# UNIT 23 PATTERNS OF ECONOMIC DEVELOPMENT IN SOUTHEAST ASIA

## Structure



## 23.0 OBJECTIVES

Asia-Pacific is economically the most dynamic region in the world. Southeast Asia forms an important part of it. Broad objective in this unit is to familiarise you with the

- structure of Southeast Asian economies,
- issues in economic development,
- pattern it has followed since the region became independent from colonial rule,
- past and present trends in economic policies.

Since there is vast diversity in economic resources, you will study as to how these resources are utilised in the economic development of the countries with differing ideologies. So that in the end, you should be able to know the imperatives behind the region's dynamism today.

## 23.1 INTRODUCTION

### 23.1.1 Region Defined

Southeast Asia consists of nine countries which are Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam, Laos, Cambodia and Burma. With the exception of Thailand, all these countries were colonies of western powers, and all achieved their independence during the 50s. Except in the case of Singapore, the economies of these countries depended heavily on primary industries, particularly a few agricultural and mineral products mostly for export to developed countries. All these countries other than Indonesia have small populations.

## 23.2 STRUCTURE AND CHARACTERISTICS OF ECONOMIES

### 23.2.1 Diversity in Economic Resources

The economies of Southeast Asia are very diverse in their resource endowment patterns. On the one hand, there are labour-surplus countries (Indonesia, the Philippines), in which large population cause continuing pressure on the limited land supply. On the other hand, there are natural resource-abundant countries, which are blessed either with a favourable population-land ratio (Thailand) or a diversified natural resource base (Malaysia). It is a major raw material producer for the advanced countries. Malaysia and Indonesia for rubber ; the Philippines for coconut, abaca, and banannas; Thailand and Burma for rice; Malaysia and Thailand for tin. Since many of these products are produced in surplus, and are consequently exported, the contribution of Southeast Asia to world exports of these commodities is quite high. For example, in the case of coconut products one country alone, the Philippines, accounted for 55-60 per cent of world coconut products exports.

In Laos, agriculture dominates, with 80 per cent of the population living off land. Gross Domestic Product (GDP) has had a fluctuating annual growth rate but is presently around 5 to 6 per cent. Agriculture and forestry's share of GDP is more than 55 per cent and industry's 16 per cent. Aid is starting to pour into Laos now. Since 1981, at least 70 per cent of government investment has been in mining, forestry exploitation, electrical generation and wood processing. This is increasing as the government seeks to develop a basis for export-led growth. Mining is the fourth largest contributor to the economy in terms of foreign exchange earnings. At Us $ 1.5 million, this would be inconsequential anywhere but Laos.

Laos has traditionally produced only four commodities: gypsum for cement production, gemstones such as sapphires, tin and anthracite coal.

There are known occurrences of bauxite (aluminium), antimony, cadmium, chromium, cobalt, copper, gold, iron, lead, manganese, nickel, rare earths, silver, tungsten, zinc, barium, phosphate, potash, natural gas and oil.

### 23.2.2 Economic Ideologies

In most of the Southeast Asian countries, a choice has been made in favour of predominantly market-oriented organization (Malaysia, Indonesia, Philippines, Singapore, and Thailand) though their systems tolerate varying degrees of government interference and control. By contrast, there are a few countries (Burma, Cambodia, Laos, Vietnam) where the organizational choice is still unresolved. There is a conflict of choice between a market system and socialism or communism.

### 23.2.3 Structural Dualism

However, it is the diversity of economic characteristics among Southeast Asian countries which must be recognized. From this viewpoint, Singapore is obviously unique. All other Southeast Asian countries inherited from colonialism structural dualism, reflected in the coexistence of a large traditional agricultural sector and a smaller enclave which is dedicated to foreign trade, commercial activities, and manufacturing. The economy of Singapore is small in size but it has a central trade location in Southeast Asia. However, the most significant distinction is the absence of dualism. Having inherited from colonialism a one-sector commercial economy, Singapore has not confronted the massive task of modernization of a large, backward traditional agricultural sector—an issue which still dominates the development process in other Southeast Asian countries.

## 23.3 POST- WAR II ECONOMIC DEVELOPMENT: AN ANALYSIS

The post-war generation (1945-70) was marked by a unique type of economic experience in less-developed countries. Southeast Asia has shared with other developing areas an initial period of transition from colonialism towards modern growth. This period of dramatic economic (and political) change was launched by widespread decolonization after 1945, accompanied by an almost universal resurgence of nationalism which sought to terminate the colonial economic heritage while pressing for rapid modernization of underdeveloped economies.

### 23.3.1 Two Dimensions of Transition Growth

The economic content of transition growth contains two major dimensions : transformation of the economy's resource base and its mode of economic organization.

Transformation of the resource base is fundamentally a matter of shifting from colonial dependence upon primary product exports based on the use of land resources to an economy in which indigenous entrepreneurship, capital and labour skills became the major growth promotion forces. Development of these non-land factors of production requires both industrialization and modernization of the resource base involved. The entire economy and growth is not confined to an export-oriented enclave as under colonialism.

During the first generation of transition growth (1945-70), Southeast Asian countries have shown uneven progress in accomplishing the basic task of shifting from a land-based to a capital and labour-based economy. In general, a relatively modest pace of transformation has been pursued in the natural resource-abundant countries (for example Malaysia and Thailand) precisely because continuation of the colonial precedent of reliance upon land-based exports offers a feasible beginning for transition growth in the short run. Modest gains in per capita income are possible by continuing to promote traditional primary product exports because of natural resource abundance. This alternative is not available to labour-surplus countries where population pressure on land resource exists. The optimum course for these countries is a rapid shift to a labour-based economy, a course which has been aggressively pursued (with varying degrees of success) in Indonesia and the Philippines.

In the Philippines, an important substitution strategy was adopted to initiate the transformation of the inherited colonial economy. The objective of this strategy was to shift from a land-based primary product export economy through rapid development of domestic manufacturing industries. The basic mechanism was to divert foreign exchange earnings produced by traditional primary product exports (for example sugar, coconut, abaca) from import of manufactured consumer goods (for example textiles) to import of producer goods (for example machinery to produce textiles). These producer goods imports are employed to create domestic productive capacity for producing manufactured consumer goods to replace imports of these goods.

These differences are accompanied by variations in the second dimension, the mode of economic organization. Variations in organization are most sharply reflected in the foreign trade. The colonial heritage left a high degree of involvement with foreign markets. Thus, a major aspect of transition organization is the extent of government interference in foreign trade and capital movements. The labour-surplus countries (Indonesia, the Philippines) have exhibited relatively aggressive government intervention in the economy to foster rapid structural change. Intervention has focussed upon foreign trade controls such as restrictive tariffs, exchange control, and prohibition of capital outflow.

In contrast, the natural-resource-abundant countries (Thailand and Malaysia) have maintained a relatively free market system (free foreign exchange market, low tariffs, and tolerance of capital outflow). The free market system is conducive to an externally oriented economy which continues to emphasize primary product exports.

### 23.3.2 Foreign Trade

Turning to foreign trade, it might be useful as a reference point to compare the pre-war and post-war positions. In 1938, Southeast Asia accounted for 3 per cent of world trade, selling 3.7 per cent of world exports and taking 2.3 per cent of world imports. Soon after the end of the second world war, Southeast Asia's share of world trade was 4.5 per cent, ASEAN's was 3.9 per cent. Southeast Asia's and ASEAN's shares in the world trade declined steadily till 1969. In 1970 the share rose somewhat to 2.5 per cent and 2.4 per cent for Southeast Asia and ASEAN respectively. ASEAN trade has declined in relative importance compared with the early post-war years. But comparing 1969-70 with 1938, it appears that the ASEAN countries have managed to remain as significant to world trade as at a previous time.

Like many developing countries in Asia and elsewhere with similar economic characteristics, most of these Southeast Asian countries have found that during a major part of the period since World War II their economies have either stagnated or grown too slowly. This resulted partly from the fact that their exports of primary products were increasingly hampered by tariff and non-tariff barriers and the worsening of terms of trade. At the same time, their trade with each other and with other developing countries has been adversely affected by such policies as import substitution and self-sufficiency.

A noteworthy feature of Southeast Asian trade and economic co-operation has been that in the production of output, there is more competitiveness than complementarity. A wind of economic nationalism swept across Southeast Asia at the time of independence which became an important factor in their international economic relations. Here two types of economic relations are emphasized—one, the relations amongst Southeast Asian countries, and two, the relations between southeast Asian countries and the rest of the world, in particular, Japan. Though economic nationalism was meant to counter the latter types of relations by the former, it nevertheless, could not do so. And the two types of relations grew simultaneously and independently. In other words, intra-region trade and economic relations flourished alongside extra region trade.

Japan occupies an important role in the context of Southeast Asian development. Japan had militarily occupied the region during World War II. Today there is dominance of Japanese products in the Southeast Asian markets, although there is widespread presence of American MNCs in the region.

### 23.3.3 Foreign Investment

In the past, DFI (Direct Foreign Investment) has caused some controversy in several countries. This was clearly shown in Indonesia and Thailand during the anti-Japanese riots coinciding with the 1974 visit of Japanese Prime Minister Tanaka. These riots had many causes but one of them was undoubtedly a reaction against perceived Japanese dominance partially resulting from the rapid increase of Japanese DFI in the region. At that time, the international mood was one of distrust toward multinationals and their motives for investing in developing economies. Policy-makers stressed the need to maintain national control and to regulate foreign investors closely so as to avoid undesirable side effects such as increased market concentration, excessive repatriation of profits, transfer pricing, inappropriate technology transfer as well as undesirable dependence on imports of foreign technology, capital goods and intermediate inputs.

Starting in the late 1970s and continuing through the mid-1980s, policies toward DFI have undergone a marked change. A major cause of this shift in attitudes was the debt crisis of the early 1980s. Owing to availability of loanable funds and negative real interest rates, foreign borrowing was very inviting for developing economies from the late 1970s through the second oil crisis. However, the unprecedented rise in debt which ensued, caused the banks to reassess lending policies, in many cases reducing the availability of capital to developing economies. Although this was a limited problem in Asia (only the Philippines has been subject to really strong pressure from the international banking community), the rising debt caused policy-makers in Indonesia, Malaysia, and the Philippines to adopt austerity measures aimed at slowing the growth of debt. Consequently, development plans were curtailed, imports were restricted, and borrowing fell during the mid-1980s.

**Check Your Progress 1**

1) Which countries of the region have generally accepted a market-oriented system?

2) What is 'transformation of resource base'?

3) Name the labour-surplus countries of this region?

4) Name the natural resource abundant countries of Southeast Asia.

5) Which country has made massive direct foreign investment (DFI) in the region?

## 23.4 ISSUES IN MACROECONOMIC POLICIES AFTER MID-70s

### 23.4.1 Trade and Industrial Policies

The hallmark of economic policy in the mid-70s has been its openness and market-orientation. That is why perhaps these economies, while facing the same external environment, have been doing better than any other group of economies. Growth in these countries was fostered by a relatively neutral trade environment for the manufacturing industry which made it more profitable to export than to produce import-competing goods for the domestic market. The absence of severe distortions in factor prices encouraged the development of an industrial structure consistent with the comparative advantage of these countries. Thus, it encouraged a pattern of industrial growth intensive in the use of labour and domestic raw materials. The policy environment encouraged rapid structural changes which progressively resulted in more broadbased economic growth and in fast expansion of employment and incomes.

This, however, has not been the case with the centrally-planned economies of the region, for example, Vietnam and Laos. In these countries, inward-looking policies dominated. With large investments in state-owned enterprises, industrial growth tended to be slower. It was further hampered by limited availability of foreign exchange, poor infrastructure, and excessive regulations and licensing that limited production flexibility.

In other Southeast Asian countries industrial policies have been shifting in harmony with trade policies towards a more competitive and less restrictive stance. With the fall of commodity prices in the mid-1980s and political crisis in the Philippines, balance of payments constraints and rising debts made it more difficult to sustain inward-oriented trade regimes. Furthermore, the success of the NIEs with outward orientation suggested a more attractive alternative. As a result, trade policies became more outward-oriented in Indonesia, the Philippines and Thailand.

Thailand has gradually reduced trade barriers and increasingly emphasized export-promotion policies since the mid-1970s. Similarly, Indonesia has also worked hard to stimulate growth in export industries other than oil and gas, mainly other primary product industries and light manufacturing. In the Philippines, political problems have overwhelmed efforts at increasing exports. Although there was a substantial reduction of most tariffs in the early 1980s, unfortunately, this tariff liberalization appears to have been largely offset by increased use of nontariff barriers and has been reversed in recent years.

Malaysia is the only country in ASEAN in which efforts to promote import substitution have increased. Largely in response to rising wages, Malaysia is attempting to build up its heavy industrial base with a strategy similar to Koreas's in the 1970s. Increased protection has thus resulted in certain infant industries (e.g., automobiles and related sectors). Nonetheless, Malaysia maintains one of the more open trading regimes among the ASEAN countries. Thus by the mid-1980s, most economies in this region were actively involved in promoting exports.

In recent years, Indonesia introduced reforms to promote a more efficient industrial structure by relaxing local content regulations in general and removing import monopolies. At the same time it encouraged greater private sector participation in sectors, such as shipping, that have been dominated by state enterprises. Malaysia has sought to raise industrial productivity and efficiency and by privatising several state-owned enterprises and has reversed an earlier trend towards increased state dominance. It has also relaxed its emphasis on redistributing ownership through the New Economic Policy (NEP) and instead, is seeking to encourage greater domestic and foreign investment. In Thailand, barriers to imports of capital goods and equipment have been reduced in order to facilitate investment. The measures taken to promote the inflow of direct foreign investment have been effective. Strong growth in domestic and foreign investment has fostered rapid structural changes and diversification in the industrial sector. Industrial policy in the Philippines is simultaneously aimed at promoting the development of labour-intensive manufacturing based on local materials and skills and at pursuing a second stage of import-substitution in heavy and technologically sophisticated industries.

Despite a number of policy reforms, import controls, a high and complex tariff structure and price controls on domestic basic commodities, continue to distort relative prices and impede economic growth. Thailand has been slow to adjust some of its industrial policies in spite of the very rapid structural changes occurring in the manufacturing sector. Rationalising trade and industrial policy is a pressing issue as uneven protection may distort the investment pattern. Thailand's industrial structure is undergoing a process of deepening, as intermediate and heavy industries are expanding to support the export oriented sectors and consumer goods industries. In Thailand, the Philippines, and to some extent Indonesia, infrastructure bottlenecks remain a serious problem constraining the industrial sector and leading to significantly higher costs. In the Philippines, for instance, shortages of electric power and a transportation crisis indicate that infrastructure is inadequate to meet demand.

In 1988, Vietnam introduced a program of economic reforms aimed at deregulating and liberalising its planned economy. The implementation of a farm household contractual system has provided greater flexibility and autonomy to farmers. The incentives led to a sharp rise in agricultural production and contributed to a marked slowdown in Vietnam's inflation rate particularly in 1989. To improve productivity, non-agricultural sectors are also being deregulated as the private sector is encouraged to assume a greater role in economic activity. A "cost/profit accounting" system has been implemented in state economic enterprises to make them financially liable and to enhance their efficiency. Generally, market prices are being restored in many sectors and subsidies progressively eliminated. Production for export has been given high priority. The adoption of a more realistic exchange rate has signficantly contributed to export growth and further stimulus should ensue from the creation of export processing zones. In Vietnam, though much progress has been made in reforms over the medium term, the main concerns of policy are attainment of higher agricultural productivity, the management of geographical decentralization and the reform of the mode of operation of state enterprises.

In Laos (or Lao People's Democratic Republic) foreign trade has been liberalised and greater autonomy has been given to state enterprises. In both Vietnam and Lao PDR, the acceleration of privatisation or the provision of greater autonomy to state enterprises is a key to the success of the reforms as well as to the alleviation of considerable bottlenecks in infrastructure and the supply of raw materials.

Laos is neighbour to one of the fastest growing economies in Asia, Thailand and potentially one of the fastest, Vietnam. This should mean large markets for raw materials from Laos. It can use both Vietnam and Thailand as outlets for international markets. Vietnam is the shortest route to the sea for Lao exports. Both Thailand and Vietnam view Laos as the buffer between them. It is important for both to keep Laos as a good neighbour.

Vietnam and Laos have had close relations since 1975. Thailand and Laos are improving theirs despite past border skirmishes.

Thailand and Vietnam have a rapidly increasing metals demand, and Laos has a high potential for the development of its lead, zinc, copper, bauxite, potash, gypsum and coal resources. Gypsum exports to Vietnam should increase significantly and Thailand may become a large importer in the future. Although Thailand has exported gypsum for years recent concerns about domestic supply have led to a ban on exports. Thailand also requires potash, fertilizer and coal.

Electricity exported to Thailand accounts for half of Lao foreign exchange earning. Thailand buys electricity very cheaply at half the world price. Prime Minister Kaysone Phomyihane's visit to China in 1990 re-established ties, and a five-year economic agreement was signed to develop timber and agriculture and exploit mineral resources. China may become another market for Lao minerals.

### 23.4.2 Financial and Capital Market Reforms

Financial policy reforms in Southeast Asia focussed on liberalization and deregulation in 1989. In Indonesia, which has made considerable progress towards financial liberalization since the first phase of banking deregulation in 1983, the need to strengthen the regulatory environment has emerged strongly in 1990. During the last few years, over 40 new private and joint venture banks and 1,000 bank branches have opened. While such rapid growth has helped raise competition in the banking sector significantly, a severe shortage of experienced banking professionals coupled with an inadequate regulatory environment has increased the potential for major financial mishaps. As a result, reforms in 1990 focussed on strengthening financial regulations.

In Thailand, the number of licensed banks competing in the domestic financial sector has been strictly controlled. However, the rapid expansion of economy and the desire to foster competition has led to more open policy with respect to the entry of new banks. Furthermore, to encourage savings, interest rate ceilings on long term deposits have been lifted and withholding tax on such deposits withdrawn. These measures are expected to stimulate competition in financial sector, encourage innovations in and diversification of instruments and generally improve the system of financial management. Malaysia has passed a new omnibus law on banking and financial institutions to strengthen and at the same time, streamline existing regulations. It has also implemented reforms to broaden and deepen the capital market for government securities and of a corporate bond market. In the Philippines small and weak banking institutions have been amalgamated into larger units, some with foreign partners. In both Lao PDR and Vietnam important progress was made in 1989 with respect to banking and financial reforms. In Lao PDR for instance, market determined interest rates have been allowed to operate.

### 23.4.3 Public Sector Reforms

Most countries in Southeast Asia are trying to implement a full or partial privatisation programme for selected public enterprises. While Malaysia has made some progress in the privatisation of state-owned enterprises, Thailand has encouraged private finance of investment by public enterprises in order to reduce the burden of these firms on the government budget and to allow for the financing of large infrastructure projects. In addition, private sector management of ports, expressways, etc. is also being considered in spite of significant resistance by labour movements. In the Philippines, the large privatisation programme has not gathered much momentum so far. In the centrally planned countries of Southeast Asia reforms in the public sector have mainly concentrated on increasing the financial responsibility of state-owned enterprises. Some privatisation which will allow production units to respond more flexibly to the changing market conditions will determine the success of their reforms and will help in the alleviation of considerable bottlenecks in the availability of raw materials and infrastructure.

### 23.4.4 Savings and Investment

It is widely believed that the relatively good economic growth performance in developing Asia rests on high saving and investment rates. While the ratios of saving and investment to GDP have declined in most regions since 1980, they have remained remarkably buoyant in Southeast Asia. The raise in investment rate during the last two decades has been particularly high in this region. The increase in investment rate was helped by the continued inflow of foreign direct investment. In Singapore and

Indonesia, the higher investment rate mainly reflected rapidly increasing domestic private investment in Malaysia, the Philippines and Thailand, public sector investment in infrastructure also rose sharpy.

A high rate of investment is a necessary, but not sufficient condition for rapid growth which demands the efficient uses of invested capital. The incremental capital output ratio (ICOR) is a useful though by no means perfect measure of investment efficiency. For years 1978-87, ICOR's of the developing countries in Southeast Asia ranged between 3 and 5. The ICORs of Singapore, Malaysia and the Philippines were particularly high at over 5 showing the progress of industrialization. The high ICORs of Singapore and Malaysia were a result of increased public investment in infrastructure and the structural changes which occurred in their industrial sector during the 1980s, while that of the Philippines was a result of generally poor utilization of capital in 1980s.

Most developing countries have achieved high savings rates. The reliance on foreign savings has increased rapidly since 1988, with the substantial rise in their current account deficits. In terms of GDP, the deficits rose particularly fast in the case of Malaysia, the Philippines and Thailand. Domestic savings, however, continued to exceed investment in Indonesia and Malaysia in spite of current account deficits. In both cases, there were substantial and increasing factor payments abroad either for the servicing of foreign debt or in the remittance of profits on foreign equity investment. Domestic savings in both countries are thus significantly larger than national savings. In Lao PDR, the resource gap, narrowed somewhat after 1988, remained very substantial at about 20 per cent of GDP in 1990. Concessional lending and foreign assistance, however, have so far been more than sufficient to finance it.

### 23.4.5 Inflation

The experience of the Southeast Asian countries with inflation displays great diversity. In Lao PDR inflation accelerated to 33 per cent in 1988 and 60 per cent in 1989. In 1988 the main reason for inflation was the devaluation of the currency and the decontrol of prices when subsidies for many commodities were phased out, wholesale prices deregulated and state economic enterprises permitted to set prices for their output.

The hyper-inflationary situation in Vietnam which developed during the early 1980s had its roots in price decontrols, successive currency devaluations and deficit financing. In 1988, the inflation rate was 492 per cent but in 1989, there was a significant deceleration and it was 40 per cent. The success in controlling inflation was achieved through austere monetary and fiscal policies and the maintenance of relative exchange rate stability. Good rice harvests also helped.

In the other four countries of Southeast Asia where inflation has been more moderate (Indonesia, Malaysia, the Philippines and Thailand) the weighted average rate rose from 5.2 per cent per annum in 1987 to 6.1 and 6.6 per cent respectively in 1988 and 1989. Strong domestic demand caused by rapid economic growth in recent years is the main source of inflationary pressure. In addition, several country-specific factors have also contributed to the increase in prices. In Thailand, inflation which stood at 5.8 per cent has become a major concern since 1989. After four years of moderate inflation the rate is rising rapidly, mainly because of strong domestic demand, higher wages and other costs due to infrastructure bottlenecks and labour supply pressure.

### 23.4.6 Trade and Foreign Investment in the Context of Asia-Pacific Growth

Export-led growth has characterized the development of Southeast Asian economies. The latter half of the 1980s saw the emergence of a new, though related trend towards strong growth in imports as domestic demand became a more prominent source of economic growth in some of the economies.

In Southeast Asia, import growth increased to 33 per cent from 26.5 per cent in 1988 and exports expanded by 19.4 per cent only marginally below the 21 per cent increase in 1988. The declining export competitiveness of NIEs and large inflows of export-oriented foreign investment to Southeast Asia provided the basis for continued strong expansion of manufactured exports. This was especially the case for Malaysia and Thailand with exports increasing in excess of 20 p.c. and imports by over 35 p.c. in 1989.

The external debt increased only marginally. In Southeast Asia, the most heavily indebted countries—Indonesia and the Philippines—were able to increase exports sufficiently to sustain downward trend in their debt-service ratios.

In the last few years important changes in trade patterns have been taking place in the Asian Pacific region. These changes emanated from currency realignments following the Plaza Accord in 1985 and from shifting comparative advantage which resulted in a restructuring of the economies in the region and gave rise to the rapid expansion of intra-Asian trade and investment in the later half of the 1980s.

Total trade (exports plus imports) among the 15 major Asian economies grew by 31 per cent in 1988 to $234 billion, more than half of which was accounted for by trade with Japan. Growth in 1987, had been about 30 per cent. Significantly, this meant that in 1988, Asia's exports to North America which in that year totalled $193 billion. This suggests that economic growth in Asia became more self-reliant as the impact on the Asian economies of a slowdown in the US economy was reduced.

Japan's leading role is indicated by the share in the total exports to Japan from many countries. Economies that registered the sharpest increases included Thailand (53 per cent), Singapore and Malaysia (more than 30 p.c). Thailand also saw a marked increase in its imports from Japan. Trade between the NIEs and Southeast Asia also expanded substantially. Exports from the NIEs to Indonesia, Malaysia, the Philippines and Thailand rose by about 50 p.c. while exports of Southeast Asian countries to the NIEs grew by 29 p.c. Exports from Korea and Taiwan to Thailand shows a particularly strong increase of 97 p.c. and 78 p.c. respectively.

Intra-ASEAN trade (excluding Brunei) rose by 36 per cent in 1988 to $19 billion though, as in previous years Singapore's share of such trade accounted for a large portion of the total. Excluding Singapore, trade among the other four ASEAN countries increased by only 12 per cent to $2.3 billion. Singapore's bilateral trade with Malaysia continued to dominate intra-ASEAN trade, accounting for about half the total. Two-way trade between Singapore and Malaysia grew by 28 p.c. in 1988 to $ 9.4 billion. Singapore's exports to Indonesia and Thailand also grew by a rapid 263 p.c. and 76 p.c. respectively in 1988.

Rapid growth in intra-ASEAN trade during the last few years has been accompanied by a phenomenal increase in intra-Asian direct foreign investment. The strong investment flows from Japan and the Asian NIEs to Southeast Asia are likely to reshape the regional structure of production over the next decade and sustain developing Asia's economic growth in the 1990s. Such investment is also likely to promote greater interdependence among the Asian economies and make the region a more cohesive entity in the world economy.

Traditionally, overseas investment by Asian companies was directed largely at the industrialized countries and focussed mainly on the acquisition of real estate, financial assets and distribution networks to gain larger market share. While these flows remain substantial, investments are now being made within the region based on the comparative advantages offered by the developing Asian economies. These investments differ from the region's traditional investment flows in several respects. First in terms of sectors, there is a growing emphasis on manufacturing. Second, in terms of destinations the developing and hitherto commodity-based economies of Southeast Asia have emerged as the prime recipients. Finally in terms of size of investors, a growing of small sized and medium sized enterprises are also involved.

These changes in the nature of investment flows in the region are to some extent a reflection of the changing cost structure in the Asian economies in recent years as exchange rates have been realigned and as wages and other costs have risen sharply in some of the countries. They are also indicative of the steady graduation of some industries in Japan and the NIEs to higher value-added and more technology intensive activities.

Overseas direct investment by Japan in 1988 grew by 41 per cent. The largest recipient of Japanese investment—40 p.c. of cumulative overseas Japanese investment at the end of 1988—Asia now ranks second along with Latin America at 17 p.c.

marginally ahead of Europe at 16 p.c. If Australia and New Zealand are included, the share of the Asia-Pacific region in total Japanese investment would rise to 22 p.c.

Japanese investment in Asia (excluding China because of a large single investment for oil exploration in 1987) grew by 73 p.c. and 45 p.c. in 1987 and 1988, respectively. The Philippines, Malaysia and Thailand had the largest increases in 1988, followed by Hong Kong and Singapore. Despite the low rate of growth in 1988, Indonesia has traditionally attracted Japanese investment and on a cumulative basis is the largest Asian recipient of such funds.

Although Japan has been the major driving force of intra-Asian investment, the NIEs in total foreign investment in four Southeast Asian countries in 1988 was only marginally below that for Japan. At the same time, while Japanese investment in these four Southeast Asian economies grew by 125 p.c. in 1988, commitments from the NIEs jumped 34 p.c. In 1988, Asian investors accounted for 64 per of the total foreign investment approved by the four developing Southeast Asian economies. This represents a combined commitment of over $7.6 billion, triple the $2.5 billion invested in 1987.

Among the NIEs, Hong Kong has been a pioneer in terms of outgoing investment. The 1970s was a significant relocation of the textile and garments industries, partly in search of cheaper operating sites and partly to circumvent quota restrictions in overseas markets.

Hong Kong is also the second largest source of investment in Indonesia and is among the top five sources for the Philippines and Thailand. In 1988 manufacturers from Hong Kong committed $755 million in the four Southeast Asian economies up by 177 p.c. from 1987. However it must be noted that some of this investment originates from third countries (including overseas Chinese) who use Hong Kong as a channel for regional investments.

With its large current account surplus and hard-pressed by currency appreciation, sharp wage gains and higher costs, Taiwan has emerged as one of the fastest growing sources of foreign investment in the region. Its industrial investment in the four Southeast Asian countries amounted to over $2 billion in 1988, up 469 p.c. from that in 1987.

Singapore and Korea are the late comers among Asian investment sources, largely because of government policy constraints. However, given the mounting pressure to upgrade domestic industry and an urgent need to expand their economies overseas investment by both Singapore and Korea—though still relatively small, is growing rapidly. In 1988, singapore's manufacturing investment in its four Southeast Asian neighbours jumped by 355 p.c. while that of Korea increased over 10 times to $329 million.

The rapid expansion of intra-Asian investment is likely to have a major impact on the pace of industrialization of the recipient countries. This is particularly so, because, aside from providing investment capital to the host countries many of the investments are in light industry which should have an impact on growth in a relatively short period and most are export-oriented operations, with the parent companies having access of overseas markets. Such investment will strengthen the export sectors of recipient that will and may be particularly important for large debtor nations like Indonesia and the Philippines. Furthermore, the labour-intensive and relative low-technology nature of these investments will offer more employment opportunities and be easier to assimilate by host countries. Moreover the investment will provide an economic link between Japan, the NIEs and Southeast Asian economies, fostering both vertical and horizontal industrial integration and enhancing the transition to higher value-added economic structures in both regions.

Laos is trying to change from publicly funded development by bringing in foreign investment. Through the 1988 law on foreign investment, foreign investment has been encouraged. According to government sources over 100 foreign investment contracts worth more than US $200 million, many with Thai companies, have been approved.

### 23.4.7 Factors behind the Growth of Trade and Investment

The dramatic rise in intra-Asian trade and investment in recent years has stemmed from a variety of factors which are likely to continue having an influence in the early 1990s. Some of the more important factors are discussed in this section.

Exchange rate realignment which occurred in the latter half of the 1980s is perhaps the single most important reason behind the dramatic growth in intra-Asian trade. Broadly, while the currencies of Japan and subsequently the NIEs, excluding Hong Kong, have appreciated against the dollar following the Plaza Accords in 1985, those of the Southeast Asian countries have mostly moved in the opposite direction. For Japan, Korea and Taiwan the real effective exchange rate (REER) index was substantially higher in 1989 than in 1985 indicating that their currencies have appreciated in real terms. For most of Southeast Asian currencies, on the other hand, the REER index in 1989 stood well below the level in 1985. With appropriate lags and in conjunction with some of the other factors discussed below, these exchange rate realignments led to a rapid increase in exports from Southeast Asian economies to Japan and the NIEs.

Another major trend during the period has been the gradual shift of labour-intensive manufacturing activities from the more developed economies in Asia to the relatively less-developed. While this relocation of manufacturing started in the early part of 1980s, it has accelerated since 1986, when exchange realignments gave a significant push to the process. The sharp appreciation of the Japanese Yen in 1986-87 and the appreciation of the Korean yon and the New Taiwan dollar (1987-88), combined with rising costs of land and labour greatly reduced the competitiveness of many traditional exports from Japan, Korea and Taiwan. This forced manufacturers of such export producers to look for ways to reduce costs and move part of their operations offshore to less expensive locations. Southeast Asia was the obvious choice because of proximity, well-developed infrastructure and substantially lower labour and other costs.

Since most of these economies lacked a strong domestic capital goods industry, the burst of investment, initially from Japan but thereafter from the NIEs, into the Southeast Asian economies was reflected in a sharp rise in imports of capital goods by the latter. As new plants have come up the need for imports of parts and components as well as intermediate goods has also risen. As domestic industry in the Southeast Asian economies develops, more capital and intermediate goods are likely to be sourced locally, but in the immediate future imports from the source country of the initial foreign investment are likely to show a strong increase.

At the same time, there has been an acceleration in the growth of exports from the Southeast Asian economies to Japan and NIEs. In the early years of manufacturing relocation companies from Japan, Korea and Taipei, China were inclined to shift offshore only a small part of their overall operations. More recently, with rising costs and exchange rate realignments which made entire industries unprofitable, the trend is toward phasing out certain lower-end consumer industries, such as footwear, plastic products, toys and some basic consumer electronic products. This will generate significant reverse trade flows from Southeast Asia to Japan and the NIEs. The 1980s have also seen substantial efforts towards economic deregulation and liberalization in the Asian countries. Although not necessarily for the same reasons, or to the same extent, China, India, Korea, Taiwan and the Southeast Asian economies have moved progressively toward deregulating their economies over this period. The liberalization of foreign trade, particularly imports deepens this overall economic deregulation. This in turn has provided a strong impetus to expansion of both trade and investment in these countries with growth generally being the highest in countries where the process of liberalization was the most advanced.

The rapid expansion of intra-Asian trade was also due to a partly perceived threat of growing protectionism in a unified EC market from 1992 onwards and the increasingly hardline attitude adopted by the US administration on "unfair trade practices". It has promoted efforts by many Asian economies to diversify trade in recent years. In addition, there is a realization that because of slower economic growth and the persistence of trade imbalances in the United States trade is to expand rapidly in future.

**Check Your Progress 2**

Fill in the blanks

1) Since the 1970s Thailand has gradually reduced its ................................................

2) .............................. is the only ASEAN country in which efforts to promote import substitution has gone up.

3) .............................. is the shortest route by sea for Lao exports.

4) A severe shortage of ........................................ professional marks the financial systems of these countries.

5) Hyper inflationary tendencies have been more visible in ............................................ and Vietnam.

6) ................................... and the Philippines have been the most heavily indebted countries.

7) ................................... of 1985 lead to currency realignments.

## 23.5 LET US SUM UP

Now let us conclude our study of Southeast Asian development experience. We have studied the diverse economic resources in the region. Countries applied different strategies which were consistent with their resource endowment pattern. In the early stages of economic development, self-reliant economic policies like import substitution were adopted. This was immediately after gaining independence from colonial rule. Later, the policy stance was changed. Export-led industrialisation took the place of import-substitution. Even the socialist countries like Vietnam and Laos have realised their past mistakes. There is a growing awareness about the virtues of Foreign Direct Investment. In the emerging Asia-Pacific growth scenario Southeast Asian development has considerable role to play. Already it is threatening to become the "Asian tigers" of growth.

## 23.6 KEY WORDS

| | | |
|---|---|---|
| **Inflation** | : | A Phenomenon in which too much money chases too few goods —more commonly it is a situation of price rise. |
| **Colonialism** | : | A stage in which a country is ruled by foreign powers. |
| **Socialism** | : | A system in which means of production are in the hands of state. It favours equal opportunity for all. |
| **Import Substitution** | : | A strategy in which a country exports only to pay for its imports. |
| **Tariff** | : | A levy to protect domestic industry. |
| **Primary Products** | : | These are natural resources like, natural rubber, tin, cocoa etc. |
| **Balance of Payments** | : | It includes a country's imports and exports of goods along with capital movements. |

## 23.7 SOME USEFUL BOOKS

Das, Parimal Kumar, 1987 : *The Troubled Region : Issues of Peace and Development in Southeast Asia,* Sage Publications, (New Delhi)

Asian Development Bank, 1971 : *Southeast Asia's Economy in the 1970s (London : Longman.*

D.G.E.Hall, *History of Southeast Asia.*

Lawrence Olson, 1970 : *Japan in Postwar Asia* (London : Pall Mall).

Lee Soo Ann (ed). 1973 : *New Direction in the International Relations of Southeast Asia* (Economic Relations), (Singapore)

George L.Hicks and Geoffrey McNicholl, 1971 : *Trade and Growth in the Philippines : An Open Dual Economy* (Ithaca: Cornell University Press)

## 23.8 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

**Check Your Progress 1**

1) Malaysia, Indonesia, Philippines, Singapore and Thailand.
2) Shifting from colonial dependence upon primary product exports to an economy which has entrepreneurship, capital and labour skills and major growth promotion forces.
3) Indonesia & Philippines.
4) Thailand & Malaysia.
5) Japan.

**Check Your Progress 2**

1) Trade barriers
2) Malaysia
3) Vietnam
4) Banking
5) Laos
6) Indonesia
7) Plaza Accord