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The ASEAN economic community and ASEAN economic integration

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ABSTRACT

ASEAN realized the ASEAN Economic Community (AEC) at the end of 2015. The AEC is an economic integration whose goals are free movement of goods, services, investment, and skilled workers, and freer movement of capital. Following the establishment of the ASEAN Free Trade Area (AFTA), ASEAN deepened its economic integration through the AEC. Evaluations of ASEAN's economic integration are mixed. While highly praised for its steady integration progress, there are also assessments suggesting there is little progress in integration. This study examines the AEC's economic integration and evaluates ASEAN economic integration, including the AFTA. The AEC is an "FTA-plus" economic integration, and its target and level of market integration are similar to those of the Economic Partnership Agreement. The AEC's greatest achievement is using tariff elimination to realize a free trade area with a high level of trade liberalization. Liberalizing trade in services, eliminating non-tariff barriers, and facilitating trade have been delayed and have become issues for AEC2025. AEC2025 aims to participate in the global value chain, and its measure is the attraction of foreign direct investment. Although ASEAN's economic integration has various issues, as a whole, it can be evaluated as successful because of its implementation of flexible liberalization over time. ASEAN's economic integration is a successful example of economic integration by developing countries; other developing countries can learn lessons from ASEAN's experiences.

KEYWORDS

ASEAN Free Trade Area; AFTA; ASEAN Economic Community; AEC; stage of economic integration; ASEAN Japanese companies

1. Introduction

ASEAN is a front-runner in East Asia's economic integration and also plays a central role in the area's regional cooperation. ASEAN was founded in August 1967 by its five original member countries: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. At the time of ASEAN's founding, Southeast Asia was in the midst of the Vietnam War, and political cooperation and security in Southeast Asia were central issues. Economic cooperation began after the 1976 Declaration of ASEAN Concord was adopted at the first summit in 1976. Economic cooperation was promoted through three projects: the ASEAN Industrial Project (AIP), the ASEAN Industrial Complementation (AIC), and the ASEAN Preferential Trade Agreement (PTA). Although the PTA aimed at trade liberalization, it did not achieve its objective. ASEAN virtually started economic

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integration with the formation of the ASEAN Free Trade Area (AFTA) in 1993. The AFTA achieved its original goal of reducing tariffs to 0–5% in 2002, and ASEAN 6 realized tariff elimination in 2010. AFTA has achieved a high rate of trade liberalization (the percentage of tariff lines subject to elimination) of 98.6%.

ASEAN began forming the ASEAN Economic Community (AEC) in 2003 at the 9th ASEAN Summit. In addition to free movement of goods, AEC aimed at deepening integration through free movement of services, investment, capital, and skilled workers. The AEC covers a wide range of areas, including mutual recognition of standards, intellectual property rights, competition policies, infrastructure development, and narrowing the development gap. The AEC furthers integration into the global economy by participating in global supply chains and actively promotes FTAs with countries outside the ASEAN region. The AEC was established at the end of 2015 as planned and ASEAN is currently implementing the AEC Blueprint 2025.

Evaluations of ASEAN's economic integration have been mixed. While highly praised for its steady integration progress, there are also assessments suggesting there is little progress toward integration compared to that of developed countries such as the EU and NAFTA. This is because progress differs among the areas of integration. For example, great results have been achieved in areas such as tariff elimination, while progress has been slow in other areas, such as eliminating non-tariff barriers and liberalizing trade in service. The fact that the AEC's name is similar to that of the European Economic Community (EEC) and that the concept of an economic community is not clearly positioned in the theory of economic integration are other factors that cause inconsistent evaluations. However, the EU, which has been regarded as a model for economic integration, has exposed serious problems such as the debt crisis and euro crisis after the 2008 global financial crisis, the growth of anti-EU political parties, and the UK's withdrawal from the EU. We should keep in mind that ASEAN is a regional cooperation organization of developing countries in a region where economic disparities and political, social, and cultural diversity are extremely large, making integration difficult. ASEAN has been steadily advancing economic integration while adapting to rapid changes in the world economic environment and despite various difficulties and centrifugal forces; it has become the most important economic integration in the world.

The evolution of ASEAN's economic integration can be divided into three phases. The first phase is AFTA's formation from 1992 to 2002, the second phase is the establishment of the AEC from 2003 to 2015, and the third phase is building AEC2025 after 2016. This paper considers the development of ASEAN economic integration as deepening integration.

The remainder of this article is organized as follows. Section two reviews the development of ASEAN's economic integration from BBC to AFTA to AEC. Section three describes the structure and features of ASEAN 2025, with a focus on the Consolidated Strategic Action Plan (CSAP). Section four discusses the AEC from various viewpoints, including stages of economic integration, and examines criticism of the AEC. Section five highlights the interactions between ASEAN economic integration and Japanese firms. Section six presents concluding remarks.

2. Development of ASEAN's economic integration

2.1. BBC and AICO

ASEAN's first effort to address trade liberalization was the ASEAN PTA 15 years before AFTA was launched. The PTA came into effect in February 1977¹; it was a scheme to reduce intra-ASEAN tariffs on products of the AIP and the AIC, as well as products agreed upon through negotiation² The PTA was unable to achieve its objective because of time-consuming product-by-product negotiation and a lack of seriousness symbolized by designating skis and nuclear reactors as liberalization target items. The fundamental reason for failure was that ASEAN countries pursued an import substitution industrialization strategy (ISI) through protective trade policies such as the prohibitively high tariffs in the 1970s³

The first effective trade liberalization was achieved in 1988 by the Brand to Brand Complementation (BBC), which reduced tariffs on auto parts by 50% in intra-firm trade in the ASEAN region⁴ The BBC is a trade liberalization program proposed by Mitsubishi Motors, but it was also used by Japanese automobile manufacturers, including Nissan and Toyota. The BBC promoted intra-ASEAN complementation of automobile parts and components produced in each ASEAN member country in accordance with comparative advantage. The BBC's main feature is the trade liberalization program proposed by Japanese companies, and it was used by Japanese automobile companies. Beginning in 1996, the BBC was expanded to ASEAN Industrial Cooperation (AICO), which increased the covered products to items other than automobile parts and applied a tariff of 0–5% to intra-company trade. AICO was also used by foreign companies, such as those in the electric industry, and its main users were also Japanese companies⁵ Effective trade liberalization, such as through the BBC and AICO, was realized because the ASEAN countries converted to an export-oriented industrialization (EOI) strategy⁶

Entering the 1990s, the international environment surrounding ASEAN changed rapidly. Huge scale economic integration, such as NAFTA and the EU, began. China accelerated its economic reform and opening policy, which caused rapid flow of foreign investment into China. The Asia-Pacific Economic Cooperation (APEC) was institutionalized in 1989. In response to these environmental changes, ASEAN launched the AFTA, a full-scale trade liberalization scheme, in 1993⁷

2.2. AFTA and reasons for success

The AFTA was agreed upon at the Economic Ministers Conference in 1991 and endorsed at the 4th Summit in Singapore in 1992 by the signing of the Framework Agreement on Enhancing Economic Cooperation and the ASEAN Agreement on the

¹.ASEAN Secretariat, 1977 Agreement on ASEAN Preferential Trading Arrangement.

².Shimizu, *Ikinaikeizaikyoryoku no Keizaigaku*, 51–58..

³.Shimizu, "Sekaikeizai no Kozohenka to ASEAN Keizaitogo," 144–145..

⁴.Shimizu, "ASEAN no Jidosyasangyo," 254–256..

⁵.Out of the 150 approvals up to September 2008, both the automobile industry and Japanese companies accounted for 90%. See Sukegawa, "ASEAN no Jiyuubokikyotei," 41..

⁶.Shimizu, "Sekaikeizai no Kozohenka to ASEAN Keizaitogo,"144–145..

⁷.Ibid., 145..

Common Effective Preferential Tariff (CEPT) Scheme for the AFTA⁸; it was launched in January 1993. The framework agreement stipulates that, (i) all member states will join the ASEAN Free Trade Area (AFTA) within 15 years and (ii) the CEPT system will be the AFTA mechanism. The CEPT agreement stipulates tariff reduction methods, rules of origin, and so on.

The AFTA is a scheme initially designed to liberalize ASEAN intra-regional trade within 15 years of 1993; this time frame was thereafter shortened to 10 years. Four new member countries (Vietnam, Laos, Myanmar, and Cambodia) who joined ASEAN after the start of AFTA also joined AFTA. AFTA aims to: (i) prepare for global trade liberalization, which was accelerated by the conclusion of the GATT Uruguay Round; (ii) attract foreign direct investment by multinational corporations; (iii) and ensure that ASEAN does not lose its importance in the expansion of economic integration, such as the establishment of NAFTA and the EU. The most important objective was to attract foreign investment, and ASEAN was concerned that China would attract most of Asia's foreign investment by optimizing the "Invest China" boom that took place in the early 1990s⁹

As scheduled, AFTA reduced tariffs to less than 5% in ASEAN6 in 2003. In 2010, ASEAN6 (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Vietnam) eliminated tariffs, and in 2015, Cambodia, Laos, Myanmar, and Vietnam (CLMV) eliminated tariffs except for certain items. In 2018, tariffs on the remaining CLMV items were abolished, and all items were liberalized. The AFTA's trade liberalization rate in January 2018 was extremely high at 99.3% for ASEAN6, 97.7% for CLMV, and 98.6% for ASEAN as a whole¹⁰. The AFTA should be evaluated as successful as it has achieved a high level of liberalization.

The reason for AFTA's success is the adoption of a flexible and gradual liberalization approach that considers the different levels of economic development across the member countries, especially the levels of industrial development. Items are classified into four categories: liberalized items (Inclusion List: IL), temporary exclusion items (Temporary Exclusion List: TEL), the sensitive list (Sensitive List: SL), and general exclusion items (General Exception List; GEL). TEL and SL subsequently moved to IL. For CLMV, the tariff reduction and elimination schedule is delayed compared to ASEAN 6. Along with CLMV's trade liberalization, ASEAN is implementing the Initiative for ASEAN Integration (IAI) to support CLMV in reducing regional disparities¹¹. Flexible liberalization was allowed for the AFTA because it was regional integration based on the Enabling Clause rather than Article 24 of the GATT¹²

2.3. Building the ASEAN economic community

ASEAN adopted the Declaration of ASEAN Concord II at the 9th ASEAN Summit held in October 2003 and decided to establish the ASEAN Community with three pillars: the

⁸.ASEAN Secretariat, "The Framework Agreement on Enhancing Economic Cooperation. ASEAN Secretariat;" "Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area."

⁹.Ishikawa, "FTA kara Keizaikyoudotai he," 249–255..

¹⁰.ASEAN Secretariat, *ASEAN Integration Report*, 20..

¹¹.Ishikawa, "Kakusa Shukusho wo Susumeru ASEAN," 67–74..

¹².Article 24 of GATT stipulates the following provisions as FTA requirements: (i) duties and other restrictive regulations of commerce are eliminated with respect to substantially all the trade between FTA members, (ii) duties and other regulations should not be higher or more restrictive to nonmembers of the FTA; and (iii) an FTA should be formed within a reasonable length of time..

ASEAN Security Community (ASC, later renamed the Political-Security Community (APSC), the AEC, and the ASEAN Socio-Cultural Community (ASCC)¹³ The AEC was proposed by Prime Minister Goh Chok Tong of Singapore, who had deep concerns that ASEAN weakened the ability to attract foreign investment. To continue to draw foreign investment, ASEAN leaders were convinced that ASEAN should demonstrate its intent to deepen the economic integration to foreign investors¹⁴ ASEAN set a target for establishing the AEC in 2020.

ASEAN adopted the Vientiane Action Programme (VAP) at the 10th ASEAN Summit and signed the ASEAN Framework Agreement for the Integration of Priority Sectors. VAP covered the term from 2004 to 2010 and laid down the ASC's five program areas, the AEC's 12 program areas, and the ASCC's four program areas. Each program area includes detailed measures, and eleven protocols containing the measures for the eleven priority sectors were signed by the Economic Ministers. The designated priority sectors were agro-based products, automotive, electronics, fisheries, rubber-based products, textiles and apparel, wood-based products, air travel, e-ASEAN (ICT), healthcare, and tourism, and were planned to be fully integrated by 2010. Logistics was added to the priority sectors in 2007.

At the 12th ASEAN Summit held in January 2007, ASEAN agreed to move establishment of the AEC forward from 2020 to 2015 and develop the Economic Community Blueprint by the 13th ASEAN Summit in November¹⁵ The VAP covered the term up to 2010, and the ASEAN Framework Agreement for the Integration of Priority Sectors targeted only 12 priority sectors. It was decided at the August 2006 ASEAN Economic Ministers' meeting to form the ASEAN Economic Blueprint, which was a comprehensive action plan covering all sectors, and move the term up to 2015. The AEC Blueprint was submitted to the 13th ASEAN Summit held in November 2007, and the Declaration on the ASEAN Economic Community Blueprint was adopted¹⁶

By establishing the AEC, ASEAN deepened economic integration by transforming to a region with free movement of goods, services, investment, and skilled labor, and freer movement of capital. The AEC aims to establish ASEAN as a single market and production base, a highly competitive economic region, an equitable economic development region, and a region fully integrated into the global economy¹⁷ These four objectives are the four pillars of the AEC Blueprint. The four pillars and core elements are presented in Table 1. As shown in the table, AEC's goals are comprehensive, ranging from market integration, infrastructure development, and intellectual property protection to narrowing the development gap across member countries. AEC aims at both negative integration that removes cross-border barriers and positive integration, in which member states conduct joint actions¹⁸ In addition to the AEC Blueprint, the Master Plan on ASEAN Connectivity 2010 (MPAC 2010), comprising physical connectivity, institutional connectivity, and people-to-people connectivity, was adopted and the IAI was conducted with a view toward reducing the development gap among ASEAN member states.

¹³.ASEAN Secretariat, *Declaration of ASEAN Concord*...

¹⁴.Severino, *Southeast Asia In Search of an ASEAN Community*, 343–344..

¹⁵.ASEAN Secretariat, "Chairperson's Statement of the 12th ASEAN Summit."

¹⁶.ASEAN Secretariat, "Chairman's Statement of the 13th ASEAN Summit."

¹⁷.ASEAN Secretariat, *ASEAN Economic Community Blueprint*..

¹⁸.Pelkmans, *The ASEAN Economic Community*, 18–40..

Table 1. Four pillars and core elements of the AEC Blueprint.

Pillars	Core elements
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, 5. Priority integration sectors, 6. Food, agriculture, and forestry
B.Competitive economic region	1. Competition policy, 2. Consumer protection, 3. Intellectual property rights, 4. Infrastructure development, 5. Taxation, 6. E-commerce
C.Equitable economic development	1.SME development, 2. Initiative for ASEAN development
D.Integration into global economy	1.Coherent approach toward external economic relations, 2. Enhanced participation in global supply networks

ASEAN Secretariat, *ASEAN Economic Community Blueprint*.

2.4. Establishment of the AEC and its achievement

While the AEC was officially established at the end of 2015 as scheduled, not all measures of the AEC Blueprint were realized¹⁹ As of October 31 2015, 469 measures were implemented out of a focused base of 506 measures, including 54 high priority measures, resulting in an implementation rate of 92.7%. Out of the total of 611 measures, 486 were implemented, an implementation rate of 79.5%. AEC 2015 is not the final goal but an important milestone toward a new phase of ASEAN economic integration²⁰

The AEC's most highly evaluated achievement is tariff elimination. The trade liberalization rate (percentage of tariff lines subject to elimination) of ASEAN Trade in Goods Agreement (ATIGA) stands at 98.6%, a rate that is as high as that of the TPP²¹ ATIGA's weighted average effective applied tariff rate dropped to 1.4% in 2018²² ASEAN has created a free trade area with a high level of liberalization; however, eliminating or reducing non-tariff measures has been slow. Based on official regulations as of May 2019, ASEAN countries had a total of 5,886 non-tariff measures²³ Liberalization of trade in service has been undertaken in line with the ASEAN Framework Agreement on Service (AFAS); all sectors were to be liberalized by 2015 through consecutive biennial rounds of negotiations. By the end of 2015, the 9th commitment package, which covers 104 subsectors, was agreed upon, and the Protocol to implement the 10th package covering 128 subsectors was signed in 2018. The AFAS aims to go beyond the General Agreement on Trade Service (GATS) commitments, but there are still significant exceptions to liberalization. Mode 3 (commercial presence) liberalization confines ASEAN's equity share to 70% and a 15% flexibility rule was introduced. In terms of investment, ASEAN signed the ASEAN Comprehensive Investment Agreement (ACIA) in March 2012. The ACIA integrated and improved the ASEAN Investment Guarantee Agreement (ASEAN IGA) and the ASEAN Investment Agreement (AIA) and allows ASEAN member countries to reserve investment prohibition/restriction areas. Reducing the ACIA's reservation list is necessary to further investment liberalization.

Trade facilitation enhances trade by reducing trade costs and time. ASEAN has a twin goal of doubling intra-ASEAN trade between 2017 and 2025 and reducing

¹⁹.ASEAN Secretariat, *ASEAN Economic Community 2015: Progress and Key Achievements*, and ASEAN Secretariat, *ASEAN Integration Report*..

²⁰.ASEAN Secretariat, *ASEAN 2025*, 13..

²¹.ASEAN Secretariat, *ASEAN Integration Report 2019*, 20..

²².Ibid..

²³.Ibid., 21..

trade costs by 10% by 2020²⁴ ASEAN adopted a number of trade facilitation initiatives such as the ASEAN Trade Facilitation Framework (ATFF), the ASEAN Trade Facilitation Strategic Action Plan(ATF-SAP), and the ASEAN Trade Repository (ATR). ASEAN has made efforts toward customs integration and modernization by adopting the ASEAN Customs Transit System (ACTS) and promoting Authorized Economic Operator (AEO) status and its mutual recognition. The ASEAN Single Window (ASW) is a platform aimed at electronic processing and exchange of customs clearance-related data and information among ASEAN member countries. All ASEAN member countries have participated in the live operation of the exchange of ATIGA e-form D (Certificate of Origin of ATIGA) in 2020²⁵ To facilitate movement of skilled workers, ASEAN concluded the ASEAN Agreement of Movement of Natural Persons in 2012. ASEAN has also signed a mutual recognition arrangement (MRA) for professional service qualifications. Eight MRAs are in effect for professional services: engineering, nursing services, architectural services, surveying qualifications, medical practitioners, dental practitioners, accounting services, and tourism professionals. ASEAN has made considerable progress in forming FTAs and economic partnership agreements (EPAs) and has concluded FTAs with six dialogue partners in East Asia. In 2019, the ASEAN and Hong Kong FTA (AHKFTA) was signed as the 7th ASEAN plus 1 FTA.

3. ASEAN Economic Community 2025

3.1. AEC Blueprint 2025

At the 27th ASEAN Summit in November 2015, ASEAN leaders issued the Kuala Lumpur Declaration on ASEAN 2025: Forging Ahead Together and adopted the ASEAN Community Vision 2025, ASEAN Political-Security Community Blueprint, ASEAN Economic Community Blueprint, and ASEAN Socio-Cultural Community Blueprint 2025²⁶ ASEAN Community Vision 2025 envisions ASEAN Economic Community 2025 (AEC2025) as highly integrated, cohesive, competitive, innovative, and dynamic; with enhanced connectivity and sectoral cooperation; and a more resilient, inclusive, and people-oriented, people-centered community, integrated with the global economy. The AEC Blueprint 2025's five characteristics and key elements are shown in [Table 2](#). The immediate priority is to complete implementing the unfinished measures of the AEC Blueprint 2015 by the end of 2016.

The AEC Blueprint 2025's basic structure is inherited from AEC Blueprint 2015; new areas have been added to the elements, but many of them have been reorganized from those in AEC2015. The scope and level of integration is similar to AEC 2015. Common external tariffs, free movement of unskilled workers, and government procurement are not included in the elements²⁷ The IAI Work Plan III and ASEAN Connectivity 2025 are integral part of ASEAN Community Vision 2025.

²⁴.Ibid., 24.

²⁵.ASEAN Secretariat, The 52nd ASEAN Economic Ministers' (AEM) Meeting, Joint Media Statement..

²⁶.ASEAN Secretariat, *ASEAN2025*..

²⁷.Ishikawa, "ASEAN Keizaikyodotai 2025 no Genkyo to Tenbo," 113–114..

Table 2. Characteristics and key elements of the AEC Blueprint 2025.

Characteristics	Elements
A. A highly integrated and cohesive economy	1.Trade in goods, 2. Trade in services, 3. Investment environment, 4. Financial integration, financial inclusion, and financial stability, 5. Facilitating movement of skilled labor and business visitors, 6. Enhancing participation in global value chains
B. A competitive, innovative and dynamic ASEAN	1. Effective competition policy, 2. Consumer protection, 3. Strengthening intellectual property rights cooperation, 4. Productivity driven growth, Innovation0, Research and development, and Technology Commercialization. 5. Taxation cooperation. 6. Good governance, 7. Effective, efficient, coherent and responsive regulations, and good regulatory practice, 8. Sustainable economic development, 9. Global megatrends and emerging trade-related Issues
C. Enhanced connectivity and sectoral cooperation	1. Transport, 2. Information and communication technology, 3. e-Commerce, 4. Energy, 5. Food, agriculture and forestry, 6. Tourism, 7. Healthcare, 8. Minerals, 9. Science and technology
D. A resilient, inclusive, people-oriented and people-centered ASEAN	1. Strengthening the role of micro, small, and medium enterprises, 2. Strengthening the role of the private sector, 3. Public-private partnerships, 4. Narrowing the development gap, 5. Contribution of stakeholders to Regional integration efforts
E. Global ASEAN	Develop a more strategic and coherent approach toward external economic relation with a view to adopting common positions in regional and global economic fora, Review and improve FTAs, Enhance economic partnership with non-FTA dialogue partners, etc.

ASEAN Secretariat, *ASEAN Economic Community 2025 Blueprint*.

3.2. Consolidated strategic action plan

AEC Blueprint 2025 set out the measures to be undertaken, but did not include a detailed action program, such as schedules, sectoral work plans, and sectoral bodies. To complement AEC2025 Blueprint, the AEC 2025 Consolidated Strategic Action Plan (CSAP) was endorsed by the AEM and AEC Council in February 2017 and updated in August 2018²⁸. The CSAP comprises key action lines, timelines, relevant sectoral work plans, and sectoral bodies. It has 153 strategic measures and 556 key action lines. as shown in Table 3. With 223 key actions items, enhanced connectivity and sectoral cooperation (Characteristic C) contains the most key action lines.

While AEC2015 set a goal of clear and easy-to-understand liberalization of free movement of goods, services, investment, and skilled workers, and freer movement of capital, AEC2025 focused on trade facilitation. The background for setting realistic and cautious goals is that liberalization, such as eliminating tariffs, has

Table 3. Number of elements, strategic measures, and key action lines of CSAP (updated in August 2018).

Characteristics	Element	Strategic Measures	Key Action Lines
A. A highly integrated and cohesive economy	6	26	106
B. Competitive, innovative and dynamic ASEAN	9	47	116
C. Enhanced connectivity and sectoral cooperation	9	51	233
D. A resilient, inclusive, people-oriented and people-centered ASEAN	5	23	87
F.Global ASEAN	1	6	14
Total	30	153	556

ASEAN Secretariat, *ASEAN Economic Community 2025 Consolidated Strategic Action Plan, Updated on August 2018*

²⁸.ASEAN Secretariat, *ASEAN Economic Community 2025 Consolidated Strategic Action Plan..*

progressed considerably in AEC2015, leaving some areas that are difficult to achieve²⁹ In that sense, the weight of integration in AEC2025 is lower than that in AEC2015.

On the other hand, fields such as competitiveness and inclusiveness are becoming more important. These are responses to the challenges facing ASEAN countries, such as the middle-income trap and widening inequality. There are concerns that Thailand, Malaysia, Indonesia, and the Philippines will fall into the middle-income trap and slow growth. Productivity improvement, innovation, and science and technology are important fields, but at present, there is no ambitious plan such as the industrial policy “Made in China 2025” found in China. This is an issue for 2020 and beyond.

In AEC2025, many areas, including information and communication technology, applied science and technology, entrepreneurship, food security and food safety, health care, and the environment have been transferred from the ASCC 2015. Inclusion is emphasized in each area of AEC2025

Assessment of the implementation status has also changed. AEC Blueprint 2015 has been evaluated using a scorecard, but problems have been pointed out, such as a self-reporting system. The AEC 2025 M & E Framework, agreed to at the 2016 46th AEM Meeting in August 2016, will include three types of evaluation: compliance monitoring, outcomes monitoring, and impact evaluation³⁰

4. AEC from the perspective of the stage of economic integration

4.1. What type of economic integration is the AEC?

To understand the AEC’s type of economic integration, the forms that indicate the stages of integration should be considered. Bella Ballasa’s theory of economic integration is well known. Ballasa advocated that economic integration takes several forms that represent varying degrees of integration. These are: (1) free trade area (FTA), (2) customs union, (3) common market, (4) economic union, and (5) complete economic integration³¹ An FTA is an economic integration that eliminates tariffs (and quantitative restrictions) between the participating countries. In a customs union, in addition to suppressing discrimination in the field of commodity movement within the union, the tariffs for trade with nonmembers are equalized. In addition to eliminating discrimination in goods movement, tariffs on nonmember countries will be standardized. In a common market, both trade restrictions and restrictions on the movement of production factors are abolished. An economic union combines suppressing restrictions on commodity and factor movement with some degree of harmonization of national economic policies, and some degree of harmonization of economic policies is carried out to eliminate discrimination due to differences in such policies. Complete economic integration is affiliated with the unification of monetary, fiscal, social, and countercyclical

²⁹.Fukunaga, “ASEAN Keizaikyodotai2025 Vision,” 323–324..

³⁰.ASEAN Secretariat, *Toward ASEAN Economic Community 2025: Monitoring ASEAN Economic Framework..*

³¹.Balassa, *The Theory of Economic Integration*, 2..

policies and requires setting up a super-national authority whose decisions are binding for the member states³²

Economic integration in Europe progressed almost in line with these stages of development with the customs union in 1968, the common market in 1993, and the introduction of a single currency, the Euro, in 1999. Balassa's five-stage theory is a classic classification and is still useful for a basic understanding of economic integration; however, modern economic integration is diversified, and a different approach is needed.

Jacques Pelkmans, a prominent scholar on economic integration of the EU and ASEAN, provides a modern six-stage approach³³ (1) FTA, (2) customs union, (3) FTA plus (customs union-plus), (4) deep and comprehensive FTA, (5) common market, and (6) single market. FTA-plus and customs union-plus, which is the third stage, is defined as an FTA and a customs union that includes all the WTO obligations and some WTO-plus elements. The fourth stage is a deep and comprehensive FTA and customs union, which covers the areas of WTO-Plus (areas not included in the WTO Agreement). Specific fields include services, investment, competition policy, trade facilitation, forceful equivalence efforts/clauses in TBT (Technical barriers to trade) issues, selective SPS (Sanitary and phytosanitary measures), economic cooperation and capacity-building, and government procurement. The fifth stage is a common market, where free market access is realized for goods, services, labor, and capital. A common competition policy, common budget for purposes of cross-border infrastructure, and/or common adjustments are options. The third and fourth stages represent negative integration, which primarily involves removing barriers, while the fifth stage is positive integration, in which the governments of participating countries take joint actions, such as regulatory harmonization and mutual recognition. The sixth stage is the single market; the EU has not yet accomplished a genuine single market. This stage is not a legal or regulatory concept, but an economic concept for ambitious purposes. Pelkmans argues that the AEC might seem to aspire to reach stage 4³⁴

There are several theories of the stages of economic integration because there are actually various forms of and names for integration. Diversification of FTA content is due to the progress in tariff elimination and globalization, which requires liberalization of services, investment, capital, and movement of natural persons. Such a comprehensive FTA (FTA-plus) is called an EPA (Economic Partnership Agreement). For example, the contents of economic partnership agreements concluded by Japan are extremely diverse, including goods, services, investment, trade facilitation, SPS, TBT, e-commerce, intellectual property rights, government procurement, movement of natural persons, competition policies, and trade remedy measures. Thus, a comprehensive FTA (or EPA) includes areas not covered by the WTO (WTO plus), as well as those covered by the WTO. Based on these facts, the reality of economic integration is that there are six stages: (1) FTA (covering trade in goods only), (2) comprehensive FTA (economic partnership), (3) customs union, (4) common market, (5) economic union, and (6) complete economic integration.

³².Ibid..

³³.Pelkmans, *The ASEAN Economic Community: A Conceptual Approach*, 18–40.

³⁴.Pelkmans, *The ASEAN Economic Community: A Conceptual Approach*, 38–39.

4.2. Economic integration similar to an EPA

As mentioned above, AECs should be classified as FTAs-plus (comprehensive FTA). Economic integration, which, in addition to goods, enables free flow of services, investment, capital, and people, is a common market. The AEC is not a common market, as there are restrictions to liberalizing services, investment, and capital movements; movement of people is targeted exclusively at skilled workers. The AEC is similar to the EEC only in name. The EEC is a customs union that developed into a common market in 1992 under the name of the EU and has achieved monetary union (currently 19 countries participate in the monetary union). In the EU, national sovereignty is pooled; by pooling, national sovereignty is jointly exercised in the relevant policies of market integration and monetary union³⁵ The AEC is an integration that adheres to national sovereignty, and its basic idea of integration is fundamentally different. ASEAN receives support from the EU on how to proceed with integration but does not consider the EU a model for integration.

It is impossible to form a customs union because Singapore has almost completely abolished tariffs while other countries have high tariffs for sensible products such as automobiles. As the economic disparity is extremely large and free movement of production factors has not been realized, an ASEAN monetary union is also impossible. It goes without saying that the AEC does not aim for a customs union or currency union. The economic integration that the AEC has is similar to is the EPA shown in Table 4. An EPA enables liberalizing things such as goods, services, investments, movement of commercial visitors, and trade facilitation, but does not set common tariffs outside the region and does not aim for a single currency.

4.3. Criticisms of ASEAN economic integration

As discussed above, overall, the AEC can be evaluated as successful. In particular, the AFTA has achieved a high trade liberalization rate of nearly 100% and should be highly

Table 4. Comparison of goals of the ASEAN economic community, the European community, and economic partnership agreements.

	European Economic Community (EC)	ASEAN Economic Community (AEC)	Economic Partnership Agreement (EPA)
Tariff elimination	○	○	○
Non-tariff barrier elimination	○	○ (*)	Δ
Common external tariff	○	×	×
Service trade liberalization	○	○ (*)	Δ
Harmonization of standards	○	Δ	Δ
Free movement of natural persons	○	Δ	Δ
Trade facilitation	○	○	○
Investment liberalization	○	○	○
Capital liberalization	○	Δ	Δ
Government procurement liberalization	○	×	Δ
Single currency	○	×	×

○ indicates a goal, Δ indicates a goal but limited, and × indicates that it is not a goal. * Indicates a goal but difficult to achieve, or partially achieved. However, this is not a strict evaluation.

Source: Created by the author.

³⁵.Pelkmans, *European Integration, Methods and Economic Analysis*, 4–5.

evaluated as an FTA in developing countries. However, there are still two criticisms of the AFTA: (i) a low intra-regional trade ratio and (ii) its low utilization rate³⁶

The intra-ASEAN trade ratio in ASEAN rose from 17% in 1990 to around 25% in the mid-2000s, but in 2018 intra-ASEAN exports were 24.2% and intra-ASEAN imports were 21.7, showing a gradual decline³⁷ As NAFTA's intra-regional trade ratio is as high as around 40% and the EU's is as high as 56%, there are arguments that the AFTA is ineffective due to its low intra-regional trade ratio. The value of intra-ASEAN trade increased 2.5 times from 260.9 USD billion in 2004, the year after the decision to establish AEC, to 647.5 USD billion in 2018. The reason the intra-ASEAN trade ratio did not rise was the expansion of trade with China. Trade with China increased 4.4 times from 89.2 USD billion in 2004 to 391.5 USD billion in 2018. The rapid expansion of trade with China and China's becoming the largest major trading partner is occurring not only in ASEAN but also in major Asian countries. Among the trading ASEAN partners, ASEAN is the largest trading partner and China is second.

It has been pointed out that the intra-regional trade ratio in ASEAN is theoretically not low. Okabe argues that AFTA far exceeds APEC, the EU, and NAFTA in terms of its intra-trade intensity index and that ASEAN's intra-regional trade is considerably large³⁸ When the theoretical intra-regional trade amount is calculated using the gravity model and considering ASEAN countries' GDP and the distance between member countries, the intra-regional trade rate is about 26%, and AFTA's intra-regional trade ratio of 25% is evaluated as appropriate. Naya also points out that AFTA is a "natural trading arrangement" given the small proportion of ASEAN trade in world trade³⁹

The AEC aims to integrate into the global economy and has been actively concluding FTAs outside the ASEAN region. It is an open regionalism that promotes not only integration within the ASEAN region but also integration outside the ASEAN region. ASEAN's economic integration should not be evaluated as a failure just because of the low trade ratio within the region.

Chia and Plummer pointed out that AFTA's utilization rate is surprisingly low and gave the following reasons: (i) low margin of preference between MFN and CEPT; (□) the prevalence of non-tariff barriers; (ii) electronic products and components had zero tariffs because of the WTO's Information Technology Agreement; (iii) duty-drawbacks in export-processing zones; (iv) many SMEs were unaware of how to apply for tariff preferences; and (v) rule-of-origin related problems such as complicated procedures and lengthy waits for forms to be issued⁴⁰ In contrast, Sukegawa uses the issuance amount of certificates of origin (Form D) to calculate the export value ratio comparing AFTA to Thailand's export value (the AFTA utilization rate)⁴¹ He points out that the utilization rate is increasing and the utilization rate of exports to Indonesia and the Philippines is high. The AFTA utilization rate in Thailand's exports to ASEAN countries in total increased from 6.4% in 2000 to 40.1% in 2017, and AFTA utilization rates in

³⁶.Chia and Plummer, *ASEAN Economic Cooperation and Integration: Progress, Challenge and Future Directions*, 54–55; Inama and Sim, *The Foundation of the ASEAN Economic Community*, 7–11..

³⁷.ASEAN Secretariat, *ASEAN Integration Report 2019*, 17..

³⁸.Intra-trade intensity index of 2010 is 3.2 for ASEAN, 1.27 for APEC, 1.70 for the EU, and 2.07 for NAFTA. See Okabe, *ASEAN Ikinai-boeki no Shinten*, 51..

³⁹.Naya, *The Asian Development Experience*, 107..

⁴⁰.Chia and Plummer, *ASEAN Economic Cooperation and Integration: Progress, Challenge and Future Directions*, 54–55..

⁴¹.Sukegawa, "ASEAN Keizaiyodotai (AEC) 2025 deno Buppinboekijiyuka nimuketa Torikumi," 25–26..

Thailand's export to Indonesia in 2017 was 70.8%, that in export to the Philippines was 69.6%, and to Vietnam was 60.8%.

One of the reasons the evaluations are different is that AFTA usage differs greatly depending on the combination of exporting and importing countries. As the years have advanced, the reduction and elimination of tariffs in the AFTA is progressing, the preferential margin is increasing, and the utilization rate is increasing. Eliminating tariffs is effective for high tariff items such as automobiles, as the preferential margin is large. According to JETRO's 2018 survey of Japanese companies operating in ASEAN, 51.1% of Japanese companies exporting to the ASEAN region responded that they use the AFTA⁴² It is not easy to calculate an accurate FTA utilization rate. The exact utilization rate should be the ratio of FTA utilization items to taxable items, excluding items that are MFN tax-free and tax-free importable items. If it were calculated using taxable items, the AFTA utilization rate would be higher than that of Sukegawa. It should be noted that many Japanese companies use the AFTA; while its utilization rate varies greatly depending on the industry and company, it is never "extremely low."

5. ASEAN economic integration and Japanese companies

5.1. Promoters and beneficiaries of economic integration

Japanese companies were promoters and users of ASEAN economic integration. The BBC was proposed by a Japanese automobile company, and the overwhelming majority of AICO users were Japanese companies. According to the 2015 JETRO survey, the FTAs most used for exports by Japanese companies operating in ASEAN are AFTA (293 companies), which is higher than the bilateral FTAs (261 companies) between Japan and ASEAN member countries⁴³ Regarding imports, bilateral FTAs with Japan (371 companies) are the largest, and AFTAs (274 companies) are second. Japanese companies have used the AFTA to avoid tariff payments and restructure production systems within the ASEAN region. Japanese companies that invested in ASEAN member countries during the period of import substitution industrialization in the 1960s and 1970s were forced to produce many products on a small scale in each domestic market protected by high tariffs. Due to tariff barriers, it was difficult to trade with other ASEAN member countries, so Japanese companies operating in the four leading ASEAN countries (Indonesia, Malaysia, the Philippines, and Thailand) had to duplicate investments and production. However, AICO and AFTA have gradually reduced intra-ASEAN tariffs, enabling trade within the ASEAN region even in typical import substitution industries such as automobiles and electric appliances.

Reorganizing production systems in the ASEAN region has been promoted since the latter half of the 1990s. In the automobile industry, Japanese automobile manufacturers are building an ASEAN-wide complementation system of automobile parts and components. For example, Toyota centrally produces diesel engines and body panels in Thailand, steering and radiators in Malaysia, transmissions and meters in the Philippines, and gasoline engines and clutches in Indonesia, and

⁴².Ibid., 24..

⁴³.JETRO, *JETRO Survey on Business Conditions of Japanese Companies in Asia and Oceania 2015.*

supplies them to each other using the preferential tariffs of AICO or AFTA⁴⁴ In the case of electric machinery, production bases in Thailand and Malaysia have been consolidated, and production bases in the Philippines and Indonesia have been reorganized. For example, Sony has stopped TV production in Vietnam (2008) and Thailand (2010) and switched to centralized production in Malaysia. Due to the early harvest of FTAs in Thailand and India, production in India was discontinued in 2004 and imported from Thailand⁴⁵ It can be said that such reorganization of the existing production networks in ASEAN is the response of Japanese companies to economic integration during the AFTA formation period.

5.2. Strategy of Japanese companies in the AEC era

What strategy can Japanese companies adopt in the AEC era? The changes in the ASEAN business environment since 2015 can be summarized as follows. ASEAN has become an integrated market, and transportation infrastructure and cross-border transportation agreements have been developed in mainland Southeast Asia. It will take time to correct the economic disparity and production cost difference. Wages continue to rise due to increasing incomes and a tight labor force, while the consumer market is expanding rapidly, mainly in urban areas. Competition will be fierce due to market integration, and it is essential that the production efficiency be improved. In response to these changes, Japanese companies view ASEAN as an integrated market and production base and have expanded their business operations to develop from points (one country) to lines (two countries) and planes (more than three countries). Existing companies must further advance the strategy of developing production networks across ASEAN, and newcomers are required to develop their business strategy on the premise that ASEAN is “one market and production base.” Next, the development of a transportation infrastructure across ASEAN member countries accelerated formation of production network that takes advantage of the large differences in production costs. Investment in the manufacturing sector by Japanese companies in Cambodia and Laos has been increasing⁴⁶ Its objective is to shift labor-intensive production processes from factories in Thailand to Cambodia and Laos. A typical example is Minebea’s investment in Cambodia in 2010. Minebea’s investment in small motor production was the first foreign investment in manufacturing large-scale electronic components in Cambodia and was the catalyst for subsequent investment in the machinery industry by Japanese companies. Minebea transports parts of small motor from Thailand to Cambodia; the small motor assembled in Cambodia are sent back to its own factory in Thailand. Denso’s investment in Cambodia in 2013 is also a “Thailand plus one” type investment, in which raw materials are shipped from Thailand to Cambodia; products (diesel filters and level switches) are manufactured in Cambodia and returned to a factory in Thailand⁴⁷

⁴⁴.Sukegawa, S., “FTA wo Jikunisusumu Kyoten Saihen to Supply Chain no Saikochiku,” 150–151..

⁴⁵.Sukegawa, S. *ASEAN no Jiyuboekikyotei*, 79..

⁴⁶.Ushiyama, “Nikkeikigyo Mekonken de Keiei wo Kyoka”, 66–70..

⁴⁷.Ibid., 66 and 72–74..

6. Conclusion

ASEAN's economic integration has proceeded despite the difficult situation of large economic disparities between member countries and differences in their stages of industrial development. The integration has been successful for the following reasons: (i) gradual and flexible liberalization over time while setting high goals; (ii) FDI companies have played a major role; (iii) trade with countries outside the region has been promoted; (iv) efforts have been made to correct intra-regional disparities; and (v) a transportation infrastructure has been developed. ASEAN economic integration is the economic integration as a development strategy. The goal was to participate in the global supply chain and measures to achieve that goal were attracting foreign capital and concluding FTAs with countries outside the region. To make the region more attractive as a foreign investment destination, ASEAN created an integrated market and promoted economic integration with countries outside the region through FTAs. ASEAN's economic integration is a successful example of economic integration in developing countries, and other developing countries can learn lessons from ASEAN's experiences.

FTAs are ineffective unless they are used by private companies. To increase use of FTA by private companies, it is necessary to solve the problems private companies face in using them, incorporate the requests of private companies, and create a business-friendly system. The same applies to other fields, such as improving the investment environment. An example of this is the successful dialogue between the Secretary-General of ASEAN and the Federation of Japanese Chamber of Commerce and Industry in ASEAN (FJCCIA), which is a federation of eight Japanese Chambers of Commerce situated in seven ASEAN countries. As of 2020, it has about 7,500 members. FJCCIA pointed out the AEC-related problems faced by members and proposed ideas to solve these problems and make improvements. The dialogue helped improve the business environment and promote ASEAN economic integration. Participation by such stakeholders is essential for economic integration to progress. The ASEAN Economic Community is an ambitious economic integration and ASEAN is also working on many significant issues, such as productivity-driven growth, connectivity, the digital economy, and regulatory reform. The actual status of efforts toward AEC 2025 is still insufficient, but will materialize as the AEC 2025 blueprint is implemented.

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