ASEAN IN THE NEW ASIA

ISSUES & TRENDS

EDITED BY

CHIA SIOW YUE | MARCELLO PACINI

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ISSUES & TRENDS

The **Giovanni Agnelli Foundation** is an independent cultural and research institution in the field of human and social sciences. The principles underlying all the Foundation's research programmes and its other activities are: the orientation to the future, focus on policy orientation, the complementary approach to socio-economic variables and cultural and value systems. This approach is applied in these years mainly in two general research areas. The first is *The New Geo-economy*: it focuses on globalization and the changing conditions of the worldwide economic competition and the international division of labour. The second is *Cultural Universes and Modernity*: it studies the new role played by the historical cultural traditions in the transition towards modernity within the different cultural areas of the world. Special attention is paid to the dialogue between cultures. The *Senator Giovanni Agnelli Prize for Dialogue between Cultural Universes*, managed by the Foundation, refers strongly to this programme. In this framework, the promotion of the knowledge on Asia has become an autonomous programme of the Giovanni Agnelli Foundation.

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PREFACE

This volume comprises the revised and edited papers first presented in late February 1996 at a conference in Turin, Italy. The conference was a collaborative effort by the Giovanni Agnelli Foundation of Italy and the Institute of Southeast Asian Studies (ISEAS) in Singapore. The idea of the conference came from the Giovanni Agnelli Foundation which saw the need to promote a better understanding of Southeast Asia among the academic, business, and media élite of Italy on the eve of the first meeting of government leaders of Asia and Europe (ASEM) in Bangkok in March 1996. The Giovanni Agnelli Foundation also bore the costs of the conference and of the production of *ASEAN in the New Asia*. ISEAS was responsible for getting scholars from Southeast Asia and for editing and publishing this volume.

Since economic matters feature prominently in Southeast Asia–Europe relations, the focus of the conference was more economic. However, the relationship between the two regions goes beyond economics, and, further, any attempt to understand Southeast Asia must take into account the changes in the security environment. So issues of politics and security were not ignored. This is evident from the Table of Contents to this volume.

We take this opportunity to thank the authors of the articles in this volume for their contributions.

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June 1997

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ASEAN IN A NEW ASIA
Challenges and Opportunities

Tan Kong Yam

I Introduction

After World War II ended in 1945, the General Agreement on Tariffs and Trade (GATT) was established to create an open and free trading system. Together with the system of fixed currency exchange established under the International Monetary Fund (IMF) agreement at Bretton Woods, a stable global trading and monetary system was instituted. These two key post-war institutions, sustained by the hegemonic power of the United States — based on its technological, economic, and military superiority — ushered in an unprecedented period of steady expansion in world output and trade as well as closer economic interdependence in the non-communist free world. World trade in volume terms expanded at an average annual rate of 5.6 per cent between 1953 and 1963 and 8.5 per cent between 1963 and 1973, much higher than the average rate of 3.5 per cent between 1873 and 1913 and the 0.9 per cent in the inter-war period of 1919–39.

This unprecedented expansion in world output and trade in the post-war era provided the Asia-Pacific economies like Japan and the four East Asian newly industrializing economies (NIEs) — South Korea, Taiwan, Hong Kong, and Singapore — with a conducive and stable environment for export-led growth. They were lucky to set sail on the tack of industrial catching-up when the gust of wind was strongest. Consequently, from the mid-1960s to the early 1990s the four NIEs were the most dynamic middle-income economies in the world. Their annual growth rates in gross national product (GNP) per capita between 1965 and 1990 have averaged 6 to 8 per cent, almost triple the average rate of 2.3 per cent for middle-income economies of the world and double the 3.6 per cent average for countries in the Association of Southeast Asian Nations (ASEAN), excluding Singapore.

The pattern of industrialization and exports of the NIEs has been rather similar. After a short period of protectionistic import-substitution policy in the 1950s and early 1960s, they soon turned to an export-oriented strategy for growth. During the early stage of the outward-oriented development strategy in the 1960s, the emphasis was on the production and export of traditional labour-intensive products such as textiles, clothing, footwear, toys, leather goods, and other light manufactured goods. Technology for these products was standard and the main competitive factor in the world market was low labour cost relative to labour productivity. Their major markets were the Organization for Economic Co-operation and Development (OECD) countries, particularly the United States which had a major strategic interest in nurturing these market economies through generous foreign aid, capital inflow, technology transfer, market access, and special tariff preferences against the ideological challenge of the socialist countries of East Asia like China, North Korea, and North Vietnam. Consequently, the manufacturing exports of the four NIEs were able to grow between 20 per cent and 50 per cent per year for the period 1965–73 and even after the first and second oil shock, at an annual rate of 13–21 per cent between 1973 and 1985. Gradually, with rising income and savings, together with a higher educational level and better infrastructural facilities, the NIEs, like Japan before them, were able to invest in and upgrade to more capital-, skill-, and technology-intensive industries like steel, shipbuilding, chemicals, machinery, electrical machinery, telecommunications, and office automation equipment.

Thus, with the benefits of being late comers in the process of industrialization and taking full advantage of the conducive world trading system as well as the ideological imperatives of the free world, the NIEs have been able to telescope an industrialization process that took the OECD countries 100 to 150 years to complete in the nineteenth and early twentieth centuries within 25 to 30 years in the post-war era. However, unlike Japan, they have industrialized with a greater degree of dependence on direct foreign investment, particularly for Singapore. Throughout the 1980s, exports of foreign firms accounted for about 80 per cent of total exports for Singapore, 25 per cent for South Korea, 15 per cent for Taiwan, and 20 per cent for Hong Kong.

By the beginning of the 1980s the success of the NIEs had begun to have a significant demonstration effect on policy makers in ASEAN and China. They had increasingly looked upon a liberal trading regime as well as the inflow of direct foreign investment as a quick way to jump-start the process of industrialization.

II Competitive Unilateral Liberalization in East Asia

1. ASEAN Countries

Until the early 1980s many ASEAN countries, particularly Indonesia, Malaysia, and Thailand, clung on to the import-substituting industrialization strategy and remained restrictive in their trade and foreign investment policies. Protection of domestic industries under this strategy made possible the proliferation of inefficient public enterprises. The role of market forces and the potential role of direct foreign investment in fostering dynamic economic growth and development were substantially circumscribed.

The substantial decline in oil and commodity prices between 1982 and 1986 resulted in a significant deterioration in the terms of trade for the ASEAN countries. Prices (in current U.S. dollars) of non-fuel primary products like rubber, tin, and palm oil fell by 25–60 per cent between 1981 and 1986. In addition, petroleum prices fell steadily from about US$39.0/barrel in 1981 to reach a low of US$14.8/barrel in 1986. This resulted in the Malaysian terms-of-trade index falling by about 24 per cent between 1980 and 1986. These external shocks were severe for the commodity-based ASEAN economies. The World Bank estimated that due to external disturbances over the period 1983–88, Indonesia suffered an income loss equivalent of some 9 per cent of its annual gross domestic product (GDP). The financial and budget burdens of the inefficient state-owned enterprises, which were masked during the commodity boom period in the 1970s, were starkly revealed. This dramatic decline in the terms of trade and consequent pressure on the budget gave the impetus to the political will for liberalization and drive against vested interests and inefficiencies.

These economic and financial liberalization policies in ASEAN from the mid-1980s were aimed at directing the economies towards a system of regulation based on the competitive markets of the private sector. The basic paradigm was the pre-eminence of competition, whether domestic or international. The key areas of liberalization were international trade in goods and services, including tariff, quota, and licensing structure; internal and external capital movement, including abandonment of financial repression, deregulation of interest rates, and easing of restrictions on foreign banks and other financial institutions; privatization of state-owned enterprises; competitive goods and factors markets, including suppression of domestic rent seekers and elimination of subsidies; and significant revision and liberalization of foreign investment regulations, particularly on equity rules for foreign investment, business fields open to foreign investors, and local content regulations.[1]

More significantly the mid-1980s, when these ASEAN countries began to learn and absorb the lessons of the NIEs' success through the outward-oriented development strategy and were keen to liberalize and deregulate their economies to welcome the inflow of foreign capital and technology, coincided with the outflow of direct foreign investments from the NIEs and Japan. These capital outflows from Northeast Asia, under the pressure of U.S. and European Community (EC) protectionism, rising domestic wages and other business costs as well as the strengthening of currencies, were searching for cheaper offshore production bases to sustain their international export competitiveness and profitability. They found them in the ASEAN countries. In particular the significant appreciation of the Japanese yen, Taiwan dollar, Korean won, and Singapore dollar against the depreciating Indonesian rupiah, Malaysian ringgit, Thai baht, and Chinese yuan between 1986 and 1990 have acted as the key push and pull factors in attracting direct foreign investments from Japan and the NIEs into ASEAN and China since 1986 (see Figure 1.1).

Consequently, since the mid-1980s, the outflows of foreign direct investment from Japan and the NIEs to ASEAN have been very rapid. Between 1986 and 1990, direct foreign investment in Malaysia rose by twelve times to US$6.2 billion, by twenty-four times in Thailand to US$14.1 billion, and by eleven times in Indonesia to US$8.8 billion (see Table 1.1). By 1990, the major foreign investors in the ASEAN countries like Malaysia, Indonesia, and Thailand were Taiwan, Japan, South Korea, Hong Kong, and Singapore, displacing the United States and Europe. While noting the usual caveats on comparability of data from different country sources, Table 1.2 shows that Hong Kong was the largest investor in Thailand, accounting for 50.7 per cent of the world total, followed by

FIGURE 1.1
Indices of Selected Currencies against the US$
(1985 = 100)

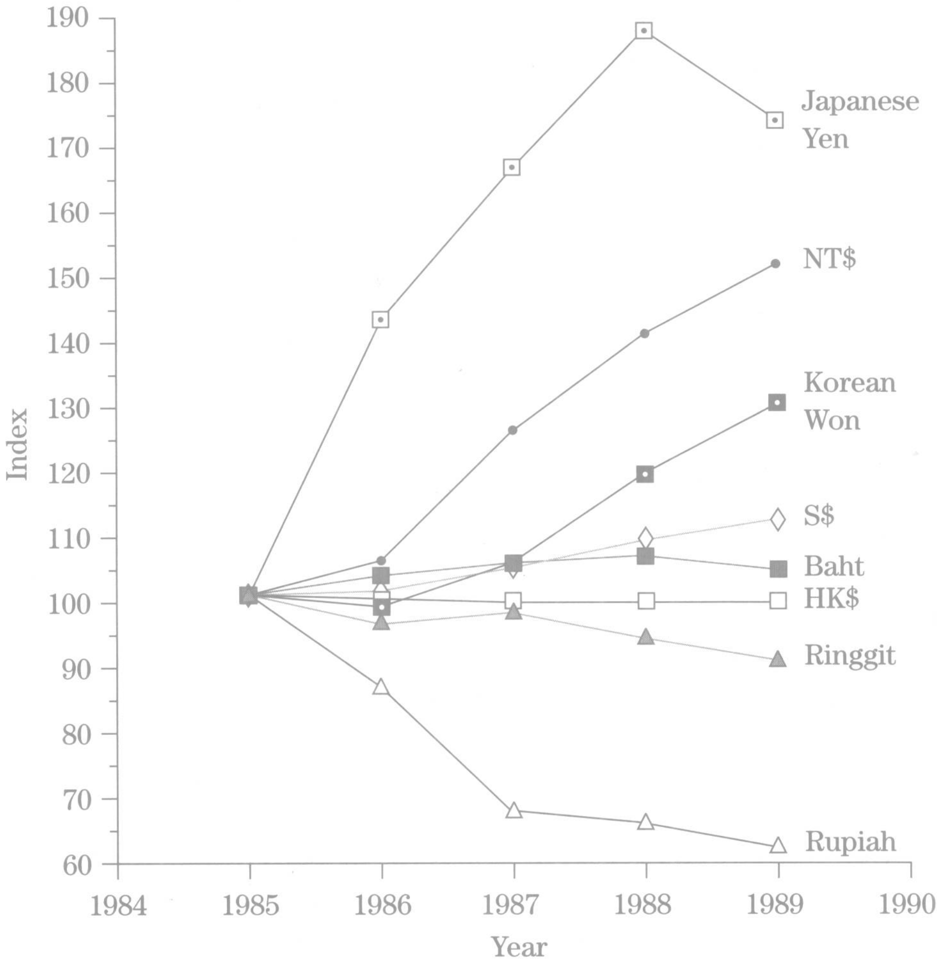

TABLE 1.1
Foreign Direct Investment in Manufacturing in Selected Asian Countries
(US$ million)

	Malaysia	Thailand	Indonesia	China
1986	525	579	800	3,330
1987	750	1,949	1,240	4,319
1988	2,011	6,249	4,409	6,191
1989	3,401	7,995	4,719	6,294
1990	6,228	14,128	8,750	6,986
1991	5,554	4,988	8,778	12,422
1992	7,036	10,792	10,180	58,736
1993	2,297	4,294	8,100	110,000
1994	4,277	5,950	23,724	81,406
1995	3,660	16,436	39,915	90,288

Sources: Malaysian Industrial Development Authority; Board of Investment, Thailand; Capital Investment Co-ordinating Board (BKPM), Indonesia; and Statistical Yearbook of China.

TABLE 1.2
Percentage Distribution of Investments in ASEAN, 1990

Source	Thailand	Malaysia	Indonesia
Asia	81.4	85.1	57.0
Japan	19.2	23.9	25.6
NIEs	62.2	47.2	29.8
Hong Kong	(50.7)	(2.1)	(11.4)
South Korea	(1.9)	(3.7)	(8.3)
Singapore	(4.2)	(5.1)	(3.0)
Taiwan	(5.4)	(36.3)	(7.1)
Europe	10.3	8.3	12.2
United States	7.7	3.2	1.8
World total (%)	100.0	100.0	100.0
World total (US$ million)	14,128	6,228	8,750

Sources: Board of Investment, Thailand; Capital Investment Co-ordinating Board (BKPM), Indonesia; and Malaysian Industrial Development Authority.