THE EUROPEAN UNION AND THE INTEGRATION OF SOUTHEAST ASIA

Although promoting regional integration in other regions is a constant in EU external policy, the EU identified in 1995 free trade agreements with the EU as instruments for achieving this goal. It is therefore legitimate to ask whether the FTA that the EU is negotiating with ASEAN may contribute to regional integration in Southeast Asia. A future FTA will mainly offer ASEAN market access to Europe, but projections suggest that ASEAN will end up specializing in the exportation to Europe of agricultural products. This outcome contrasts with ASEAN's vision of Southeast Asia as a production base for the world economy. In the past, the region acquired this character by participating in Japanese regional production networks. Trends in Japanese FDI suggest that enhancing and deepening participation in such networks will be more likely than an ASEAN-EU FTA to contribute to realizing ASEAN's vision of the regional political economy.

Since 1957, the European Union has been committed to promoting regional integration in other world regions. As Karen Smith puts it, "the conviction that regional cooperation is beneficial for others lies at the heart of the EU's activities (Smith 2003, p. 71)". The commitment is said to be inherent in the EU's nature and derives from the EU experience (Smith 2003, p. 71). In 1995, though, a significant change was introduced in EU policy when the Commission singled out FTAs with the EU as instruments of support for regional integration among developing countries: an FTA would provide a major incentive to developing countries to lower intraregional trade barriers before entering into an FTA with the EU (European Commission COM(95) 219 final). The first such FTAs were negotiated with the ACP countries between 2000 and 2007. In 2006, the Commission announced that it would negotiate FTAs with three organizations of developing countries - ASEAN, Mercosur and the Gulf Cooperation Council (European Commission COM(2006)567final). It is therefore legitimate to ask whether FTAs with the EU may indeed contribute to regional integration among developing countries.

Any attempt to answer this question will run up against the absence of a coherent theoretical framework that goes beyond the oft-repeated assertion that the EU example influences other regions, by providing a model or by constituting a protectionist threat (Hettne 1999, p. 14). This paper aims to contribute, with the help of one example, to the initial reflection on a framework for analyzing EU support for regional integration among developing countries. A plausible starting point may be found in the European Commission's paper "Global Europe", in which the Commission explained the role of FTAs in the context of its overall conception of the region's political economy. In this vision, growth and jobs are stressed as priorities in efforts to ensure economic prosperity, social justice and sustainable development. This internal agenda dictates an external agenda of securing market access abroad for European firms (European Commission (2006)567 final, p. 2; European Commission SEC(2006) 1230, p. 1). Following this logic, we must also understand the ways in which the EU's future FTA partner envisions regional political economy and the place of an FTA with the EU in that regional political economy. If this vision is compatible with that of the EU, then we have grounds for supposing that an FTA with the EU would indeed stimulate regional integration among developing countries. On the other hand, a contradiction between the two visions would suggest the opposite conclusion.

In the case of Southeast Asia, ASEAN's vision of regional integration is not confined to the creation of a single market; ASEAN is also envisioned as a production base for the world economy. This vision is shaped by the present structure of the regional economy, which is characterized by the participation of the more advanced Southeast Asian countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand, known as "ASEAN5") in regional production networks constructed by Japanese firms in nearly 25 years. Southeast Asian states seek to maintain this structure by attracting foreign direct investment (FDI) that will enhance their ability to export high value-added goods to markets outside the region.

It is in the context of the Southeast Asia states' vision of the region's political economy that one must assess an ASEAN-EU FTA's potential contribution to regional integration in Southeast Asia. By definition, an FTA's immediate impact will be guaranteed market access to the European market, but whether it will assist ASEAN countries in realizing their vision by deepening their participation in existing networks or creating new ones is another matter. Available projections suggest that the result of an FTA will be a region comprising states that specialize in the production of agricultural products for exportation to the EU. For all the uncertainty surrounding the evolution of FDI, it appears that a convergence between trends in Japanese FDI and national policies of ASEAN members offers the best chances of fulfilling the vision of ASEAN as a production base for the world economy.

The paper will proceed as follows. The first part will summarize EU policy towards regional integration in Southeast Asia. It will examine the nature and forms of EU support for ASEAN until the initiation of FTA negotiations; it will then present the specific projections of changes in ASEAN's production structures resulting from the implementation of an FTA. ASEAN's vision of the region's political economy will be discussed in the second part. After briefly explaining the process that transformed ASEAN5 into production bases for the world economy, an attempt will be made to identify trends in Japanese FDI that seem to offer concrete opportunities for ASEAN as a production base.

I. EU SUPPORT FOR REGIONAL INTEGRATION IN SOUTHEAST ASIA

The EU rarely misses an opportunity to declare its support for regional integration in Southeast Asia. However, the emphasis on market access as a rationale for ASEAN-EU FTA negotiations in 2006 and the projected impact of an FTA on ASEAN production structures force us to raise questions regarding the contribution of an FTA to realizing ASEAN's vision.

A. EU Support for ASEAN

EU rhetorical support for regional integration in Southeast Asia has been unwavering, but in the first decade of the 21st century, its concrete assistance to ASEAN seemed to contradict two elements of EU policy.

EU support for ASEAN as a regional organization is a constant theme in the ASEAN-EU dialogue since the 1970s. The 1980 ASEAN-EC Cooperation Agreement embodied a European commitment to "take all possible measures to intensify …[EC] support…for ASEAN development and regional cooperation (Art. 4, §2). " In 2003 , the European Commission asserted that a commitment to regional integration was "the clearest manifestation of common interests and values" that the EU and ASEAN shared (European Commission (2003), 399/4, p. 11). The Commission demonstrated understanding for the specificity of the regional integration process in Southeast Asia. It defended ASEAN against European critics who were impatient about the pace and depth of regional integration in Southeast Asia, which were the "prerogative" of ASEAN. The EU's duty was "to stand ready to fully support ASEAN integration efforts with an open mind and in fields where assistance is requested (European Commission (2003) 399/4, p. 11)."

In thirty years, concrete European assistance to ASEAN has been relatively modest. The EC funded a number of regional programs, such as the ASEAN-EC Timber Technology Centre

(AETTC) and the ASEAN-EC Energy Management Training and Research Centre (AEEMTRC); granted cumulative regional treatment to ASEAN within the Generalized System of Preferences (GSP); and provided some technical assistance to the ASEAN Secretariat (Robles 2004, pp. 19-28). In 1999, as part of efforts to revive a dialogue that had stalled following disagreements over Myanmar, the EU initiated the ASEAN Project for Regional Integration Support (APRIS). Evaluations of APRIS projects are not publicly available, but the Commission's references to projects being "too ambitious", "not paced with ASEAN's own agenda", "in advance of the realities of ASEAN integration" and lacking "sufficient ownership" on the part of ASEAN hint at a lack of ASEAN interest and/or active collaboration in APRIS projects. In particular, the ASEAN Secretariat's insufficient institutional capacity forced the EU to negotiate with each ASEAN member state (European Commission n.d., p. 4).

The rationale of Phase II of APRIS, which was launched in 2005 appears to contradict the EU's attitude of respect for ASEAN's prerogative in determining the pace of regional integration. In the Commission's words, supporting the ASEAN secretariat through APRIS II would be the "overriding political priority" because the Secretariat was the "motor for regional integration". With a stronger Secretariat, ASEAN's capacity to plan and develop policies aiming at regional integration would be enhanced (European Commission n.d., p. 11). The rationale for statistical cooperation, a second element in the EU's regional strategy for ASEAN, was similar: with reliable information, the Secretariat would be able to develop and implement regional economic and trade policies (European Commission, n.d., pp. 9-10). The question seems not to have been raised whether ASEAN member states would agree to grant the Secretariat or national and regional statistical offices such powers (European Commission, n.d., pp. 12-13).

This was not the only instance when EU actions contradicted EU policy. In 2002 and 2003, Singapore, Thailand and ASEAN offered to negotiate an FTA with the EU (Goh 2004, p. 4; Chirathivat and Mallikanas, 2004, p. 44). In view of the central role attributed to FTAs in EU policy, one would have expected the EU to accede readily to the request. Instead, the Commission refused, on the grounds that consideration (not to mention negotiation) of an FTA required a successful conclusion of the WTO Doha negotiations and progress in harmonization of ASEAN and EU regulations (European Commission (2003), 399/4, p. 17). Contrary to the rhetoric demonstrating understanding of regional integration in Southeast Asia, EU trade Commissioner Pascal Lamy indirectly criticized ASEAN members for “backloading” (i.e., reserving for the FTA’s final implementation stage) the convergence and harmonization of regulations in their bilateral FTAs with Japan or the US (Lamy, 2004, p. 487). The Commission’s reasons for refusing FTA negotiations might have been more credible had it not been for the fact that, the EU negotiated regulatory harmonization and convergence together with trade liberalization, and not prior to it, with the ACP countries and with Mercosur. Regulatory convergence seems to have been required as a precondition only in the context of EU relations with Southeast Asia. The Commission’s caution was probably born of the fear that an FTA with ASEAN would only cause the EU’s trade deficit with the latter to balloon (Robles, 2008).

In place of an FTA, the Commission proposed a dialogue, called Trans-Regional EU-ASEAN Trade Initiative (TREATI), which would inform ASEAN and the EU of each other’s regulatory systems, particularly on trade facilitation, market access and investment. At this point, no ASEAN member state had ever expressed any interest in a regulatory dialogue with the EU, much less requested it. For the EU, it was therefore logical to offer to start such a dialogue when at least two ASEAN member states wished to do so; other members would be allowed to participate as observers (European Commission (2003), 399/4, p. 17). From the ASEAN point of view, the condition could well have been construed as a "divide-and-rule" tactic: acceptance by a subgroup of ASEAN members might be considered by the others as an attempt to obtain more privileged treatment at their expense.

In spite of the absence of progress in regulatory convergence, the EU reversed its position on an ASEAN-EU FTA in 2006. This change of policy seemed to neglect the implications of an FTA for regional integration in Southeast Asia, in the name of market access.

B. Market Access versus Regional Integration in Southeast Asia

The ASEAN-EU Vision Group, when recommending in May 2006 the initiation of FTA negotiations, claimed that an FTA would support ASEAN integration and urged support for it in an expanded ASEAN-EU economic cooperation programme. However, access of European goods and services to ASEAN markets seemed to be the EU's major concern in the run-up to ASEAN-EU FTA negotiations. Support for regional integration in Southeast Asia did not seem to have been a consideration at all in the EU's new policy. Yet an FTA with the EU will restructure Southeast Asia as a region by altering its production structures, to the benefit of agriculture and to a lesser extent, services, and at the expense of manufacturing.

The 2006 European Commission communication, "Global Europe", which formally announced the EU's intention of negotiating "second-generation FTAs" (European Commission 2006)567final), made no explicit reference at all to FTAs' potential role in accelerating regional integration among the EU's partners. Regional integration in Southeast Asia was mentioned only when the Commission acknowledged that ASEAN members are at different levels of development and that these differences should be taken into account in the FTA negotiations (European Commission SEC(2006) 1230, pp. 18-19). Presumably the aim would be to prevent intraregional disparities from widening. ASEAN's negotiation of FTAs with Japan and the US was undoubtedly the decisive consideration. These FTAs entailed a risk of trade diversion to the EU's disadvantage; an EU FTA with ASEAN would restore the level playing field (European Commission SEC(2006) 1230, pp. 14, 16). The Commission did not mince words, asserting that the EU's goal would be to obtain from ASEAN the same concessions that it had granted to Japan and the US (European Commission SEC(2006) 1230, p. 17).

In press releases, the Commission emphasizes that ASEAN and the EU would derive considerable economic benefits from an FTA. ASEAN exports to the EU would be boosted by 18.5%, although EU exports to ASEAN would increase even more (24.2%). If trade in services is liberalized, as the Commission desires, the biggest gains for the EU would lie in the export of business services to ASEAN (European Commission IP/07/540). This implies that ASEAN will become an importer of business services from the EU. In which sectors will ASEAN increase its exports? At present, tariffs on Southeast Asian agricultural exports to the EU are higher than tariffs on manufactured goods. Some of the Southeast Asian agricultural exports are tropical products, such as cocoa, palm oil, tobacco, coffee, that are not produced in the EU but compete with imports from the ACP and Mediterranean countries. Other agricultural products, such as sugar, compete directly with products protected by the Common Agricultural Policy (Niemi 2003, pp. 26-28). In the event that tariffs on these products were abolished or reduced them drastically, ASEAN agricultural exports to the EU should increase considerably.

No estimates of increases in ASEAN exports following an FTA appear to have been made. However, we do have estimates of variations in ASEAN production structures by 2020 that were prepared for the ASEAN-EU Vision Group (CEPII-CIREM, 2006). Assuming trade in goods is fully liberalized and barriers to trade in services are reduced by at least 50%, production will increase in the following sectors and countries : fishing (all ASEAN members except Vietnam); rice (all ASEAN members); sugar (all ASEAN members); animals and other meat (all ASEAN members except the Philippines and Vietnam); vegetable fats and oils (the Philippines, rest of ASEAN, Thailand); beverages, tobacco and dairy (all ASEAN members except Singapore and the rest of ASEAN); food products (all ASEAN members except Vietnam)(CEPII-CIREM 2006, pp. 26-27).

In this scenario, production of services would increase in most sectors in most Southeast Asian countries: transport (in all ASEAN members except Indonesia and Malaysia); recreation and other services (in all ASEAN members except Singapore); financial services (in Indonesia, rest of ASEAN, and Thailand); business services (in Malaysia and the rest of ASEAN); energy and water supply (in all ASEAN members except Singapore and Vietnam); public interest services (in Malaysia, the Philippines, rest of ASEAN); communication (in all ASEAN members except Indonesia); construction (in all ASEAN members except Singapore); air transport (Philippines, rest of A, Singapore, and Thailand)(CEPII-CIREM 2006, p. 27). Services being non-tradable, their provision requires FDI. We can thus deduce that an unspecified percentage of the growth in services production in ASEAN will be the result of EU FDI in service sectors in ASEAN countries. The amount of EU FDI was not estimated by the consultants, but another set of consultants, also commissioned by the ASEAN-EU Vision Group, admitted that substantial net positive gains from liberalization of trade in services would accrue mainly to the EU (EAC-IFRI 2006, p. 133). The ASEAN-EU Vision Group estimated that more than 50% of total EU gains from the FTA would come from liberalization in services, and that EU gains would be largest in the service sectors (ASEAN-EU Vision Group, 2006, p. 7). In an attempt to prove that ASEAN would benefit from EU FDI in services, the consultants stressed that telecommunications and transport services are necessary for the expansion of exports (EAC-IFRI 2006, p. 133). Unfortunately, they failed to explain why Europe would (or should) be the optimal source of investments of this type.

The picture is not all rosy. The first set of consultants acknowledged the other side of the coin: “almost all production of other sectors will decrease as a result of the resource reallocation” in Southeast Asia (CEPII-CIREM 2006, p. 28). Production in ASEAN is expected to decline by 2020 primarily in manufacturing sectors: apparel (Malaysia and rest of ASEAN); textile (Malaysia, rest of ASEAN, Singapore); leather (Indonesia, the Philippines and rest of ASEAN); wood products (Indonesia, Malaysia, the Philippines, Singapore, Vietnam); cars and trucks (Indonesia, Malaysia, the Philippines, Singapore, Vietnam); other transport equipment (Indonesia, Malaysia, rest of ASEAN, Singapore); paper (Indonesia, Malaysia, Singapore, Vietnam); electronic equipment (Indonesia, Malaysia, Singapore, Vietnam); machinery and equipment (Indonesia, Malaysia, rest of ASEAN, Singapore, Vietnam); other manufactures (Indonesia, Malaysia rest of ASEAN, Singapore, Vietnam) (CEPII-CIREM 2006, pp. 26-27).

The mechanisms generating these outcomes are not made explicit, but they are not hard to fathom. The abolition of tariffs will trigger an influx into Southeast Asian countries of relatively cheap manufactured goods from Europe, against which locally produced goods will be unable to compete. Neoclassical economists might contend that this outcome is consistent with each region's respective factor endowments and will yield welfare gains for consumers, who will enjoy lower prices and wider choices. The point here is that the picture emerging from the study is that of a region comprising countries that increasingly specialize in primary products and steadily withdraw from industrial production.

Should these projections not be taken with a grain of salt? Surely there is a chance that they will be proven false? Unfortunately, no others seem to have been considered when ASEAN and the EU decided to initiate FTA negotiations. While it is not clear whether ASEAN members were aware of these particular scenarios, they could not have been oblivious to objections to FTAs based on their negative consequences for industrial development. A survey carried out for the ASEAN-EU Vision Group revealed that respondents in Southeast Asia recognized the risks associated with competition from the EU. Filipinos expressed concern about competition in manufacturing. For Indonesians, Malaysians and Thais, competition would be most intense in services. Among the least developed ASEAN members, Cambodia and Vietnam feared competition in all three sectors of the economy (EAC-IFRI 2006, p. 167).

So far no attempt has been made in the scholarly literature to assess the compatibility between the projected outcomes of an ASEAN-EU FTA and ASEAN's own vision of regional integration. This will be attempted in the next section.

II. SOUTHEAST ASIA AS A PRODUCTION BASE FOR THE WORLD ECONOMY

Since the 1997 Asian financial crisis, ASEAN members recognize that regional economic integration would be at the heart of ASEAN's recovery (Freistein 2005, p. 189). By 2015 an ASEAN Economic Community (AEC) should be in place, and by 2020, an ASEAN Community, incorporating two other communities – the ASEAN Security Community and the ASEAN Socio-Cultural Community - would be in existence. Not enough stress has been placed on the content of ASEAN's vision for AEC – ASEAN as a production base for the world economy. This ambitious goal confirms the experience of ASEAN5, which provide models for the less industrialized members (Brunei, Cambodia, the Lao PDR, Myanmar, and Vietnam). ASEAN 5 achieved this goal through a synergy between Japanese FDI and national policies, rather than through regional integration. Given present difficulties encountered in implementing ASEAN policies, it is not improbable that this same synergy will play a decisive role in transforming ASEAN's vision into reality.

A. Southeast Asia's Emergence as a Production Base

The ASEAN5 became production bases for the world economy through their participation in Japanese regional production networks, and it is this structure that ASEAN's vision aims to maintain (for the ASEAN5) and to transform into reality (for the less advanced members).

ASEAN's Vision 2020, adopted in 1997, and its first operational plan, the Hanoi Plan of Action merely describe "a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities (ASEAN 1997)." It was only in 2003 that the Declaration of ASEAN Concord II introduced the idea that an AEC would establish ASEAN as "a single market and production base". The idea of ASEAN as a production base for the world economy runs through the Hanoi Plan of Action's successor, the Vientiane Action Programme, adopted in November 2004. In it, ASEAN declares its aspiration to be a "highly competitive region functioning as a single market and production base by 2020."

ASEAN's overall strategy would involve "deepening and broadening integration in product and factor markets, and acceleration of the integration process towards a single market and production base." ASEAN members undertake to put in place all essential elements or conditions "for ASEAN to function as a single market and production base (ASEAN 2004, p. 9)." A free and open investment regime is identified as the key "to enhancing ASEAN's competitiveness as a single production base (ASEAN 2004 p. 10)." In goods trade, one major goal is to integrate Southeast Asian SMEs into regional and international production networks, enabling them to act as suppliers of regional and global markets (ASEAN 2004, p. 12). Even in services, the purpose of developing high quality service industries is to allow ASEAN "to position itself as a global outsourcing hub (ASEAN 2004, p. 13)."

This vision reflects the experience of ASEAN's more industrialized members since the mid-1980s. The ASEAN5 were recipients of large amounts of Japanese FDI, triggered by Japanese firms' efforts to maintain profitability in the face of the appreciation of the yen following the 1985 Plaza Agreement. They were attractive as production bases for several reasons: low technological levels, proximity, and incentives that they granted to FDI (particularly export-oriented FDI). Nearly a third of Japanese FDI in manufacturing went to Southeast Asia, and the bulk of Japanese FDI in Southeast Asia - between 50 and 60% - was in manufacturing, particularly in consumer electronics and automobiles. Japanese FDI grew most rapidly in Thailand and Malaysia, although in absolute value Indonesia and Singapore were the most important host countries. After another revaluation of the yen in October 1993, another wave of Japanese FDI in Southeast Asia began. By the eve of the ASEAN-Japan Summit in November

2003, Japanese FDI amounted to $229.5 billion, or 21.6% of total FDI in ASEAN (Shiraishi 2003, p. B1).

Across the ASEAN countries, Japanese manufacturing firms organized hierarchical production networks that aim at regional specialization. Under a vertical integration strategy, the firms produce in Southeast Asia lower-end models of finished goods that they used to produce in Japan for export. Under the horizontal integration strategy, intermediate goods and components are produced by affiliates of a firm in different countries on the bases of factor endowment and other locational advantages and then exchanged among the affiliates (Doner 1997, p. 214). The relationship between the parent company and its affiliates or local partners is hierarchical in that the former supplies the latter with high-technology inputs but keeps control over research and development (R and D) as well as design and precision manufacturing work, which are retained in Japan. In organizing these networks, Japanese firms reproduced in Southeast Asia a particular relationship prevailing in Japan, in which the firm producing an end product exercises strict control over suppliers that are formally independent. Large Japanese manufacturing firms encouraged the small and medium firms that supply them with inputs to relocate in East Asia, with the inputs either being reexported to Japan or supplied to the manufacturing company that has relocated in Southeast Asia.

A recent survey of Japanese affiliates in Southeast Asia confirms the linkage between Japanese FDI and the development of the ASEAN countries’ production and export capacity. Nearly half (49.8%) of 625 Japanese affiliates in Southeast Asia have an export ratio rate of 70% or higher in 2007, a substantial increase from the 2006 figure of 49.5%. The ratios are high in Japanese affiliates based in the Philippines (71.4%), Singapore (63.3%) and Vietnam (51.9%), which were intended as export bases from the very start of operations, because of their small markets. In Vietnam and the Philippines one in three firms exported 100% of their output. The percentage of firms with export ratios of 70% or higher is high in the apparel and textiles (83.3% of firms) and rubber products industries (85.7% of firms), followed by automobile and automobile parts (40.7%), electric and electronic parts and components (38.5%) and precision machinery and equipment (38.3%)(JETRO, 2008 pp. 16-18).

The paradox is that Southeast Asia acquired its character as a production base in spite of the failure of ASEAN's regional integration schemes in the first 25 years of its existence (1967-1992 (see e.g., Suriyamongkol 1988; Langhammer 1991; Plummer 1997; Hill 1997; Chia 1998). The projects of this time were inward-looking – they sought to increase industrial and trade linkages among ASEAN members – and they bore little fruit. Of the five ASEAN Industrial Projects in heavy industry, adopted in 1976, only two– the urea projects in Indonesia and Malaysia - were implemented . AICO (ASEAN Industrial Complementation) projects, intended to encourage the private sector to introduce complementarities in production, were finalized only in the automobile industry, and only three ASEAN Industrial Joint Ventures (AIJV) reached the operational stage (Legewie 2000, pp. 210-18). PTAs (Preferential Trading Arrangements) introduced in 1977 were unable to raise intra-regional trade beyond 20%.

Participation in Japanese regional production networks may appear to be less of an achievement if it is true that they are "exclusionary" (Yamamura and Hatch 1997, pp. 4-5; see also Hatch and Yamamura 1996). Japanese firms are said to be much less likely than US firms to employ local managers and local personnel in senior technical roles or to have nationals of the host country on their boards; to depend heavily on capital goods and components imported from

Japan; and to be less likely than US firms to conduct R and D in ASEAN (Ernst and Ravenhill 1999, pp. 40-44). Yet Southeast Asian countries progressed beyond final assembly of imported components. Significant production deepening took place, involving production of parts and components. For example in Malaysia, Matsushita established a complex of assembly, component and tooling subsidiaries in order to produce air conditioners and color television sets. Furthermore, the Southeast Asian countries were able to attract multinational corporations from countries other than Japan, and a number of foreign firms transferred to their Southeast Asian subsidiaries an increasing share of engineering, design and even R and D close to manufacturing operations (Felker 2003, pp. 262-63).

The ASEAN5 are acutely aware that past success no guarantee for the future, in view of competition from China. If ASEAN is to remain as a production base, the region must upgrade its production structures and for this purpose, continue to attract FDI. A comparative study of industrial policy in Indonesia, Malaysia, the Philippines and Thailand reveals that at the time of the adoption of the AEC project in 2003, they shared the goal of increasing production and exportation of high value-added goods by introducing advanced technology, stimulating research and development, upgrading human resources and not least, attracting FDI.

Industrial upgrading is most urgent in Indonesia, where industrial output fell during the financial crisis and industrial exports started to decline in 2000. The move of Sony to Malaysia in 2002 was a warning that deindustrialization was starting (Bird and Hill 2006, pp. 338, 339, 342, 344, 346, 355). In the Philippines, production in the electronics industry must move up the value chain. At present, production is concentrated in the labor-intensive stages of semiconductor production transferred to the country by Japanese, US and European firms, and the competitiveness of the electronics industry, which furnishes the bulk of the country's exports, is being eroded by production costs that are three times higher than costs in China (Tecson 2006, pp. 232, 244, 246).

Even Malaysia and Thailand, the two most successful exporters of manufactured goods (other than Singapore) face formidable challenges. In Malaysia, industrialization in the 1980s and 1990s relied on "low technology". Hence, the government recognizes the need to foster technology and knowledge-based activities that would permit integration of all components of the value-added chain in Malaysia. To this end, it provides direct state support to transfer of technology and investment in indigenous R and D (Tham and Ragayah 2006, p. 191-93, 211, 221). Like the other countries, Thailand remains a low-cost assembly and export base for multinational corporations, with little value being added in the country. During the period of rapid growth, firms' and workers' technological capabilities did not substantially increase. Thus, Thailand finds itself in the paradoxical position of being the second largest hard disk drive producer in the world without an R and D center for hard disk drives. In order to prevent foreign firms from transferring their operations to China and Vietnam, and to increase production of higher quality and more value-added products, Thailand must support R and D in manufacturing and upgrade human resources (Krongkaew and Krongkaew 2006, pp. 260, 268, 282).

Deepening and enhancing regional integration may be considered one of the major strategies for successfully completing ASEAN's "high-tech drive" (Chu and Hill 2006). Liberalization of intraregional trade, by allowing for the exchange of parts and components among firms located in different member states, would attract FDI and make possible the relocation of more technology-intensive phases of production to Southeast Asia. Otherwise, global production chains would be increasingly concentrated in China. Competition from Chinese exports is already said to be responsible for the slower pace of growth in Malaysia's electronics industry and without regional integration, this trend might accelerate (Cook 2008, p. 36). Indeed, as 2015 approaches, pessimism is growing about ASEAN's ability to establish AEC (Ravenhill 2008). Intraregional trade in parts and components and the development of regional production networks are said to be undermined by ASEAN members' failure to implement tariff cuts; the maintenance of tariff peaks; the small differences between WTO tariff rates and ASEAN rates; and the prevalence of non tariff measures (NTMs)(Findlay, Parsons and Plunkett 2007, pp. 120-21, 126, Cuyvers, de Lombaerde and Verherstrateten 2005, p. 6; De Dios 2007, pp. 90-91, 102).

If the AEC project failed, it would certainly not be the first ASEAN project to fall by the wayside. It is thus unlikely that failure would cause ASEAN members to abandon their vision of Southeast Asia as a production base for the world economy. After all, slow progress in regional integration did not prevent ASEAN5 from participating in Japanese regional production networks. It was policies and strategies implemented by individual Southeast Asian countries that created an environment attractive to FDI, and acted in synergy with Japanese FDI. The question now is whether action by individual ASEAN members can be expected to produce a similar synergy.

Assessing the chances that Southeast Asia can continue to participate in Japanese production networks will therefore require an understanding, no matter how tentative, of the directions in which these networks may evolve.

B. Southeast Asia and the Future of Japanese Regional Production Networks

In the medium- to long-term Japanese regional production networks must search for new markets and reorganize production. The best chance for ASEAN to deepen their participation in these networks and to maintain the region's structure as a production base appears to lie in the conclusion of strategic alliances with Japanese firms.

According to the Japan External Trade Organization (JETRO), which defines itself as "a government-related organization that works to promote mutual trade and investment between Japan and the rest of the world," (JETRO n.d.), during Japan's decade-long recession, it became clear to the Japanese government and to many firms that recovery demanded expansion of exports through FDI and productivity increases through innovation. With a declining birth rate and an ageing population domestic demand could not be relied on to revive the economy. (JETRO 2002, p. 27; JETRO 2004, p. 24; JETRO 2007, p. 55, 164). Japanese firms will have to simultaneously develop new or higher value-added goods and find new markets. Particular attention will most likely be paid to the BRIC (Brazil, Russia, India and China), which offer significant potential because of their population size (JETRO 2005, p. 29; JETRO 2007, pp. 170, 178).

If they are to succeed, Japanese firms must reorganize production. JETRO argues that Japanese firms must pursue a combination of integral and modular approaches to production. Integral type production requires fine adjustments among components and is typical in the automobile, drugs, medicines, cosmetics, plastics and chemical industries. On the other hand, in the modular approach dominant in communications equipment and electronic components and devices, pre-designed components are brought together in finished products. Japanese firms' failure to adopt this approach has resulted in loss of market share to firms from China and

Taiwan which do not even possess the fundamental technology. In the future, Japanese firms must produce for developed-country markets using the integral approach; in production for developing countries, they must resort to modular approaches, which will in turn require outsourcing and the conclusion of strategic alliances with Asian firms (JETRO 2003, p. 21; JETRO 2007, pp. 169-70, 177-79, 180,184-86, 227).

Would Southeast Asian firms be attractive as partners in strategic alliances? China appears to be an obvious priory in forming such alliances (JETRO 2006, p. 28). Since 2000, Japanese FDI in China exceeds that which goes to Southeast Asia (JETRO 2004, p. 16). In 2002, Japanese firms placed China ahead of ASEAN as an investment site for low-cost production (JETRO 2002, p. 20). Unsurprisingly, Japanese affiliates in ASEAN identify China as the main source of competition particularly in iron and steel, non-ferrous metals, metal products, general machinery, electric and electronic parts and components, and automobile and motorcycle parts industries (JETRO 2008, p. 44). Furthermore, more than two thirds (71.4%) of Japanese firms in Southeast Asia reported that costs are higher in Southeast Asia than in China. It is only in Indonesia and the Philippines where more firms report lower costs than in China (JETRO, 2008, p. 32). As may be expected, the main source of competitiveness of Chinese firms is price. Consequently, in industries where Japanese firms have parallel networks in China and Southeast Asia, such as the electronics industry, pressure is increasing on Japanese firms to rationalize and consolidate the two networks in favor of China (Ernst 2006, p. 174).

Without denying the advantages of China, there may still be opportunities for deepening ASEAN firms’ participation in Japanese regional production networks. Japanese firms’ assessments of China as a production base are not wholly positive and may evolve over time.

Although China appeared to be more promising than Southeast Asia in 2001, China also presented the most problems among possible investment sites. Japanese firms cited restrictions on FDI, unpredictability and lack of transparency in implementation of legislation, the existence of performance requirements, discrimination against foreign companies, and restrictions on capital remittances. Interestingly, Thailand and Malaysia were ranked higher in the areas of economic and political stability, the investment law, the tax system, and infrastructure. As a result, firms that were planning to invest in China also intended to do so in ASEAN. JETRO concluded that Japanese firms wished to maintain their presence in ASEAN in part to avoid putting all their East Asian operations in one country (JETRO 2002, pp. 20-21). Subsequent JETRO surveys confirm the existence of a “China + 1” strategy, which seeks to avoid concentrating investment in China by distributing investment over China and one other country (JETRO 2007, p. 111).

Other conditions may be changing in favor of some ASEAN countries. By 2005, wages in China had increased above those in the Philippines and Indonesia, not to mention Vietnam. Rising wages were the main reason for a surprising development – the relocation of 49 Japanese firms from China to Southeast Asia between 2003 and 2007 (JETRO 2008, pp. 61-63). In the medium- and long-term (five to 10 years), Vietnam and Thailand were identified by Japanese affiliates in Southeast Asia as optimal production bases; China came in only third. For several industries (automobile and motorcycle, automobile and motorcycle, metal products and chemicals), Thailand was the most promising location. For the electric machinery and electronic equipment industry and the electric and electronic parts and components industry, the two most promising production bases are Malaysia (particularly in audiovisual equipment) and Vietnam.

No Japanese affiliate in Southeast Asia planned in the short-term to downsize or move to a third country. On the contrary, nearly 60% of firms in manufacturing reported that they were planning to expand their operations (JETRO 2008, pp. 55-56, 63-67).

Japanese firms' strategies to counter Chinese competition appear to dovetail with individual Southeast Asian countries' industrial policies discussed earlier. Rather than competing on the basis of price, Japanese affiliates in most industries (apparel and textile, paper and pulp, textiles, lumber and wood, petroleum products, nonferrous metals, pharmaceuticals, metal goods, and electric and electronic parts and components industries) plan to increase the value added to their products. In order to do so, many firms will strengthen their R and D capabilities, especially in the two most advanced states, Malaysia and Singapore, (JETRO 2008, p. 48).

There is certainly no room for complacency on the part of ASEAN member countries. Japanese firms continue to complain about underdeveloped infrastructure (electric power, transportation and telecommunication), notably in the Philippines, Vietnam and Indonesia; restrictions on foreign investment, such as restrictions on permitted ratios of foreign capital in an enterprise; and complicated and time-consuming customs procedures (JETRO, 2008, pp. 40-42). But is regional integration the only (or the best) way of approaching these problems? Perhaps the web of Economic Partnership Agreements (EPA) that Japan has already signed with ASEAN5 and others that it is negotiating (e.g., with Vietnam) will enable Japanese firms to obtain satisfaction on their major demands. All the agreements contain provisions that address Japanese firms' complaints on such matters as customs procedures and provide for national treatment and most-favored nation treatment for Japanese investors. The latter would do away with restrictions on FDI from Japan. It is conceivable that even without AEC, Japan's EPAs with individual ASEAN countries will generate a synergy between Japanese FDI and the policies of individual Southeast Asian countries, thus contributing to the vision of Southeast Asia as a production base for the world economy.

CONCLUSION

EU support for regional integration among developing countries is an article of faith of EU foreign policy. It is so deeply ingrained that even EU negotiation of FTAs with developing countries has at least in part been justified as a means of supporting regional integration among them. Yet scholarly analyses fail to take into account the possibility that the EU's vision of regional integration is incompatible with that of its future FTA partners. Examination of EU policy towards integration in Southeast Asia is instructive precisely because it reveals such an incompatibility. The EU offers market access, one of whose side-effects is anticipated to be a decline in industrial production in Southeast Asia. The prospect of decline contradicts ASEAN's vision of the region as a production base for the world economy, which is more likely to become a reality through their continued participation in Japanese regional production networks.

The ASEAN-EU case is only one possible case among many. It would be desirable to carry out a comparison of the EU vision with that of its present or future FTA partners. Moreover, in order to develop a framework for analyzing EU support for regional integration among developing countries, research must research the extent to which contradictions between visions account for the progress (or lack of it) in FTA negotiations. If and when an FTA is concluded, it must be analyzed in terms of the compromises between two competing visions. Where FTAs have been implemented for a sufficiently long period, their impact on regional integration among the EU's FTA partners must be assessed. The results of research might well convince the EU to refrain from claiming that FTAs with the EU are instruments of support for regional integration among developing countries.

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