

The Formation of the ASEAN Economic Community (AEC) & Policy Issues for Japan's Globalization Strategy



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Introduction

On Nov. 22, 2015, the 10 leaders of the member countries of the Association of Southeast Asian Nations (ASEAN) declared the formation of the ASEAN Economic Community (AEC). The bloc — consisting of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam — has become an increasingly important player in the world economy. With a population of more than 600 million, the AEC is one of the largest economies in the world. In 2014, the group's share of world GDP was 6.2% (in purchasing power parity, or PPP\$) and 3.3% in US\$ terms. These figures are comparable to those of India (7.0% in PPP\$ and 2.7% in US\$) (Table 1).

The vision for the formation of the AEC was first proposed by ASEAN leaders in 2003 at the 9th ASEAN Summit held in Bali, Indonesia. At the 12th ASEAN Summit in Cebu in the Philippines in 2007, ASEAN leaders agreed to accelerate the establishment of the AEC, from its original schedule of 2020 to 2015. The 2015 Blueprint proposed at the 13th ASEAN Summit in Singapore in November 2013 outlines a strategic framework of four pillars for building the AEC: (a) a single market and production base, with top priorities given to free movement of goods, services, investment, capital, and skilled labor;

(b) a highly competitive economic region, for which infrastructure development plays a crucial role; (c) equitable economic development, with special attention to promoting ASEAN SMEs; and (d) deep integration into the global economy, fostering ASEAN's participation in global supply networks (Chart 1).

Based on the 2015 Blueprint, a scorecard was developed to monitor progress toward the 2015 establishment of the AEC. The scorecard comprises a total of 611 ASEAN-wide measures, of which 506 are considered a focused base for monitoring implementation. As of October 2015, 92.7% of all focused base measures (469/506) have been fully implemented. For individual pillars, this percentage is 92.4% (256/277) for Single Market and Production Base; 90.6% (154/170) for Competitive Economic Region; and 100% each for Equitable Economic Development and Integration into the Global Economy. It should be noted that progress towards the free flow of goods has been faster. As of October 2015, 96% of intra-regional tariffs have been virtually eliminated (see *A Blueprint for Growth - ASEAN Economic Community 2015: Progress and Key Achievements*, The ASEAN Secretariat, Jakarta; available at www.asean.org). The AEC Blueprint 2025, adopted by the ASEAN leaders at the formation of the AEC in November 2015, specifies five strategic elements for the first 10 years of the bloc's development: (i) integration and cohesiveness; (ii)

TABLE 1

ASEAN Economic Community vs. China & India: selected indicators in 2014

	Population		GDP (PPP\$)			GDP (Current US\$)		
	(millions)	Share in World	(billions)	Share in World	Income Level*	(billions)	Share in World	Income Level*
ASEAN-10	623.3	8.9%	6,522.4	6.2%	70	2,520.5	3.3%	38
Brunei	0.4	0.01%	29.7	0.03%	475	17.1	0.02%	380
Cambodia	15.3	0.2%	50.0	0.05%	22	16.8	0.02%	10
Indonesia	254.5	3.6%	2,676.1	2.5%	70	888.5	1.2%	32
Laos	6.7	0.1%	35.6	0.03%	36	12.0	0.02%	17
Malaysia	29.9	0.4%	766.6	0.7%	171	338.1	0.4%	105
Myanmar	53.4	0.8%	244.4	0.2%	31	64.3	0.1%	11
Philippines	99.1	1.4%	690.9	0.7%	47	284.8	0.4%	27
Singapore	5.5	0.1%	452.7	0.4%	553	307.9	0.4%	523
Thailand	67.7	1.0%	1,065.7	1.0%	105	404.8	0.5%	56
Vietnam	90.7	1.3%	510.7	0.5%	38	186.2	0.2%	19
Asia's largest economies								
China	1,364.3	19.4%	18,017.1	17.1%	88	10,354.8	13.7%	70
India	1,295.3	18.4%	7,384.1	7.0%	38	2,048.5	2.7%	15
Japan	127.1	1.8%	4,630.9	4.4%	243	4,601.5	6.1%	336
World	7,031.0	100%	105,306.3	100%	100	75,723.4	100%	100

Note: * World aggregate income per capita level=100
Source: World Bank Development Indicator Dataset

CHART 1

The 4 pillars of AEC integration



Source: *A Blueprint for Growth — ASEAN Economic Community 2015: Progress and Key Achievements*, The ASEAN Secretariat, Jakarta; available at www.asean.org.

competitiveness, innovativeness, and dynamism; (iii) connectivity and sectoral cooperation; (iv) resilience, inclusiveness, and people-centric focus; and (v) global integration. The stated aim of this development strategy is to help the region leverage its distinctive strengths for growth and competitiveness: strategic location, openness, dynamism, diversity, and capabilities to undertake bold reforms. Situated between two rising economic powers (China and India), the AEC is positioned to exploit growth opportunities arising from the rapid expansion of its immediate neighbors. This strategic location, coupled with outward-looking development strategies, has already made the AEC one of the most open and dynamic economies in the world. The AEC outpaced the world aggregate, China, and India on key openness measures between 1990 and 2014. In 2014, the AEC's trade-to-GDP ratio was 125% compared to 60% for the world aggregate, 42% for China, and 50% for India (Chart 2). At the same time, the FDI stock-to-GDP ratio was 68.1% for the AEC, 33.6% for the world aggregate, 10.5% for

China, and 12.3% for India (Chart 3). Further, the AEC is becoming an attractive destination for FDI. The share of the bloc in global FDI inflows increased from less than 2% in 2000 to 5% in 2007 and 11% in 2014 (according to the World Investment Report 2015, UNTAC).

The AEC is also distinctive in its diversity and capabilities to undertake unprecedented reforms. The region is home to hundreds of millions of Muslims (clustered in Indonesia and Malaysia), Christians (the Philippines), and Buddhists (Thailand, Vietnam, Myanmar, and Cambodia), with cultural harmony a prevailing feature. The 10 member countries of the bloc are also at varying stages of development, with per capita income ranging by a factor of 50 (around \$1,000 for Myanmar and Cambodia to over \$50,000 for Singapore). The AEC member countries exhibit the region's considerable capabilities in undertaking bold reforms and managing change. Examples include Vietnam's economic reforms, Myanmar's peaceful transition to democracy, the Philippines' turnaround in

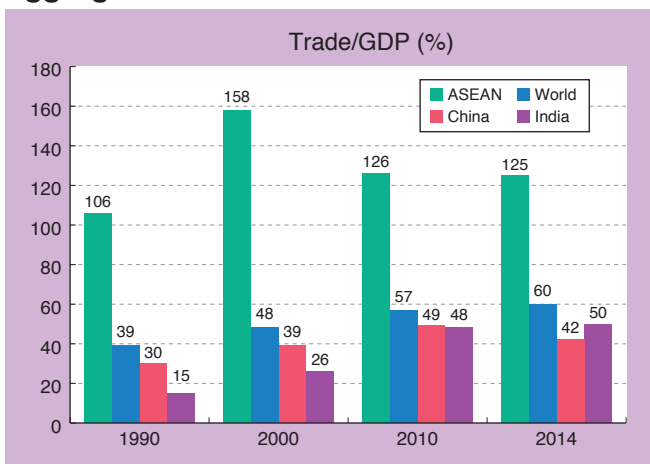
economic performance, and Indonesia's smooth institutional restructuring.

The formation of the AEC and its promising prospects should be seriously considered in Japan's globalization strategy. As a major investor and leading provider of official development aid (ODA) in the region, Japan has played an important role in the development of many AEC member countries. The sizable contribution of Japan to the region's development, coupled with its strong reputation in quality control and partnership reliability, affords the country significant advantages for participating in the AEC's long-term development and strategic projects.

Sections 2 and 3 provide comparative views of Japan's economic links with ASEAN in recent years. This examination focuses on trade (Section 2) and Japan's FDI inflows to ASEAN (Section 3).

CHART 2

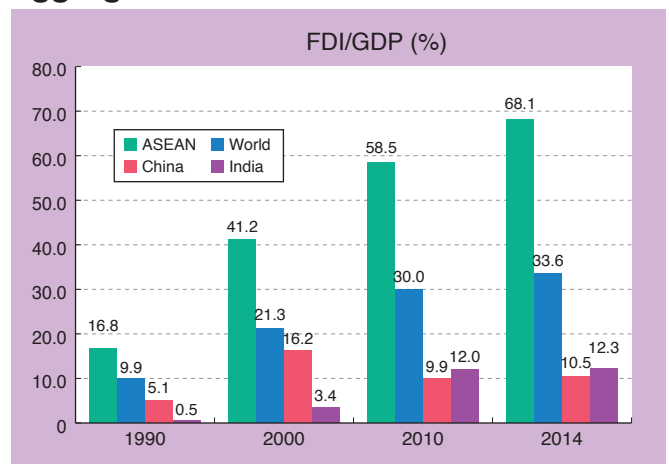
Openness – AEC vs. China, India & world aggregate on trade-to-GDP ratio



Source: Data from World Development Indicators 2015, World Bank, accessed Dec. 20, 2015

CHART 3

Openness – AEC vs. China, India & world aggregate on FDI stock-to-GDP ratio



Source: Data from World Investment Report 2015, UNTAC

TABLE 2

Share of key partners in total trade by ASEAN country: 2008-2013 vs. 2001-2007

Reporter	Amount (\$ billion)	Share in Total								
		ASEAN	Japan	S. Korea	EU	US	China	India	ROW	World
Annual average 2001-2007 (I)										
ASEAN	1,068.5	24.0	12.8	4.3	12.2	13.4	8.7	1.8	22.7	100
Cambodia	4.9	19.0	2.5	2.6	12.7	28.4	7.5	0.4	27.0	100
Indonesia	126.0	21.7	17.7	6.3	12.1	10.1	8.0	2.8	21.4	100
Malaysia	227.0	24.8	12.5	4.2	12.4	16.6	8.4	2.0	19.2	100
Philippines	86.9	17.8	16.6	4.8	12.8	19.2	6.5	0.6	21.7	100
Singapore	367.0	28.9	7.9	4.0	11.9	12.3	9.1	2.2	23.8	100
Thailand	195.0	19.3	17.9	2.9	12.2	12.0	8.8	1.2	25.7	100
Vietnam	61.7	21.2	12.3	6.4	13.2	10.0	12.3	1.2	23.5	100
Annual average 2008-2013 (II)										
ASEAN	2,053.4	24.3	10.6	5.1	10.3	9.0	12.5	2.8	25.4	100
Cambodia	12.4	23.1	2.6	2.7	12.6	18.3	14.3	0.7	25.8	100
Indonesia	316.0	25.1	13.7	6.8	9.0	7.4	12.7	4.4	20.8	100
Malaysia	371.0	26.4	11.1	4.1	10.5	9.5	13.0	2.9	22.6	100
Philippines	103.0	20.7	14.2	6.2	10.8	13.2	10.6	0.9	23.5	100
Singapore	662.0	27.6	5.8	5.2	10.5	8.7	11.0	3.2	27.9	100
Thailand	403.0	20.3	14.7	3.0	9.6	8.1	12.5	1.8	30.0	100
Vietnam	186.0	17.2	10.6	8.7	12.3	11.0	17.6	1.8	20.9	100
Change from 2001-2007 to 2008-2013*										
ASEAN	1.9	0.2	-2.2	0.8	-2.0	-4.4	3.8	1.0	2.7	—
Cambodia	2.5	4.1	0.1	0.2	-0.1	-10.1	6.8	0.3	-1.2	—
Indonesia	2.5	3.4	-4.0	0.5	-3.0	-2.6	4.7	1.7	-0.6	—
Malaysia	1.6	1.6	-1.4	-0.1	-1.9	-7.1	4.6	1.0	3.4	—
Philippines	1.2	2.8	-2.4	1.4	-2.0	-6.0	4.0	0.3	1.8	—
Singapore	1.8	-1.2	-2.1	1.2	-1.5	-3.5	1.9	1.0	4.1	—
Thailand	2.1	1.0	-3.2	0.1	-2.6	-3.9	3.7	0.5	4.4	—
Vietnam	3.0	-4.1	-1.7	2.3	-0.9	1.0	5.3	0.7	-2.6	—

Note: * (I)/(I) for the amount and (II)-(I) for the share

Source: ASEAN secretariat for ASEAN countries; UNCTAD for China and India. Data is not available for Brunei, Laos, and Myanmar.

Trade Between Japan & ASEAN

Table 2 shows the shares of Japan and other major global players in the total trade of ASEAN and its member countries. This share is averaged for two periods (2001-2007 and 2008-2013) for which data is available, to correct for short-term fluctuations. The choice of these two periods allows for structural changes in global trade patterns caused by the 2008 global financial crisis.

Three observations stand out. First, the total trade of ASEAN and its member countries increased significantly from the first period (2001-2007) to the second (2008-2013), implying that, for the region, globalization prevailed over the adverse effects of the global financial crisis. The expansion rate of total trade between the two periods was 1.9 times for ASEAN as a whole. This rate, however, varied by country: 3.0 for Vietnam and 2.5 for Cambodia and Indonesia, but only 1.2 for the Philippines and 1.6 for Malaysia.

Second, the share of Japan in the total trade of ASEAN fell by 2.2 percentage points between 2001-2007 and 2008-2013 (12.8% to 10.6%). Similar patterns were observed for all the ASEAN member countries, with the exception of Cambodia. The magnitude of Japan's share decline ranged from 1.4 percentage points for Malaysia and 1.7 percentage points for Vietnam to 3.2 percentage points for Thailand and 4.0 percentage points for Indonesia.

Third, the European Union and the United States followed the patterns observed for Japan. In terms of the magnitude of contraction, however, the EU suffered less and the US suffered more compared to Japan. In contrast, China, India, and South Korea significantly expanded their shares in the total trade of ASEAN and of most of its member countries between the two periods. In particular, the expansion of China's share was 3.8 percentage points for ASEAN,

while ranging from 1.9 percentage points for Singapore and 3.7 percentage points for Thailand to 5.3 percentage points for Vietnam and 6.8 percentage points for Cambodia.

A deeper look at *Chart 4* reveals that, for the aggregate economy, similar patterns were observed for most sectors regarding trade share change among ASEAN's key trade partners. On the one hand, the shares in ASEAN's trade of three developed economies — Japan, the EU, and the US — contracted significantly over 2000-2013 for nearly all sectors. Exceptions include "Wood" and "Apparel" for Japan (Panel A); "Transport equipment", "Medical instruments" and "Petroleum" for the EU (Panel B); and "Transport equipment" "Publishing" (Software), and "Textiles" for the US (Panel C). On the other hand, the shares of South Korea, China, and India in ASEAN's trade considerably expanded for almost all sectors. "Telecom" and "Textiles" were among the sectors with largest share gains for both South Korea (Panel D) and China (Panel E), while "Agriculture" and "Mining" were the leading drivers of India's integration into the region (Panel F).

One of the possible factors causing the contraction of Japan's share in ASEAN's trade is the large volume of FDI by Japanese multinational corporations into the region. These companies, which serve global markets, have recently shifted many of their production activities to the region; hence the reduced need for intra-firm and intra-industry trade between Japan and ASEAN.

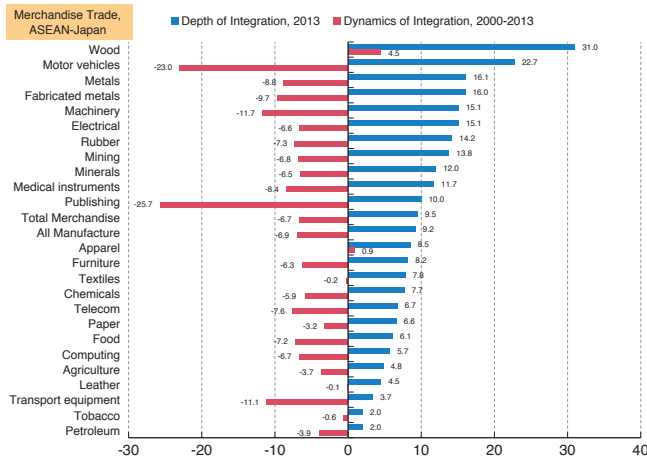
Japan's FDI Inflows to ASEAN

Similar to *Table 2* for international trade, *Table 3* presents the growth and structure by source of FDI inflows to ASEAN and its member countries over the same periods (2001-2007 and 2008-2013). There are three salient factors here. First, compared to international trade,

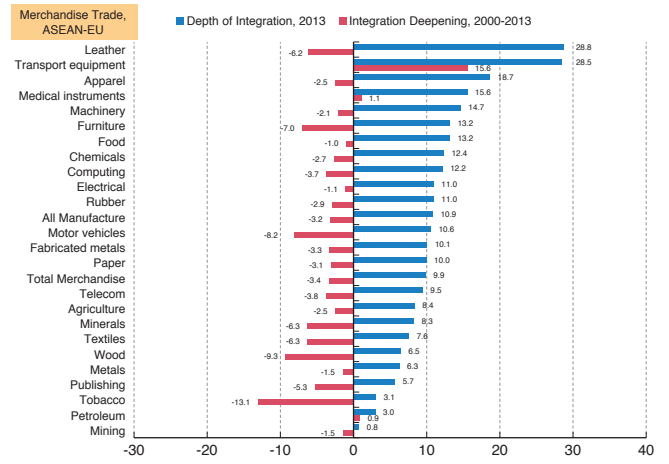
CHART 4

ASEAN's merchandise trade integration with major partners by sector, 2000-2013

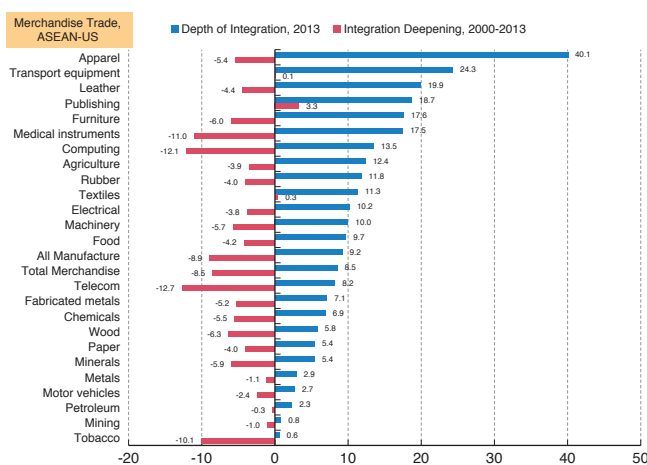
a) With Japan



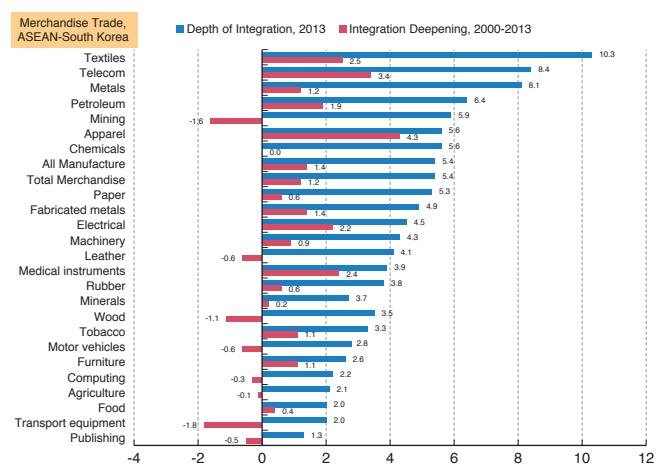
b) With the EU



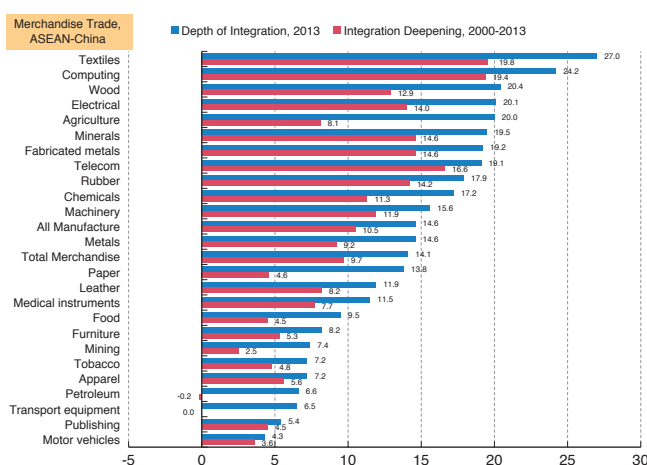
c) With the US



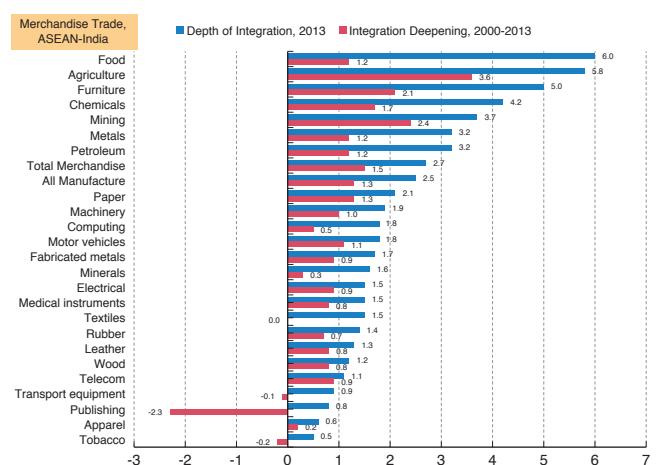
d) With South Korea



e) With China



f) With India



Source: Author's calculation with data from UN COMTRADE database.

TABLE 3

Share of key sources of FDI inflows into ASEAN countries: 2008-2013 vs. 2001-2007

Reporter	Amount (\$ billion)	Share in Total								
		ASEAN	Japan	S. Korea	EU	US	China	India	ROW	World
Annual average 2001-2007 (I)										
ASEAN	43.1	11.6	14.3	1.8	27.1	10.9	2.0	1.1	31.1	100.0
Brunei	0.9	2.9	7.6	0.6	82.5	0.9	0.4	0.1	4.9	100.0
Cambodia	0.3	29.2	1.8	11.9	4.8	3.6	22.7	0.0	26.0	100.0
Indonesia	2.7	26.9	10.5	3.9	34.1	11.6	4.5	-2.0	10.4	100.0
Laos	0.1	21.5	3.7	3.4	30.3	0.6	4.2	0.1	36.1	100.0
Malaysia	4.2	21.2	20.2	0.4	21.7	26.8	0.3	-3.6	12.9	100.0
Myanmar	0.3	14.3	0.7	6.5	33.2	5.9	20.2	0.0	19.2	100.0
Philippines	1.5	5.1	18.6	0.2	3.7	16.8	0.0	0.0	55.7	100.0
Singapore	23.8	4.1	8.0	0.8	32.6	9.2	2.1	2.8	40.4	100.0
Thailand	6.9	27.6	35.4	0.9	9.5	8.0	0.3	0.1	18.1	100.0
Vietnam	2.4	10.0	13.0	14.3	22.5	9.8	3.0	0.1	27.2	100.0
Annual average 2008-2013 (II)										
ASEAN	87.8	16.5	13.5	2.7	18.2	9.4	5.2	1.8	32.7	100.0
Brunei	0.7	3.3	10.4	0.0	76.4	2.3	0.0	0.0	7.6	100.0
Cambodia	1.0	30.9	2.2	14.1	7.5	2.2	19.4	1.0	22.8	100.0
Indonesia	14.1	41.7	30.0	3.5	4.9	3.8	2.8	0.0	13.2	100.0
Laos	0.3	23.9	2.1	2.7	2.5	0.1	19.5	0.1	49.0	100.0
Malaysia	8.6	19.0	18.0	2.9	22.6	4.3	0.2	-0.1	33.0	100.0
Myanmar	1.7	15.8	0.7	2.5	17.2	1.0	41.0	0.7	21.1	100.0
Philippines	2.2	2.8	10.8	0.6	-8.7	22.8	0.0	0.0	71.8	100.0
Singapore	42.5	9.4	2.8	0.7	26.2	12.5	6.0	3.6	38.7	100.0
Thailand	8.3	8.1	36.3	2.1	8.4	7.5	4.1	0.1	33.2	100.0
Vietnam	8.3	18.6	17.7	11.6	9.6	9.5	3.6	0.3	29.1	100.0
Change from 2001-2007 to 2008-2013*										
ASEAN	2.0	4.9	-0.8	0.9	-8.9	-1.5	3.2	0.7	1.6	—
Brunei	0.8	0.3	2.8	-0.6	-6.1	1.4	0.4	-0.1	2.7	—
Cambodia	3.1	1.7	0.3	2.2	2.8	-1.4	3.3	0.9	-3.3	—
Indonesia	5.3	14.8	19.5	-0.4	-29.1	-7.8	1.7	2.0	2.7	—
Laos	3.9	2.4	-1.6	-0.6	-27.8	-0.6	15.2	0.1	12.9	—
Malaysia	2.0	2.3	-2.2	2.5	0.9	-22.4	0.2	3.5	20.1	—
Myanmar	5.2	1.6	0.0	-4.0	-16.0	-4.9	20.8	0.7	1.9	—
Philippines	1.5	2.3	-7.8	0.4	-12.5	6.0	0.0	0.0	16.1	—
Singapore	1.8	5.3	-5.2	-0.1	-6.3	3.4	3.9	0.7	-1.7	—
Thailand	1.2	19.5	0.9	1.2	-1.1	-0.5	3.8	0.0	15.1	—
Vietnam	3.5	8.6	4.7	-2.7	-12.9	-0.4	0.6	0.1	1.9	—

Note: * (II)/(I) for the amount and (II)-(I) for the share

Source: ASEAN secretariat for ASEAN countries; UNCTAD for China and India

FDI flows to ASEAN from the first to the second period increased more rapidly in most countries, especially Indonesia (5.3 times for FDI; 2.5 times for trade), Vietnam (3.5; 3.0), and Cambodia (3.1, 2.5). Only for Thailand, in which political uncertainty might be a factor, was the increase in FDI inflows below that in trade (1.2 vs. 2.1).

Second, Japan is a major source of FDI inflows to ASEAN, and its share in the region's FDI inflows is larger than those of two bigger economies, the US and China. Japan's share was 14.3% in 2001-2007 and 13.5% in 2008-2013, higher than the US (10.9% and 9.4%) and China (2.0% and 5.2%). On the other hand, it should be noted that this share slightly decreased between the two periods for Japan (by -0.8 percentage points), while it expanded for China (+3.2 percentage points), South Korea (+0.9 percentage points), and India (+0.7 percentage points).

Third, Japan's contribution to ASEAN's FDI is stronger than its contribution to ASEAN's trade. This difference is particularly evident for Thailand, Indonesia, and Vietnam. The share of Japan in FDI inflows expanded by 19.5 percentage points (from 10.5% in 2001-2007 to 30.0% in 2008-2013) for Indonesia, by 4.7 percentage points (from 13.0% to 17.7%) for Vietnam, and by 0.9 percentage points (from 35.4% to 36.3%) for Thailand. In contrast, the share of Japan trade shrank between the two periods for all ASEAN countries, with the exception of Cambodia. In particular, this contraction was -4.0 percentage points (from 17.7% in 2001-2007 to 13.7% in 2008-2013) for Indonesia, -1.7 percentage points (from 12.3% to 10.6%) for Vietnam, and -3.2 percentage points (from 17.9% to 14.7%) for Thailand.

Conclusion

The formation of the AEC in 2015 has established a foundation for the 10 ASEAN countries to pool their resources and strengths, with the aim of collectively developing one of the largest economies in the world. Through its distinctive strengths, especially in strategic location, openness, and dynamism, the AEC will elevate its global status and in some ways may achieve the same significance as China and India. The AEC will also play an important role in the economic growth and changing dynamics of greater Asia and the world.

Japan has developed strong economic links with ASEAN member countries, as observed through the country's share in the region's trade and FDI inflows. With its strong record of FDI in the region, Japan will be an important player contributing to the performance of the AEC in the coming decades.

Moreover, Japan may need to review its globalization strategy, taking into account the formation of the AEC. The significant contraction of Japan's share in the region's trade in the last decade suggests that Japan might have lacked an effective strategy to create more vigorous economic linkages with ASEAN members. Simply shifting production activities to ASEAN member countries for the sake of labor cost reduction is no longer the best way to benefit from the growth and dynamism of the AEC.

JS

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