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The Development of the ASEAN Industrial
Cooperation Arrangement**

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Preferences, Interest, and Regional Integration: The Development of the ASEAN Industrial Cooperation Arrangement

by

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Abstract

This article is concerned with regional economic cooperation and integration in East Asia. While the previous research focuses on international factors such as power relations among major states and market power, or the states' interest as factors qualifying regional economic cooperation, this study highlights preferences and activities of foreign multinational corporations (MNCs). This study assumes that as foreign MNCs in small local market sought greater markets for achieving an efficient production level, they raised their preferences for regional economic arrangements, and that these preferences and functioned as critical factors promoting regional economic integration in the Association of Southeast Asian Nations (ASEAN) region. The case of the ASEAN Industrial Cooperation (AICO) arrangement showed complicated development patterns. While MNCs successfully encouraged the states to introduce the AICO arrangement in 1996, the arrangement did not work effectively after its introduction because of the states' adherence to maintaining their national interest, seeking to increase the benefits of their local economies and firms. The ASEAN members relaxed regulations concerning AICO applications later. This policy change stemmed from a renewed interest in regional economic cooperation as a consequence of the Asian economic crises in 1997-98, as well as persistent pressure from manufacturing MNCs.

Keywords

Regional economic cooperation; East Asia; ASEAN; AICO; industrial development; automobile industry

Introduction

The world economy has been integrated into regional economic groupings. While the twelve European countries formed the European Union (EU) in 1993, the United States, Canada and Mexico signed the North American Free Trade Agreement (NAFTA) in 1992. Unlike Europe and North America, moves toward regional economic integration have been slow in East Asia.¹ The official institutional forum encompassing the region had not emerged until the Asia-Pacific Economic Cooperation (APEC) forum was founded in 1989. The APEC, a loose consultative forum without any binding power, has been institutionally primitive compared with NAFTA that is based on a treaty with binding power, not to mention EU that introduced a common currency in January 1999.

Southeast Asia is an exception in East Asia in terms of the development of regional cooperation and cooperative institutions. The major five countries in the region – Indonesia, Malaysia, Thailand, the Philippines, and Singapore – formed the Association of Southeast Asian Nations (ASEAN) in August 1967, developing various institutional systems centred on this organisation. In the 1990s, regional cooperation has deepened in terms of quality and quantity. While the ASEAN Regional Forum (ARF) was institutionalised in 1994 as the first region-wide multilateral forum to discuss security matters, the first Asia-Europe meeting was held in 1996 under the ASEAN initiative. In 1999, Southeast Asian countries achieved ‘the ASEAN 10’ encompassing the whole Southeast Asia by accepting the participation of Cambodia in ASEAN.

Economic and industrial development has been a major field of regional cooperation among the ASEAN members. They have formulated and implemented various schemes for this objective since the late 1970s. In the 1990s, the ASEAN states have taken great strides in this respect. At the Fourth Summit meeting in January 1992, the members agreed to form the ASEAN Free Trade Area (AFTA) by the year 2008, reducing import tariffs for industrial products, agricultural products and capital goods to 0-5 percent. While they shortened the target year of the AFTA from 2008 to 2002 afterward, they reached the Framework Agreement on the ASEAN Investment Area (AIA) in October 1998 in order to enhance the attractiveness and competitiveness of the region as investment recipients.

¹ The concept of East Asia in this article includes Japan, Korea, China, Taiwan and Southeast Asian countries.

In considering regional economic cooperation in Southeast Asia, two aspects need particular attention. The first is that the states with a strong sense of the national interest have played a critical role in economic development. Externally, the ASEAN members were forced to mobilise domestic resources in order to repel the threat of the spread of communism through the Cold War period. Internally, the unification of the whole nation has been a major objective for the policymakers. Accordingly, authoritarian states have taken the lead in social and economic development and external economic policies.

The second is that economic and industrial development in the ASEAN countries has been sustained by intensive involvement of foreign companies. Unlike the Northeast Asian countries whose governments imposed strict restrictions on investment from developed countries, the Southeast Asian states provided various incentives to attract foreign capital after the mid 1980s. Industrialisation has been promoted in export-oriented sectors such as automobiles and electronics where foreign companies were the major players.

Given the above two elements characterising economic development in Southeast Asia, regional economic cooperation is likely to be promoted on the basis of interactions between the states' perception of the national interest and the preferences of major foreign multinational corporations (MNCs). In particular, MNCs' evolving stance and activities might affect the start and development of regional trade and industrial arrangements and the states' perception of regional cooperation. In this article, I will examine the development of a particular regional economic arrangement in order to see MNCs' preferences for policies to promote regional economic integration and their interactions with the states. Before taking a close look at a case, the following section examines the literature relevant to this study in order to suggest a central argument.

Regional economic arrangements in East Asia

What factors have determined the formation and development of regional economic arrangements in East Asia? It is often claimed that diversities have worked as intrinsic constraints on the development of regional economic collaboration in East Asia (Foot, 1991: 234-35). In fact, East Asia is characterised by various disparities including the political system, the degree of economic development and cultural and religious

traditions. In addition to this basic characteristic of East Asia, a number of studies have striven to look for more explanations for regional economic cooperation and integration.

The first set of approaches explains the development of regional economic arrangements in terms of international power relations. After the Second World War, the United States was long the dominant power in East Asia in political, economic and military dimensions. In particular, it developed the bilateral security relationships with regional countries including Japan, South Korea, Taiwan and the ASEAN members. These US-centred bilateral political and security practices dissuaded the East Asian countries from developing regional arrangements. As the US economic power gradually declined after the 1970s, the US government tended to favour unilateralism or bilateralism in its economic policies, departing from multilateral principles (Bhagwati, 1990). As a consequence, the institutionalisation of regional economic order emerged as a viable and necessary option for the smaller states in the region. They needed to prepare for the likely instability of the world economic system and moves to exclusive economic blocs in other regions (Crone, 1993). This power-based approach is likely to explain moves to regional economic arrangements in the 1990s. The support for the East Asian Economic Caucus (EAEC) did not expand in East Asia because it ran counter to the US interest.² Japan's proposal to form the Asian Monetary Fund during the Asian currency crisis in 1997 was not realised largely because of the opposition from the United States (and China).

A second type of explanations focuses on the influence of market power. According to this explanation, East Asia long lacked interest in promoting regional economic integration because intra-regional economic activities were limited in spite of their geographical proximity. For instance, in 1980 the share of intra-regional in total trade was 0.229 in East Asia compared with 0.416 in the European Community (Frankel, Stein and Wei, 1995: 63). However, Japanese investment into Southeast Asia increased sharply after the mid 1980s, and the newly industrialised economies (NIEs) followed Japan in the 1990s. As a consequence, the East Asian economies have deepened the interdependent relationships in terms of trade, investment, and financial transactions. Economic activities also served to the formation of sub-regional economic

zones including the Indonesia-Malaysia-Thailand growth triangle, the South China coast, and the SIJORI growth triangles involving Singapore, Johor in Malaysia and the Indonesian Riau. These dynamic economic activities have provided the bases for regional economic cooperation patterns (Kaztenstein, 1997; Kikuchi, 1995: 327). Of particular note is that the same market-driven forces have impeded APEC's rigid institutionalisation by inducing the states to pursue 'open regionalism'.³

The third set of approaches, unlike the previous two explanations, focus on a domestic factor: the interest of the state. Some political scientists allow priority to policymakers' decisions in formulating economic policy in order to pursue the national interest (Krasner, 1978; Nordlinger, 1981; Skocpol, 1985). According to this statist perspective, public officials are independent, autonomous actors to pursue their own policy goals that are distant from the parochial concerns of societal interest groups. This perspective has particular appeals for the East Asian countries. Most countries in East Asia achieved independence after the Second World War, and social unification has been an imperative national objective. Accordingly, these states have been reluctant to abandon substantial policy autonomy and some measure of national sovereignty. In addition, economic and industrial development in these countries was achieved under the state leadership. Such state initiative has influenced the formation of external economic policies including the development of regional trade and industrial arrangements. For instance, the small states' concern that regional powers might use the APEC as a means to impose various agenda on them has been the major constraint on its start and further institutionalisation (Nesadurai, 1996: 32).

A critical element that the previous theoretical perspectives have paid little attention is the influence of societal actors – industries and firms in particular – on the development of regional economic arrangements in East Asia. In recent years, a significant strand of theoretical and empirical work has focused on societal interest groups as forces shaping foreign economic policy (Milner, 1988; Rogowski, 1989;

² The EAEC was proposed by Malaysian Prime Minister Mahathir in 1991. it comprises the ASEAN countries, Japan, South Korea, and China, excluding Australia and New Zealand as well as the United States.

³ Open regionalism is referred to as regional economic cooperation that is consistent with the GATT principles and does not discriminate against other economies (Elek, 1992). The benefits of trade liberalisation in one economy are expanded not only to all APEC member economies, but also to any non-member economy.

Frieden, 1991). According to these scholars, the government's choice in economic policy is distributive consequences of domestic politics conducted by various societal groups. The groups that obtain benefits from an introduction or changes of a particular economic policy support it, while those suffering from the policy oppose it.

Several studies have highlighted the influence of firms and industries on the development of regional economic arrangements. In particular, some scholars who have analysed the development of market integration in Europe conclude that industrial actors in evolving regional and international markets changed their preferences in favour of policies and institutions that promote the unified European market. For instance, Sandholtz and Zysman (1989) argue that the transnational industrial coalitions, which experienced changes in the international economic structure, allied with the European Commission to push for the 1992 market unification process.⁴ Similarly, Cox (1996) holds that US auto and electronics firms have supported NAFTA or the Caribbean Basin Initiative because these regional trade arrangements gave them preferential access to both low wage export platforms and larger markets and thereby enabled them to maintain a competitive advantage against their foreign rivals.

An issue to be explored in analysing the influence of firms and industries on the development of regional economic arrangements is why some firms and industries pursue the formation of regional economic arrangements and others not. It is generally held that demands for regional economic arrangements have much to do with particular industrial characteristics. Export-oriented industries tend to support the formation of a regional trade arrangement when they can enjoy benefits from preferential access to foreign markets covered by the arrangement (Mansfield and Milner, 1999: 602).

A favour for regional trade arrangements is also strong in industries where scale economies (or increasing returns to scale) exist. For firms in industries with scale economies, achieving the optimal scale is essential to maximising profits. If firms with scale economies operate in the market where they can achieve the optimal scale, they would prefer import protection because such protectionist policy enables the firms to capture a large domestic market and/or promote exports. However, under certain conditions, firms with scale economies prefer regional liberalisation to either market

⁴ For a similar argument, see Robson and Wooton (1993) and Moravcsik (1998).

protection or global liberalisation because their profitability may become greater by moving from a protected market to a preferential trade arrangement. This preference can be explained by the modified theory of customs union.

Corden (1972) introduced scale economies into the standard customs union theory. He argues that trade diversion and trade creation effects, which are seen in perfect competition, should be supplemented by two other concepts in analysing a custom union in imperfect competition.⁵ One is the cost reduction effect and the other is trade suppression effect. Assume three countries, A and B, which form a customs union, and country C representing the rest of the world. When a union is formed, a more efficient country A's producer will replace domestic production in country B, and thereby move down its cost curve by the increased demand for both country A and B. Thus, the cost reduction effect derives from achieving economies of scale in a customs union. When country B imports goods from country C, a customs union enables country A's producer to capture the market in country B by driving out imports from country C. This is trade suppression.

Some empirical studies show that trade and welfare gains resulting from regional trade arrangements had much to do with economies of scale. Pearson and Ingram (1980) argue that the significant portion of welfare gains from economic integration between Ghana and the Ivory Coast derived from production effects that were relevant to unrealised internal economies of scale. Milner (1997) analyses trade barriers in seven key sectors covered by the NAFTA accord and concludes that scale economies, in addition to other factors such as the past tariff level, export-orientation and geographic concentration, positively related to trade liberalisation.

The main focus of the previous research is the preferences and influence of firms on regional economic arrangements in which their home countries are involved. However, given MNCs' basic characteristics as global market players and the logic deriving from economies of scale, we can expect that even MNCs in foreign markets prefer to regional economic arrangements under certain conditions. The arrangements might be more attractive for MNCs with scale economies in developing countries whose domestic markets are small.

⁵ The trade diversion effect and trade creation effect deriving from the formation of a customs union were first suggested by Viner (1950).

Southeast Asia is such an area where each country has a small domestic market. The economic development in ASEAN countries has been sustained by deep involvement of foreign MNCs. Responding to policy changes to export-oriented industrialisation in Southeast Asia and the sharp appreciation of the yen in the mid 1980s, Japanese companies relocated their operations to Southeast Asia. In particular, the manufacturing firms formed integrated production networks throughout Southeast Asia (Ernst, 1994; Hatch and Yamamura, 1996). While some firms penetrated the Southeast Asian countries as export platforms, other firms aimed to sell products at the domestic markets. For the latter case, the small domestic market is likely to be a significant constraint on greater profitability.

This article assumes that the promotion of regional economic arrangements in ASEAN might be influenced by preferences and activities of some foreign MNCs. These companies are likely to raise their preferences for preferential economic arrangements, as they need extended markets in order to enjoy economies of scale. These preferences and demands might induce the states to launch a new initiative for regional economic cooperation.

The studies of the relationship between corporate preferences and policy outcomes often lack in-depth analysis of causal linkages between these two variables. Accordingly, this study pays particular attention to firms' preferences and strategies underpinning them on the one hand, and the states' policy stance on regional economic arrangements, on the other hand. It seeks to analyse the mechanism by which firms' preferences affect the states' policy stance. For these objectives, it is useful to take up a particular arrangement and examine carefully the relevant actors' evolving interests in the arrangement and their interactions over its development. This study takes up the AICO arrangement as the case.

The background of the AICO introduction

The ASEAN countries have formed and implemented various industrial and trade cooperation schemes since the mid 1970s: the Preferential Trade Arrangement (PTA, 1977), ASEAN Industrial Project (AIP, 1980), ASEAN Industrial Complementation (AIC, 1981), and ASEAN Industrial Joint Venture (AIJV, 1983). These schemes, by

and large, produced meagre outcomes because of diverse interest among the countries.⁶ An exceptionally successful was the Brand-to-Brand Complementation (BBC) scheme. The scheme, adopted at the ASEAN Economic Ministerial (AEM) meeting in October 1988, allowed an approved auto part to enjoy a minimum of 50 percent margin of tariff preference and local content accreditation if it was a component for the manufacture of any product in the participating countries. The scheme originated from a proposal by a Japanese automaker Mitsubishi Motors (Machado, 1992; Shimizu, 1998).

Although the ASEAN auto market gradually expanded after the mid 1980s, each market size was still quite small. For instance, the Thai auto market, the largest in Southeast Asia, was 304,000 in 1989, 3.9 percent of the Japanese market (Nikkan Jidosha Shinbumsha, 1998: 222, 239). In this small market, 14 automakers provided 34 models, and only five models were sold with more than 5,000 units (Fourin, 1996: 71-73). Mitsubishi Motors constructed production plants in the Philippines, Thailand and Malaysia, responding to local content regulations. However, the company considered that investment burden for each local plant was too heavy given the small domestic market size, and aimed to reduce investment costs by consolidating production of particular parts in one country and export them to plants in other countries (Kamo, 1997: 72). This strategy led Mitsubishi to propose the BBC scheme that granted tariff reduction and local content accreditation.

After the introduction of the BBC arrangement, major automakers in ASEAN accelerated the development of the parts complementation system in the region. In so doing, they allocated the production of value-added parts such as engines and transmissions to several ASEAN countries in order to balance trade and investment among these countries. Toyota Motor was a typical example. Toyota strengthened the formation of parts complementation in Southeast Asia after its BBC proposal was approved in November 1989. The leading Japanese automaker held three manufacturing plants in Thailand, one in Indonesia, one in Malaysia, and one in the Philippines. In the summer of 1990, Toyota began to construct two parts plants in order to promote the complementation of parts production: T & K Autoparts in Malaysia and Toyota Autoparts Philippines. In mid 1993, Toyota began parts circulation among four

⁶ For regional economic cooperation in Southeast Asia, see Ravenhill (1995) and Tan (1996).

production plants.⁷ In the Toyota group, the transaction value of parts and components within the ASEAN region increased from 1.6 billion yen in 1992 to 15.5 billion yen in 1994 to 35.6 billion yen in 1996 (*Nikkan Jidosha Shimbun*, 31 October 1995: *Nihon Keizai Shimbun*, 7 April 1997).

New trends toward liberalisation in the early 1990s changed the BBC's fate. In January 1992, the ASEAN states declared that they would establish AFTA by the year 2008 at the Fourth Summit in Singapore. Under the Common Effective Preferential Tariff (CEPT) scheme, the main mechanism for reaching AFTA, existing tariff rates will be reduced to below 5 percent and quantitative restrictions and other non-tariff barriers will be eliminated. In April 1995, an informal AEM meeting decided to phase out the BBC scheme. The ASEAN officials considered that the CEPT scheme would provide sufficient incentives for the whole ASEAN investors including auto manufacturers. In addition, the BBC was regarded as offering privileged benefits to automakers alone. Japanese automakers in particular took advantage of the BBC scheme, while local companies gained small or no benefits from it.

The scrapping of the BBC scheme was a serious problem for auto MNCs that expanded investment in ASEAN in order to take advantage of the privileges granted by the scheme. In addition to Toyota that established auto parts plants in Malaysia and the Philippines in 1990, Honda Motor constructed an engine plant in the Philippines in 1992 and a plastic parts plant in Malaysia in 1993. These investments, designed to establish parts complementation among the major ASEAN countries, were based on the assumption that the privileges under the scheme would continue indefinitely for all models. The scrapping of the BBC scheme would overturn the basis of their strategies.

Opposition activities were particularly adamant in Thailand. Ninnart Chaithirapinya, director of Toyota Motor Thailand as well as president of the Thai Automotive Industry Association, stated that if the BBC scheme would be scrapped, Toyota would revise a plan to play a greater role in the BBC by investing more in parts (*Bangkok Post*, 4 May 1995). The Automobile Industry Club of the Federation of Thai Industries was also concerned about the scrapping of the BBC. When the Ministry of

⁷ T & K Autoparts started the offer of steering systems to Thailand, the Philippines, and Indonesia. Toyota Autoparts Philippines also began the exports of transmissions to Malaysia, Thailand, and

Commerce summoned car assemblers in order to listen to their views on the influence of the scrapping, Supachai Chavanavesh, secretary-general of the club, argued that a new scheme to replace the BBC should be introduced in order to cushion the impact of the planned phase-out of the BBC (*Bangkok Post*, 17 May 1995). The Japanese government and the Japan Automobile Manufacturers Association (JAMA) also opposed the scrapping. The government objected to the phase-out on the grounds that the automakers increased investment in ASEAN on the basis of the BBC.⁸ JAMA demanded that if the BBC would be scrapped, an exceptional measure for the CEPT should be formulated.⁹

Another important factor that influenced the handling of the BBC was moves of auto parts makers. As explained before, the BBC was applied to auto assemblers alone. However, some parts makers had strong interest in joining the BBC. Denso, the largest auto parts maker in Japan, had three auto parts plants in ASEAN: Denso Thailand that manufactures alternators and starter motors; Denso Indonesia that makes compressors and spark plugs; and Denso Malaysia that manufactures various electronics parts. The preferential tariff treatment under the BBC was a big lure for establishing a parts circulation system among the ASEAN countries.¹⁰ Denso had lobbied the ASEAN Secretariat and the member governments to extend the BBC preferential tariff measure to parts makers since the BBC was adopted in 1988. The company gained a positive response from the ASEAN side to consider this issue at the time of revising the BBC, and almost gained an accord on the inclusion of parts makers in the BBC. Yet, this issue was integrated into the overall revision of the scheme.¹¹ Thus, the treatment of parts makers gave a momentum to revise the program for parts complementation.

The parts makers' interest in the BBC had much to do with scale economies. While vehicle assembly can achieve an optimal production with the production volume

Indonesia. Toyota-Astra Motor began to provide gasoline engines to Malaysia, while Toyota Auto Body Thailand did floor panels to UMW Toyota Motor in Malaysia.

⁸ Interview, MITI, May 1997, Tokyo.

⁹ Interview, JAMA, May 1997, Tokyo.

¹⁰ Later, Denso established Philippines Auto Components (PAC) in 1995, and began the production of meters in March 1997. In July 1995, Denso also established Denso International Singapore whose aims are to coordinate production at the ASEAN facilities and provide post-sales services. With the establishment of PAC, Denso completed the parts complementation system among four major ASEAN countries.

¹¹ Interview, Denso Corporation, September 1997, Tokyo.

of 200,000 units annually, auto parts need far more production volume. The ideal annual production volume for alternators, distributors and starter motors in ASEAN is 1.25 million, 1 million, and 0.93 million respectively. However, actual production volume in the ASEAN four was 470,000, 55,000, and 352,000 for respective parts in 1995.¹² Accordingly, the parts makers represented by Denso were keen to join the BBC arrangement as a means to reduce production costs by acquiring preferential tariff rate.

The activities for opposing a scrapping of the BBC yielded fruit. The introduction of a new industrial cooperation scheme was agreed in September 1995, and the Basic Agreement on the ASEAN Industrial Cooperation (AICO) scheme was signed at the AEM meeting in Singapore in April 1996. The scheme is open to any ASEAN-brand company, which has a minimum 30 percent ASEAN national equity, and that is willing to undertake resource pooling, industrial complementation, or other industrial cooperation activities. A minimum of two companies in two different ASEAN countries is required to form an AICO arrangement. The AICO approved products obtain a preferential tariff rate in the range of 0-5 percent, local content accreditation, and other non-tariff incentives.

There are several features in the AICO arrangement. First, unlike the BBC scheme whose target is the automobile sector, the AICO scheme is open to all manufacturing sectors. It aims to attract inward investment in broad manufacturing industries because the status of the ASEAN members as FDI recipients declined in the 1990s.¹³ Second, the scheme paid attention to the development of small and medium scale enterprises (SMEs). This was clearly stated in the preamble of the Basic Agreement: ‘mindful of the need to develop the growth of SMEs taking into consideration the stages of development among ASEAN Member Countries’. Third, it has an aspect of the advanced implementation of the CEPT scheme. The AICO is based on the principle and concept of the CEPT and provide companies the immediate benefits of the CEPT tariff rate.

¹² ‘The Interim Report of the Meeting of Automobile Experts from ASEAN, CLM and Japan’, July, 1996: Annex 3.

¹³ The ranking of the ASEAN countries among major developing countries as FDI recipients fell between 1987-92 and 1997-98 as follows: from third to fourth in Singapore; from fourth to ninth in Malaysia; and from tenth to seventeenth in Indonesia (ASEAN Secretariat, 1999: 130).

Conflict over the AICO clauses and implementation

The acceptance of an AICO application began in November 1996. However, not only the number of applications was far smaller than expected but also the administrative process accepting the application was not implemented smoothly. For a year after the AICO began, only 17 applications were submitted. Toyota, Matsushita Electric, and Denso became the first applicants in December 1996, but they found little or no progress in the approval process in 1997.

The ASEAN Secretariat attributed the slow progress of the AICO scheme to the fact that detailed conditions on the scheme application and administrative procedures were still uncertain.¹⁴ Some companies also mentioned that administrative officials were not prepared for the AICO procedure well and internal coordination between the Ministry of Industry and the Ministry of Finance were insufficient.¹⁵ In fact, Matsushita and Denso submitted an integrated application covering transactions among four countries, while Toyota submitted six applications for bilateral transactions among four ASEAN countries. Thus, even the basic application method was not fixed clearly.

Indeed, the insufficient preparation and internal coordination surely led to the slow progress, and its fundamental cause lay in the 'ASEAN way' in that agreeing on principles first and creating substance through the consultation process.¹⁶ However, additional two factors seem to impede the smooth progress of the scheme: one was conflict between MNCs and local governments over conditions applying for the AICO, and the other was the diverse stance of the ASEAN states on the scheme.

After the AICO was agreed in September 1995, the ASEAN states and relevant companies and industries conducted negotiations over detailed conditions. Although overall objectives of the AICO were to promote industrial complementation and to stimulate both intra-regional trade and inward investment, the ASEAN states sought to utilise the scheme as a means to raise the interest of their local enterprises and economies, and imposed regulations for this objective. This policy orientation was

¹⁴ Interview, ASEAN Secretariat, March 2000, Jakarta

¹⁵ Interviews, Isuzu Motors Asia, March 2000, Singapore; Toyota Motor Management Services Singapore, March 2000, Singapore; and Yanmar Diesel Indonesia, March 2000, Jakarta.

¹⁶ For the ASEAN way, see Acharya (1997).

confronted with MNCs' strategies to promote efficient inter-corporate complementation.

The most controversial issue was the national equity clause. The scheme shall be applied to companies that have a minimum 30 percent national equity.¹⁷ This means that those whose local equity was less than 30 percent had to boost local equity shares, otherwise they were unable to join the scheme. This clause, designed to encourage participation of local firms in the AICO, was imperative for several MNCs. In case of Toshiba, a representative Japanese electronics maker, eight out of fourteen manufacturing plants operated in the five ASEAN countries did not meet this criterion (Noda, 1999: 127). These subsidiaries were established responding to the local governments' preferential measures to allow the majority or more foreign ownership.

Foreign MNCs adamantly opposed the 30 percent national equity, asserting that it would run counter to the trend towards liberalisation.¹⁸ In spite of strong oppositions, the national equity provision was adopted with a list of waiver criteria. Then, the MNCs focused on the waiver criteria, which differed country by country.¹⁹ Although Thailand raised only two criteria, manufacturing new products not yet manufactured in Thailand and participation of SMEs, it listed additional four items responding to demands from the private sector.²⁰ Some MNCs also lobbied the ASEAN governments to make a particular condition included in the waiver list. For instance, the Philippine government put a criterion 'export commitment'. This criterion was included due to a demand from Denso.²¹ The company held 90 percent share of the Philippine Auto Components, but it could get the waiver because of the inclusion of this export yardstick.

Another issue with respect to the 30 percent national equity is the handling of parts suppliers under assembly makers. Toyota proposed the 'umbrella' method: an AICO company (assembly maker), which conducts consolidated purchasing of parts

¹⁷ Basic Agreement on the ASEAN Industrial Cooperation, Article III (1).

¹⁸ Interview, Denso Corporation, September 1997, Tokyo: *Nation*, 17 February 1997.

¹⁹ For instance, the waiver of Singapore was quite simple: ASEAN cumulative equity, linkages to SME, export commitment and new technology. Indonesia raised complicated conditions: ASEAN cumulative equity; export oriented industry of which at least 50 percent be exported to outside ASEAN countries; project located in eastern part of Indonesia, engineering or capital goods industry which deals with the manufacturing such as machine tools and mould/die jig fixture, and so on (ASEAN Secretariat, 1997: 40).

²⁰ Interview, the Thai Ministry of Industry, December 1997, Bangkok.

²¹ Interview, Denso Corporation, September 1997, Tokyo.

from suppliers in each country, applies for the AICO scheme including these suppliers. This method would enable parts suppliers to evade the regulation of the 30 percent national equity. It also served to simplify the application procedure. The Thai and Philippine governments accepted this method, and the Malaysian and Indonesian governments had little interest in this issue. However, Singapore was reluctant to accept this method. There were no assembly makers in Singapore, but there was an influential parts maker, Delco Electronics. The umbrella method put Delco in a disadvantageous status because it would not get such a loophole. Toyota asserted this method at several meetings of the ASEAN Working Group on Industrial Cooperation (WGIC), the technical body responsible for the AICO implementation. The company also asked Japanese MITI to push for the method.²² But, all parts suppliers were eventually required the 30 percent national equity at the WAIC meeting in April 1997.

The third issue concerned the requirement of trade balancing. The BBC scheme required trade balancing in the document. But, since this requirement became a critical impediment to promoting the scheme, the AICO scheme intentionally removed this demand in its Basic Agreement.²³ In practice, however, the government officials tended to regard increases in imports through the AICO as the encroachment of their home market by other countries. This concern led them to require trade balances under the AICO transaction strictly as a virtual criterion to accept an AICO application and approve it. In some case, applicants had to make serious efforts to show that their transactions under the AICO would contribute to the overall expansion of intra-regional trade. In other cases, companies were forced to draw up application forms to coordinate export and import values in balance.²⁴

The second impediment to the smooth implementation of the AICO lay in diverse stance on the scheme among the ASEAN countries. Differences in industrial structure and industrial policy led each state to adopt a diverse stance on the AICO scheme. The Thai government has been the most positive in activating the AICO. As the background of the AICO introduction demonstrates, the auto and auto parts companies have shown the strongest interest in the AICO. Not only did Thailand retain the largest vehicle

²² Interview, Toyota Motor, September 1997, Tokyo.

²³ Interview, ASEAN Automobile Federation, March 2000, Jakarta.

²⁴ Interviews, Honda Motor, March 2000, Tokyo; Denso Singapore, March 2000, Singapore; and Isuzu Motors Asia, March 2000, Singapore.

production volume but also social and economic conditions have promoted the accumulation of auto parts production. For instance, as of April 1999, Japanese parts makers had 143 manufacturing bases in Thailand, 45.7 percent of total 313 bases in the ASEAN region (JAPIA, 1999: 2). Accordingly, Thai's auto parts industry was the most developed and competitive. For instance, when Honda applied for the AICO scheme about 572 parts in December 1999, 531 parts were made in Thailand, compared with 3 in Indonesia and Malaysia each and 35 in the Philippines.²⁵

Reflecting confidence in competitiveness in auto and auto parts production, Thailand became the first country that provided AICO approvals. In March 1997, the Ministry of Industry approved projects from Toyota, Denso and Matsushita. But these approvals did not go forward because other members did not carry the applications further, claiming that the projects did not meet AICO's criteria on ownership and the ratio of suppliers contributing to the projects (*Bangkok Post*, 1 April 1997 4 1; *Nation*, 30 August 1997). In order to facilitate the approval procedure, the Thai government encouraged other ASEAN members to approve preferential tariffs when an AICO company obtained approval from at least two countries at the October 1997 AEM meeting (*Nihon Keizai Shimbun*, 6 October 1997). Of particular note is that even the Thai government still adhered to protecting the national interest. While the government approved the three projects from the auto and electronics sectors, it denied a proposal from Indopet, a resin producer affiliated to Indorams, an Indonesian polyester maker. The government did not approve the project in order to protect three other domestic resin makers.

The Philippine government had maintained relatively open trade policy and adopted a relatively positive stance on the AICO. For instance, the government opposed the 30 percent national equity clause. This was because most foreign-affiliated parts makers in that country accepted more than 70 percent foreign equity.²⁶ However, the government considered some AICO applications cautiously. In December 1996, Matsushita Electric Philippines Co. (MEPCO) applied for the AICO. MEPCO, the largest fan maker in the Philippines, planned to exchange fan parts with its sister companies in Indonesia, Malaysia and Thailand. Almost one year later, the Philippine

²⁵ Interview, Honda Motor, March 2000, Tokyo.

²⁶ Interview, ASEAN Automobile Federation, March 2000, Jakarta.

Board of Investment (BOI) denied the proposal from MEPCO on the grounds that MEPCO's project would jeopardise the interest of domestic makers. The BOI was also anxious about trade deficits because MEPCO would import US\$715,000 from the three countries while exporting US\$374,000 (*News Net Asia*, 14 November 1997).

The Indonesian government was cautious about proceeding with the AICO. The government did not admit local content accreditation even under the BBC. Indonesia adopted the tax incentive method as a means to promote localisation. Assemblers were eligible for reduction of tariffs on imported parts if they achieved a certain point of local content. The government considered that this method provided sufficient incentives for the manufacturers. In addition, Indonesia had a strong favour for obtaining concrete benefits in exchange for the approval of the AICO. While other countries demanded practical and statistical data in the application form, Indonesia required documents to explain what benefits the country could gain in exchange for the approval. Responding to the request, Toyota proposed a plan to increase local content by transferring the production of tyres and brakes from Japan to Indonesia.²⁷

The Malaysian government also showed cautious attitudes toward the AICO. Its basic stance was that the AICO was formulated for the benefit of indigenous enterprises in ASEAN not of foreign MNCs, and the government should pay due attention to its influence on the domestic industry.²⁸ The Malaysian government has fostered the national passenger carmakers, Proton and Perodua. In particular, the first national carmaker Proton could dominate the large share of the domestic market (60 percent in 1997) under the intensive government protection including the exemption of the 40 percent import tariffs. If the government had approved the AICO privileges for foreign affiliated automakers, they would have stood at an advantageous status *vis-à-vis* the national carmakers by curtailing production costs with reduced tariffs on imported parts.

The diverse stance naturally impeded smooth negotiations over the AICO conditions and influenced the AICO procedure. The national authority shall indicate a decision on the tariff rate within 60 days of the receipt of the application from companies.²⁹ However, some governments refused receiving applications because of

²⁷ Interview, Toyota Motor, September 1997, Tokyo.

²⁸ Interview, Toyota Motor, September 1997, Tokyo.

²⁹ Basic Agreement on the ASEAN Industrial Cooperation, Article VII (2).

this time constraints. For instance, Denso submitted an AICO proposal to four countries in December 1996 just after the AICO began. The date when each government received the proposal formally was diverse: within the same month in Thailand, September 1997 in Malaysia and the Philippines, and August 1997 in Indonesia (Ito, 1999: 102). Sanden Corporation, a Japanese air conditioning maker, submitted two AICO applications – transactions between Singapore and Thailand and between Singapore and Malaysia – in 1997 simultaneously. While the Thai government issued an approval one year later, the Malaysian government did not make any response to the proposal.³⁰

Thus, MNCs had a great expectation with the AICO as a promoter of industrial complementation in the ASEAN countries whose domestic markets were small. However, the arrangement did not work smoothly largely. The states' adherence to augmenting their national interest came into collusion with MNCs' strategies to promote operational efficiency in the region and impeded forging the common front on the AICO. This situation changed after 1998.

The development the AICO implementation

The Asian currency and financial crises that began in Thailand in July 1997 had serious damages to the ASEAN economies. In 1998, per capita GDP measured in the current US\$ fell 26 percent in Thailand, 29 percent in Malaysia, 57 percent in Indonesia, and 22 percent in the Philippines (ICSEAD, 2000: 4). While intra-exports among the ASEAN five shrank by 7.4 percent in 1998 from \$77.8 billion to \$72.0 billion, intra-regional FDI reduced by 81.9 percent in Thailand, 47.0 percent in Malaysia, 49.4 percent in Indonesia, and 74.2 percent in the Philippines (Kawada, 1999: 2-5). The manufacturing production also declined sharply in 1998. The production of vehicles in the ASEAN five dropped by 64 percent from 1.34 million units in 1997 to 0.49 million units in 1998.³¹

The depressed economies and severe production setback generated a favour for protectionist measures among the ASEAN governments. Thailand increased import tariffs on finished cars and luxury goods in October 1997 and steel products in May 1998. The Thai government also postponed the removal of local content regulations for two years, which would have been implemented in July 1998. While the Malaysian

³⁰ Interview, Sanden International Singapore, March 2000, Singapore.

government raised import tariffs on finished cars and construction machinery in October 1997, the Philippine government raise import duties on textile products from 10 percent to 15 percent and on auto parts from 3 percent to 7 percent in January 1998.

At the same time, the ASEAN states raised the perception that further moves to regional economic integration were indispensable for overcoming the economic crises and revitalising the economies. This perception was revealed in several official documents. For instance, the 'Hanoi Plan of Action' declared at the Sixth ASEAN Summit in December 1998 clearly stated that:

'In recognition of the need to address the current economic situation in the region, ASEAN shall implement initiatives to hasten economic recovery and address the social impact of the global economic and financial crisis. These measures reaffirm ASEAN commitments to closer regional integration and are directed at consolidating and strengthening the economic fundamentals of the Member Countries'.

In this trend, the ASEAN governments took into account the AICO more seriously. Indeed, some governments, which tried to strengthen exports and reduce imports, were still cautious about the AICO because effects that the implementation of the AICO would have on trade flows were ambiguous. However, the AICO was recognised as a critical measure to encourage the existing manufacturing companies to maintain their operations and raise the attractiveness of ASEAN as a location for foreign investment.

The ASEAN governments gradually deregulated operational conditions of the AICO after the Asian economic crises became serious. In February 1998, they agreed to relax an eligibility criterion. Previously, only companies that were incorporated and operating in ASEAN were entitled to take in the scheme. This requirement was relaxed to allow non-registered companies to apply for the scheme on the condition that they would meet the original criteria within one year. When the Sixth ASEAN Summit was held in Hanoi in December 1998, the ASEAN governments adopted measures to accelerate the AICO. The governments declared the 'Hanoi Plan of Action', which stressed the importance of economic integration and macro-financial cooperation. In this action plan, they agreed to 'expedite the implementation of AICO'. The governments also issued the 'Statement on Bold Measures', which spelled out urgent

³¹ Interview, JAMA Singapore Office, March 2000, Singapore.

measures to implement AFTA, AIA and AICO. As for AICO, they agreed to waive the 30 percent national equity requirement during the period 1999-2000. With this statement, the most critical impediment for MNCs to utilising the AICO was removed.

After the ASEAN governments implemented the revisions of the AICO, the scheme began to move forward. The first approval was issued in January 1998 to an arrangement of completely knocked-down (CKD) auto pack between Thai-Swedish Assembly Co. and Swedish Motor Assembly (Malaysia) under a Swedish automaker Volvo. Between April 1998 and March 1999, the number of received application increased from 26 to 40 and that of approved application grew from two to eighteen (Table 1). As of March 2000, the governments received and proceeded with 89 applications, 52 of which were approved.

Table 1 The number of AICO applications

	10/1997	4/1998	3/1999	3/2000
Total applications received	17	26	40	89
Total applications approved	-	2	18	52
Total applications rejected	-	5	5	14

Source: The author's interview survey at the ASEAN Secretariat and various documents issued by the ASEAN Secretariat.

Although the numbers of application and approval increased substantially in 1998, the applications did not reach the degree to the constellation of companies operating in the region. The WGIC continued to discuss measures to facilitate the AICO approval process. At the WGIC meeting in Jakarta in February 1999, several measures were agreed. The most critical item was that manufacturing companies that belonged to the same group or administered by the same principal were allowed to form an AICO arrangement among themselves and exchange products that they specialised in with one another under an intra-firm AICO arrangement.³² The application process was also

³² Under the previous rules, an AICO arrangement must result in the production of at least one AICO final product, and the AICO final product must contain AICO intermediate products or raw material sourced from the participating companies.

revised. After March 1999, an application is submitted to the national authority through the ASEAN Secretariat, not directly to the national authority. This revision enabled an applicant to reduce troubles and time resulting from a submission to each national authority. Furthermore, the whole processing time concerning the AICO application was shortened from 134 days to 100 days.

The major deregulations that facilitated the AICO application were reactions to pressure from MNCs and their industrial associations. The deregulation of the pre-investment AICO participation in February 1998 was a reaction to pressure from US MNCs.³³ The US MNCs complained that the AICO gave an advantage to Japanese MNCs that had already established production bases in the region. In January 1998, the US-ASEAN Business Council asked the ASEAN governments to relax the provision that requires AICO applicants to register in an ASEAN country. Ernest Bower, president of the council, warned that ASEAN should create an economy of scale to attract foreign investment; otherwise it might lose out to other countries, especially China (*Nation*, 24 January 1998). The council included executives of representative US manufacturing MNCs.

A more strong pressure was exerted by Japanese manufacturers, the major MNCs in the ASEAN region. They required that the AICO scheme should be implemented smoothly and its restrictive provisions should be relaxed at various institutions and opportunities: the WGIC meetings, the Japan-ASEAN Auto Expert Group meetings, informal talks with political and business leaders, and hearings at the ASEAN Secretariat and ASEAN Chamber of Commerce and Industry (ASEAN-CCI). The WGIC was the most important. The meeting has been held once per 3-4 months in each ASEAN member. Major Japanese auto MNCs have sent their delegates to the WGIC meetings in order to deliver their opinions and suggestions about the AICO. In particular, Toyota has attended every WGIC meeting, and explained preferences and problems in utilising the AICO.³⁴ Its delegate comprised members from the headquarters in Japan, Toyota Motor Management Service Singapore (TMSS), the regional management office, and an affiliated company in the country where the WGIC meeting was held.

³³ Interview, ASEAN Secretariat, March 2000, Jakarta.

³⁴ Interview, Toyota Motor Management Services Singapore, March 2000, Singapore.

JAMA has lobbied the ASEAN governments to rectify problematic aspects of the AICO scheme at various opportunities such as talks with relevant government authorities and the Japan-ASEAN auto expert group meetings. For instance, JAMA and the Japan Auto Parts Industries Association (JAPIA) organised the Japan-Indonesia Automobile Dialogue in autumn 1998. JAMA asked the Indonesian governments to promote the AICO at the dialogue meetings.³⁵ JAMA also collaborated with the ASEAN Automobile Federation (AAF) in propelling the AICO. JAMA has maintained close linkages with AAF since its reorganisation in July 1997. While JAMA played a crucial role in forming the federation by advising each industry in the countries to have an ASEAN-wide organisation, it has formed several joint committees to promote technical and management cooperation. AAF petitioned the ASEAN Secretariat, ASEAN-CCI, and local governments to accelerate the AICO implementation (*Nation*, 10 April 10 1998; *Nikkan Jidosha Shimbun*, 3 July 1998). The AAF also encouraged its member associations to demand each government to promote the AICO smoothly.³⁶

The most critical deregulation in 1999 was the AICO application to intra-firm transaction. Japanese MNCs had demanded this deregulation since 1996 because transactions of specialised products among affiliated companies were the most desirable for enjoying benefits from industrial complementation and scale economies. The intra-firm deregulation was implemented responding to demands from the private sector.³⁷ This deregulation had critical impacts on the promotion of the AICO application and approval. In case of Indonesia, the number of approval was only one before May 1999. Between June 1999 and March 2000, the government approved thirteen projects and additional fifteen were in progress. Most projects were relevant to intra-firm transactions.³⁸

In addition to direct lobbying, indirect support for local industries strengthened the stance of Japanese MNCs. As the economic crises became serious, the local governments asked foreign partners of joint ventures to increase their equity share and strengthen capitals. For instance, Mitsubishi Motors raised its equity share of MMC Sittipol Co. in Thailand from 48 percent to 94 percent in October 1997, while Honda

³⁵ Interview, JAMA, March 2000, Tokyo.

³⁶ Interview, ASEAN Automobile Federation, March 2000, Jakarta.

³⁷ Interview, ASEAN Secretariat, March 2000, Jakarta.

raised its share of Honda Cars Mfg. Thailand from 38 percent to 88 percent in 1998. Major Japanese auto parts makers including Koito Manufacturing and Toyota Gosei also raised their share in joint ventures in 1998 (Fourin, 1999: 55). These commitments made it difficult for the local governments to stick to the national equity requirement. Japanese automakers also increased imports of parts manufactured in ASEAN. Japan's import value of auto parts from ASEAN four increased from US\$294 million in 1996 to US\$393 million in 1997 to US\$430 million in 1998 in spite of parts production in the region declined sharply during this period. (JAMA, 1999: 12).

The AICO scheme went forward after 1998 largely because the ASEAN states relaxed regulations on the AICO application. This policy change stemmed from the states' renewed recognition of the necessity for regional economic cooperation and MNCs' persistent pressure for smooth implementation of the scheme.

MNCs' preferences for regional economic arrangements

The demand for the smooth implementation of the AICO scheme reflects preferences for preferential regional arrangement among MNCs with scale economies. For MNCs in capital-intensive sectors where economies of scale work strongly, the AICO scheme that includes preferential tariffs was valuable in the ASEAN region where each market size is small. The benefits from the AICO are shown by some corporate data. Honda applied for the second set of the AICO application in December 1999. The scheme will enable the company to reduce tariff payment in ASEAN by 6 billion yen for five years. In addition, Honda will cut investment costs in ASEAN by 4.62 billion yen by consolidating parts production and avoiding duplicated investment. Furthermore, the company will increase local and regional sourcing and reduce imports from Japan. In Thailand, procurement within the region will increase from 5.4 percent to 10.2 percent while imports from Japan will decrease from 39.2 percent to 25.9 percent. Changes in the whole ASEAN region are more salient. While regional sourcing will rise from 4.8 percent to 20.8 percent, imports from Japan will decline sharply from 55.4 percent to 34.9 percent (Table 2).

³⁸ Interview, the Indonesian Ministry of Industry, March 2000, Jakarta.

Table 2 Changes of parts sourcing before and after the AICO in Honda affiliated companies (percent)

Area	Source	Before AICO	After AICO
Thailand	Local	55.4	63.9
	Japanese	39.2	25.9
	Regional	5.4	10.2
	Total	100.0	100.0
Total ASEAN	Local	39.8	44.3
	Japanese	55.4	34.9
	Regional	4.8	20.8
	Total	100.0	100.0

Source: Interview, Honda, March 2000, Tokyo.

The above observation shows that Japanese auto MNCs preferred tariff reduction under the AICO in order to consolidate production of specified parts at particular plants in the region. But, they considered that extra-regional barriers were still necessary in order to protect the ASEAN auto industries with weak competitiveness. This stance was expressed by Japanese business leaders. Koji Hasegawa, director of Toyota who was responsible for the ASEAN business, argued that ASEAN had to work as a group to make their production costs most competitive, while the liberalisation and opening of their markets should be implemented gradually in order to prevent import flood from developed countries (*Nation*, 17 March 1997). Hiroshi Imai, Chairman of Keidanren (Japan Federation of Economic Organisations), also revealed a favour for preferential regional arrangements in ASEAN as follows: ‘if tariffs were removed all at once, all ASEAN companies would go into bankruptcy. Accordingly, tariffs should be removed gradually, targeting the year of 2010 or 2020. But, it is better to remove tariffs within the ASEAN region. Since automakers often manufacture engines, steel frames, or others at one plant in the region, the imposition of tariff is troublesome for their operations’ (*Gekkan Keidanren*, February, 1999: 16). Although Keidanren encompasses leading enterprises in various industries from trading companies, retailers, and banks to a complete range of manufacturers, Imai’s statement represents the stance of automakers.

In addition to the statement by the company executives, several facts demonstrate that Japanese auto MNCs favour discriminatory regional measures in Southeast Asia. First, the major sectors that have applied for the AICO and obtained approval are auto and auto parts.³⁹ Indeed, the electronics makers have been the major force to accelerate industrialisation and intra-regional trade in Southeast Asia, and the ASEAN Secretariat has encouraged the electronics makers to apply for the AICO scheme.⁴⁰ While some electronics makers applied for the scheme, they have been, by and large, less interested in the AICO scheme. The diverse stance between auto and electronics makers sprang partly from the perception that 0-5 percent tariffs under the CEPT scheme were likely to apply to most electronic products but was not uncertain to auto products that were more important for local economies. At the same time, most electronics makers, which made inroads into the ASEAN countries as export platforms, obtained the reduction of tariffs on imported parts under the export promotion policies. Accordingly, unlike the automakers that faced high tariffs on imports parts, they could utilise scale economies with low imports tariffs.

Second, Japanese auto MNCs show less interest in market liberalisation at the more multilateral level. The APEC Automobile Dialogue began in July 1999 under the initiative of the US Department of Commerce. The US government, reflecting the US automakers' interest in further advance into Southeast Asia, sought to promote trade and investment liberalisation in the auto markets. However, Japanese automakers, in concert with the local partners, pushed back the liberalisation proposal, seeking to make the automobile dialogue a forum to discuss economic and technical support from developed to developing countries (*Nikkan Jidosha Shimbun*, 5 November 1998; 17 February 1999). Given the serious management condition, Japanese automakers stressed the necessity to develop auto infrastructure including the fostering of parts makers in ASEAN before implementing market liberalisation. At the same time, they feared to lose preferential treatments in the ASEAN market against their US rivals.

Japanese auto MNCs also showed passive attitudes toward tariff reductions at the wider level. In 1999, the Thai government raised duties on CKD parts imported outside

³⁹ As of March 1999, 79 percent of AICO applications came from the auto related industry, followed by the electric/electronics industry (8 percent) and the food processing industry (8 percent) (ASEAN Secretariat).

⁴⁰ Interview, ASEAN Secretariat, March 2000, Jakarta.

ASEAN from 20 percent to 33 percent. This rise was implemented largely responding to lobbying from local parts makers including Japanese-affiliated.⁴¹ The Philippine government decided to reduce tariffs on finished vehicles imported outside ASEAN to 5 percent by 2004. This duty level would become far lower than those adopted by other ASEAN states. Some Japanese automakers were concerned with this low tariff level because products from developed countries would flood into the ASEAN markets through the Philippines.⁴²

Japanese auto MNCs have preferred discriminatory regional arrangements in order to secure their status in the ASEAN market against foreign competition. At the same time, they hope to extend the preferential arrangement adopted in ASEAN to neighbouring Taiwan and Australia.⁴³ This was because even the whole ASEAN countries still small in enjoying scale economies. The inclusion of Taiwan and Australia, where they operate with small production volume as well, would serve to achieve more optimal production level.

Conclusion

This article concerns the relationship between MNCs' evolving preferences for regional economic arrangements and the states' interest in regional economic cooperation. The central assumption of this study is that foreign MNCs in small local markets might raise their preferences for regional economic arrangements, as they need greater markets for achieving an optimal production level. In order to examine this argument, I have focused on the development of the AICO arrangement in Southeast Asia. The detailed investigation of the AICO development showed the complicated relationship between MNCs' preferences and the states' interest.

The influence of manufacturing MNCs operating in Southeast Asia was apparent in the introduction of the industrial cooperation schemes. The BBC scheme, a precursor of the AICO arrangement, was launched in 1988, responding to demands from an auto MNC that hoped to raise its operational efficiency. The 50 percent tariff reduction and local content accreditation were beneficial in developing auto parts complementation in the region. The AICO scheme was also introduced in November 1996 under auto

⁴¹ Interview, Denso Singapore, March 2000, Singapore.

⁴² Interview, Toyota Motor, March 2000, Tokyo.

⁴³ Interview, JAMA, March 2000, Tokyo.

MNCs' ongoing efforts to promote and complete the parts complementation system in the ASEAN region. While major assemblers objected to the scrapping of the BBC scheme in order to maintain their privileges to receive preferential tariffs, some parts makers demanded their participation in the BBC scheme. These factors worked as a background of the AICO introduction.

While MNCs' successful encouragement led to the introduction of the AICO arrangement in November 1996, it did not work effectively for one and half years after its introduction. The dysfunction of the arrangement stemmed largely from the ASEAN states' persistence in maintaining their national interest, seeking to increase the benefits of their local economies and firms. Most countries adhered to the 30 percent national equity as a condition to participate in the scheme with an eye to fostering local firms, while government officials did not put forward procedures for AICO applications that were likely to exacerbate trade balances of their countries. The ASEAN members recognised the necessity of and value in economic cooperation and integration covering the whole region, but practical operations were hindered by the states' national interest. They were less likely to subordinate the direct interest to the far-reaching objective.

The ASEAN members relaxed regulations concerning AICO applications after 1998. One factor underpinning this policy change was the Asian economic crises in 1997-98. They recognised the risk that the crises would lead foreign investors to escape from the region, looking for alternative investment target. The ASEAN states needed to promote regional economic cooperation in order to raise the attractiveness of the integrated market. At the same time, manufacturing MNCs have been a major force to encourage the ASEAN states to facilitate the AICO procedure. The auto MNCs and their associations persistently demanded that the states relax the AICO's strict regulations at various opportunities including the policy development meetings and the lobbying of local business associations.

The auto MNCs' preferences for the AICO scheme had much to do with economies of scale. They needed a certain level of production volume in order to manufacture high value-added parts efficiently. Given a small domestic market in each ASEAN country, they sought to circulate parts manufactured in one plant to other countries. In order to complete this strategy, tariff reductions and local content accreditation, which were granted under the AICO scheme, was indispensable.

Significantly, while they were eager to gain tariff reduction under the AICO scheme, they showed less or no interest in reducing duties applied to external trade. This was because they hoped to maintain the dominant status in the ASEAN market against competition from their rival companies.

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