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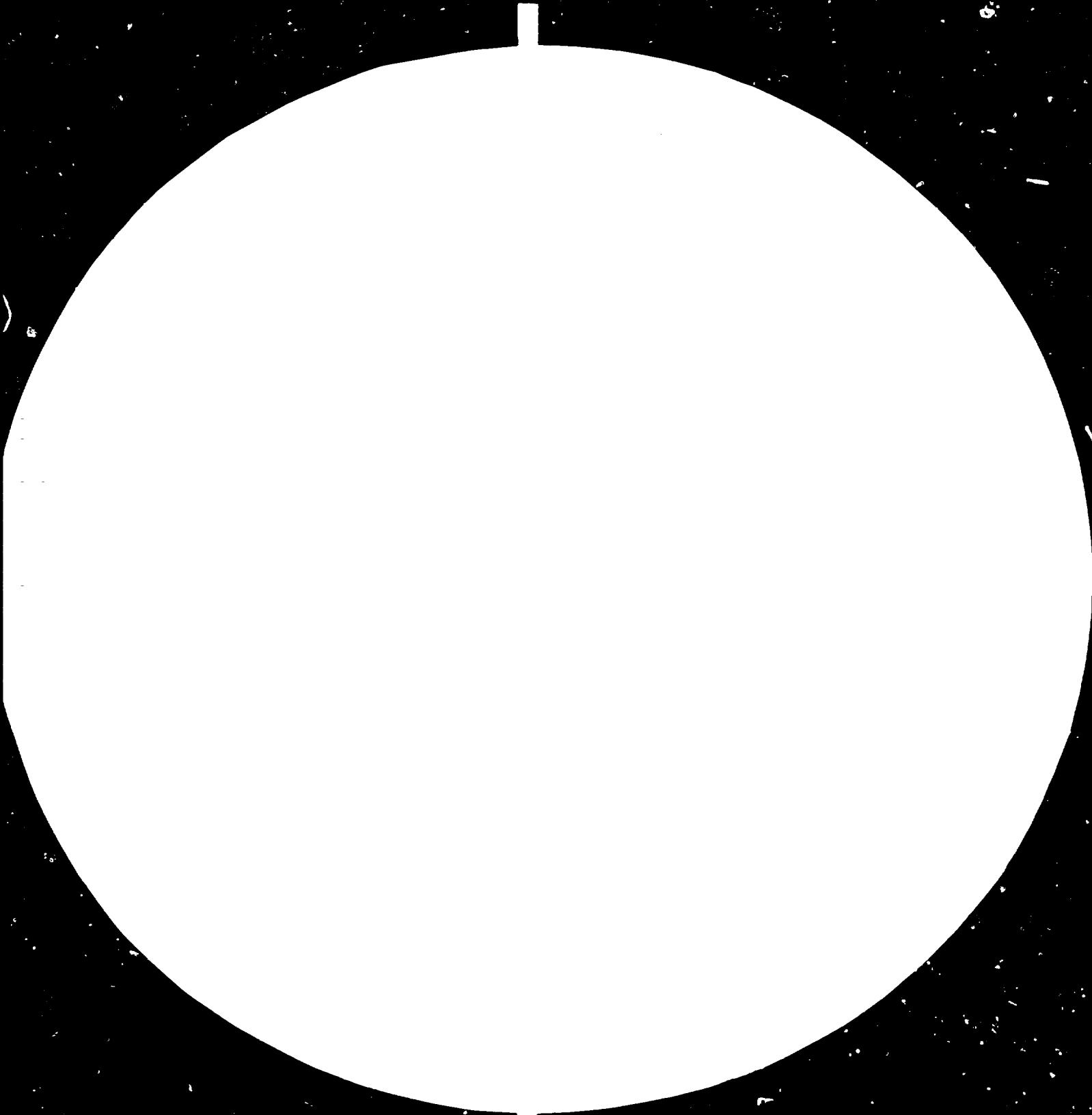
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REGIONAL INDUSTRIAL CO-OPERATION -  
THE APPROACHES PURSUED BY ASEAN\*

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## PREFACE

This paper has been prepared essentially on basis of a series of study papers written in 1981/82 by UNIDO consultants in the ASEAN countries, in order to provide the ASEAN/Andean Pact Conference on Regional Industrial Cooperation with a summary and analysis of the findings and conclusions of these papers, to which reference is given in the text. The views expressed and conclusions drawn do not necessarily reflect the views of the Government of any of the countries mentioned in the paper.

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Chapter I. Summary and conclusions

The Association of Southeast Asian nations (ASEAN) comprises five neighbouring states: Indonesia, Malaysia, the Philippines, Singapore and Thailand. The five countries have very different population, political structures, histories and cultures. Their economies have been highly competitive rather than complementary. ASEAN was established in 1967 and, while limited actual progress as far as economic co-operation was concerned could be recorded during the early years of its existence, from 1976 - the year of the first ASEAN summit meeting at Bali - a steady progress has been achieved through different approaches, particularly in the field of industrial co-operation.

There have been important changes in the five countries over the 15 years, with rapid industrial growth in all five countries. Singapore has been transformed into a modern manufacturing and financial centre supplying worldwide markets and Indonesia, Malaysia, the Philippines and Thailand - while remaining strongly specialized in the export of primary products - have seen a considerable widening of their industrial bases, including significant export-orientation in some areas.

Although inter-ASEAN trade has been relatively unimportant (except for transactions between Singapore and one or other of Indonesia, Malaysia and Thailand) all five countries have extensive economic links with industrialized countries, in particular Japan, US, Australia and the EEC countries. In its foreign economic relations Singapore has adopted a thoroughly outward-looking approach while Indonesia has followed a policy of protection of its industry in its early stages of development. Malaysia, the Philippines and Thailand have displayed ambivalence between outward-looking and inward-looking approaches. For all this diversity the five member countries have in common a recent record of strong economic growth, led by strong trade growth.

As could be expected, five countries with such different economic structures and approaches to trade policy have sought very different benefits from regional co-operation. This has contributed to a cautious pace of progress. Singapore, with its worldwide trading links and interests, could have much to lose from any major diversion of trade towards less competitive neighbours but at the same time the country has an important strategic interest in close and constructive relations amongst the ASEAN partners.

At the other extreme, Indonesia with its large untapped domestic market and less developed industry has primarily focused attention to supporting the growth of domestically-oriented production. Malaysia, the Philippines and Thailand have tended to be more willing to consider costs of trade diversion than Singapore and less definite about preserving their local markets for domestic production than Indonesia, but have nevertheless each been very careful in the calculation of national advantage.

There has been great awareness of convergence of interest among the five countries on common problems vis-a-vis the rest of the world: commodity market stabilization issues; access to markets of the industrial countries in context of MTN; bilateral relations with Japan, the EEC, the US and Australia.

Thus, although economic co-operation was stressed as one of the main objectives of ASEAN right from the very beginning, such co-operation has been beset with practical problems.

ASEAN industrial co-operation has been and is being pursued primarily through three different although supplementary approaches which each have been examined in some depth in the present paper, namely,

- through establishment of large-scale government-sponsored ASEAN Industrial Projects (AIPs);
- through ASEAN Industrial Complementation (AIC) programmes; and
- through establishment of ASEAN Industrial Joint Ventures (AIJVs) in the private sector.

(a) ASEAN Industrial Projects (AIPs)

In early 1976 the first package of ASEAN Industrial Projects (AIPs) - large-scale Government-sponsored industrial projects with preferential access to the ASEAN market - was identified and the responsibility of making a feasibility study for the projects was given in respect of each project to the country wishing to set it up. It was resolved that the host country would own 60 per cent of total equity and the remaining 40 per cent be shared between the other four ASEAN countries. In the further evolution of the projects a cautious step-by-step approach involving long and complex procedures and negotiations was adopted.



In spite of the fact that political will in favour of regional economic co-operation in general and industrial co-operation in particular seems to have gained considerable strength in recent years, and that there is evidence of a sense of commitment on the part of the ASEAN leaders to forge ahead with the AIPs, yet the rate of progress has been limited. Of the initial five projects, two are expected to commence operation in 1984 (the two urea fertilizer projects), one is in the process of final evaluation (the soda ash project) and two have been withdrawn. Difficulties were encountered in particular due to the fact that some industries in the first package were not 'new' industries in ASEAN, that the countries possessing these capacities were reluctant to provide preferential access to the local market to the envisaged AIP. Accordingly, in respect of future packages, many projects may in the first hand aim at a part - although possibly quite substantial - of the ASEAN market.

In the study on AIPs by the UNIDO consultant, Professor Mohamed Ariff, Kuala Lumpur,<sup>1/</sup> an alternative approach to the one followed in the case of the first AIP package, is proposed. Under this, trade liberalization becomes a pre-requisite for industrial co-operation in the sense that free intra-regional trade will provide an atmosphere in which opportunities for efficient investment become apparent to private investors. The establishment of regional industries may proceed along the lines suggested by the following sequence of steps:

1. Identification of large-scale 'infant' industries which require a regional market to be viable during infancy.
2. Removal, complete or partial, of intra-regional trade barriers facing these industrial products.
3. Declaration of government policy support (effective subsidy) for investment in these areas (that is, how society is willing to pay over and above world market prices and for how long).
4. Response forthcoming from the private sector by way of investment proposals.
5. Establishment of institutional arrangements to impose such conditions as may be required to achieve other normal goals, such as equitable distribution of benefits and costs resulting from the regional industries.

Some of the problems associated with the present package of five industries might be avoided if such an approach is adopted. Obviously, conflicts of national interests and the emergence of political issues can

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<sup>1/</sup> Mohamed Ariff, 'The development of the ASEAN Industrial Projects (AIPs)', UNIDO/IS.281, dated 25 January 1982.

never be ruled out totally. However, to confine regional co-operation to only those solutions for which complete acceptance could be achieved would seriously limit the range of industries that could be established within the framework of ASEAN, and would thus reduce the scope for and potential gains of regional co-operation to a minimum. Obviously, it could not be an absolute requirement that each country would accrue major benefits for any one investment project. Quite evidently, the spirit of regional co-operation presupposes a much wider and longer-term concept. The lack of major benefits from one individual project should be compensated for in the course of the realization of the programme of industrial co-operation at large.

(b) ASEAN Industrial Complementation (AIC)

A Basic Agreement on ASEAN Industrial Complementation was signed in June 1981. The Agreement provides the guidelines and institutional framework within which the ASEAN governmental machinery and the private sector through ASEAN-Chambers of Commerce and Industry (ASEAN-CCI) may collaborate in pursuing industrial complementation. A framework agreement on Preferential Trading Arrangements (PTA) provides for mutual and reciprocal trade preferences for products as agreed in continuing negotiations.

The proposals for industrial complementation emanate from the national industry associations and are submitted to the Regional Industry Club (RIC) of which they are a member. The RIC proposal is then considered by the ASEAN-CCI Working Group of Industrial Complementation. After endorsement by the ASEAN-CCI Council, the Secretary-General of ASEAN-CCI transmits the proposal to the Chairman of the ASEAN governmental committees concerned, Committee on Industry, Minerals and Energy (COIME) and Committee on Trade and Tourism (COTT) respectively. In practice, care is taken by the proponents and each level of the ASEAN-CCI to consult with interested or affected parties. In many cases, the national industry association will have prior consultations with the Ministries concerned, usually Industry and/or Trade, to ensure that the intended proposal would be in line with national policies, and to seek favourable indication that the proposal would in principle be supported if and when brought for consideration of COIME and/or COTT.

As yet only two complementation programmes or packages - both in the automotive industry - have been agreed upon. A number of further potential programmes are, however, under active investigation at different stages.

Towards the objectives of accelerating ASEAN Industrial Complementation recommendations are made, in the study on AIC by the UNIDO consultant, Mr. Vicente T. Paterno, Manila<sup>1/</sup>, in five areas:

1. Generating public acceptance
2. Developing the trading and distribution aspects
3. Improving the quality of AIC proposals and project studies
4. Developing parameters to guide allocation of projects among countries
5. Greater co-ordination of national industrial plans and policies with AIC programmes

(c) ASEAN Industrial Joint Ventures (AIJVs)

Because of difficulties in identifying further projects for AIC programmes a proposal was made by ASEAN-CCI for a new concept, called "ASEAN Industrial Joint Ventures", whereby, instead of requiring participation by all ASEAN countries, proponents from even two or three of the ASEAN partners from the private sector would be able to form a joint venture, and the capital requirements for any one project may not be too great. These AIJVs could be allocated to different ASEAN countries in a pragmatic manner, under relatively flexible conditions and rules in order to speed up the rate of implementing industrial co-operation.

The AIJVs would thus be different from the large-scale AIPs and the AIC projects. The AIJVs would be individual projects without being considered together with other projects in a package manner or with other restrictive conditions. AIJVs can be approved individually by the ASEAN Economic Ministers who will have to maintain an equitable distribution of benefits accruing from the AIJVs in the long-run.

COIME, in conjunction with ASEAN-CCI, is presently drafting the Basic Agreement on ASEAN Industrial Joint Ventures in which, inter alia, following main principles are reflected:

1. Participation in an AIJV will comprise at least two ASEAN countries but is not limited to only ASEAN countries, provided that membership by the ASEAN nationals is at least 51 per cent. ASEAN investors in AIJV projects are to be accorded national status by the host country for the purpose of qualifying the projects for national treatment.

<sup>1/</sup> Vicente T. Paterno, "ASEAN Industrial Complementation", UNIDO/IS.282, dated 25 January 1982.

2. An approved AIJV product is to be granted ASEAN Preferential Trading Arrangements (PTA) to the extent of 50 per cent preferential treatment; further tariff cut can be negotiated among the participating ASEAN countries.
3. The AIJV product will have 'exclusivity privileges' (similar to those under the AIC programmes).
4. Other ASEAN countries, which choose not to join the AIJV, are free to do so but their similar products cannot enjoy such a exclusive and special tariff preference.
5. Without prejudice to the right of identification by ASEAN Governments, the ASEAN-CCI shall identify AIJV products for possible allocation to member countries. The principle is to have equitable distribution of benefits for the ASEAN countries. Whenever feasible, AIJV products are to be equitably allocated to the participating ASEAN countries.
6. An AIJV product shall be of internationally accepted quality. the price should be relatively competitive and there should be an assurance of continuity of supply.

It is evident that much flexibility for easier implementation has been sought in the draft Basic Agreement. For instance, at least two ASEAN countries can propose an AIJV; this can be considered as a further extension of the "five minus one" principle, as originally proposed by Mr. Lee Kwan Yew, the Prime Minister of Singapore, for AIC programmes. It is suggested, in the study on AIJVs by the UNIDO consultant Professor Lee Sheng-Yi, Singapore,<sup>1/</sup> that in order to facilitate the orderly development of a series of AIJVs that ASEAN-sponsored pre-feasibility studies be carried out in the case of prospective projects at the suggestion of the proposing country for each such project.

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<sup>1/</sup> Lee Sheng-Yi, "ASEAN Industrial Joint Ventures (AIJVs) in the private sector", UNIDO/IS.310, dated 1 February 1982.

Chapter II. Note on rationale for regional industrial co-operation

It is recognized that one of the principal constraints to industrialization in many developing countries is the fact that industrial plants require certain minimum volumes of production to be established at reasonable investment per unit of capacity and to be operated with economy and efficiency. As plant capacity is increased above this minimum economic level, investment per unit decreases. Further technical refinements may also become economic to incorporate into the plant, in order to lower overall cost of production and improve quality of the product. A developing country whose industries are oriented to serving the requirements of its domestic market will find that for a number of industrial products, the small domestic demand cannot support economic-size production. A number of industries oriented to serve domestic demand may not be on large enough scale to attain cost and/or quality levels competitive with the same industries operating at greater scale of production at the truly international - or world market - level.

This manufacturing disadvantage due to market size is compound by the fact that design and engineering of the bulk of industrial equipment and industrial processes is carried out in the industrial countries in response to the needs of industries in these countries and may not fully correspond to developing country needs and resource endowment. Thus, industries in the developing countries have to compete with the products from the industrial nations using tools and equipment designed for the industrial nations' needs, cost structure, and resources, and which often do not take full advantage of the developing country's competitive resources, e.g. less expensive and more abundant labour.<sup>1/</sup>

In the longer term, the evolution by and among developing countries of technology to modify processes and design new products and/or tools and equipment could contribute greatly to alleviate such problems. However, many problems have to be overcome before such appropriate technology choices for a wide range of industries can become available. In the meantime one practical step is to expand the market for the individual developing country through organized industrial co-operation at regional level.

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<sup>1/</sup> Ref. Vicente T. Paterno, ASEAN Industrial Complementation, UNIDO/IS.282, 25 January 1982.

Chapter III. Key factors in the industrial structures of and policies applied  
in the individual ASEAN countries

To assess the potential in ASEAN for regional co-operation in the field of industry, an examination of the key factors in the economies of the five member countries, such as the industrial structure and the factor endowment patterns of the industrial countries and the policies applied, is required. On the following pages such an assessment, in highly condensed form, is given.

(a) Indonesia

The Indonesia economy is an open one in the sense that its economic growth has been largely export-led. Indonesia's exports consist essentially of primary products. Extractives, i.e., petroleum, minerals and lumber, account for 80 per cent of the total exports.

Indonesia is well endowed with a diversity of natural resources and it has a large population. The existence of a vast domestic market has led Indonesia to adopt restrictive trade policies aimed at national self-sufficiency. At the same time the industrialization has had considerable negative effects on the country's balance of payments since its manufacturing sector is much dependent on imports of intermediate and capital goods.

Import substituting manufacturing production in Indonesia has been sustained by heavy tariff protection and non-tariff barriers. Indonesia's tariffs escalate steeply, with tariff rates rising from earlier to later stages of fabrication in the production process. Thus, the Indonesian tariff rates are much higher for final consumer goods than those for intermediate or capital goods. But the Indonesian tariffs by themselves are in general not prohibitive. It is the non-tariff barriers which effectively put off the imports of consumer goods into Indonesia. Non-tariff barriers in Indonesia range from quantitative restrictions to cumbersome customs regulations.

The restrictive trade policies have thus provided industries in Indonesia with a captive market, insulated from foreign competition. As a result, industries in Indonesia have generally remained relatively inefficient and uncompetitive. The trade policies of Indonesia have thus encouraged manufacturing production for the domestic market with an un-

mistakable bias against exporting. Moreover, import substitution based on imported inputs and borrowed technology has failed to create domestic linkages, as a result of which labour-intensive activities have not developed as much as they should have. Indonesia may therefore be compelled by domestic forces in the long run to adopt trade policies which would be consistent with its factor endowment pattern. The 33.6 per cent devaluation of the Indonesian rupiah in November 1978 is indicative of such a policy re-orientation.

(b) Malaysia

Malaysia is a very open economy, with exports accounting for about 46 per cent of GNP and imports for about 39 per cent of domestic aggregate expenditure. The Malaysian economy is characterized by its specialization in primary production, export orientation and vulnerability to external fluctuations. But, developments during the last decade, including those associated with the rapidly growing industrial sector, have changed its profile somewhat.

The primary sector is dominated by a few export products such as rubber, tin, palm oil, timber and, more recently, petroleum. Most primary output is exported in raw or semi-processed forms mainly to industrialized countries. The manufacturing sector is becoming increasingly prominent. Its share of GDP has risen from 12 per cent in 1970 to 21 per cent in 1980 and it presently accounts for about 16 per cent of total employment.

Import substitution was the basis of industrialization in the initial stages. At first, attention was focused primarily upon consumer goods, mainly because the existing domestic market was by and large oriented toward consumer goods. Subsequently, industrialization based on import substitution could be extended to cover intermediate and investment goods and also to production for export.

Modest protective duties had been imposed on more than 200 imported items by 1963 when tariffs averaged 15 per cent and rarely exceeded 25 per cent, while many products had no tariffs at all. Although tariffs were raised in many cases

and extended to several items especially after 1965, the Malaysian tariffs on the whole might be considered as rather mild in comparison with most developing countries. Import quotas were imposed in addition to tariffs, but such quantitative restrictions were applied neither stringently nor widely.

There are several compelling reasons why import substitution must give way eventually to an outward-looking strategy. Although import substitution did serve to initiate industrial growth, this growth could not be sustained for long because of the size of the market. Besides, industrialization is costly when it depends heavily upon a domestic market that is small and not expanding rapidly.

Serious efforts to gear the manufacturing industries towards exports were consciously undertaken with the launching of the Investment Incentives Act 1968. Effective subsidies granted to export-oriented manufacturing activities have increased with the offer of various investment incentives to these industries. Light manufactures, such as textiles and wearing apparel and products based on domestic raw materials, such as timber and rubber, have made some inroads into export markets. The export performance of the manufacturing sector has been fairly impressive. The share of manufactures in gross merchandise exports has increased from less than 5 per cent in 1960 to 27 per cent in 1979.

(c) The Philippines

In the post-war era, industrialization in the Philippines assumed mainly the form of fabricating, assembling and processing along import-substitution lines. As a result, the import composition changed gradually in favour of capital goods at the expense of the consumer goods. That the Philippines' import substitution programme reached a fairly advanced stage is reflected by the fact that imports accounted for less than 5 per cent of the total supply (production plus imports) of manufactured consumer goods in 1965. The Philippines' exports are still dominated by primary products although manufactured exports account for a significant proportion of the total exports (14 per cent in 1977). In the late 1950s tariffs became the main instrument of protection, with exchange control.



The general pattern of tariffs portray low rates for machinery, moderate rates for intermediate goods and high rates for finished consumer goods. The system thus strongly favours production of finished consumer goods with heavy dependence on imported supplies.

Manufacturing production in the Philippines has thus been heavily biased in favour of import replacements, especially at higher levels of fabrication, namely finished consumer goods. This inward-looking industrialization has been made possible by the protective system. The process of import substitution, which was most rapid in the 1950s, slowed down sharply in the 1960s, as the process had already reached the saturation point in many lines of activity; further expansion being constrained by the rate of growth of domestic market itself.

The prolonged import substitution phase of industrialization sheltered high-cost industries and caused severe balance of payments difficulties. The need to revitalize its ailing industries was strongly felt in the early 1970s. This called for a shift in the industrialization and trade strategies. It now appears that many industries in the Philippines have moved into the "export expansion" stage, thanks mainly to the various export promotion incentives made available by the Export Incentives Act of 1970 and the rationalization of the structure of protection which has been undertaken time and again in the 1970s.

(d) Singapore

The trade policies of Singapore traditionally have been rather liberal. The two main considerations which have determined Singapore's trade policies in the post-war years are entrepot trade and industrialization. Singapore's prosperity had been closely associated for a long time with its "free port" posture. Thus, it has been imperative for Singapore to ensure that the restrictions on trade flows are reduced to the minimum. Moreover, protectionist trade policies to promote import substitution were clearly inappropriate for the small city state of Singapore.

Industrialization provided a challenge to Singapore with its limited land resources and a population of 2 million people. Manufacturing became the main economic activity since 1964. Import substitution formed the main basis of industrialization in the initial phase, although under

relatively mild protection. The short-comings of import substitution as the industrialization strategy became apparent sooner in Singapore than elsewhere, simply because of the extremely limited size of its domestic market.

Recent years have witnessed not only very few additions to the tariff lists but also the abolition of many of the existing tariffs together with the scaling-down of some others. A rapid liberalization of import controls took place in the first half of the 1970s, and most of the goods subject to import licensing were de-licensed by 1975.

The deproliferation of tariffs in the face of increasing export-orientation has apparently forced the industries to be more efficient and competitive, judging from subsequent performance in exporting, especially in the field of machinery and transport equipment.

(e) Thailand

Industrial promotion in Thailand was intensified since the early 1960s. Trade policies have accordingly been adjusted. The 1964 tariff reform, for instance, resulted in an expansion and consolidation of protective tariffs.

It can be concluded that the tariff structure in Thailand, as indeed in other ASEAN countries except for Singapore, clearly exhibits a bias in favour of production for the domestic market and against exports. There has also been a tendency for the protection, both nominal and effective, to escalate from lower to higher degrees of fabrication. Thus, the trade policy, as exemplified by the tariff structures, has been designed mainly to build up an industrial base that is essentially domestic-oriented. It has led to industrial excess capacity and high production costs. Further industrial expansion requires in the first hand either extension of production to the lower levels of fabrication or export promotion for existing production at the higher level of fabrication.

Chapter IV. Future trends in ASEAN manufacturing and potential for regional industrial co-operation

There are unmistakable signs that manufactures will figure prominently in the exports of ASEAN countries, except perhaps Indonesia, in the 1980s. Impressive beginnings in the exportation of manufactures have already taken place. This trend is expected to gather momentum in the 1980s, judging from the changes in ASEAN's industrial structure during the last few years. The lessons of the past have shown Malaysia, the Philippines and Thailand that inward-looking import substitution will not take them far enough in industrial development, and the process of structural adjustments to re-orientate their industries, which began in the 1970s, will continue into the 1980s.

The preference for large-scale industries based on capital-intensive technologies, which was evident in the manufacturing sectors in ASEAN countries in the last two decades, is expected to decline in favour of small- or medium-scale, labour-intensive activities based on domestic raw materials. ASEAN countries have discovered that most of their comparative advantage lies in the latter. ASEAN countries are likely to benefit from any industrial restructuring that would take place in advanced industrial countries, in the sense that several industries which get weeded out in the process may be relocated in ASEAN countries in the 1980s.

That the export-orientation of industries in the ASEAN region will increase in the next decade does not necessarily imply a deproliferation of the tariff protection given to the import-substituting industries. Powerful vested interests in the region may prevent the relaxation of tariff barriers and other import controls. The tariff schedules may be modified in such a way as not to alter markedly the nominal protection given to major import-substituting industries, and resources may be guided towards export manufacturing activities through changes in effective subsidies.

Singapore's manufacturing sector is almost exclusively oriented towards the foreign markets. Nonetheless, it appears that Singapore's industrial structure will undergo important changes in the 1980s in the face of rising labour costs and growing affluence. It can be expected that Singapore will continue to make structural adjustments which

began in the second half of the 1970s and increasingly concentrate on capital-intensive, skill-intensive and technology-intensive industries.

Indonesia's problems in this regard are quite different from those of other ASEAN countries, particularly Singapore. Indonesia is, relatively seen, a latecomer in the field of industrialization. Industrial development in Indonesia seems to be somewhat at a standstill, firmly rooted in the initial phase of import substitution, facilitated by the existence of a vast domestic market and sustained by restrictive tariff and non-tariff barriers. Consequently, industries in Indonesia have remained relatively inefficient, import-dependent and uncompetitive. It appears, however, that a turning point will be soon reached and there are two compelling reasons forcing a departure from the past pattern. First, the import substitution strategy has failed to absorb the labour surplus and to create linkages between the modern manufacturing sector and the traditional primary sector. Second, the growth of the foreign exchange earning extractive exports is expected to slow down in the first half of the 1980s. Indonesia may therefore be forced to reorientate its industries towards export markets.

Malaysia, the Philippines and Thailand lie between the polar cases of Singapore and Indonesia. These three countries are likely to pursue the promotion of manufactured exports more vigorously in the 1980s than in the 1970s. There is no question of going back to the import substitution phase for these countries, since the domestic markets for consumer goods are already saturated, although one cannot rule out the possibility of a second round of import substitution in the manufacture of intermediate and capital goods.

While it can safely be concluded that ASEAN countries are poised to become important exporters of manufactured goods in the 1980s, it must also be stressed that it is not going to be easy. ASEAN countries will have not only to overcome the protectionist barriers in advanced industrial countries but also to compete with other developing countries.

It is possible to draw inferences from the above analysis regarding the potential for ASEAN co-operation in the field of industry. Evidently, the ASEAN entity consists of an unique mixture of national economies at different stages of industrial development. The range is rather wide. At one extreme, there is the Singapore economy which is poor in natural re-

sources, rich in skill endowments, highly industrialized and heavily export-oriented with an outward-looking development strategy. At the other extreme, there is the Indonesian economy which is rich in natural resources but poor in skill and technology, specializing in primary production mainly for the export market, with "infant" industries that are domestic market oriented, based on an inward-looking industrialization strategy. Between these two extremes lie the economies of Malaysia, the Philippines and Thailand whose export specialization in traditional commodities is gradually giving way to export orientation in modern manufactures.

Although there is enough complementarity in the natural resource endowments of ASEAN countries to permit a meaningful division of labour, the existing industrial patterns, which are the result of years of import substitution efforts, are strikingly similar in all ASEAN countries, with the exception of Singapore. Many of these import-competing industries are operating at high costs behind protective tariffs, and with substantial un-utilized capacity. Industrial complementation could certainly bring about a more rational allocation of resources in the ASEAN region. In such context, however, the setting up of new industries could prove to be less difficult than rationalization of existing industries.

ASEAN countries, with the possible exception of Indonesia, have reached an industrialization stage where the manufacturing of intermediate and capital goods is being considered seriously. It also appears that some of these countries have been contemplating a second round of import substitution for the production of intermediate and capital goods. However, these countries have learned from past experiences that import substitution has serious limitations, given the small size of the individual domestic market. Industrial co-operation offers a way out of the dilemma. Industrial projects which are not quite competitive on an international basis (in view of, for instance, transport costs) nor viable on a national basis, may well be viable and efficient on a regional basis.

Chapter V. The ASEAN mechanism for industrial co-operation

As shown earlier it is evident that conceptually ASEAN regional co-operation in the field of industry is sound and appealing. There is also a political will which seems to exhibit strong determination on the part of the member states to have industrial projects operating on a regional basis fairly quickly. To translate this into reality ASEAN needs a workable mechanism for industrial co-operation. This mechanism, within the framework of the organizational structure of ASEAN, is briefly described below.

The meetings of Heads of Governments of ASEAN states represent the highest form of ASEAN deliberations although such meetings are to be held on an ad hoc basis as and when necessary. Meetings of Foreign Ministers are held annually, on a rotation basis, in each of the five countries. There are also provisions for special meetings of Foreign Ministers as is deemed necessary. In addition, meetings of Economic Ministers are held on a regular basis to discuss economic matters of common interest. The meetings of the ASEAN Economic Ministers represent the highest decision-making body for economic matters. It is of interest to note that Ministers of specific economic areas also meet as and when necessary for the purpose of accelerating the process of regional economic co-operation. Thus, there are meetings of the ASEAN Ministers with industry and energy portfolios.

The Standing Committee consists of the Foreign Minister of the host country as Chairman and the resident ambassadors of the other ASEAN countries as members. This means that the seat of the Standing Committee shifts with the site of the Meeting of Foreign Ministers. The role of the Standing Committee is to maintain continuing operations of ASEAN regional co-operation in between the Meetings of ASEAN Foreign Ministers. Prior to 1977, the Standing Committee comprised only Foreign Ministry officials; in 1977 it was expanded to involve other Ministries as well.

Each country has its own national ASEAN Secretariat which manages matters relating to ASEAN regional co-operation. A central ASEAN Secretariat was set up in 1976 in Jakarta. The central ASEAN Secretariat is headed by the Secretary-General who is responsible to the Foreign Ministers and through them, to the Standing Committee. The Secretary-General is charged with the main responsibilities of (a) initiating plans and programmes of activities for ASEAN regional co-operation and (b) harmonizing, facilitating

and monitoring progress in the implementation of all approved ASEAN activities. The central ASEAN Secretariat has three bureaus, viz., economic, science and technology and social and cultural affairs.

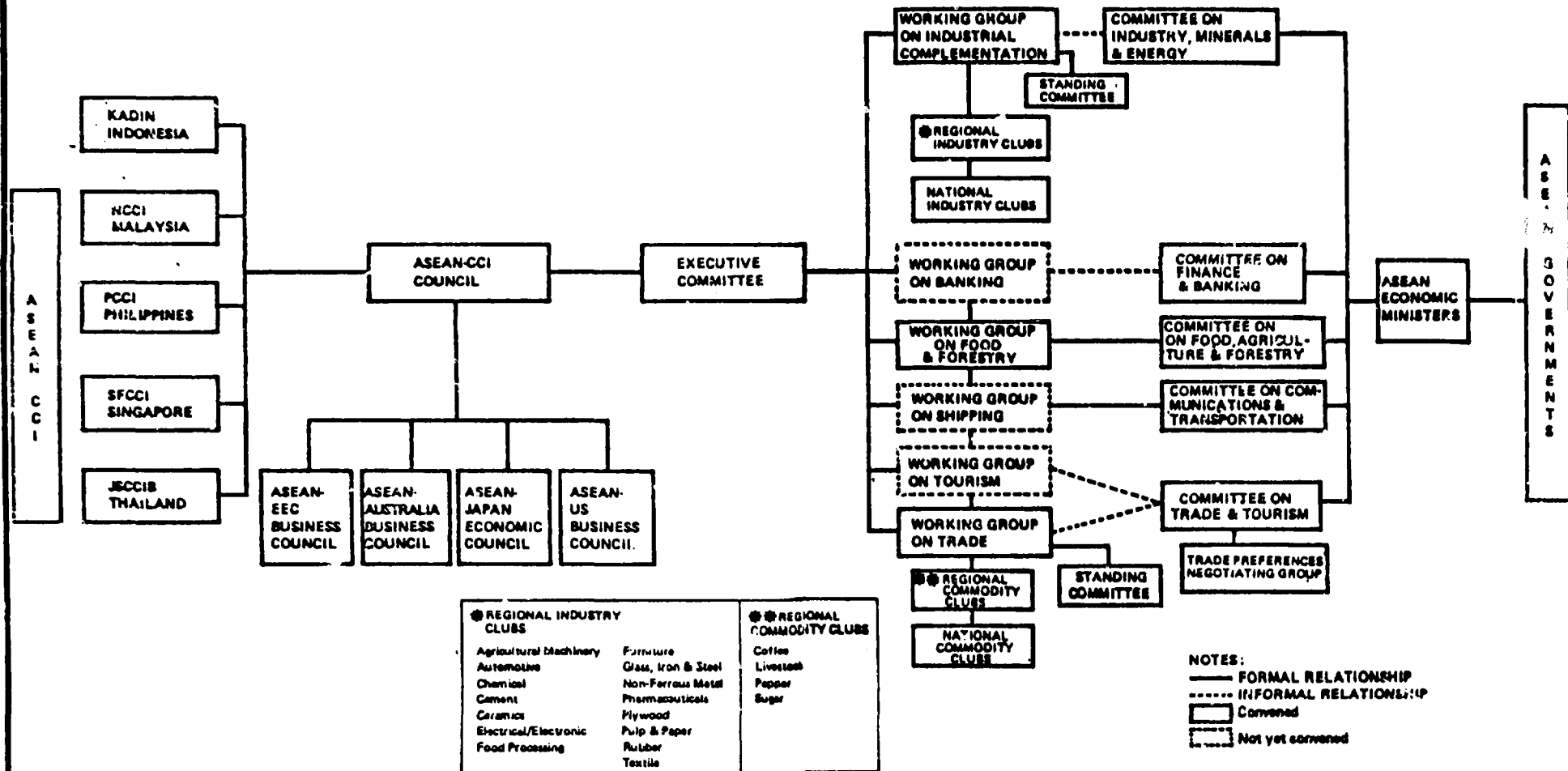
ASEAN economic co-operation is being promoted by five economic committees established by the ASEAN Economic Ministers, namely, Committee on Industry, Mineral and Energy (COIME), Committee on Trade and Tourism (COTT), Committee on Transport and Communication (COTAC), Committee on Food, Agriculture and Forestry (COFAF) and Committee on Finance and Banking (COFAB). In addition to these, there are Special Committees and Ad Hoc Committees. An example of the former is the Special Co-ordinating Committee of ASEAN Central Banks and Monetary Authorities.

The ASEAN Chambers of Commerce and Industry (ASEAN-CCI) is also an important part of the ASEAN machinery. The ASEAN-CCI is a confederation of the chambers of commerce and industry of the ASEAN member countries. The role of the ASEAN-CCI, which was inaugurated in Jakarta 1971, is not only to translate government initiatives into private sector actions, but also to discuss and formulate suggestions for consideration in ASEAN government fora. The ASEAN-CCI organizational structure in respect of industry is the most elaborate and extensive among all the five economic sectors, as will be seen from following chart. Each of the five ASEAN governmental economic committees has a counterpart working group within ASEAN-CCI.

In the field of industry there is an ASEAN-CCI Standing Committee on Industrial Complementation, in addition to the Working Group on Industrial Complementation (WGIC) which co-ordinates the work of Regional Industry Clubs (RICs). The RIC is the forum at which discussions are held and proposals debated on all matters relating to regional co-operation for the particular industry. Membership of the RICs is made up of the corresponding industry associations in the member countries. Delegates to the meetings of a RIC are nominated by the member associations in the respective countries. Some RICs, such as the one for chemicals, have found it necessary to create several sub-groups within the RIC, in order to focus discussions on specific branches of the industry.

In the field of trade, ASEAN-CCI has a Standing Committee on Trade, which has been organized as the private sector counterpart vehicle for dialogues between the private and government sectors in the areas of trade and tourism.

# ASEAN-CCI/ASEAN GOVERNMENT INTERACTION CHART





Chapter VI. ASEAN Industrial Projects (AIPs)<sup>1/</sup>

(a) The concept of AIPs

The Declaration of ASEAN Concord, which was signed during the Bali Summit in February 1976, set out areas of ASEAN economic co-operation and provided, inter alia, that member countries "shall co-operate to establish large-scale ASEAN industrial plants particularly to meet regional requirements of essential commodities, and that the expansion of trade among member states shall be facilitated through co-operation in ASEAN industrial projects". It was, furthermore, stated that priority shall be given to industrial projects which utilize the raw materials of member countries, create employment, contribute to the growth of food production and lead to increased foreign exchange earnings or savings.

The concept of large-scale ASEAN industrial projects has been brought out quite clearly in some comprehensive studies, of which the Kansu/Robinson and the Bos/Feraldis reports<sup>2/</sup> merit special mention in view of the impact they might have had on the ASEAN approach taken regarding large-scale projects, the concept and technique which - referred to as 'package-deal' technique - was elaborated on in detail and exemplified in both studies. The 'package-deal' takes the form of an agreement to allocate among the ASEAN member countries certain large-scale industrial projects and to create conditions, including preferential trading arrangements, which would enable them to cater for the whole or a large part of the ASEAN market.

It has been economically shown - for instance in the above-mentioned UN studies - that for ASEAN many regional industrial projects would yield substantial gains in the form of economies of scale. Professor Ariff in his study on AIPs,<sup>3/</sup> notes as examples, that, in the case of Malaysia, it has been estimated that it would cost Malaysia 15 per cent more than the world

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1/ This chapter is essentially based on Mohamed Ariff "The Development of the ASEAN Industrial Projects (AIPs)", UNIDO/IS.281, dated 25 January 1982.

2/ "Economic Co-operation among Member Countries of ASEAN" report of a UN Study Team with Mr. G. Kansu as Team Leader and Professor E.A.C. Robinson as Senior Adviser. The report is published in the Journal of Development Planning, Number 7, United Nations, New York, 1974.

"Asian Industrial Survey for Regional Co-operation", report prepared under the auspices of ECAFE (now ESCAP) in co-operation with the Asian Development Bank, UNDP and UNIDO. Professor H.C. Bos was co-ordinator for the study project, Mr. A. Feraldis was leader of the permanent team. The report is published as Document AIDC(9)/1, United Nations, New York, 1973.

3/ UNIDO/IS.281, op.cit.,

market price to produce newsprint for the national market and 5 per cent less than the world market price to produce it for the ASEAN market. Likewise, it would cost 18 per cent more for Malaysia to produce printing paper for the Malaysian market and 7 per cent less to produce it for the ASEAN market as compared with the world market prices. Similarly, electrical transformers would cost Malaysia 9 per cent more than imports if they are produced for the domestic market and 25 per cent less than imports if Malaysia produced them for the ASEAN region as a whole. By the same token, it will cost Malaysia 4.5 per cent less to have ammonium phosphate imported from the Philippines than to have it produced locally for the Malaysian market. Likewise, it would cost 15.4 per cent less for Malaysia to import transmission cables from Thailand than to produce them domestically.<sup>1/</sup> In all such cases, intra-regional trade will bring about a shift from high-cost foreign or domestic sources to low-cost partner sources. To be sure, there are many industries which cannot be competitive at world market prices even on a regional basis, and regional co-operation in such cases would cause the sources of imports to be shifted from low-cost foreign sources to high-cost partner sources, with strong trade diversion effects. It is therefore important that such industries are carefully avoided by ASEAN.

Another aspect of the package deal technique is that in the case of the products covered it entails the elimination of 'internal' trade barriers while protection against 'external' competition may continue to be provided. Needless to say, the effects of regional co-operation in industrial projects in the short-term may be less favourable or more adverse to the member countries than have been indicated above, since regional projects must emerge from their infancy before cost advantages can be fully realized. This raises the question of protection. The survival of the project during its infancy will depend crucially upon the preferential treatment it receives in the member countries. Its products must have preferential access to the markets of the member countries and in addition it must be given tariff protection from the external competition, the tariff rate being at least equal to the percentage cost

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1/ These calculations are based on the data given in the UN(ECAFE) study AIDC(9)/1, op.cit. See also: Mohamed Ariff "Malaysia's Trade and Industrialization Strategy with Special Reference to ASEAN Industrial Co-operation", in Ross Garnaut (ed.), ASEAN in a Changing Pacific and World Economy, Australian National University Press, Canberra, 1980.

differential. It is, however, important to specify the time period during which protection will be accorded to the projects, to be gradually withdrawn as the projects begin to operate at full capacity.

A most striking feature of the package deal approach is the predominance attached to the role of the governments in the identification, selection, location and implementation of the industrial projects. At the same time it should be borne in mind that the large-scale regional industry by its very nature is highly capital-intensive and that as such the employment creation will be rather limited. It would take less investment to generate more employment in small-scale industries. Moreover, as the regional projects require large inputs of capital resources, there is a need for a workable formula for equity participation by the member countries, by the public and private sectors and by the foreign and local investors.

The location of regional projects can be expected to be influenced considerably by equity considerations so as to ensure an equitable distribution of benefits among the member countries. This does not mean that such economic factors as the availability of local raw materials and other local inputs will be given less attention. A basic guiding principle would be that potential AIPs can be so selected as to avoid any sacrifice of efficiency for the sake of equity.

(b) The first package of AIPs

At the post-summit meeting of ASEAN Economic Ministers held in Kuala Lumpur in March 1976, the first package of ASEAN Industrial Projects (AIPs) was identified and the responsibility of undertaking a feasibility study for each plant was given to the country wishing to set it up. To this end, urea projects were assigned to Indonesia and Malaysia, a diesel engine project to Singapore, a soda ash project to Thailand and a super-phosphate project to the Philippines.

At the next meeting of the Economic Ministers (Manila, January 1977) the progress of work on the five AIPs was reviewed and an agreement was reached to set up an expert group to evaluate the feasibility studies of the projects. Each of the five projects was expected to require an investment of about US \$250-300 million. It was resolved that the host country would own 60 per cent of total equity while the remaining 40 per cent would

be allocated equally among the other four countries.<sup>1/</sup> It was indicated that equity participation by private sector interest might account for as much as 40 per cent of the host country's 60 per cent depending upon the attitude of the host country. Bearing in mind, inter alia, an offer of the Government of Japan of a US \$1000 million loan towards the financing of the ASEAN industrial projects, it was also suggested that 70 per cent of the infra-structural costs of these projects might be financed by foreign aid while 60 per cent of the balance would be met by the host country and the other four members contributing 10 per cent each.

In the further evolution of the projects ASEAN adopted a cautious step-by-step approach involving protracted and complex procedures and negotiations. There appears to be at least 10 steps involved, as shown in a UNIDO study.<sup>2/</sup> In sequence of the steps in the case of the urea fertilizer project allocated to Indonesia, for example, was as follows:

1. Identification of Indonesia for the purpose of undertaking the feasibility study of the first AIP;
2. Commissioning of the feasibility study;
3. Policy formulations with respect to equity participation, production volume, product pricing, infrastructure cost and raw material cost (natural gas from Pertamina);
4. Completion of detailed feasibility study;
5. Evaluation of the feasibility study by the Committee of Senior Officials and formal adoption as an ASEAN Industrial Project;
6. Negotiations on the terms of project financing;
7. Discussions and negotiations of the articles of incorporation and by-laws of the AIP Corporation;
8. Incorporation of ASEAN Aceh Fertilizer and subscription by stockholders;

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<sup>1/</sup> In 1978, the ASEAN Economic Ministers approved a Basic Agreement on AIPs. According to this Basic Agreement, inter alia, the product of the AIPs were to be accorded preferential access to the market of the member countries, and the host country should have 60 per cent of the equity of the AIP, with the rest being shared equally by the other four ASEAN countries (i.e. 10 per cent each). However, at the meeting of the ASEAN Ministers of Industry held in September 1980, it was resolved that the participation of all five member countries would no longer be required in future ASEAN Industrial Projects.

<sup>2/</sup> Sanchez, Conrado Jr., "Industrial Redeployment in the Context of Economic Integration among Developing Countries - The Case of ASEAN", draft (1979) UNIDO/IS/GLO.

9. Organization of the Board of Directors and Appointment of Management Staff;
10. Finalizing loans, and invitation to bid for equipment supply and plant construction.

(c) Lessons of experience

In spite of the fact that political will in favour of regional economic co-operation in general and industrial co-operation in particular seems to have gained considerable strength in recent years, and that there is evidence of a sense of commitment on the part of the ASEAN leaders to forge ahead with the AIPs, yet the rate of progress appears to be too slow. The first package of AIPs has hit serious snags. Of the initial five projects, two have taken off the ground (the two urea fertilizer projects), one is in the process of serious evaluation (the soda ash project) and two have been withdrawn. Does it mean that there is a gap between theory and practice? What has really gone wrong? And why? To attempt to answer these questions, Professor Ariff in his study<sup>1/</sup> tried to examine the first package of AIPs systematically, and to look at other possible packages<sup>2/</sup> which would lend themselves to industrial co-operation in the ASEAN region. His conclusions and findings are reflected in following section.

(i) Market constraints

The main thrust of the argument in favour of package deal agreements was that they would pave the way for the establishment of "new" industries on a scale which cannot otherwise be accommodated on a national basis. But, the contents of the ASEAN industrial packages were not totally new to the region in that there were already existing or planned capacities in one or more of the member countries. It was the presence of such capacities which cast serious doubts on the viability of the ASEAN projects. Countries

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1/ UNIDG/IS.281, op.cit

2/ In addition to the five projects for industrial regional co-operation in the first package, ASEAN has identified seven new projects, namely newsprint, potash, metal working machine tools, electrolytic tin-plating, heavy-duty tyres, TV picture tubes and fisheries which would form the second industrial package for regional co-operation. The projects have been allocated for purposes of pre-feasibility studies to member countries as follows:

Indonesia	: heavy-duty rubber tyres
Malaysia	: metal working machine tools
Philippines	: newsprint and electrolytic tin-plating
Singapore	: TV picture tubes
Thailand	: potash and fisheries

which already possess or have firm plans to put up such plants, would, it was feared, be unwilling or unable to open their markets to the products of the ASEAN project.

This indeed was the case with the proposed ASEAN diesel engines project. Indonesia had already indicated that it was to close its market to diesel engines below 500 HP, while Malaysia and the Philippines would follow suit by closing their markets for ASEAN diesel engines below 200 HP and 400 HP, respectively, to protect their national diesel engines projects of corresponding HP ranges which were either in operation or being planned. Many of the projects contained in the second industrial package, especially newsprint, machine working tools, heavy duty tyres, and TV colour picture tubes seem to have encountered similar problems. Still, what these projects can aim at is a, possibly quite substantial, residual ASEAN market. The size of the residual market will of course depend on the project in question, i.e., whether it competes with the existing or planned projects in any of the ASEAN member countries.

The problem of ASEAN-wide access can, of course, be totally avoided by designing the package in such a way as not to step on the toes of any project which is already in existence or which is firmly planned in any member country. This approach would, however, seriously limit the range of industries, as many useful projects which can be better organized on a regional basis are already being considered on a national basis. The problem can be resolved in the long run if the members agree to some phasing out of existing domestic capacities and reduction of planned capacities. This however presupposes the prevalence of a strong spirit of regionalism within ASEAN.

(ii) Political realities

Both the first package of five projects as well as the second package of seven projects seem to be running into serious practical difficulties which may be ascribed to the political realities of the ASEAN region. Despite the gradually rising tide of regionalism in Southeast Asia, ASEAN countries are strongly nationalistic in their outlook and approaches. As noted earlier, the ASEAN countries has found it easier to co-operate with each other on external issues of common interest, than on intra-regional matters. Experience has shown that ASEAN countries are not ready yet to make economic "adjustments" which seem to be painful in the short run,

although such adjustments may well be in the long-term interest of all member countries. The inability or the unwillingness to grant preferential treatment to the AIP products because it would hurt existing domestic industries, is evidently clear. As indicated above some ASEAN countries have been unwilling or unable to abandon national projects which are still in the planning stage, let alone phase out the existing plants for the sake of industrial co-operation.

(iii) Alternative approaches

It is possible to identify two different approaches to regional industrial co-operation. One approach calls for industrial planning which determines the choice, location, financing and other aspects of industries, while the other seeks private market solutions. The former approach requires specific trade policies to facilitate intra-regional movement of goods of selected industries through reduction if not elimination of intra-regional tariff and non-tariff barriers and to protect the chosen regional industries from extra-regional competition through the establishment and enforcement of common external tariffs. The second approach, on the other hand, assigns a more active role to trade policy which will then provide an economic environment conducive to regional specialization in manufacturing production and trade.

That ASEAN (as far as the AIPs are concerned) has opted for the first approach is manifest from the manner in which the first package of five projects has been identified and allocated among member countries. The experience so far with these five projects has brought to light some of the shortcomings of this approach. It appears in retrospect that the post-Bali decision on the projects was made rather hastily, prompted more by political will than by any serious preliminary study. In fairness, however, it may be pointed out that the post-Bali decision was merely to allocate the projects among member countries for the purpose of examining the feasibility of establishing the five plants. Implicit, however, was the understanding that the countries which undertook the feasibility studies would also host their respective projects if they were found to be economically viable.

The Bali-type approach contains two possible dangers: a good project may be rejected and a bad one may be implemented. For example, project A may not be economically viable if it is to be located in country X, which undertakes the feasibility study, but may well be economically viable

if it is to be located in country Y, and the chances are that the project will be thrown overboard in the process; country Z which is keen on project B and which undertakes the feasibility study, may make a case for it, even if its economic viability is in serious doubt, and use its political influence to persuade other members to extend preferential treatment which would render the project financially viable. These dangers can, however, be minimized if feasibility studies are undertaken by a supra-national body prior to project allocation.

It is still possible, although unlikely, for some projects to be implemented for political reasons. They may be supported by trade and other policies which are incompatible with efficient allocation of regional resources. The danger here is that trade policies might cause price distortions which affect adversely the economic welfare of society in general and of consumers in particular.

The second approach presents an almost diametrically opposite strategy for regional industrial co-operation. Under this approach, trade liberalization becomes a prerequisite for industrial co-operation in the sense that free intra-regional trade will provide an atmosphere in which opportunities for efficient investment become apparent to private investors. The fact that the initiative comes from the private sector without solutions being imposed on it will facilitate an efficient allocation of resources and the successful implementation of industrial projects.<sup>1/</sup>

Regional industrial co-operation should not necessarily be left entirely to the market forces. Efficiency is not the only criterion for assessing a regional industrial project, and in any case, political realities may not permit the free play of private forces within the regional framework. These realities impose constraints upon the second approach, but they do not render it inapplicable. Complete removal of all trade barriers is too ambitious a goal, but selective trade liberalization would preserve important elements of the second approach. The establishment of regional industries may proceed along the lines suggested by the following sequence of steps:

1. Identification of large-scale 'infant' industries which require a regional market to be viable during infancy.
2. The removal, complete or partial, of intra-regional trade barriers facing these industrial products.

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1/ See also Chapter VIII, 'ASEAN Industrial Joint Ventures (AIJVs)', below.



3. Declaration of government policy support (effective subsidy) for investment in these areas (that is, how much society is willing to pay over and above world market prices and for how long).
4. Response from the private sector.
5. Institutional arrangements to impose such conditions as may be required to achieve other goals such as equitable distribution of benefits and costs.

Some of the problems associated with the present package of five industries would not arise if such an approach was adopted. But conflicts of national interests and political issues cannot be avoided totally. If it is necessary to find solutions that are completely acceptable to all parties, the range of eligible industries will be so narrow that the full benefits of regional co-operation will not be secured, and regional co-operation itself will become a futile exercise. A requirement that no member country feels that it is hurt by any single industrial project would clearly be the antithesis of the spirit of regional co-operation. Although one member country may not benefit from an individual project, it is possible for the nation to gain from a programme of industrial co-operation of which the project forms a part, with the negative effects associated with a given project more than offset by the positive effects associated with some other project.

Chapter VII. ASEAN Industrial Complementation (AIC)<sup>1/</sup>

(a) The concept and mechanism for ASEAN Industrial Complementation

In lieu of the free market route adopted, for instance, by EEC, ASEAN has elected to approach economic integration on an industry-by-industry/product-by-product basis. As noted above the governments, having taken the initiative in negotiating and implementing ASEAN Industrial Projects, have also declared their expectation and encouragement for the private sector to play the major role in regional industrial co-operation activities. The governments expect that industrial complementation projects will be negotiated among the private sector of the member countries and presented for authorization by the inter-governmental bodies of ASEAN.

Various types of complementation agreements may be envisaged, providing for differing manners of intercountry specialization. One type of complementation agreement might provide for establishment in each participating member country of an integrated industrial plant, which would cover all stages of a manufacturing process from raw materials to finished products. A portion of the resulting output of finished product would be then shipped to the other participating countries, so that each plant in the complementation scheme benefits from having been able to specialize in a product for the regional, rather than just one country's market. Another type of agreement could provide for horizontal specialization, by which participating countries could specialize in producing different components or materials/ingredients for the same product. These components and materials would then be shipped to the other countries where they would be used in the manufacture or assembly of similar end products. Other kinds of complementation agreements could provide for combinations of vertical and horizontal specialization.

Although proposals for the adoption of guidelines on ASEAN Industrial Complementation had been advanced to the ASEAN governmental bodies as early as 1978 and tentative guidelines authorized to be circulated in late 1980, the Basic Agreement on ASEAN Industrial Complementation was signed only in June 1981.

The Agreement affirms that the private sector shall continue to be encouraged to play the major role in most of the economic activities, including industry and trade. The Agreement further notes that suggestions

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<sup>1/</sup> This chapter is essentially based on Vicente T. Paterno "ASEAN Industrial Complementation", UNIDO/IS.282, dated 25 January 1982.

on industrial complementation may be advanced by the ASEAN Chambers of Commerce and Industry (ASEAN-CCI). The Agreement provides the guidelines and institutional framework within which the ASEAN governmental machinery and the private sector through ASEAN-CCI may collaborate in pursuing industrial complementation.

The more important provisions of the Agreement are:

1. An AIC package must be participated in by at least four of the five member countries, unless otherwise approved by the ASEAN governmental organizations.
2. Identification of products for inclusion in an AIC package shall be done by ASEAN-CCI; approval of the package and associated trade preferences shall be undertaken by the ASEAN governmental organizations.
3. "Exclusivity privileges" shall be enjoyed by the products in an AIC package. Periods of enjoyment of "exclusivity privileges" shall be two years for "existing products" and three years, extensible by another year, for "new products".
4. ASEAN governmental approvals shall first be granted for allocation of products in the AIC package to participating countries; thereafter, trade preferences shall be negotiated within six months for "existing products", or one year for "new products". The AIC package, with any necessary modification, including arrangements for trade preferences, shall then be granted final approval by the ASEAN governmental organizations.

A framework agreement on Preferential Trading Arrangements (PTA) signed in February 1977, provides for mutual and reciprocal trade preferences to be extended by and among the member countries for products as agreed in continuing negotiations. The trade preferences to be negotiated consist not only of reductions in tariffs, but also long-term quantity contracts, purchase finance support at preferential interest rates, preference in procurement by government entities, preferential liberalization of non-tariff measures, and other forms of assistance which may be agreed upon. The extent of trade preferences for products of AIP's and of projects under the AIC programme are negotiated for specific projects within the framework of the PTA agreement.

Accreditation of the AIC package is performed by the Committee on Industry, Minerals and Energy (COIME), while evaluation of requested trade

preferences for the products in the complementation package is undertaken within the Trade Preferences Negotiating Group of the Committee on Trade and Tourism (COTT).

(b) Preparation and assessment of AIC proposals

The proposals for industrial complementation emanate from the national industry associations and are submitted to the Regional Industry Club (RIC) of which they are a member. If there is a consensus on the proposal as it may have been amended after discussion within the RIC, the proposal is forwarded to the Working Group on Industrial Complementation, for endorsement to the ASEAN-CCI Council or its Standing Committee. The Secretary-General of ASEAN-CCI transmits the proposal to the Chairman of the ASEAN governmental committee concerned.

In practice, care is taken by the proponents and each level of the ASEAN-CCI to consult with interested or affected parties. In many cases, the national industry association will have prior consultations with the Ministries concerned, usually Industry and/or Trade, to ensure that the intended proposal would be in line with national policies, and to seek favourable indication that the proposal would in principle be supported if and when brought for consideration of COIME and/or COTT. Prior to formal submission of the proposal to the RIC, informal consultations with the other national industry associations concerned are often held to anticipate any difficulties in obtaining consensus. These difficulties may be resolved through suitable amendments to the proposals prior to formal presentation, or through negotiations at the meeting of the RIC. The Working Group on Industrial Complementation likewise makes efforts to identify any conflicts that may be raised in connection with the proposals of a RIC vis-a-vis other RICs, and to evaluate the acceptability and practicability of a proposal to the general membership of ASEAN-CCI, and to the ASEAN governmental organization.

The AIC proposal is transmitted by the Secretary-General of ASEAN-CCI to the Chairman of COIME. An analysis of the proposal may be made by COIME's Interim Technical Secretariat, before transmitting copies of the proposal to the heads of country delegations to COIME. The proposal will then be discussed at the next meeting of COIME, which may approve it forthwith, or agree to create an ad hoc group which will carry out a detailed analysis of the proposal, in consultation with the concerned units of ASEAN-CCI, as necessary, or make recommendations for consideration of COIME at a subsequent meeting.

If a favourable consensus is achieved in COIME on the proposal, it is then endorsed for approval in the next ASEAN Economic Ministers Meeting. During the ASEAN Economic Ministers Meeting, the approval will be sought by consensus on the allocation of the products in the AIC package to the respective member countries. The Committee on Trade and Tourism (COTT) will then be instructed to consider and recommend on the trade preferences requested for the products in the AIC package.

As indicated above, the initiatives and preparatory work of the Regional Industry Clubs (RICs) towards developing concrete proposals for the consideration of the ASEAN governmental organizations is of crucial importance. The pace and scope of co-operation activities vary among the different RICs. Every RIC has at some stage discussed at least one project to produce a new product for industrial complementation. Table 1 lists the various projects which have been identified and presented for discussion at ten RICs.

The study prepared by Mr. Paterno<sup>1/</sup> presents detailed review of the activities of the ASEAN Automotive Federation which led to the formulation of two AIC proposals: one for existing, and one for new projects. These AIC packages are the only ones which have to date received approval from the ASEAN Economic Ministers. An examination of these activities gives some idea of the great amount of time and effort devoted by the private sector towards identifying, validating and agreeing on an AIC package. The process within the RIC took three years, from December 1976 to November 1979. The ASEAN governmental organizations took 10 months to study and approve the proposals.

The information bases for identification by RIC's of possible AIC projects have been uneven in quality. While attempts have been made in all cases to quantify regional demand for the products of proposed projects, the quality and thoroughness of documentation of the market studies is uneven. In some cases, the data gathered on the market have been limited to historical demand for the product or to importation figures. In other cases, projections of future demand have been drawn up. Several RIC's such as the ones for chemicals, glass, pulp and paper, iron and steel, have been able to compile data from their member (national) associations on existing and planned production capacities in the member countries for certain products. However, elements of market studies such as pricing, channels of distribution, seasonality of demand, major import sources and

1/ UNIDO/IS.282, op.cit.

Table 1. Industrial Complementation Projects considered by Regional Industry Clubs

Industry	AIC project considered	Status of project
1. Automotive	First AIC package, (existing products)	Approved by ASEAN
	Second AIC package, (new products) (Total of 10 projects)	Economic Ministers
2. Electrical/electronics	TV picture tubes, black and white	Dropped in 1978 due to lack of consensus
	Transformers	Dropped in 1981
	Hermetic compressors	Feasibility study discontinued, 1981
3. Agricultural machinery	Mini tractors	UNDP's technical assistance requested by COIME for feasibility study
	Power sprayers	Under consideration by RIC
	Power transmissions	Under consideration by RIC
4. Chemicals	Acetylene black	} For discussions at next RIC meeting, December 1981.
	Chlorinated paraffin wax	
	Titanium dioxide	
	High test sodium hypochlorite	
	Freon gas	
5. Food processing	Regional grain storage	Disapproved December 1980 by Committee on Food, Agriculture and Forestry
	Fish cannery	Endorsed to working group on Food, Agriculture and Forestry, December 1980.
	Slaughter house and cold storage for beef	Seeking feasibility study
	Dry baker's yeast	To be proposed for PTA
6. Rubber products	Heavy duty tyres	} RIC concluded not viable. Under RIC consideration. Dropped by RIC, November 1978 Found not viable by RIC.
	Carbon black	
	Tyre cord, nylon	
	Chemical for fabrication of rubber products	
	Synthetic rubber	
7. Glass	Tinted sheet glass	} Under discussion by RIC
	Figured sheet glass	
	Safety glass	
8. Pulp and paper	Security paper mill	UNDP technical assistance for feasibility study requested by COIME
9. Textiles	Mill spare parts and accessories	Study group to be convened to make pre-feasibility study
10. Iron and steel	Magnesia clinker	UNDP's technical assistance requested by COIME for feasibility study
	Billet mill	Dropped by RIC, March 1980.
	Ferro alloys	To be presented to RIC at next meeting.
	Graphite electrodes	Prefeasibility study to be prepared.

other significant information necessary for an adequate assessment of the regional market to be served by possible AIC projects do not seem to be part of the documentation of any of the available market data.

In general, the information generated and compiled by the RICs to validate proposals for AIC projects is insufficient for a well-considered judgement on the viability of the AIC project proposal and its benefits to the region and the member countries. The available information would seem sufficient only to indicate the possibilities for specific AIC project proposals.

The inadequacy of information to support proposals for AIC projects may be traced to the following factors:

1. RIC's do not usually have full-time nor permanent secretariats which would design, send and follow-up replies to questionnaires; carry out market research to cross-check submitted information; conduct correspondence with equipment manufacturers or do library research to obtain data on plant investment requirements for economic-sized plants; compile and disseminate information to member associations and carry on continuing correspondence with them between meetings.

In the absence of a permanent full-time secretariat, much of the time at RIC meetings is taken up by exchanges of information, presentation of position papers, and discussions of matters which could be handled by a secretariat between meetings.

2. The funds available to RIC's from contributions of members and member associations do not allow the RIC's to employ technical services for the production of prefeasibility studies.
3. Individual companies could be reluctant to invest time of their technical staffs to develop project studies because the information contained therein, when presented to the national association and the RIC, might be used by other companies without any benefits or compensation accruing to the company that prepared and presented the study.
4. There are no minimum requirements, specified by WGIC or by COIME, for the information to be contained in an AIC project proposal. It may be useful for such standards to be drawn up as a guide for preparation and submission of AIC project proposals.

Investigations leading to the making of an industrial investment by a commercial entity are generally carried out in four stages. The first stage is the identification of an investment (and profit) opportunity, arising from pinpointing of a market opportunity. The second stage is the collation and analysis of various items of information relating to market potential, estimates of prices and costs of production and distribution, estimates of plant investment, possible sources of materials and required technologies, all of which are used to develop a prima facie case for the advisability of making a prefeasibility study, which comprises the third stage. The fourth stage is a detailed feasibility study which may require significant expenditures and the employment of engineering and other consulting services. The final investment decision will hinge on the outcome of the feasibility study, particularly its conclusions on rate of return realizable on the investment.

The investment of funds for carrying out these investigations is essentially speculative, since there is no assurance that it will yield any returns. Established industrial companies make decisions to spend for such investigations from time to time, as part of their strategy for expansion and growth, drawing on appropriations from operating income or out of reserves for this purpose. The process is more complex when joint ventures are involved, for it is then necessary to agree on the contributions to the investigations from each of the parties and the participation of each party in the joint venture investment if and when it is materialized.

The member companies in the national industry associations and the RIC's who may be interested in pursuing a particular AIC project find themselves in the position of prospective participants in that AIC project. Although materialization of the project requires expenditures for the investigation of its viability, project uncertainty makes mustering of the funds difficult. The uncertainty of the project arises not only from the current lack of information on its viability as an investment, but also from the uncertainty of whether it will be approved by the ASEAN governmental organizations as an AIC project, the extent of the incentives which the project may receive thereby, and the identity of the company or companies which will actually be authorized by the governments to implement the project.

In the light of this situation, it is not surprising that the AIC project proposals which have been submitted by ASEAN-CCI to COIME, may



at best be described as presenting a prima facie case for a possible AIC project, but not as a proposal for a project ready for establishment upon approval by the governments concerned.

It is recommended that ASEAN-CCI and the ASEAN governmental organizations give some thought to this matter, and determine what form of AIC proposals for new projects they may realistically expect to be presented initially and to materialize after completion of each stage of the approval process. In the present framework, COIME should probably not expect to receive AIC project proposals more advanced than the second stage of the project investigation process, i.e. a prima facie case for an AIC project. Private companies, who are accountable to their shareholders for wise expenditures of funds, are naturally reluctant to spend substantial sums of money for studies in connection with pursuing approval of a prospective AIC project in which they might be a principal or participant. However, for deciding on allocation to countries of AIC projects, COIME needs more information than a tabulation of the regional market potential for a possible AIC project. It would probably be advisable to specify the minimum information which COIME needs in order to make this decision. Specification of these minimum information requirements would provide necessary guidance on the contents of the study to be accomplished by the membership of the RIC for presenting a project proposal.

It is also useful to realize that in the present context allocation by COIME of an AIC project (new product) to a particular country, and approval by COTT of the trade preferences to be received by the products of that project, only serve to define the bases on which pre-feasibility and subsequently, detailed feasibility studies can be carried out. Time is consumed for the carrying out of these two-stage feasibility studies, the firming up of the investment decision, the organization of the project company (if a new one is to be formed to carry out the project), the finalization of project financing arrangements and the construction of project facilities. The time lag between approval of an AIC project for new products and its commercial operation could be several years, from a probable minimum of two years to five years or more.

Given the difficulties and the length of time it will take to investigate fully and to materialize AIC projects for new products, greater emphasis is appropriately given to the possibilities for putting together AIC packages for existing products. Although the industries established in the member countries are generally similar, enough differences may exist

in size of population, resource endowments and levels of industrial development to create opportunities for complementation of certain industrial products.

Out of some 30 AIC proposals considered by nine RIC's only four were for complementation of existing products. The exceptional RIC in this respect was the ASEAN Automotive Federation which presented, and received the ASEAN Economic Ministers approval for, one AIC package of existing products together with one AIC package of new products. It may be coincidental that the ASEAN Automotive Federation is the only RIC to have progressed this far in its AIC activities. But there are indications, that inclusion of existing products in its AIC discussions may have been an important factor in motivating its membership, thus sustaining the pace of deliberations.

Some RIC's have discussed industrial complementation through trade in existing industrial products. Among these are:

- (a) Rubber - reclaimed rubber, golf balls, rubber floor tiles, rubber cot sheets, canvas/sports shoes with rubber soles, bare latex extruded thread
- (b) Glass - tinted sheet glass, figured flat glass, safety glass (curved and flat)
- (c) Chemicals - ferro alloys

Other RIC's have agreed that development of regional trade in industrial products would a priori require adoption of uniform standards among the member countries. For example, in electrical and electronics products, trade is held back by differences in voltage and cycles of electric current; in glass containers by use of US measurement systems in one country, British system in another, and metric system in the others; in iron and steel by non-universal usage of the metric system and use of different gauging and metal standards. In these RIC's, emphasis is being given to the study of regional standards for the products concerned, so that these may be considered for adoption by the respective governments.

Notwithstanding the standardization problems, a number of possibilities exist for putting together AIC packages in the case of all the RICs reviewed.

Mr. Paterno, in his study<sup>1/</sup> notes that, at several meetings held with members of national industry associations which are active in RIC discussion

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1/ UNIDO/IS.282, op.cit.

it was indicated that one of the difficulties in putting together AIC packages for complementation products is that of obtaining relevant information on the market in the prospective buyer member countries. Since the members of the national industry associations and participants in RIC meetings are manufacturers, they can not be expected to have much knowledge of the market for products which they do not themselves manufacture. Furthermore, the manufacturer's interest lies in exporting his products to the member countries, and not in importing products of other manufacturers from member countries. In addition, many of the transnational companies represented in the national industry associations can not be expected to become enthusiastic or active supporters of programmes to provide trade preferences to products from other member countries at the expense of imports from the transnational company and its affiliates in countries outside of the region.

Due in part to the difficulties mentioned above, to date only one AIC package for existing products has been presented to and approved by COIME: that from the ASEAN Automotive Federation. It is worth noting that in the case of the ASEAN Automotive Federation, prospective buyers and sellers of the products were participating in the complementation discussions - the assemblers of vehicles and the manufacturers of automotive components. There was pressure being exerted by the governments' local content programmes for the assemblers to source components from within the host country or the region. Some of the assemblers involved in the discussions also had affiliates in the other member countries which were manufacturers of automotive components. Hence, the climate in which the discussions were held encouraged accommodations and negotiations among the participants to agree on an AIC package for existing products.

There may be some lessons to be learned from the above experiences of the RICs. Manufacturers from a member country A, interested in participating in an AIC package for their industry might consider franchising a trading firm to be the sole exporter of their products included in an AIC package for a designated period equal to or exceeding the exclusivity period allotted to that package, and authorizing that trading firm to participate in the negotiations within the RIC or that package. The franchised trading firm would, in its own interest, assist the manufacturer to identify markets in the other member countries for those products, and at the same time assist the manufacturers in the other member countries (or their franchised trading firms) to identify markets in country A for the products

in which they are interested. In this matter, trading expertise of the franchised trading firm would benefit the manufacturers in identifying market opportunities and carrying out buying and selling negotiations to materialize AIC package for existing products.<sup>1/</sup>

Regional industrial complementation could also receive a boost from adoption of a policy by the governments of all member countries that local content programmes may be partially fulfilled by components sourced from other ASEAN member countries. In most of the member countries, imports of completely assembled products are levied higher rates of import duty than the imports of the components (CKD), giving incentive to assembly industries. Some governments have inaugurated local content programmes on some of these products, extending lower rates of sales tax, and/or raising import duties on certain components, and/or mandating deletion of certain components from the CKD imports to increase the proportion of domestically manufactured components (local content) in the assembled product. Adoption of a policy in the relevant member countries that components sourced from other member countries will be credited towards their local content programmes would open up new industrial complementation possibilities for existing products, and at the same time help reduce the cost penalties often associated with local content programmes.

Finally, some other RIC activities in support of industrial complementation might be mentioned here. Several RICs have formed sub-committees so that discussions could focus on specific topics and sub-branches of the industry. For instance, with respect to standardization of electrical and electronics products, committees have been formed to study possible adoption of regional standards on six items. In a similar view the ASEAN Iron and Steel Industries Federation has decided to give priority to studies on common regional standards for several specific products.

Other activities undertaken by various RICs which would support industrial complementation include:

1. Studies and representations at fora on international trade negotiations for the pooling by member countries of unused export quotas in textiles.
2. Intra-ASEAN technical collaboration in design and manufacture of machinery and equipment for agriculture; joint procurement by manufacturers of components and materials required for manufacture

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1/ See also page 54 below regarding the proposal for an ASEAN general trading and industrial firm.

of agricultural machinery, e.g. discs for plows and harrows, steel bearings.

3. Surveys of existing and planned manufacturing capacities for selected products.

(c) General outlook and recommendations for future activities

Mr. Paterno notes that at the time of writing his study<sup>1/</sup> (later part of 1981) the climate is more favourable for increased activity in ASEAN industrial Complementation than it has been in the previous two to three years. Leaders in the governments of ASEAN countries have over the past year expressed the need to re-examine the framework, policies and machinery of ASEAN to quicken the pace of economic co-operation, and have recognized a new important role of the private sector of ASEAN. On their part, the private sector is encouraged by the approval of the two automotive complementation packages, the signing of the Basic Agreement on Industrial Complementation in mid-year and the authorization for ASEAN-CCI representatives to attend meetings of the various committees of the ASEAN Economic Ministers.

It should be observed, however, that there is still inadequate understanding of the concept and possible benefits of the ASEAN Industrial Complementation Programme, outside of a small segment of the bureaucracies, and a similarly small segment of the business community. Steps should be taken to increase popular awareness of the concept and possible benefits and thus to prepare for wider political acceptance of the AIC programme. Some recommendations toward this end are advanced below.

The opportunities for AIC in some industry branches have been discussed, both in existing products and for new projects. In general these opportunities lie more in products forming industrial inputs, such as components, industrial materials, and capital goods, than in consumer goods, which are already relatively well developed in the individual countries.

It is recognized that, although the attainment of a free trade area in ASEAN may be considered a possible goal, it will not materialize in the near future. Limited free trade in some sectors may, however, be possible in the medium-term. Successful industrial complementation involving tariff preferences by reductions of 50 per cent or more of prevailing rates could pave the way for a decision on limited free trade in those sectors where industrial complementation proves to be effective and generates perceived benefits.

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<sup>1/</sup> UNID/IS.282, op.cit.

The AIC programme requires close consultation between government and private sector. Possible synergisms between AIP's in the government sector and AIC in the private sector may be possible, for instance, in steel, chemicals and pulp industries. Since the governments retain approval authority over AIC packages, it is necessary for the interested entities to be kept informed of relevant policies so that the private sector discussions and negotiations may be conducted with full awareness of the framework within which the governmental decisions will be made. Guiding policies will eventually need to be formulated and issued by the ASEAN governmental organizations to provide clearer frameworks and guidelines for the private sector in identifying, formulating and studying AIC projects. These policies may not need to be as detailed as those of other regional groupings such as those of the Andean Pact, which carries out regional industrial development planning. But they have to be explicit enough to provide more guidance than is contained in the Basic Agreement on AIC.

Towards the objective of accelerating ASEAN Industrial Complementation, Mr. Paterno in his paper<sup>1/</sup> is making recommendations in five areas - generating public acceptance, developing the trading and distribution aspects, improving the quality of AIC proposals, developing parameters to guide allocation of projects among countries, and greater co-ordination of national industrial plans and policies with AIC programmes.

(1) Increasing public acceptance of AIC

It is recommended that ASEAN-CCI and the ASEAN Secretariat take steps for comprehensive discussion in academic circles in the member countries of the concept and benefits derivable from industrial complementation in selected industry branches, e.g. metals, chemicals and engineering. The notion is still widely held by many academics that the economies of the ASEAN member countries produce similar products and therefore there are no or few complementarities. This notion, as pointed out in several published papers, is not correct when broad products classifications are disaggregated, and when the industrial opportunities are examined more closely, particularly for those products requiring large-scale production to be internationally competitive.

There is one other aspect of public acceptance of industrial complementation which seems to have received little specific attention so far. This aspect is the equitable sharing of the benefits of industrial complementation.

1/ UNIDO/IS.282, op.cit.

There are several advantages in establishing at an early stage the parameters on the sharing of these benefits among the member countries at an early stage. With established parameters it becomes easier to anticipate the allocation of projects among participating countries; this will provide greater assurance that expenditures for project investigation will be rewarded by award of the project to the country that made the investment on its study. Pre-established parameters also make clear the extent to which a participating country, making its market preferentially accessible to AIC projects in other countries, will benefit through establishment of its own AIC projects which are reciprocally provided preferential access to the markets of other countries. The existence of such parameters will answer the questions that inevitably arise as to how fairly and equitably regional programmes advance the self-interest of the participating countries. A statement is noted from a leader of one of the ASEAN countries in February 1981 apropos of economic integration that "ASEAN countries have not really got down to short-term sacrificing for long-term gains". Perhaps the problem is to demonstrate through concrete operating projects what the long-term gains from economic integration could be, and to adopt measures which assure that any "short-term sacrificing" by the countries will be adequately compensated by long-term gains, equitably distributed.

(ii) Strengthening and improving the trading aspects of AIC

The Basic Agreement on AIC covers packages of existing products as well as of new products. The suggestion has been made in an earlier section to devote at least equal emphasis to AIC packages on existing products; considering that it takes several years to study, negotiate, organize and construct new projects. The increased production volume for the selected products, achieved through access to a regional market, could in many cases make possible significant reductions in manufacturing cost, benefiting the consumers in the participating countries and possibly even stimulating increased demand in the project's host country.

Participation of traders in the formulation and negotiations on AIC packages, particularly for existing products, is recommended. The interests of manufacturers who are presently the only participants in RIC negotiations need to be supplemented by the interests of trading entities in order to implement the sale of products of the AIC projects. Manufacturers are interested to sell their products, but would not be interested in buying products from other manufacturers, unless these are inputs to

their own manufacturing operations. Traders on the other hand are interested in materializing sale transactions, which require both a seller and buyer.

It is noted that the prefeasibility or prima facie studies presented to support AIC project proposals generally assume that the entire regional demand would be served by the AIC project. It is believed more realistic to premise market estimates on the basis that the entire demand of the project's host country would be served by the project, but that only, say, half of the respective national demands may be expected to be serviced by the AIC project in the other countries.

In view of the importance of trading entities to commercial viability and materialization of AIC projects, there may be logic for project organizers to consider inclusion of relevant trading entities among the equity owners of AIC projects.<sup>1/</sup>

Consideration may be given by the ASEAN government organizations to accreditation of Regional Industry Clubs to COTT as well as to COIME, particularly for those industrial branches which have identified significant trade possibilities on existing products, given ASEAN tariff preferences. Such accreditation of RIC's to COTT could materially shorten the process of project proposal and evaluation within ASEAN-CCI as well as the ASEAN governmental organization.

(iii) Strengthening and improving quality of project studies

Repeated mention has been made in previous sections that the information and analysis supporting AIC proposals are considered inadequate to demonstrate the feasibility of the projects making up the proposal. Market, technical and economic studies presented at best demonstrate a prima facie case of the AIC proposal's viability.

A major reason for this inadequacy of supporting information is the unwillingness of the proposing private entity to invest the time and efforts of technical staff to make the necessary studies. Present procedures do not provide assurance to the proposing private entity that if the project is approved by the ASEAN governmental organization, that project will be allocated to the country of the proposing entity, nor that, if so allocated, the project will be awarded to the entity that developed and presented the proposal. In this situation, the private entity can not consider the expenditures made for careful studies of a

<sup>1/</sup> See also page 54 below regarding the proposed ASEAN general trading and industrial firm.



possible AIC project to be a business investment. The tendency is thus to limit the expenditures for studies on AIC projects to the minimum, and to consider them as evidence of goodwill and co-operation with the movement for ASEAN economic co-operation.

It is believed that substantial improvement in the quality of supporting project studies could be brought about with adoption of mechanisms and procedures which provide assurance that the private entity that developed, and is formally recognized to have submitted, the proposal, would have the entitlement to pursue the project, if and when approved as an AIC project. Given this assurance, the proposing private entities would be more willing to make the expenditures for prefeasibility studies so that concrete project proposals are put forward and adequately evaluated. Detailed feasibility studies could then be made by the same entity upon approval of the project, and prior to its organization, financing and implementation.

Adoption of parameters which will guide the allocation of projects among countries participating in AIC packages would better enable the private sector to anticipate the decisions on such allocations. It is also suggested that the appropriate agencies of the national governments consider procedures for registration, in co-ordination and consultation with the national industry associations and with the COIME Secretariat, of the private entity submitting AIC project proposals. COIME may also consider, with the establishment of these procedures, the setting of minimum standards for supporting studies which AIC project proposals must comply with to be accepted and evaluated by COIME. The setting of such standards would save COIME time in evaluating the proposals, which is now carried out by ad hoc experts groups. These experts groups may not be required if there is adequate information and analysis supporting the AIC proposals.

Governmental and private sector organizations will continue to require objective and expert technical assistance in the identification and study of opportunities for ASEAN Industrial Complementation. They have in the past looked to the United Nations for such assistance. UNIDO has received requests for technical assistance to carry out prefeasibility on identified AIC opportunities. UNCTAD may also be a valuable, but now little tapped source, of information on market opportunities, including statistical data on imports by the region of different products which may be the subject

of AIC. With the objective of enabling ASEAN CCI and its member entities to become more familiar with the technical information and services possibilities available from UNIDO and UNCTAD, it is suggested that ASEAN-CCI be encouraged to communicate directly with these two UN agencies, except on matters requiring TA grants or loans, which can be negotiated only by the governments or the authorized national or regional government organizations.

(iv) Suggested parameters for allocation of projects among countries

One of the problems that must be faced in ASEAN economic co-operation, as probably in co-operation programmes of other regions, is how to achieve equity of distribution among the participating countries of the benefits resulting from co-operation. Unless satisfactorily resolved, the question can not but weaken the resolve and slow the progress of regional economic co-operation. The argument that the economic forces unleashed by co-operation generate advancements for all the countries in the long-term may be accepted if borne out by a history of regional experience. However, none of the ASEAN countries except Thailand have been independent for more than 35 years, and are only newly developing economic and commercial relationships among them. In comparison the nations of Central and South America have been sovereign for over a century, and have therefore had much longer history of economic and commercial relationships with one another than the countries in ASEAN. The countries of ASEAN do not have similarly long histories of economic sovereignty and experience of intra-ASEAN economic relationships to draw upon as a reservoir of experience for organized regional programmes of economic co-operation. Hence the suggestion to formulate the proposed parameters.

ASEAN Industrial Complementation is based on the participating countries sharing their markets for selected products with one another. This pooling provides the opportunity for establishment of industrial projects which are efficient and internationally competitive because of the scale of production. The contributions of a participating country to the AIC programme may be quantified as the sum of national demand for various products which is made accessible to AIC projects established in other countries through special trade preferences extended, while the country realizes benefits through its establishment of AIC projects which reciprocally enjoy access to the markets of the other countries through similar special trade preferences.

It would seem equitable that the benefits, i.e. exported production volume from AIC projects, be distributed proportionately among the countries as their contributions, i.e. market made available by the countries to AIC projects. This is expressed quantitatively as follows:

$$\frac{PV(1)}{PV(1) + PV(2) + PV(3) + PV(4) + PV(5)} = \frac{MC(1)}{MC(1) + MC(2) + MC(3) + MC(4) + MC(5)}$$

In the above formula, PV(1) is the cumulation of that part of the production volumes of complementation projects established in country (1) market-able in other countries through AIP, AIC and AIJV special trading arrangements; and MC(1) is cumulative market volume in country (1) made accessible under similar arrangements to countries (2) to (5).

The foregoing could guide the allocation of projects among the member countries, not for each complementation package, but on the overall. Application of this parameter when reviewing the distribution of projects will seek to establish that over a period of time, the share of each country in the markets accessed by its industrial complementation projects will be proportional to the market volume it makes accessible to similar projects in the other countries. The existence of such accepted parameter will also regulate the tendency for the industry associations in each country to be "grabby" about projects, to lay claim to as many projects as possible. By introducing effective limits over the long run on the project volumes that may be assigned to each country, adoption of this parameter will tend to make each country consider more closely which projects best fit in with its industrial structure, development plans and policies. This could induce the formulation and articulation in each country of its project priorities for regional complementation, and the relationship of regional complementation with national development plans, a very helpful development in setting directions and guidelines for the private sector.

The foregoing suggested parameter is not meant to be applied as a mathematical formula for calculating project-by-project allocation within a specific package. It would rather be applied from time to time to gauge the balance of project allocations resulting from decisions taken to date and guide the project allocations to be made in future. It is proposed that project-by-project allocation decisions observe the following criteria among others:

1. Distribution of "primary" production projects should be made according to efficiency and availability of major resource inputs such as minerals and energy. "Primary" projects would include mining, primary metals such as steel in billets, slabs and blooms, aluminium ingots, and copper blister and electrodes; ammonia; polymers of ethylene and other primary hydrocarbons, and other chemicals derived from coal, air, water, natural gas, or naturally occurring materials.
2. Allocation of "secondary" and "tertiary" projects would be managed giving due consideration to market contribution and project efficiency, as principal factors.

It is emphasized that it would be unrealistic and impractical to require that exact balance be maintained at all times between each country's cumulative share of project production export volumes and the volume contributions it makes to the market pool for complementation projects. In order to keep track of the distribution of PV's and MC's, COIME and/or COTT might keep a journal into which they would post the PV and MC for and from every country arising with each allocated complementation project. The current "debit" and "credit" balances of the member countries would be consulted from time to time, to guide future decisions on allocations of projects to the respective countries.

(v) Increasing the co-ordination between national industrial development plans and AIC programmes

Each of the member countries of ASEAN has an operating investment board. The functions exercised by the investment boards differ from one country to another, but all of them administer fiscal incentives for industrial projects considered to be of high economic priority, formulate lists of such priority projects, and regulate the entry of foreign investments. In performing these functions, the investment boards exercise a great influence on the shape of the structure of industry, and the directions of industrial development, including regional co-operation. For the purpose of initial discussions on matters of mutual concern the heads of investment boards in ASEAN held their first meeting in 1981.

It is suggested that the national investment boards take greater account of the possibilities for regional industrial complementation when evaluating project applications. Each investment board receives some applications for national projects, which, if established solely to serve the domestic market, would require a high tariff protection but which could be internationally competitive serving the regional demand. It is recommended that such projects be denied for establishment as a domestic project, and steered by the investment board towards regional complementation.

Another area in which the governments of ASEAN countries could assist one another is in the exchange of technical information about various industrial projects. From time to time, each country commissions feasibility studies on certain projects, some of which turn out to be not feasible for establishment in the country. The technical data contained in these studies such as estimates of equipment cost, estimates of cost of imported materials and supplies, labour requirements in various steps of the production processes, materials required per unit of output, could be helpful to other countries in carrying out or evaluating project studies. Contribution of such information to a technical data bank from which the investment boards, the COIME Secretariat and accredited organizations of ASEAN-CCI could retrieve useful information could be helpful to all the parties concerned.

Chapter VIII. ASEAN Industrial Joint Ventures (AIJVs)<sup>1/</sup>

(a) The concept of AIJVs

As indicated above, the RICs have found it difficult to identify industrial complementation projects, similar to the automotive one, in which all five countries are involved in the manufacture of the component parts with roughly equal distribution of benefit.

Because of such difficulties, the ASEAN-CCI President Mr. Wee Cho Yaw, proposed in 1980 a new concept, called "ASEAN Industrial Joint Ventures", whereby even two or three ASEAN partners from the private sector would be able to form a joint venture, and the capital fund for any one project may not be too great. These AIJVs could be allocated to different ASEAN countries in a pragmatic manner, under relatively flexible conditions and rules in order to speed up the rate of industrial co-operation.

The AIJVs would thus be different from the large-scale AIPs and the AIC projects, because the AIJVs would be individual projects and not usually considered together with other projects in a package manner or with other restrictive conditions which may perhaps hamper the speed of industrial co-operation. AIJVs can be approved individually by the ASEAN Economic Ministers who will have to maintain an equitable distribution of benefits accruing from the AIJVs in the long run.

(b) Proposed guidelines for AIJVs

COIME, in conjunction with ASEAN-CCI, is presently drafting a Basic Agreement on ASEAN Industrial Joint Ventures with the following general principles:

- (i) Participation in an AIJV will comprise at least two ASEAN countries but is not limited to only ASEAN countries, provided that membership by the ASEAN nationals is at least 51 per cent. ASEAN investors in AIJV projects are to be accorded national status by the host country for the purpose of qualifying the projects for national treatment.

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<sup>1/</sup> This chapter is essentially based on Dr. Lee Sheng-Yi; "ASEAN Industrial Joint Ventures (AIJVs) in the private sector", UNIDO/IS.310, dated 1 February 1982.

- (ii) An approved AIJV product is to be granted ASEAN Preferential Trading Arrangements (PTA) to the extent of 50 per cent preferential treatment; further tariff cut can be negotiated among the participating ASEAN countries.<sup>1/</sup> "ASEAN countries may consider not to encourage new or additional capacity for approved AIJV products for a period of two years for existing products and 3 to 4 years for new products". This exclusivity with respect to production and marketing is reckoned as from the date of actual production.<sup>2/</sup>
- (iii) The host country, where the AIJV is located, will accord to it a treatment no less favourable than that enjoyed by her own nationals provided that ASEAN nationals' ownership ratios meet the host country's national ownership investments requirement.
- (iv) Other ASEAN countries, which choose not to join the AIJV, are free to do so but their similar products cannot enjoy such a exclusive and special tariff preference.
- (v) COIME will recommend for the consideration of the ASEAN Economic Ministers the allocation of AIJV projects to the participating countries.
- (vi) Without prejudice to the right of identification by ASEAN Governments, the ASEAN-CCI shall identify AIJV products for possible allocation to member countries. The principle is to have equitable distribution of benefits for the ASEAN countries. Whenever feasible, AIJV products are to be equitably allocated to the participating ASEAN countries.
- (vii) An AIJV product shall be of internationally accepted quality, the price should be relatively competitive and there should be an assurance of continuity of supply.

It is evident that much flexibility for easier implementation has been sought in the draft Basic Agreement. For instance, at least two ASEAN countries can propose an AIJV; this can be considered as a further extension of the "five minus one" principle, as originally proposed by Mr. Lee Kwan Yew, the Prime Minister of Singapore, for AIC programmes.

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<sup>1/</sup> This was the decision of ASEAN Economic Ministers in a meeting in Jakarta on May 1981.

<sup>2/</sup> COIME proposed originally "as from the date of ASEAN Economic Ministers' final approval", but ASEAN-CCI desired to change to "as from the date of actual production". This is similar to what is stipulated in the Basic Agreement on ASEAN Industrial Complementation.

The proposed AIJVs would seem to rely much on ASEAN Preferential Trading Arrangement (PTA) and exclusivity arrangements with respect to production and marketing as catalysts to start such projects; the idea being to create an enlarged and initially protected ASEAN market for products of ASEAN joint ventures. Concern may, however, be expressed that at the end of the exclusivity period, political lobbying, particularly in the country where the AIJVs is located, may induce the exclusivity period to be extended further and further, so that the regional protection may become a permanent feature. This would defeat the ultimate objective of regional co-operation, i.e. to exploit the economy of scale in an enlarged market for the sake of efficiency and productivity. It is in this vein that Mr. Wee Koo Yaw, the ASEAN-CCI President, once remarked that it would be better if the AIJVs would not rely too much on PTA and other protective measures for their successful implementation, and that really competitive joint ventures were to be identified.

In this early stage, the approach is towards regional imports substitution, although in country terms there is an enhanced encouragement for exports from one ASEAN country to another. No attention has yet been given to regional export-orientation, i.e. to encourage exports to non-ASEAN countries. This idea is, however, very desirable, because, firstly, exports to non-ASEAN countries would avoid the conflict against national interest owing to the earnest desire of each ASEAN country to develop its own industries; and, secondly, the acid test of competitiveness and efficiency is the capability of exporting to the non-ASEAN countries without the regional protectionism. Hence, tax incentive measures for exporting to the non-ASEAN countries may perhaps be considered for possible inclusion in the Basic Agreement. For example, a reduced income tax or even tax holidays for such exports can be included so that the AIJVs may be encouraged to look for markets in the non-ASEAN countries as well. However, that would involve the final decision of the home country concerned. Perhaps, in the later stage, when some AIJVs have been set up, the ASEAN countries may amend the Basic Agreement to encourage regional export-orientation.

(c) Identification and selection of AIJVs

In order to avoid conflicts of national and regional interests, it would be better to move rather cautiously, so that each AIJV would have the whole-hearted support from the ASEAN countries and consequently a better chance of success. Some of the guiding principles for selecting



the AIJVs can be suggested as follows:

- (i) Although the draft Basic Agreement for AIJVs covers both existing and new products, it might be better if initially new products rather than existing ones are selected. This is because if the AIJV is exclusively favoured with the 50 per cent or more tariff preference, the products of other existing producers can only enjoy the usual PTA of 20/25 per cent in the ASEAN countries and hence cannot compete on equal ground with those of the AIJV. There would be much complaint and political lobbying.
- (ii) It is advisable to select producer or intermediate goods, rather than consumer goods, because in each of the ASEAN countries in their early phases of industrialization a wide variety of consumer goods industries have already been set up mainly for import-substitution. The ASEAN countries, however, have generally not yet come to the manufacture of producer or intermediate goods because of the economy of scale, and of the need of a higher level of technology. To illustrate, it would be difficult for the ASEAN textile industries to propose any yarn spinning mill for the AIJV. Even though most of the spinning mills in a member state produce 45 counts or under, they would not like to see an AIJV to be set to produce 100 counts fine yarn or above, as they could claim if they were given that exclusive preference they could produce such high-quality fine yarn themselves. The industry is more interested in organizing AIJVs for manufacturing spareparts and accessories for the textile machinery.
- (iii) For the similar reasoning, an AIJV industry should be of a fairly large or medium-size scale in order to exploit the economy of scale of regional co-operation, and not of small-scale type, for which the national market could suffice. On the other hand an AIJV may not be as large scale as the AIP type.

As already noted, the draft Basic Agreement has no provision for tax incentives or other measures to encourage exports to non-ASEAN countries. Nevertheless, for example, among the potential AIJVs reviewed in Dr. Lee's study<sup>1/</sup> and noted below, titanium dioxide may have a high potential for exporting to non-ASEAN countries. Magnesium clinker can be competitive in world market if dolomite and natural gas are found in plentiful supply in Thailand and other ASEAN countries. Ferrosilicon may have a prospect of exporting to non-ASEAN countries, if available raw material resources are effectively utilized and the hydroelectric potential developed. Other proposed AIJVs such as spare and accessory parts of textile machinery, mini-tractors, security paper, and graphite electrode may have less possibility of exporting to the non-ASEAN market at least in the early stage, because their production involves high technology and it would be difficult for them to compete with well-established manufacturers in developed countries.

<sup>1/</sup> UNIDO/IS.310, op.cit.

Unless the AIJV products are competitive in price and quality, it would be difficult or uneconomical to compel ASEAN industries to use those products. It is realistic to presume that the proposed AIJVs may only command about 60-70 per cent of the ASEAN markets of those products, but not 100 per cent. In reviewing identified potential AIJVs, Dr. Lee noted that in most cases the optimum or minimum scale of production of those products exceeds considerably the volume of demand in the whole ASEAN region. Therefore the balance quantities have to be exported to the non-ASEAN countries. The ASEAN countries, in considering AIJVs, have to pay attention to the potential non-ASEAN markets in the long-run perspective -- i. e. ASEAN export-oriented strategy instead of merely ASEAN import-substitution strategy. This implies that the production must be very efficient and competitive in the world market, which is indeed a challenging task.

(d) Potential AIJVs and proposals for future action

The ASEAN-CCI meetings in Manila in June 1981 and in Bangkok in November 1981 saw much deliberation on the AIJVs. The various ASEAN RICs such as ASEAN Chemical Industries Club, ASEAN Iron and Steel Industry Federation, ASEAN Automotive Federation, and ASEAN Federation of Textile Industries were requested to identify potential joint ventures. The proposals will be submitted to the COIME and hence to the ASEAN Economic Ministers.

For example, the ASEAN Iron and Steel Federation has proposed magnesium clinker, graphite electrode and ferro-alloy projects. They support proposed feasibility studies of the AIJV projects. The ASEAN Agricultural Machinery Federation has proposed a mini-tractor project. The ASEAN Pulp and Paper Industry Club has proposed a security paper project. The ASEAN Chemical Industries Club has proposed five projects, namely, chlorinated parafin wax, acetylene black, high test sodium hypochlorite, titanium dioxide, and feron. The Institute of Textile Technology at Bandung has been requested to identify potential of manufacture of spare and accessory parts of textile machinery for AIJVs.

Some of the proposed AIJVs certainly stand a good chance of success. In his paper<sup>1/</sup> Dr. Lee recommends, however, that ASEAN-sponsored pre-feasibility studies in the case of prospective AIJVs be carried out by special team(s), at the suggestion of the proposing country in respect of the project in question. In that context following aspects should be considered.

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1/ UNIDO/IS.310, op.cit.

1. Before a pre-feasibility study of a project is started, it is very important that full information is obtained from the five ASEAN countries whether any one of them has also a similar project in the planning stage. If so, how can the regional planning be reconciled with the national one?
2. The pre-feasibility study team should comprise an economist as team leader, who has good knowledge in industries and in business management, and one or two engineers. In the case of the five chemicals projects, magnesium clinker and graphite electrode, they should be chemical engineers or applied chemists who have experience in the chemical field. In the case of mini-tractors, security paper plant, and spareparts of textile machinery, they should be mechanical engineers.
3. The team should be familiar with (and possibly visit) relevant production plants in, for instance, the US, Japan and/or EEC to study their production cost relative to the scale of production, their techniques of production, machinery used, management, marketing etc.
4. The team should then study, at the site where the AIJV is proposed to be located, the transportation problem, labour supply, and the various aspects of infrastructure. These would be related to the production cost.
5. The volumes of demand should be assessed in respect of the total ASEAN market and of each individual country? To be realistic, the team should presume that the AIJV may only be able to sell to the ASEAN countries to the extent of 60-70 per cent of their requirement but not 100 per cent.
6. Other important considerations include:
  - (a) What is the optimum of minimum scale of production? Since cost per unit varies with the scale, they should estimate a range of costs relative to different scales.
  - (b) What is the choice of technique in the production? Would the level of technology and the supply of engineers and skilled labour force be adequate for the production in the country, where the AIJV is located. What is the economy or comparative advantage in choosing such a site?
  - (c) What are the alternative supplies of these products in the world market? Since the AIJVs may have to sell a part of their products in the world market, it is important to know the competitive supplies.

Finally, mention should be made of the potential role in identifying and promoting AIJVs of the ASEAN Finance Corporation (AFC) which was established in Singapore in June 1981 with some 135 banks and financial institutions in the five countries constituting - directly or indirectly - the shareholders. The aim of AFC is to serve as a catalyst for ASEAN industrial development by participating actively in and even initiating new private

sector industrial investment. AFC will also be expected to be instrumental to mobilization of capital from non-ASEAN sources. One example is the establishment in November 1981 of the ASEAN-Japan Development Corporation (AJDC), as joint venture between AFC and the Tokyo-based Japan-ASEAN Investment Co. (JAIC).

Through the setting up of AFC very important linkages have been established in the ASEAN countries' financial and banking sector with its widespread sphere of influence and contacts. It has been suggested<sup>1/</sup> that the next scenario that may be envisaged is the organization of linkages in the industrial and business sectors in another institute, a 'general trading and industrial enterprise'. This concept of general trading and industrial enterprise, modelled after the traditional English trading houses and, above all, after the Japanese Sogo Shosha, has lately been given a great deal of attention by both developed and developing countries looking for an effective vehicle in their search for an enhancement of their bargaining position in the international world. At the national level, such enterprises are being looked upon as most valuable institutions assisting the national economy by mobilizing, combining and developing the national production efforts and comparative advantages. At the regional level, this concept could then be extended to promote the combined ASEAN production efforts and comparative advantages. It should be noted in this connexion that the ASEAN-CCI has recently proposed the establishment of an 'ASEAN General Trading Corporation' with envisaged functions along the above lines.

Such a general trading and industrial firm may be used as a 'search arm' of the ASEAN Finance Corporation in its search for investment opportunities and also as a mobilizer and promoter of ASEAN projects. The linkage between trade investments and industrial investments can then be established. The ASEAN general trading and industrial firm which could be established with AFC and other ASEAN industrial and business enterprises as shareholders, would be able to handle the various products manufactured in the ASEAN region and market them in assortments, regionally and internationally. A combined tie-up with the region's existing national general trading and industrial firms in penetrating the international markets might well be envisaged.

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<sup>1/</sup> See J. Panglaykim, "ASEAN Finance Corporation: Prospects and Challenge," UNIDG/IS.291, dated 1 March 1982.

