
3601	propellant powders			1	MFN						
3602	prepared explosives other than propellant powders			1	MFN						
3604	fireworks, signalling flares, rain rockets etc.	1	MFN								
3825	chemical industry residual material, urban waste, etc.			10	MFN						
8710	lank & other armored fight vehicle, motorized, and parts			1	MFN						
9301	military weapons ex revolvers pistols lances etc	3	MFN	3	MFN	3	GE	3	GE		
9302	revolvers & pistols, designed to fire live ammo	1	MFN	1	MFN	1	GE	1	GE		
9303	sport shotguns & rifles etc, very pistols etc	4	MFN	4	MFN	4	GE	4	GE		
9304	arms nesoi, other than side arms and similar arms	2	MFN	2	MFN	2	GE	2	GE		
9305	parts & accessories of arms of head 9301 to 9304	8	MFN	8	MFN	8	GE	8	GE		
9306	bombs, grenades etc, cartridges etc and parts	8	MFN	8	MFN	10	GE	8	GE		
9307	swords, cutlasses, bayonets, & siml arms & parts	1	MFN	1	MFN	1	GE				
	No. of items	72		113		115		135		14	

Note: "GE" refers to "general exceptions", "MFN" refers to "Most Favored Nation", "nesoi" refers to "not elsewhere specified or included".

Source: Sukegawa (2013)

Furthermore, 10,667 of the items have tariff rates of 0–5%, which is 28.9% of the total. Moreover, 2.5% of the items have tariff rates over 5%.

A look at the percentage of tariff elimination among the countries reveals that Laos, Myanmar and Vietnam have eliminated tariffs on more than 70% of all items: Laos (78.7%), Myanmar (79.7%), Vietnam (72.2%). However, the percentage is only 40.1% at present in Cambodia. Although Cambodia had promised to reduce tariff rates upon all items in the IL to 0–5% and to eliminate tariffs on 60% on such items, progress has been slow.

While the four countries of the CLMV are scheduled to eliminate tariffs upon items in the IL in 2015, they are allowed an extension of the deadline to 2018 as long as they do not exceed 7% of all items. Although all four countries will be determining the items and schedule of tariff reduction in 2014, it is still unknown as of February 2014 which items will be subject to the extension. Having said so, in the case of Vietnam, it is said that almost all motor vehicles and motorcycles are included in the list of items granted the extension of the deadline (Ishikawa, Shimizu, Sukegawa (2013)).

b. Initiatives for the expansion of preferential tariffs

To qualify for application of the CEPT for transactions within the ASEAN, the relevant product must be ASEAN originating goods. The Rules of Origin (note 11) determines whether a certain product is a good originating in the ASEAN.

The Rules of Origin under the AFTA has ruled from the outset that the “cumulative regional value content (note 12) must be at least 40%”. This cumulative rule poses a risk for companies since fluctuations in foreign exchange rates and raw material costs may make it difficult to meet the requirement. As such, many companies reportedly avoid this risk in consideration of such fluctuation by maintaining a buffer of 5–10% (Ishikawa, Shimizu, Sukegawa (2013)). Furthermore, given the need for companies to manage the regional value content for each product model, the operational cost would be a considerable burden with a large number of models. These

operational costs are serving as a barrier to the usage of the CEPT.

In the light of these circumstances, the ASEAN has started to accept the adoption of the “Change in Tariff Classification” (CTC) since August 2008 (note 13). The attachment of a reference number to the components form of goods filing for Certificates of Origin will make it possible to determine the “locality” of a good by ascertaining whether or not there has been a change in the reference number of the “good” and the “materials/components” used therein. Price fluctuation risks accompanying the adoption of cumulative regional procurement standards may be avoided by adopting the foregoing.

In fact, when a more lenient application of the Rules of Origin was permitted in 2008, liquid crystal TVs could not enjoy the benefits of the CEPT under the cumulative rule since the additional value of the panels procured from outside the ASEAN such as Japan and South Korea made up approximately 60–70% of the total value of the product. However, the requirements for Rules of Origin may be cleared by adopting the CTC since the tariff number on certain components imported from outside the ASEAN (mainly components and materials) would differ from the tariff number on exports of the final product (final goods). This enabled liquid crystal TVs assembled as final products in Malaysia to be exported to other countries of the ASEAN as products originating in the ASEAN.

The system allowing a choice of either the “cumulative regional procurement standards” or the CTC is also adopted in FTAs and EPAs concluded by the ASEAN with countries outside the region, enabling companies within the ASEAN to expand their breadth of procurement and exports benefitting from the CEPT to regions outside of the ASEAN (Ishikawa, Shimizu, Sukegawa (2013)).

(3) Initiatives toward the elimination of non-tariff barriers

As shown above, the reduction and elimination of tariffs within the ASEAN is progressing steadily. However, it is necessary not only to eliminate tariffs but also to eliminate and reduce non-tariff barriers in order to facilitate the smooth flow of trade. Even if tariffs are eliminated, the efforts to do so would be futile if there are other

barriers to the promotion of trade.

The ASEAN Secretariat requires the member countries of the ASEAN to report their trade-restricting measures on a voluntary basis. Upon doing so, the ASEAN Secretariat will assess whether the continuation of the reported measures are appropriate, and request, as much as possible, the elimination or reduction of the measures which are not considered appropriate.

Under the ATIGA, which is based upon the principle of refraining from the introduction of new trade restrictive measures and to reduce and eliminate existing such measures, the countries of the ASEAN were planning to eliminate non-tariff barriers according to the following time schedules: the ASEAN5 (the ASEAN6 excluding the Philippines) (2010), the Philippines (2012), the CLMV (by 2018 at the latest).

However, it should be noted that non-tariff measures include those which are explicit import restriction measures such as import quotas and non-automatic import permits, and those which are technical measures such as safety standards, industrial standards, health and hygiene regulations, and quality standards. Note also that the elimination of non-tariff measures require the amendment of domestic laws in many cases, and is generally a time-consuming process. Therefore, the reduction and elimination of non-tariff measures according to the time schedule agreed under the ATIGA would not be an easy task (Ishikawa, Shimizu, Sukegawa (2013)).

As a matter of fact, progress is slow in each of the member countries. For example, the section on “Non-tariff Measures” in the ATIGA states explicitly that in the event of the introduction of new measures or the amendment of existing measures, such shall be reported in accordance with reporting procedures. According to this provision, countries introducing new measures are required to report such introduction to the ASEAN Secretariat 60 days prior to the date the measure becomes effective (note 14).

Nevertheless, in practice, there are many cases in which measures are introduced without reporting to the ASEAN Secretariat. For example, Indonesia introduced a measure making

import inspections obligatory for seven items including motor vehicle parts, cosmetics, ceramics, iron & steel, energy-saving light bulbs, cell-phones, and bicycles (note 15). While it is said that this measure was introduced due to concerns regarding the increase of imports reflecting the elimination of tariffs within the ASEAN in 2010 and the ASEAN-China FTA, note that the foregoing reporting procedures were not taken prior to its introduction.

Under these circumstances, the ASEAN Economic Ministers Meeting in August 2013 expressed its concern regarding the slow progress of the member countries in the reduction and elimination of non-tariff barriers. Upon doing so, it confirmed the importance to eliminate non-tariff barriers and, as required by the ATIGA, the necessity for transparency, appropriate reporting and to abide by evaluation obligations.

(4) Initiatives for the liberalization of trade in services

The ASEAN is engaged in the liberalization of trade in services under the ASEAN Framework Agreement on Services (AFAS) in the form of implementing multiple schedules of specific commitments referred to as “package(s) of commitments”.

Trade in services are classified into four modes as follows: Mode 1 (Cross-Border Supply), Mode 2 (Consumption Abroad), Mode 3 (Commercial Presence), Mode 4 (Movement of Natural

Chart 12: Target for foreign equity participation in services areas

	(%)			
	Up to 2008	Up to 2010	Up to 2013	Up to 2015
Aviation, e-ASEAN, healthcare, tourism	51%	70%	70%	70%
Logistics service	49%	51%	70%	70%
Others	49%	51%	51%	70%

Source: ASEAN Secretariat, *AEC Blueprint*.

Persons) (note 16). Having liberalized Modes 1 and 2, negotiations are currently progressing regarding the liberalization of services categorized as Mode 3.

The AEC Blueprint is attempting to liberalize service areas by setting forth five Priority Integration Sectors (**Chart 12**). More specifically, the AEC Blueprint requests members to allow foreign (ASEAN companies) equity participation of not less than 70% in the four sectors of aviation, e-ASEAN (electronic government), healthcare, and tourism by 2010, by 2013 for logistics services, and by 2015 for all other services sectors.

Currently, the members other than Singapore are all cautious regarding the liberalization of investment in the services sectors. Under the 8th package, the AEC Blueprint initially targeted the allowance of ASEAN equity participation of not less than 51% in the Priority Integration Sectors by 2008, and in other sectors including the logistics sector by 2010. However, it was only in 2012 – two years later than initially scheduled – that the 8th package was agreed upon. Given such delay, the ASEAN postponed its target by two years on the basis of its judgment that it would be difficult to achieve its initial target date of 2015.

Even after amendment, the members are already behind the liberalization schedule. Even though the 9th package was scheduled to allow equity participation of not less than 70% in the logistics sector, and not less than 51% in at least 14 sectors in other services sectors, the members were unable to sign the 9th package at the ASEAN Economic Ministers Meeting in August 2013.

(5) Evaluation of the AEC Blueprint by scorecards

As mentioned above, the action plan for formation of the AEC is set forth in the Blueprint publicly released in 2007. Furthermore, the state of implementation of the Blueprint is tracked by means of scorecards.

According to the scorecard for the first half of the Blueprint (2008–2011) which has been published, the achievement of the Blueprint has been evaluated as follows: “a single market and

production base” (65.9%), “a highly competitive economic region” (67.9%), “a region of equitable economic development” (66.7%), “a region fully integrated into the global economy” (85.7%), and in overall terms (67.5%) (**Chart 13**). According to the state of progress ascertained by the ASEAN Economic Ministers Meeting, the status of achievement is said to be 74.5% as of October 2012 and 79.4% as of August 2013 (the details are not publicly released).

As far as the foregoing indicates, it appears that the initiatives for the formation of the AEC are progressing steadily. However, as we have seen already, despite the progress in the reduction and elimination of tariffs, the elimination of non-tariff barriers and liberalization in the services sector is still lagging.

A look at the state of initiatives toward “a single market and production base” reveals that its progress has been lagging since entry into Phase II (**Chart 14**). A plausible reason for this delay may be that integration first progressed in areas which are easy to tackle, leaving other difficult areas requiring the coordination of

Chart 13: Overall evaluation of the ASEAN Economic Community (AEC) scorecard

	(%)		
	Phase I and II	Phase I (2008 - 09)	Phase II (2010 - 11)
A single market and production base	65.9	93.8	49.1
A highly competitive economic region	67.9	68.7	67.4
A region of equitable economic development	66.7	100.0	55.5
A region fully integrated into the global economy	85.7	100.0	77.8
Total	67.5	86.7	55.8

Note: Details regarding Phase III (2012 – 13) are not disclosed.

Source: ASEAN Economic Community Scorecard – Charting Progress Toward Regional Economic Integration Phase I (2008 – 2009) and Phase II (2010 – 2011).

interests among the countries left behind (note 17).

It appears that the ASEAN Secretariat is keeping a count on the basis of declarations on the implementation of initiatives in the AEC Blueprint by member countries (Umesaki (2011)). In this case, in the event the commitments agreed upon by the ASEAN are ratified by the legislature, this is evaluated as being “completed” in the scorecard. However, note that the actual implementation of the commitments would require amendments and/or improvements of domestic legal systems, dissemination among related parties, and the establishment of responsible institutions/agencies. To deem such a state without the completion of such processes as “completed” is subject to views as being out of touch with reality (note 18).

In view of the foregoing, it is quite likely that the initiatives toward the AEC have not progressed as much as indicated by the scorecard. From a realistic point of view, there may be items stated in the AEC Blueprint which may not be achieved as scheduled during 2015.

As the member countries of the ASEAN have not delegated their sovereignty to the ASEAN, there are no clear sanctions even in the

Chart 14: The ASEAN Economic Community (AEC) scorecard (single market and production base)

	Implementation of initiatives during 2008 - 2011			Phase I (2008 - 09)			Phase II (2010 - 2011)		
	Fully implemented	Implementation unfinished	Implementation rate (%)	Fully implemented	Implementation unfinished	Implementation rate (%)	Fully implemented	Implementation unfinished	Implementation rate (%)
(1) Free flow of goods	32	24	57.1	9	0	100.0	23	24	48.9
(2) Free flow of services	23	20	53.5	10	3	76.9	13	17	43.3
(3) Free flow of investment	10	9	52.6	5	1	83.3	5	8	38.5
(4) Freer flow of capital	6	0	100.0	1	0	100.0	5	0	100.0
(5) Free flow of skilled labor	1	0	100.0	-	-	-	1	0	-
(6) Priority integration sectors	29	0	100.0	28	0	100.0	1	0	100.0
(7) Food, agriculture and forestry	13	6	68.4	8	0	100.0	5	6	45.5
Total	114	59	65.9	61	4	93.8	53	55	49.1

Source: ASEAN Economic Community Scorecard – Charting Progress Toward Regional Economic Integration Phase I (2008 – 2009) and Phase II (2010 – 2011).

event the integration measures are delayed. Furthermore, in contrast to the EU which possesses an administrative organization for the promotion of economic integration, the ASEAN Secretariat does not possess such legal power. The AEC-related measures are only implemented as domestic measures through legislation or administrative guidance by the governments of each of the member countries. Under such circumstances, there are no legal means or binding power as an institution to stop any movements which hamper integration such as intentional procrastination in introduction of rules, establishment of non-tariff barriers, or the introduction of restrictions upon foreign capital.

All told, we are left to rely upon plain “peer pressure” among the member countries to promote the implementation of the measures. To make this mechanism work, it would be necessary for the member countries to share a “political intention” to achieve a greater level of perfection of the AEC.

5. Countermeasures taken by Japanese companies in response to the progress of economic integration

In this section, we shall survey the countermeasures taken by Japanese companies in response to the progress of economic integration in the ASEAN.

(1) Promotion of the usage of preferential intra-regional tariffs

The AFTA has been referred to rather mockingly as a “low-level FTA” or “the FTA that is never used” by scholars and researchers, reflecting the high level of preferential tariffs up to the first half of the 2000s and tariff exemption measures taken among the countries of the ASEAN with respect to imports of raw materials and parts

necessary for production of export products as part of their preferential investment measures.

However, as shown above, tariffs have been eliminated already with respect to 99.2% of all items – with very few exceptional items left – among the ASEAN6. Furthermore, AFTA's usage is rising steadily, given the lenient application of the Rules of Origin restrictions which form the precondition to the application of preferential tariffs.

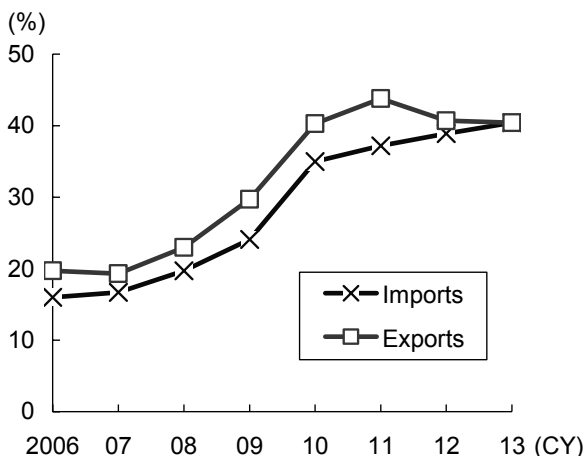
According to the *Survey of Japanese-Affiliated Companies in Asia and Oceania* by the Japan External Trade Organization (JETRO), the utilization rate of AFTA is rising steadily among Japanese companies in the ASEAN. In 2013, the utilization rate was approximately 40% for both exports and imports (**Chart 15**).

A look at the utilization rate in terms of each country reveals that the utilization rate is rising among Thailand, Malaysia and Indonesia (**Chart 16**). Transport equipment, chemical/pharmaceutical, wholesale/retail ranked among the top of the list of items which utilized the AFTA. Japanese companies in the ASEAN are raising the percentage of intra-regional procurement through the utilization of preferential tariffs.

(2) Realignment of the production system in view of the progress of intra-regional integration

Prior to the full-scale progress of AFTA in 2003, the ASEAN market was divided because of high tariffs established by each of the countries. Therefore, in order to avoid the high tariffs and tap the ASEAN market, Japanese companies had to establish production sites in each of the countries. As a result, Japanese companies have had to establish numerous small-scale production sites within the ASEAN. The progress of market integration through the formation of the AFTA has enabled Japanese companies to take a more efficient production & supply system. The review of the production system by Japanese corporations may be divided into two main patterns (note 19).

Chart 15: Utilization rate of the AFTA among Japanese companies in the ASEAN



Source: Japan External Trade Organization (JETRO), *Survey of Japanese-Affiliated Companies In Asia and Oceania (FY2013 Survey)*.

Chart 16: Utilization rate of the AFTA among Japanese companies in the ASEAN (breakdown by country)

		2010			2013			No. of utilizing firms in 2013 (Top 3 industries)		
		No. of firms	Utilizing firms	Ratio (%)	No. of firms	Utilizing firms	Ratio (%)	1st	2nd	3rd
Thailand	Exports	271	115	42.4	264	129	48.9	Transport equipment	Wholesale/retail	Chemical/Pharmaceutical
	Imports	164	79	48.2	170	92	54.1	Wholesale/retail	Chemical/Pharmaceutical	Transport
Malaysia	Exports	122	52	42.6	83	47	56.6	Electrical machinery	Chemical/Pharmaceutical	Iron/Non-ferrous metals/Metals
	Imports	101	39	38.6	67	31	46.3	Wholesale/retail	Chemical/Pharmaceutical	Iron/Non-ferrous metals/Metals
Indonesia	Exports	58	27	46.6	74	41	55.4	Transport equipment	Iron/Non-ferrous metals/Metals	Electrical machinery
	Imports	53	28	52.8	101	62	61.4	Wholesale & retail	Transport equipment	Chemical/Pharmaceutical
Philippines	Exports	45	15	33.3	45	13	28.9	Transport equipment	Wholesale/retail	Iron/Non-ferrous metals/Metals
	Imports	47	16	34.0	58	17	29.3	Transport equipment	Wholesale/retail	Iron/Non-ferrous metals/Metals
Vietnam	Exports	39	14	35.9	134	50	37.3	Chemical/Pharmaceutical	Transport equipment	Iron/Non-ferrous metals/Metals
	Imports	52	13	25.0	137	46	33.6	Transport equipment	Wholesale/retail	Chemical/Pharmaceutical

Source: Japan External Trade Organization (JETRO), *Survey of Japanese-Affiliated Companies in Asia and Oceania*.

a. Construction of a system of concentrated production & mutual supplementation

The first pattern, which seeks to adjust the production items, purports to build a system for the mutual supply of parts among production sites based upon the premise to maintain existing sites. A typical example of this case is the automotive industry.

In the 1990s, Japanese automobile makers located in the ASEAN procured much of its parts and capital goods from Japan. With the launch of the ASEAN Industrial Cooperation Scheme (AICO), it became possible to import parts and materials from within the ASEAN region if both countries agree upon the supplementation of parts. This led to the mutual procurement of major parts among automobile makers through the use of AICO. Furthermore, given the reduction of intra-regional tariffs to less than 5% in 2002 and its abolition in 2010 in the course of initiatives toward the AFTA, Japanese automobile makers reduced the percentage of parts and materials procured from Japan and raised the percentage of procurement from within the ASEAN region.

As a result, automobile makers now have a system of concentrating their production sites according to each of their parts and mutually supplying the parts among each other in the countries of the ASEAN. For example, Honda is manufacturing and assembling cars in Thailand, Indonesia and Malaysia. In this case, pressed parts, frame panels, electronic parts, interior parts, electronic engine parts and suspensions are procured from Thailand, cylinder heads, engine valves, handles and automatic transmissions are procured from Indonesia, and instrumental panels, bumpers and drive shafts are procured from Malaysia.

However, the knockdown production of the final vehicle is continued in each of the countries, without consolidating its production sites. Note also that it may be difficult for automobile makers to close down their production sites because of possible requests by the host governments to maintain the sites in consideration of its social impact due to the existence of their local supporting industries.

Furthermore, there are also movements to reinforce the production sites' manufacturing functions for exports to areas outside of the ASEAN region. For example, in 2002, Toyota Motor Corporation launched its "Innovative International Multipurpose Vehicle (IMV)" project targeting the emerging markets. In this project, the four countries of Thailand, Indonesia, South Africa and Argentina are deemed as concentrated production sites for IMV exports targeted toward the emerging markets. The "Hilux Vigo" pickup truck is made in Thailand, and the minivan "Kijang Innova" is made in Indonesia. As for principal parts, diesel engines are made in Thailand, gasoline engines in Indonesia, and transmissions in the Philippines and India, for supply toward countries producing the whole vehicles (note 20).

Other companies are also acting in a similar pattern. For example, in the production of its compact car, the "March", Nissan Motor considers Thailand as its main production site. Starting production in 2010, Thai-made March vehicles are exported to the ASEAN and Japanese markets.

b. Consolidation of production sites

The second pattern seeks to achieve economies of scale and to enhance business efficiency through the consolidation of production sites. A good example of this pattern of action may be seen in the electrical machinery industries such as household electrical appliances and audio-visual equipment.

Chart 17 sets forth the number of production sites of Japanese companies in the ASEAN according to the household electric appliance they produce. The chart provides the number of production sites in 2000 (before the full-fledged progress of AFTA), and 2010 and 2013 (when nearly all intra-regional tariffs have been abolished).

A look at **Chart 17** reveals a decrease in number of sites producing household electric appliances other than microwave ovens. During this period, the number of production sites for electric refrigerators decreased most steeply – falling from 17 to 11

sites. This was followed by the decrease of four production sites producing electric washing machines, fans and air conditioners.

Furthermore, a closer look at each of the countries reveals that the number of production sites fell during the period from 2000 to 2013 in all countries (excluding Vietnam). It should be noted that the number of production sites fell more steeply in Malaysia, the Philippines and Indonesia in comparison to Thailand which has a large number of production sites (**Chart 17**). As a result, approximately half the total number of production sites in the ASEAN (43 production sites) are now concentrated in Thailand (23 production sites). This provides a look at how electric appliance makers concentrated their intra-regional production sites in Thailand around the timing of the AFTA.

For example, Panasonic (formerly Matsushita Electric Industrial Co., Ltd.) had spread out its factories for refrigerators and washing machines (so-called “white goods”) throughout the ASEAN. As such, the realignment and merger of these “mini-Matsushitas” in each of the countries became a serious managerial challenge in the

Chart 17: The number of production sites of Japanese electric appliance makers in the ASEAN

(Sites)

	Electric refrigerators				Microwave ovens				Electric fans			
	2000	2010	2013	Change	2000	2010	2013	Change	2000	2010	2013	Change
ASEAN	17	14	11	-6	3	2	4	1	10	6	6	-4
Thailand	7	6	6	-1	2	2	4	2	5	3	3	-2
Malaysia	2	-	-	-2	1	-	-	1	1	1	1	0
Philippines	2	1	1	-1	-	-	-	-	2	1	1	-1
Indonesia	5	4	3	-2	-	-	-	-	2	1	1	-1
Vietnam	1	3	1	0	-	-	-	-	-	-	-	-
	Electric washing machines				Air conditioners				Accumulated total			
	2000	2010	2013	Change	2000	2010	2013	Change	2000	2010	2013	Change
ASEAN	14	11	10	-4	16	12	12	-4	60	45	43	-17
Thailand	5	4	4	-1	7	6	6	-1	26	21	23	-3
Malaysia	2	-	-	-2	3	3	3	0	9	4	4	-5
Philippines	3	2	2	-1	3	2	2	-1	10	6	6	-4
Indonesia	3	3	3	0	3	1	1	-2	13	6	8	-5
Vietnam	1	2	1	0	-	-	-	-	2	5	2	0

Note: The “change” in number of sites refers to the difference between 2013 and 2000.

Source: Association for Electric Home Appliances

second half of the 1990s. However, with the progress of AFTA, the “mini–Matsushitas” were gradually realigned and the production sites of white goods came to be concentrated mainly in Thailand.

Sony is another company which took drastic steps to realign its production sites in the light of the progress of AFTA. As of 2013, Sony had reduced the number of its production sites in the ASEAN by 11 in comparison with the year 2000 (**Chart 18**).

While Sony had spread its production sites for TVs in the ASEAN, it withdrew its sites from the Philippines in 2002 and Vietnam in 2008. Although Vietnam had permitted the domestic sales of goods by foreign corporations only with respect to goods manufactured in Vietnam, it promised to open its market to foreign corporations by January 2009 as a condition to accession to the WTO in 2007. In view of this development, Sony’s production sites in Vietnam stopped production of flat–panel TVs for the domestic market and became a 100% foreign–owned sales company (note 21).

Sony’s withdrawal from Thailand also stemmed from the FTA. While TVs for the Indian market were supplied domestically in India, the conclusion of an FTA between Thailand and India led to the closure of production sites in India from 2004 onward, moving to the

Chart 18: Production sites in the ASEAN (Sony, Toshiba)

	Sony				Toshiba			
	2000	2010	2013	Change	2000	2010	2013	Change
ASEAN	16	6	5	-11	18	11	11	-7
Vietnam	1	0	0	-1	1	1	2	1
Thailand	5	3	3	-2	7	3	3	-4
Singapore	2	1	1	-1	3	2	1	-2
Malaysia	3	1	1	-2	2	2	2	0
Philippines	1	0	0	-1	1	1	1	0
Indonesia	4	1	0	-4	4	2	2	-2

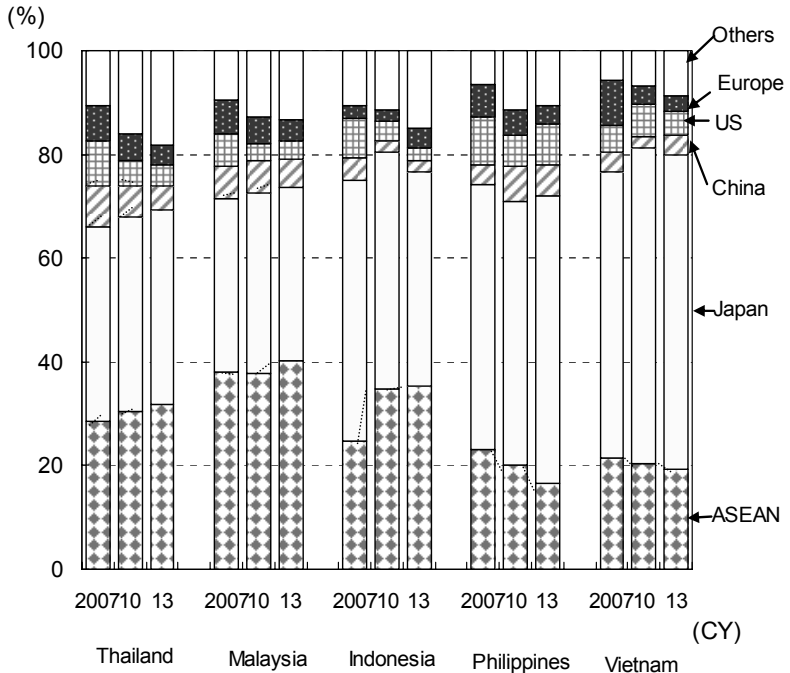
Note: The “change” in number of sites refers to the difference between 2013 and 2000.

Source: Toyo Keizai Inc., *Kaigai Shinshutsu Kigyo Soran (Comprehensive list of companies expanding overseas)*.

manufacture of parts in Malaysia, the assembly of the parts in Thailand, and exports of the final goods to India. With the abolition of intra-regional tariffs in the ASEAN in 2010, products were exported directly from Malaysia to India because Thailand's role in the production process no longer became necessary. Along with the progress of AFTA, Sony ultimately concentrated its intra-regional production sites in Malaysia.

Chart 19 sets forth the destination of exports by Japanese companies in the ASEAN. This shows that Japanese companies in Thailand, Malaysia and Indonesia are raising the percentage of

Chart 19: Destination of exports by Japanese companies in the ASEAN



Source: Japan External Trade Organization (JETRO), *Survey of Japanese-Affiliated Companies in Asia and Oceania*.

exports to the ASEAN region. On the other hand, Japanese companies in the Philippines and Vietnam are reducing the percentage of exports. This tendency is particularly notable in the Philippines.

The foregoing observations lead to speculation that Japanese companies in the ASEAN are choosing Thailand for the consolidation of their production sites and exporting their products to countries such as the Philippines. In fact, as of 2001, there were four Japanese makers (Sony, Victor Company of Japan, Sanyo Electric and Sharp) manufacturing TVs of their own brands in the Philippines. However, given the reduction of intra-regional tariffs to 5% in 2003, the four companies took steps to export its TVs to the Philippines from the following countries: Sony (Malaysia), Victor Company of Japan (Thailand), Sanyo (export from Indonesia to the Philippines).

6. Concluding remarks

From the latter half of the 1980s, the ASEAN has continued to expand its trade volume and has raised the ratio of intra-regional trade even higher. Furthermore we confirmed that the ASEAN has not only increased trade in terms of volume but also strengthened its economic ties from the three following perspectives: the trade intensity index, the coefficient on trade complementarity, and empirical analysis using the gravity model. While these developments coincide with the formation of vast supply chains within the ASEAN region, the elimination of intra-regional tariffs for the formation of the AFTA may have provided additional support.

However, the results also suggest that the process of intra-regional integration is not progressing as much as before since the latter half of the 2000s. For the promotion of intra-regional integration, a further institutional and systemic integration would be

necessary.

The ASEAN is engaged in initiatives toward the establishment of the AEC. As observed in Section 2, the liberalization of trade in goods has made significant progress. For example, the Rules of Origin may be applied more flexibly, providing an environment in which companies may use the intra-regional preferential tariffs more easily. In contrast, initiatives for the reduction of non-tariff barriers and the liberalization of investment in services are lagging. A look at the scorecard for the AEC Blueprint shows that the rate of progress has slowed down since Phase II. A plausible reason for this delay may be that initiatives toward the AEC first progressed with respect to initiatives which have already been achieved or are easy to tackle, leaving other difficult areas requiring the domestic coordination of interests left behind. With less than two years left until the target date, it appears difficult to implement all the items included in the Blueprint during 2015.

However, even if the ASEAN does not achieve its target as scheduled, the initiatives are being continued without cancelling the target itself. As indicated by the Asian Development Bank (ADB) (note 22), the ASEAN's initiatives toward institutional integration will most likely progress at snail's pace.

Amid the movements toward elimination of intra-regional tariffs accompanying the formation of the AFTA, Japanese companies stepped up their use of intra-regional preferential tariffs and realigned their production sites from a medium-term perspective. To be more precise, a system of mutual supply of goods made in various locations within the ASEAN was developed in industrial sectors such as automobiles. In industries such as electronic and electrical machinery, Japanese companies took steps to consolidate their production sites in a bid to concentrate their manufactured items.

However, note the possibility that the elimination of intra-regional tariffs may take an entirely different course in the CLMV. For example in Vietnam, while intra-regional tariffs will be maintained until 2018, the tariffs will be eliminated from then

onward. It is said that this will make finished automobiles exported into Vietnam cheaper than those produced domestically in Vietnam. Since Vietnam's automotive market is not so large, there is not much merit in maintaining the existing sites at the moment. Therefore, the Japanese automobile makers in Vietnam are currently facing the decision as to whether or not to continue the domestic production of automobiles in Vietnam (note 23).

While there are great expectations toward the ASEAN region's attractiveness as a consumer market due to the rise of the region's middle class, it would be necessary to gain a good understanding of the characteristics and needs of the local consumers, and to develop organizations and supply chains such as the establishment of development sites suited to such local consumer tastes (note 24)

Furthermore, Thailand is increasing its presence as a production site, given its wide range of supporting industries mainly in the automotive industry. Amid these developments, part of the labor-intensive processes undertaken in Thailand are being shifted to neighboring countries such as Cambodia, Myanmar and Laos as a result of the development of road networks in the Mekong region (note 25) and the simplification of customs clearance procedures. Accordingly, a production network is being formed with Bangkok as the hub. This is referred to as the "Thailand Plus One" business model. Looking forward, we expect not only the progress of institutional integration but also the reinforcement of physical connectivity through the development of infrastructure such as road networks. Under these conditions, it will become increasingly important for Japanese companies to devise management strategies not in terms of points (a country-basis) but in terms of planes (the ASEAN region).

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(Endnotes)

- 1 There is a General Exception List (GEL) which includes products which are permanently excluded from the free trade area for reasons of protection of national security, public morals and health etc.
- 2 For the CLMV, the number of items and targets regarding the tariff cuts were eased in comparison to the ASEAN6. This is due to the lag in economic development of the CLMV in comparison to the ASEAN6. It was decided that the four countries of the CLMV would lower the intra-regional tariffs for as many items as possible to 0–5% by the years set forth in parentheses as follows: Vietnam (2003), Laos and Myanmar (2005), Cambodia (2007).
- 3 Although Malaysia had left 218 automobile-related items in the TEL and kept tariffs intact even after 2003, it transferred the items to the IL in 2005 and reduced all intra-regional tariffs on automobiles to less than 5% in March 2006.
- 4 In the early 1980s, the ratio of exports to countries outside the ASEAN temporarily fell sharply due to the global recession triggered by the Second Oil Crisis in 1979. However, exports to areas outside the ASEAN region picked up along with the recovery of the US economy, serving to push down the ratio of intra-regional exports.

- 5 It would be possible to say that the ratio of intra–regional trade remained more or less flat without rising sharply since the second half of the 2000s. We shall refer to this point in more detail in Section 3.2.c.
- 6 Refer to Endo (2005) and Fennstra (2003) for the theoretical background to the gravity model.
- 7 The number of samples for each year are approximately 14,000 to 20,000.
- 8 The gravity model in this paper uses “The CEPII gravity dataset” available from Centre d’Etudes Prospectives et d’Informations Internationales (CEPII). This contains data up to 2006, and the years thereafter are estimated by extending the same data source. Trade data is based upon the value of imports in the IMF’s “Direction of Trade”. For countries on which trade data is not available, trade data is substituted by the value of exports. GDP and population are based upon the World Bank’s “World Development Indicators”. The CEPII dataset is used for the “distance between two countries”, the “common border”, and “common language” dummies.
- 9 Given the expression “by 2015”, the initial target was to establish the AEC as of January 1, 2015. However, since the target was expressed as “during 2015” at the ASEAN Summit in 2012, the target was in effect postponed by one year to December 31, 2015.
- 10 The EU achieved a common market in 1993. The EU not only eliminated intra–regional tariffs, but also unified extra–regional tariffs due to its character as a customs tariff union.
- 11 The following explanation takes into consideration Ishikawa, Shimizu, Sukegawa (2013), p. 52 – p. 56.
- 12 In the event the manufacturing process takes place in a number of locations by a number of people, such is deemed as a whole, and the “cumulative regional value content” judges whether the cumulative level of value–added satisfies the rules of origin requirements.
- 13 The application of the “Change in Tariff Classification” (CTC) was permitted for certain items such as wood products and aluminum products.
- 14 The ASEAN Trade in Goods Agreement (ATIGA) requires reporting to the ASEAN Secretariat for the following 13 items: (1) tariffs, (2) numerical quotas, (3) additional expenses, (4) numerical limitations, (5) other non–tariff measures, (6) tariff assessment, (7) rules of origin restrictions, (8) standards & certification systems, (9) sanitary and phytosanitary (SPS) measures, (10) export tax, (11) trade license procedures, (12) trade–related foreign exchange controls, (13) configuration of ASEAN Harmonized Tariff Nomenclature (AHTN) of eight digits or more.
- 15 Reporting is necessary since this falls within the purview of (5) other non–tariff measures in Note 12.
- 16 Examples such as the following may be cited: Mode 1 (use of a foreign airline by a Japanese individual), Mode 2 (use of a taxi overseas), Mode 3 (establishment of an overseas entity by a Japanese services–related company), Mode 4 (an overseas

- concert tour by a Japanese musician).
- 17 The “Master Plan on ASEAN Connectivity” was released at the 17th ASEAN Summit in October 2010 in a bid to encourage the establishment of the AEC and correction of intra-regional gaps. It is said that this stemmed from the delay in initiatives toward the realization of the AEC such as the slow progress in elimination of non-tariff barriers.
 - 18 The ASEAN Economic Ministers Meeting requested the Economic Research Institute for ASEAN and East Asia (ERIA) to design a new scorecard to supplement the AEC Scorecard so as to reflect the impact upon the real economy and the real feeling of the private sector.
 - 19 The following explanation takes into consideration Sukegawa (2011), Sawatari (2013) and others.
 - 20 The forays of Japanese suppliers with the purpose of supplying parts have accelerated as a result of Toyota Motor Corporation’s announcement of its policy to source all its parts and materials in the ASEAN for production within the ASEAN region.
 - 21 According to person(s) related to Sony, it is said that the decision for the realignment of production sites stemmed from the change of AFTA’s rules of origin.
 - 22 Although ADB (2013) indicated that “the 100% achievement of the AEC Blueprint would be difficult as of 2015”, it set forth its view that its initiatives would progress at a “slow but steady” pace.
 - 23 According to Toyota Motor Corporation’s Vietnamese subsidiary, “it is necessary to enter into production preparations three to four years in advance in the case of automotive production. Therefore, we are currently faced with the question of whether to keep its subsidiary in Vietnam or to switch to imported cars”. (“Nihon Keizai Shimbun”, January 22, 2014, morning edition).
 - 24 Although Sanyo Electric manufactured refrigerators for the ASEAN market in Thailand, it has established a development site in Thailand. In the past, Sanyo had sold refrigerator models already sold in the Japanese after making improvisations, from now on, it will develop models suited to local tastes in Thailand. (“Nihon Keizai Shimbun”, January 7, 2014, morning edition).
 - 25 The “Mekong region” is a collective term referring to the countries of Thailand, Laos, Cambodia, Vietnam and Myanmar etc. which are located in the Mekong river basin. In the Mekong region, international institutions such as the ADB and the private sector are engaged in the development of road networks and energy developments in the Mekong region.

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