

# Introduction

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The six original member states of the Association of Southeast Asian Nations (ASEAN) will achieve the first step towards the formation of the ASEAN Free Trade Area (AFTA) in 2003 by implementing the Common Effective Preferential Tariff (CEPT), under which tariffs will be reduced to less than 5 percent on goods traded within the region that meet a 40 percent ASEAN content requirement. The same will apply for Vietnam by 2006, for Lao PDR and Myanmar by 2008, and for Cambodia by 2010. Each member state has the option of excluding products from the CEPT scheme: temporary exclusions covering products to be protected temporarily but to be included in the scheme by 2005, sensitive agricultural products, and general exclusions for national-security or environmental reasons. Malaysia included automobiles in its temporary exclusions, the Philippines petrochemical products and sugar, and Indonesia sugar.

Besides the AFTA scheme, ASEAN plans to liberalize investment and services and to facilitate the transnational mobility of goods in the region. In literal terms, ASEAN is moving towards a single market with a population of 530 million (the ASEAN Economic Community). At the same time, some bilateral regional cooperation has progressed. For instance, Thailand and Malaysia agreed in July 2003 to strengthen economic relations with the ASEAN Economic Community—streamlining customs procedures, establishing special economic zones near borders, jointly promoting small- and medium-scale enterprises, and so on.

ASEAN has also strengthened external economic partnerships. ASEAN reached a framework agreement with China in November 2002 to complete an ASEAN-China Free Trade Area within ten years, which was proposed by China. In November 2003, ASEAN and Japan are expected to agree on the framework for the ASEAN-Japan Comprehensive Economic

Partnership (AJCEP), which was proposed by Japan in January 2002. Meanwhile, the U.S. Enterprise for ASEAN Initiative (EAI) has offered a proposal for bilateral free trade agreements (FTAs) between the United States and ASEAN countries. Indeed, Singapore and the U.S. agreed on a bilateral FTA in May 2003. The EU is also preparing an initiative for drawing up trade agreements with ASEAN. Thailand has basically agreed to a bilateral FTA with India.

These initiatives towards regional economic integration will provide new investment opportunities for both foreign and indigenous firms and strengthen the potential competitiveness of each ASEAN economy as well as ASEAN economy as a whole. However, competitive-enhancing policies in line with liberalization of trade and investment must be implemented by each government so that indigenous firms will develop along with foreign firms and each ASEAN economy will upgrade its industry.

Recognizing the importance of coherent policies in line with this economic integration, IDE-JETRO of Japan and research institutes of five ASEAN countries (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) conducted a joint project to study competitive strategies in the context of economic integration.

We held the first AJRIM on “Japan-ASEAN Strategy for Upgrading Industries and Competing in East Asia” in Bangkok in October 2002 and discussed competitive strategies of ASEAN countries. We prepared revised papers and some additional ones to compile a background paper for the second AJRIM on *Toward ASEAN-Japan Comprehensive Economic Partnership*, held in Tokyo in July 2003. This second AJRIM, in which research institutes of the ASEAN member states and IDE-JETRO participated, finalized a joint study report to present to the Tenth Consultation between ASEAN Economic Ministers and the Minister of Economy, Trade, and Industry of Japan (AEM-METI) in Phnom Penh on September 3, 2003.

This volume is a compilation of all the papers presented in the background report titled *ASEAN-Japan Competitive Strategy Report*. Chapter 1 summarizes the individual papers from the above ASEAN members plus Vietnam. It discusses the competitive-enhancing policies to be emphasized in the course of economic integration. The main pillar of those policies would be capacity building such as human resource development and the enhancement of facilities to raise the level of technology and skills, in order to create new locational advantages, that is, to satisfy market demand and factor endowment, including industry agglomeration. This shift in focus enables adjustment to a rapidly changing

economic environment, as well as the establishment of complementary trade relations within ASEAN and with China. The results of this study are incorporated in the AJRIM's joint study report, titled *ASEAN-Japan Comprehensive Economic Partnership: Vision and Tasks Ahead*.

In Chapters 2-7, we discuss the strategy for upgrading industries and enhancing the competitiveness of the six ASEAN countries, with attention paid to the remarkable rise of China, which has intensified market competition, and emphasis on the need for competitive-enhancing policies. In order to survive the intensified competition, Singapore, Malaysia, and Thailand have already formulated policies to shift from mass-production-based economies to knowledge-based economies through enhanced capacity building. The Philippines and Indonesia, however, have not yet prepared adequate industrial policies in line with liberalization of trade. Vietnam has been taking the traditional priority industry approach to promote specific industries.

In Chapter 8, we discuss Japan's industrial structure and structural reforms. Readers will find that the Japanese government has been introducing coherent policies to respond to the economic integration that has rapidly progressed in the East Asian region.

In Chapter 9, we measure the competitiveness of ASEAN, China, and Japan by industry and conclude that ASEAN countries are competing against one another within the region as well as with China, while Japan has complementary trade relationships with both ASEAN and China. In Chapter 10, we emphasize strengthening the fundamentals to determine competitiveness and developed a quantitative measure of the fundamentals in order to prioritize for policy implementation.