



## **50th Anniversary of ASEAN: Present Situation of its Economic Integration and Challenges Ahead**

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### <Summary>

- The Association of South-East Asian Nations (ASEAN) was established in August 1967, with initial membership of 5 countries. The membership increased later to the present 10 countries. In the initial days, it was a community with a strong political hue under the Cold War structure, but since the middle of 1970s, it started to promote regional economic cooperation.
- It can be said that ASEAN is characterized by the diversity of its members in many aspects including the degree of economic development, history of their economic evolution, cultures and religions. The ASEAN countries have achieved high economic growth by introducing foreign capital mainly from Japanese companies and becoming a unit of global value chains.
- ASEAN is now deepening its integration aiming at realization of the ASEAN Community (AC) composed of three pillars of political-security community, economic community and socio-cultural community. The ASEAN Economic Community (AEC) was launched in December 2015, and is currently promoting further deepening of its integration based on the “AEC 2025 Blueprint”.
- The challenges for ASEAN include correction of regional income gaps, overcoming of middle-income trap, etc. It is desired for them to enhance the economic level of the whole region by further deepening the integration while giving due consideration to the weak.

## **1. History of ASEAN : From Inauguration as Political Integration to Evolution to Economic Integration<sup>1</sup>**

ASEAN started in 1967 with 5 countries of Indonesia, Malaysia, Philippines, Singapore and Thailand and initially it was a political integration to prevent regional conflicts and protect peace in the region. At the first summit meeting held in 1976, the Treaty of Amity and Cooperation in Southeast Asia (TAC) was adopted, and the regional economic cooperation started. In the early days, ASEAN promoted a “strategy on collective import-substitution-oriented industrialization of heavy industries” while restricting the inflow of foreign capitals. The strategy failed to produce desired outcome and at the third summit meeting in 1987, ASEAN took a turn to shift toward the “strategy on collective export-oriented industrialization dependent on foreign-capital”. Increase of direct investment in Asia by the Japanese companies in the backdrop of the appreciating yen after the 1985 Plaza Accord contributed to the high economic growth of ASEAN countries, coupled with the policy efforts of the ASEAN countries themselves.

Against the background of structural change of the global economy which started at the beginning of the 1990s, namely, the end of cold war, rapid growth of China based on the reform and opening policy and following rapid increase of foreign direct investment in China, ASEAN was under the pressure to deepen its regional economic cooperation in view of attracting foreign capital, and since 1992 customs tariffs had been repeatedly reduced aiming at the completion of ASEAN Free Trade Area (AFTA). The end of cold war structure brought about a change in the regional political situation, which prompted a new membership of Viet Nam in 1995, Lao PDR and Myanmar in 1997, and Cambodia in 1999 to form a present ten-country association<sup>2</sup>.

The Asian Currency Crisis of 1997 and the following structural reforms pursued in individual countries necessitated further integration of ASEAN. In October 2003, an initiative for ASEAN Economic Community (AEC) was proposed to constitute one of the pillars of ASEAN Community<sup>3</sup>. The initiative aimed to construct by 2020 a single market and production base which is characterized by the “free flow of goods, services, capital, and labor force”. At the summit meeting in January 2007, the leaders declared to bring forward the accomplishment of the AEC by 5 years to be realized in 2015. In November 2007, “AEC Blueprint” was published. The elimination of customs tariffs for 99.6% of commodity items was realized by the leading 6 members, thereby the AFTA virtually completed. At the end of 2015, the AEC was realized. In

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<sup>1</sup> Ishikawa, Kuchiki and Shimizu (2015) Introductory. Prof. Shimizu classified the development policy as “Strategy on collective import-substitution- oriented industrialization of heavy industries” and “Strategy on collective export-oriented industrialization dependent on foreign capital.”

<sup>2</sup> Ahead of it, Brunei Darussalam joined ASEAN to form a six-country framework. Sometimes the original members are called ASEAN5, and the ASEAN5 with Brunei are called leading ASEAN6. The late comers of 4 members are called CLMV by their initials.

<sup>3</sup> ASEAN Community consists of three pillars of political-security community, economic community and socio-cultural community.

November 2015, “AEC 2025 Blueprint” was adopted to promote further deepening of integration. Based on this blueprint, negotiations are in progress in the individual areas such as liberalization of services, non-tariff barriers, and so on.

## 2. Development of the ASEAN Economy

### (1) Overview

As of 2015, ASEAN has a population of 630 million with an economic scale of \$2.4 trillion in nominal GDP for the aggregate of 10 countries (Table 1). Average per capita GDP is \$3,867, ranking around the middle of middle income countries. Yet, the gap among the member countries is quite large, with the per capita income of the highest Singapore accounting for 47 times larger than the poorest Cambodia. In terms of the GDP scale, GDP in Indonesia with a population of 256 million is 67 times larger than that in Brunei with a population of 420,000.

Table 1 : Economic Indicators of Main Asian Countries

|                       | GDP<br>2015<br>(\$ billions) | Populatin<br>2015<br>(millions) | Per capita<br>GDP<br>2000<br>(\$) | Per capita<br>GDP<br>2015<br>(\$) | Real GDP growth rate (%) |                    |                          |                          |                          |     |
|-----------------------|------------------------------|---------------------------------|-----------------------------------|-----------------------------------|--------------------------|--------------------|--------------------------|--------------------------|--------------------------|-----|
|                       |                              |                                 |                                   |                                   | 1980-89<br>average       | 1990-99<br>average | 2000-<br>2010<br>average | 2011-<br>2015<br>average | 2016-<br>2022<br>average |     |
| A<br>S<br>E<br>A<br>N | Singapore                    | 296.8                           | 5.5                               | 23,793                            | 53,629                   | 7.8                | 7.3                      | 6.2                      | 4.1                      | 2.5 |
|                       | Brunei Darussalam            | 12.9                            | 0.42                              | 20,511                            | 30,995                   | -0.2               | 2.1                      | 1.5                      | -0.1                     | 4.5 |
|                       | Malaysia                     | 296.3                           | 31.2                              | 4,287                             | 9,501                    | 5.9                | 7.2                      | 5.0                      | 5.3                      | 4.7 |
|                       | Thailand                     | 399.2                           | 68.8                              | 2,028                             | 5,799                    | 7.2                | 5.4                      | 4.6                      | 2.9                      | 3.1 |
|                       | Indonesia                    | 861.1                           | 255.5                             | 870                               | 3,371                    | 6.5                | 4.8                      | 5.4                      | 5.5                      | 5.3 |
|                       | Philippines                  | 292.5                           | 102.2                             | 1,055                             | 2,863                    | 2.0                | 2.8                      | 4.7                      | 5.9                      | 6.9 |
|                       | Viet Nam                     | 191.3                           | 91.7                              | 402                               | 2,087                    | 5.0                | 7.4                      | 6.8                      | 5.9                      | 6.3 |
|                       | Lao PDR                      | 12.6                            | 7.0                               | 292                               | 1,787                    | 6.0                | 6.1                      | 7.1                      | 7.9                      | 6.9 |
|                       | Myanmar                      | 59.5                            | 51.8                              | 221                               | 1,148                    | n.a.               | 8.4                      | 10.7                     | 7.3                      | 7.4 |
|                       | Cambodia                     | 17.8                            | 15.5                              | 300                               | 1,145                    | 6.5                | 6.2                      | 8.1                      | 7.2                      | 6.7 |
|                       | India                        | 2,088.2                         | 1292.3                            | 463                               | 1,616                    | 5.5                | 5.7                      | 7.2                      | 6.8                      | 7.7 |
|                       | China                        | 11,226.2                        | 1374.6                            | 959                               | 8,167                    | 9.8                | 10.0                     | 10.3                     | 7.9                      | 6.1 |
|                       | South Korea                  | 1,382.8                         | 51.0                              | 11,947                            | 27,105                   | 8.8                | 7.1                      | 4.8                      | 3.0                      | 2.9 |
|                       | Japan                        | 4,382.4                         | 127.0                             | 38,534                            | 34,513                   | 4.4                | 1.6                      | 0.9                      | 1.0                      | 0.8 |

(Notes) GDP data are available only from 1985 for Brunei Darussalam, from 1987 for Cambodia, from 1997 for Myanmar. Average growth rates are average of years fro which data are available, from 1985 for Brunei Darussalam, from 1987 for Cambodia, and from 1997 for Myanmar. The data after 2015 are the estimate by the IMF.

(Srouce) IMF

The economic structure shows a wide diversity among oil producing Brunei, City state Singapore, industrialized Thailand and Malaysia, and Cambodia and Lao PDR which are still highly dependent on agriculture (Table 2).

Table 2 : Economic Structure of ASEAN Countries

|                   | Structure of output                  |      |                       |      |                           |      |                                    |      | Trade<br>(Exp.+Imp.)<br>% of GDP | Exports<br>% of GDP | Current<br>Account<br>Balances<br>% of GDP | Ratio of<br>elderly<br>population<br>% ** |
|-------------------|--------------------------------------|------|-----------------------|------|---------------------------|------|------------------------------------|------|----------------------------------|---------------------|--|---|
|                   | Primary<br>(Agriculture)<br>% of GDP |      | Secondary<br>% of GDP |      |                           |      | Tertiary<br>(Services)<br>% of GDP |      |                                  |                     |  |   |
|                   |                                      |      |                       |      | Manufacturing<br>% of GDP |      |                                    |      |                                  |                     |  |   |
|                   | 2005                                 | 2016 | 2005                  | 2016 | 2005                      | 2016 | 2005                               | 2016 |                                  |                     |  |   |
| Singapore         | 0                                    | 0    | 32                    | 26   | 28                        | 20   | 68                                 | 74   | 227.1                            | 125.5               | 18.1                                       | 12  |
| Brunei Darussalam | 1                                    | 1    | 72                    | 57   | 12                        | 11   | 27                                 | 42   | 72.8                             | 49.2                | 16.0 *                                     | 5   |
| Malaysia          | 8                                    | 9    | 46                    | 36   | 28                        | 20   | 46                                 | 56   | 127.7                            | 67.9                | 3.0  | n.a.                                      |
| Thailand          | 9                                    | 8    | 39                    | 36   | 30                        | 27   | 52                                 | 56   | 105.4                            | 54.2                | 8.1  | 11  |
| Philippines       | 13                                   | 10   | 34                    | 31   | 24                        | 20   | 54                                 | 60   | 44.5                             | 20.3                | 2.5  | 5   |
| Indonesia         | 13                                   | 13   | 47                    | 39   | 27                        | 21   | 40                                 | 44   | 34.2                             | 17.5                | -2.0                                       | 5   |
| Viet Nam          | n.a.                                 | 18   | n.a.                  | 36   | n.a.                      | 16   | n.a.                               | 45   | 169.5                            | 83.8                | 0.5 *                                      | 7   |
| Lao PDR           | 36                                   | 19   | 25                    | 33   | 10                        | 9    | 39                                 | 48   | 53.5                             | 29.4                | -16.8 *                                    | 4   |
| Myanmar           | 47                                   | 28   | 18                    | 30   | 13                        | 21   | 36                                 | 42   | 43.2                             | 17.5                | -5.2                                       | 6   |
| Cambodia          | 33                                   | 27   | 27                    | 32   | 19                        | 17   | 41                                 | 42   | 106.6                            | 47.9                | -10.6 *                                    | 4   |

(Notes) \* means IMF estimates. \*\*Ratio of elderly population is calculated by population aged 65 and over to total population.

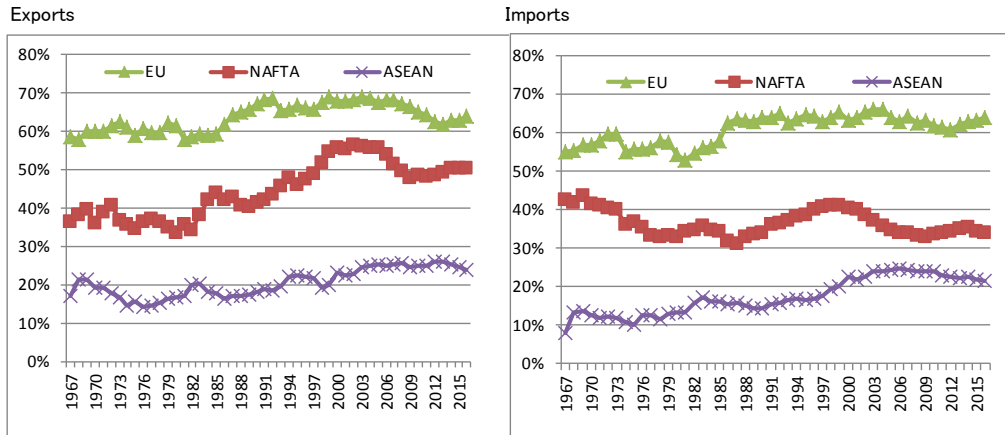
(Sources) World Bank "World Development Indicators 2017", IMF and the ASEAN Secretariat.

## (2) Trade and Investment : Stronger Linkage in the East Asian region through global value chains

East Asian countries that include ASEAN are well known with their high GDP ratio of trade in goods. Looking at their ratios of trade values (exports and imports) against GDP, Singapore records the highest 227% (126% for exports) and Indonesia shows the lowest 34% (18% for exports), with average ASEAN ratio showing a high level of 93% (Table 2) . Average GDP ratio of exports amounts around 30% for developing countries as a whole, and around 20% for advanced countries. Compared with these data, the level of slightly below 50% for ASEAN is quite high. In the 1970s ASEAN had a high weight of exports of natural resources, but in the transition from industrialization of import substitution to export-oriented industrialization, the member countries achieved a high growth supported by exports of manufactured goods. The present export structure shows that, except for Brunei in which fuels account for 93% of exports (2016, World Bank data), and Indonesia (ratio of manufactured goods 45%) and Malaysia (same 67%) in which fuels account for substantial weights, the exports of manufactured goods account for around 80% for the rest of the countries as indicated by Cambodia (93%) and the Philippines (85%)<sup>4</sup>. Exports of Cambodia are mostly accounted for by light manufactured goods like clothing and textiles, which contrasts remarkably with the Philippines in which electric machines and the like account for 60%.

<sup>4</sup> No data available from the World Bank for Lao PDR and Myanmar.

Chart 1 Ratios of Intra-regional trade



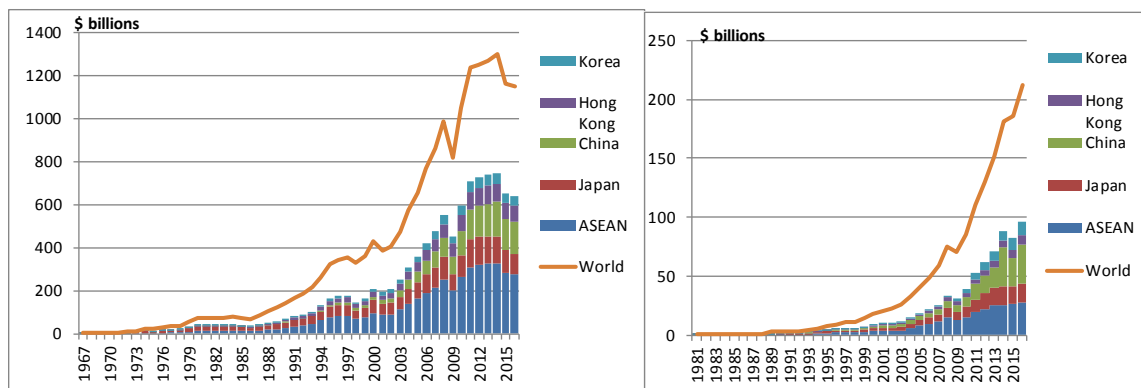
(Note) ASEAN includes 5 original members for 1967–2000, 10 members for 2001 and afterwards. (Source) IMF “Direction of Trade Statistics”

The ratio of intra-regional trade in ASEAN is almost 25% for both exports and imports, lagging by a large margin behind 60-70% in the European Union (EU) and 30-60% in the North American Free Trade Area (NAFTA). From the beginning the EU had been a group of countries with high level of economic development, and its ratio of intra-regional trade had been high from the old times since it had a well-developed transportation network on land and horizontal trades where mutual trades in manufactured goods were active and vigorous among member countries. On the other hand, ASEAN countries used to have strong trading ties with their colonial powers in the process of economic development<sup>5</sup>, and they had a stronger trade relationship with Japan and Newly Industrialized Economies (NIEs) which had actively made direct investment in ASEAN countries since the middle of the 1980s, and with emerging China, than with their neighboring countries. These backgrounds seem to have contributed to the low ratio of intra-regional trade within the ASEAN region.

Chart 2 : ASEAN’s Exports by trading partners

< ASEAN10 >

< CLMV4 >



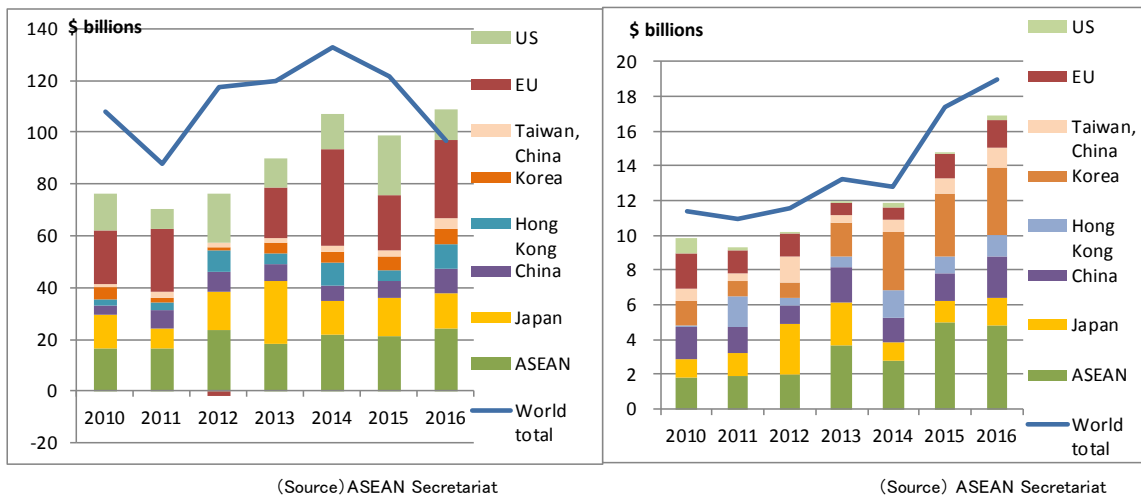
(Note) ASEAN as a partner is 10 members. CLMV means Cambodia, Lao PDR, Myanmar, Viet Nam. (Source) IMF, “Direction of Trade Statistics”

<sup>5</sup> The former colonial powers for ASEAN members are the UK (for Brunei, Malaysia, Myanmar, and Singapore), France (for Viet Nam, Lao PDR, Cambodia), Netherland (for Indonesia), and Spain and the U.S. (for the Philippines). Diversity can also be seen here.

East Asia that includes ASEAN as well as Japan, China, Hong Kong and Korea is the biggest trade partner of ASEAN that accounts for the majority of exports. The trading ties between ASEAN and East Asia have been increasingly strengthened. It is also true that the intra-regional trading ratio of ASEAN has been moderately rising, since the members have made efforts to lower their tariffs since 1992 aiming at completing the ASEAN Free Trade Area (AFTA). In the cases of the EU and the NAFTA, establishment of common market (European common market in the middle of the 1980s, NAFTA in 1994) led to the rise of ratio of intra-regional trading and the establishment of the AEC at the end of 2015 will also act in the direction to raise the ratio of intra-regional trade in the ASEAN region.

As for the foreign direct investment to ASEAN, while a substantial investment has continued from the EU and the U.S., it is notable that the investment from East Asia including intra-ASEAN, Japan, China, Korea, Hong Kong and Taiwan has been steadily increasing (Chart 3). By industry, manufacturing accounts for a large part of investment, but in recent years, investment in wholesale/retail trade and finance/insurance are also increasing reflecting the rise of income levels in the ASEAN countries.

Chart 3 : Foreign Direct Investment in ASEAN by Investor (Flow)  
 < ASEAN10 > < CLMV4 >



Many Japanese-affiliated manufacturing companies in automobile, its parts and electric and electronic industries position ASEAN as a link to their global value chains (GVC). Especially the ASEAN countries have tried to protect and nurture the automobile industry that has a wide range of supporting industries, while introducing foreign capitals mainly through such Japanese-affiliates. The Brand-to-Brand Complementation (BBC) Schemes<sup>6</sup> and the ASEAN Industrial Cooperation Scheme (AICO) which were adopted as part of the ASEAN intra-regional cooperation made the mutual shift of auto parts easier and more convenient and pushed the construction of GVC by the Japanese-affiliated auto makers. Thus the automobile industry in the ASEAN countries has grown up to produce four-wheel vehicles in the order of aggregate 3.64 million in 2016 in the three countries of Thailand, Indonesia, and Malaysia. The production represents 3.8% in the world production, and taken them together as a country, it ranks 7th in the world.

In addition, although still small in scale, direct investment in the less developed CLMV has also been increasing. Singapore, Thailand and Malaysia are the major investors from within ASEAN to CLMV. It is noticeable that among CLMV, investment in Cambodia and Myanmar by a more developed Viet Nam is expanding. From outside the ASEAN region, the East Asian countries like Korea, China, Japan, Hong Kong, and Taiwan are the main players, and it is shown that along the ongoing trend of “China + one” and “Thailand + one” investment<sup>7</sup>, not only Japanese-affiliated companies but also all of the East Asian companies have been making region-wide efforts to build a GVC network. The participation in the GVC will accelerate the speed of industrialization of developing countries<sup>8</sup>. The recent rapid catch-up of CLMV is a reflection of such active global business activities of Asian countries including Japanese-affiliated companies.

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<sup>6</sup> BBC Schemes were introduced in 1988. Until then, the ASEAN countries had been separated by customs tariffs, and automobile makers were forced to bear higher costs for a full set production within a country, without being able to enjoy a scale merit of in-process division of labor. In order to solve this problem, special measures were taken, while limiting to auto parts and exports to other member countries of such parts that were collectively produced in a specified member country, to allow the auto makers to get the benefit of tariff elimination and to include them in their local contents. In a manner to expand the BBC Schemes to other industries, the AICO was introduced in 1996.

<sup>7</sup> Direct investment in China from Japan rapidly increased since the 1990s, but rising wages in China, deceleration of the Chinese economy and heightening political risks, increasingly encouraged the Japanese companies to diversify, taking the overconcentration of investment in China as a business risk, their investment to Thailand and Viet Nam etc. (China + One). Also in Thailand, concerns over labor shortage and wage increases have increased, inviting a move to diversify their investment to further peripheral CLMV (Thailand + One).

<sup>8</sup> World Bank Group and others (2017)

### 3. ASEAN Economic Community (AEC) and Economic and Financial Cooperation in Asia

#### (1) “AEC2025 Blueprint”

“AEC2025 Blueprint” consists of 5 pillars that aim at (i) a deeply integrated and highly cohesive economy; (ii) a competitive, innovative, and dynamic ASEAN; (iii) enhanced connectivity and sectoral cooperation; (iv) a resilient, inclusive, people-oriented, and people-centered ASEAN; and (v) a global ASEAN.

The concrete key elements under the first pillar include trade in goods, trade in services, investment environment, financial integration, financial inclusion and financial stability, facilitation of movement of skilled labor and business visitors, and enhanced participation in GVC, the last element of which was added to the Blueprint as of 2007. As the globalization of business activities progresses, the old FTA that covered only trade in “goods” was not sufficient and broader economic alliance including liberalization of services and the like has become of increasing importance. The second pillar includes such elements as effective competition policy, consumer protection, intellectual property rights, innovation, and so on. The biggest challenge here is how to control the anti-competitive actions and discriminatory government procurement practices by the state owned enterprises. The third pillar puts emphasis on the enhancing connectivity especially in the areas of transportation, communication, and energy. The key elements of the fourth pillar incorporate fostering of micro- and small and medium enterprises (MSMEs) and narrowing of development gaps. The fifth pillar aims at a globalized ASEAN. Through the FTAs and comprehensive economic partnership with extra-region areas, it aims to strengthen the position of ASEAN as an economic area that is open and inclusive for all, keeping the centrality of ASEAN in the changing world and regional environment.

Chart 4 : Aims of the AEC, EU, and EPAs

|                                  | European Community<br>(EC) | ASEAN Economic Community<br>(AEC) | Economic Partnership Agreement<br>(EPA) |
|----------------------------------|----------------------------|-----------------------------------|---|
| Tariff elimination               | ○                          | ○                                 | ○                                       |
| Non-tariff barriers elimination  | ○                          | ○(* )                             | △                                       |
| Common tariff                    | ○                          | x                                 | x                                       |
| Liberalisation of services trade | ○                          | ○(* )                             | △                                       |
| Harmonisation of Standards       | ○                          | △                                 | △                                       |
| Free movement of labor           | ○                          | △                                 | △                                       |
| Trade liberalisation             | ○                          | ○                                 | ○                                       |
| Investment liberalisation        | ○                          | ○                                 | ○                                       |
| Free movement of capital         | ○                          | △                                 | △                                       |
| Government procurement           | ○                          | x                                 | △                                       |
| Common currency                  | ○                          | x                                 | x                                       |

(Notes) ○ means it is an object. △ means an object in a limited way. x means “not classified as an object”. \* means an object but difficult to realise or only partial realisation is argued. Those judgements are not official ones, but of the authors of the book.

(Source) Ishikawa and others(2016) P.29

ASEAN has cautiously promoted the deepening of its economic integration as they had a big



development gap in the region. Unlike the EU, ASEAN does not assume transfer of national sovereign rights of each member to ASEAN after the market integration. This is one of the reasons why the process of integration is slow with many issues unsolved especially in the areas of non-tariff barrier matters, local contents, rules of origin, liberalization of trade in services, despite its progress in the area of liberalization of customs tariffs.

The merits of deepening economic integration are difficult to be known to the people while they may sometimes force the part of the society to bear a burden. It is obvious from the cases in the EU and the UK that the insufficient consideration to the weak has led to a rise of populism and anti-economic integration movement. It will be necessary for ASEAN to continue to make steady efforts to cautiously promote its integration, in a different way from the EU, i.e. in an “ASEAN way” that is based on the consensus after having sufficient and through consultations among the member countries.

## (2) Economic and Financial Alliances in the Asia and Pacific Region

The Asia and Pacific region already has many forms of economic and financial alliance. Some of the representative ones are Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP)<sup>9</sup>.

Among the ASEAN members, four countries of Brunei, Malaysia, Singapore and Viet Nam have decided to join the TPP negotiation. The 12 participating countries largely agreed on the outline of the TPP in October 2015, which was signed in February 2016 to be effectuated after ratification of the participants<sup>10</sup>. Its realization became suddenly remote, however, when in early 2017 the U.S. President Donald Trump formally expressed its withdrawal from the TPP. The effectuation of the TPP treaty needs the ratification of members with combined GDP share of at least 85% of total GDP, and the withdrawal of the U.S. made it impossible to satisfy the criteria of effectuation. Currently, the remaining 11 countries such as Japan, Australia and New Zealand are making efforts to make the treaty come into force without the U.S. Viet Nam and Malaysia are passive and reluctant in making the effectuation without the participation of the U.S., since they had made concessions on their market opening in exchange for the improved access to the U.S. market on the premise of the U.S. participation in the agreement. So the review of conditions is now under negotiation.

The RCEP is a broader economic alliance participated by 16 countries ranging from ASEAN 10 to Japan, China, Korea, Australia, New Zealand and India. ASEAN had concluded an FTA

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<sup>9</sup> Please refer to Yamaguchi (2014) for the ASEAN+3 (Japan, China and Korea) regional economic and financial cooperation. [http://www.iima.or.jp/Docs/newsletter/2014/NL2014No\\_20\\_e.pdf](http://www.iima.or.jp/Docs/newsletter/2014/NL2014No_20_e.pdf)

<sup>10</sup> For the process of TPP negotiations, see Yamaguchi (2015). [http://www.iima.or.jp/Docs/column/2015/1009\\_2\\_e.pdf](http://www.iima.or.jp/Docs/column/2015/1009_2_e.pdf)

individually with each non-ASEAN participant (ASEAN+1 FTA<sup>11</sup>), namely, with China (effective in 2005), Korea (2007), Japan (2008), India (2010), and Australia and New Zealand (2010). But each FTA differs in its degree of liberalization. Under the RCEP, its Guiding Principles and Objectives promise the realization of “broader and deeper engagement with significant improvements over the existing ASEAN+1 FTAs, while recognizing the individual and diverse circumstances of the participating countries”. However, it would be harder in the RCEP to realize the agreements in the areas on which liberalization has not been achieved in the AEC. Therefore, it will be needed more than else to improve the 5 ASEAN+1 FTAs and deepen the AEC.

Japan has made efforts to promote the effectuation of the TPP with the participation of 11 countries, while trying to encourage the return of the U.S. to the negotiation, and at the same time trying to strengthen the partnership with the East-Asia and Pacific Rim countries as a whole by promoting the RCEP negotiations. Through promoting both the TPP and the RCEP, Japan is expected to put pressure on the RCEP to become a higher and enhanced partnership while preparing the way for the U.S. to return to the TPP negotiations.

#### **4. Issues Remaining: Narrowing of Intra-regional Economic Gaps (Development Divide) and Overcoming of Middle Income Trap**

##### **(1) Narrowing of Intra-regional Economic Gaps**

In order to the AEC to deepen its integration while achieving more enhanced effects, it is important to tackle the issue of income gaps between more advanced ASEAN countries and CLMV. Looking at the case of a more integrated EU, among the 28 member countries, the income gap between the poorest Bulgaria and the most affluent Luxembourg was 20 times in terms of per capita GDP in 2006, just before the accession of Bulgaria to the EU, and 14 times in 2014. On the other hand, there was a gap of 108 times in ASEAN in 2000 between the poorest Myanmar and the richest Singapore and 47 times in 2015 between the poorest Cambodia and the richest Singapore, showing more marked gap in ASEAN than the EU. Since 2000, however, CLMV countries have achieved faster growth than the advanced ASEAN countries, rapidly catching up to the latter (Table 1), although the gap still remains large. Taking into account the big gap among them and concerns over the impact of liberalization of tariffs on CLMV, ASEAN has given them a longer grace period (by January 2018) for achieving the liberalization than the advanced ASEAN countries. Further, in order to correct the gap, various projects including infrastructure investment, human resources development, poverty reduction, etc. have been implemented since the early 2000s under the Initiatives of ASEAN Integration

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<sup>11</sup> The FTA of ASEAN with an extra-region country is called like this.

(IAI). The IAI has been incorporated also in the “ASEAN2025 Blueprint”, and the IAI Work plan III (2016-2020) is currently under implementation.

## (2) Overcoming of Middle Income Trap

In the economic development process from low income countries to middle income countries, urbanization will be accelerated in a way the excessive labor force of less productive rural areas to be absorbed in the higher productive industries in the urban areas, thus improving the total productivity of the whole economy and accelerating economic growth. However, with the population shift from rural areas to urban areas taking a round, the high growth will be hard to be sustained. Growth relied on the introduction of foreign capital attracted by low wage and low cost will soon face with a competition from later coming developing countries, and unless a country cannot improve the productivity of local industries, it will often fail to make a sustainable development from middle income country to high income country. This was the problem over which the World Bank raised an alarm in 2007 as a “Middle Income Trap”.

Out of ASEAN 10 countries, Singapore and Brunei have already shifted to a high income country. All the remaining countries have reached the level of middle income country in 2015, but they have different issues between upper middle income countries of Malaysia and Thailand and other lower middle income countries.

In Malaysia and Thailand, the excess labor force in the rural areas has been almost absorbed by the non-agricultural sector, causing a problem of labor shortage. In the future, it will be necessary for them to shift from input-oriented growth with increased capital and labor to growth based on the increase of total factor productivity (TFP). In concrete terms, it is an urgent issue for them to improve TFP through technology advancement supported by strengthened research and development (R&D), improvement of quality of labor force through education and training, and enhanced infrastructural investment. The ratio of R&D to GDP is 1.26% for Malaysia and 0.48% for Thailand on an average of 2005-2015 (World Bank data). As compared to the average of 1.56% for the world upper middle income countries and 0.55% for the lower middle income countries, the level of Thailand is lower than the average of lower middle income countries. Enrollment ratio to higher education<sup>12</sup> shows that Malaysia stays at 26.1% and Thailand 48.9% as against 46.9% for the average of upper middle income countries and 73.7% for high income countries. Both countries will need to make further efforts to improve the investment in these areas.

Indonesia, the Philippines and Viet Nam have a room to promote labor-intensive growth as they still have excess labor force in rural areas. But they will have to promote capita-intensive growth in order to expand employment opportunities. Also they will have to make efforts to

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<sup>12</sup> Ratio of enrollment to total population of educational age.

attract foreign capital through improved corporate governance, enhancement of business environment, review of permission and authorization system, etc. Especially in the case of the Philippines more than 30 years have passed since it reached a level of lower middle income country. It is strongly hoped for it to succeed in promoting growth through such efforts to attract foreign enterprises.

According to the Doing Business Ranking provided by the World Bank, which measures business regulations and their enforcement to show the ease of doing business, Singapore, the first runner in ASEAN, ranks the top (easiest), followed by Malaysia, Thailand, Brunei among advanced ASEAN countries, and then by Viet Nam, Indonesia, the Philippines, and late coming CLM countries excluding Viet Nam (Chart 5).

Chart 5 : Ranking of Doing Business and Competitiveness in Asia

|                   | 1.Ease of doing business ranking | 2.The Global Competitiveness Index Ranking | 3.Logistics Performance Ranking |
|-------------------|----------------------------------|--|---------------------------------|
| Singapore         | 2                                | 2  | 5                               |
| Hong Kong         | 4                                | 9  | 9                               |
| South Korea       | 5                                | 26   | 24                              |
| Taiwan, China     | 11                               | 15   | 25                              |
| Malaysia          | 23                               | 25   | 32                              |
| Japan             | 34                               | 8  | 12                              |
| Thailand          | 46                               | 34   | 45                              |
| Brunei Darussalam | 72                               | 58   | 70                              |
| China             | 78                               | 28   | 27                              |
| Viet Nam          | 82                               | 60   | 64                              |
| Indonesia         | 91                               | 41   | 63                              |
| Philippines       | 99                               | 57   | 71                              |
| India             | 130                              | 39   | 35                              |
| Cambodia          | 131                              | 89   | 73                              |
| Lao PDR           | 139                              | 93   | 152                             |
| Myanmar           | 170                              | --   | 113                             |

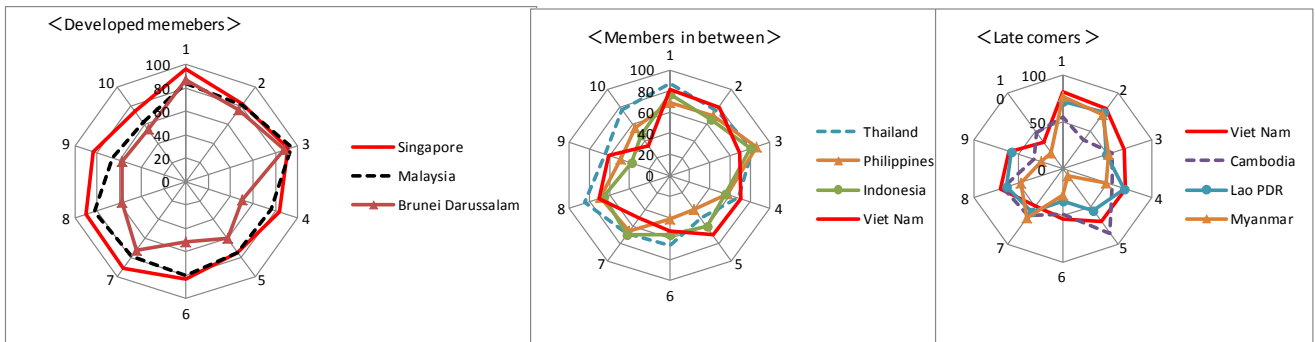
(Notes) 1.Ranking by the World Bank among 190 economies. 2.Ranking by the World Economic Forum among 138 economies.

3.Ranking by the World Bank among 160 economies.

(Sources) World Bank, "Doing business 2017", World Economic Forum, "Global Competitiveness Index 2017", World Bank, "Connecting to compete,2016".

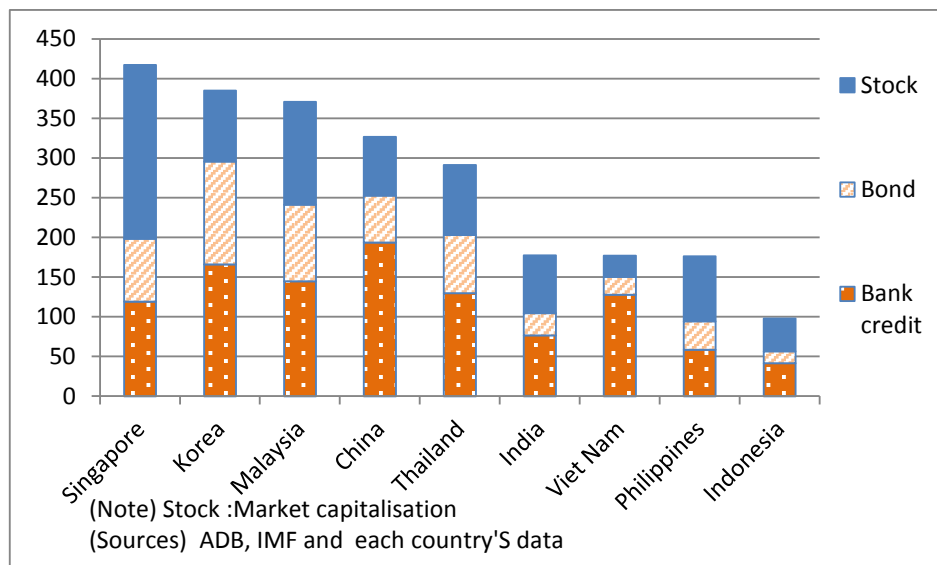
Looking at the Doing Business ranking in more detail by its composite items, the lower ranked countries lag behind them in all items, especially in financially-related items as compared to the highest three countries (Chart 6). Although Viet Nam is regarded as a late comer in ASEAN in terms of income level, it has a financial market well comparable to those in Indonesia and the Philippines (Chart 7). The development in financial aspects will play a key role in attracting investment.

Chart 6 : Doing Business Ranking in ASEAN Countries (by composite items)



Items: 1.Starting a business, 2.Dealing with construction permit, 3.Getting electricity, 4.Registering property, 5.Getting credit, 6.Protecting minority investors, 7.Paying taxes, 8.Trading across the borders, 9.Enforcing contracts, 10.Resolving insolvency  
 (Notes) The score of Resolving insolvency in LaoPDR is zero because of no data. Viet Nam is usually classified as a late comer. But as far as the ease of doing business ranking concerned, Viet Nam is ranked higher than Indonesia and Philippines. For an easier comparison, Viet Nam is shown in both charts for Members in between and Late comers.  
 (Source) World Bank "Doing business in 2017"

Chart 7 : Size of Financial Market in Asia (as of end 2015, % of GDP)



Further, CLMV, as well as Indonesia and the Philippines rank low in the Logistics Performance Index (LPI) that indicates the ease of transportation and traffics. According to the studies of the World Bank and others, there is a correlation between LPI and degree of involvement in GVC<sup>13</sup>. To these late comers in ASEAN, it is considered to be the key to economic development to make themselves more accessible to GVC by upgrading their transportation infrastructure like roads and railways as well as by making institutional improvement of their customs procedures and the like.

The deepening of economic integration will give an important impetus to these countries in their efforts to address various challenges.

<sup>13</sup> The World Bank Group and others (2017)

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