

Report on Asian Research: Japan Center for Economic Research

Roadmap to Revival of High Growth in ASEAN

Enhancement of financial and corporate sectors urged

Complementary relationship with China key to revival

Shujiro Urata

Senior economist at the Japan Center for Economic Research,

Professor at Waseda University

With the rise of the Chinese economy, the Association of Southeast Asian Nations (ASEAN) is in the doldrums. In order to revive sustainable high-growth, ASEAN needs to beef up financial and corporate sectors by aiming at making the most of ample savings, encouraging investment from overseas and enhancing their complementary economic relationships with China. The early conclusion of a free trade agreement (FTA) between Japan and ASEAN would also benefit these economies.

ASEAN nations quickly surmounted the economic crisis that occurred in 1997 and realized a V-shaped recovery by 2000. However, exports have not shown growth since then, due in part to the burst of the information technology (IT) bubble and the terrorist attacks in the U.S. on September 11, 2001. While China has maintained economic growth of 7-8%, growth rates of the five major ASEAN members stood at 2-5% in 2002, much lower than the high growth rates of 6-7% or more before the financial crisis.

Meanwhile, China has maintained high growth despite financial turmoil elsewhere. Rather than futilely regarding China as a threat, other economies, including ASEAN, should view China's growth as an opportunity for their own development. Political and social stability in East Asia can be achieved by reaching sustainable growth in the region. Well-balanced, sustainable growth in East Asia is also significant for Japan, which is becoming more and more dependent on the East Asian economy.

Against this backdrop, the Asian Research Project of the Japan Center for Economic Research (JCER) surveyed conditions for the revival of sustainable economic growth in ASEAN and compiled policy proposals for the governments of ASEAN and Japan.

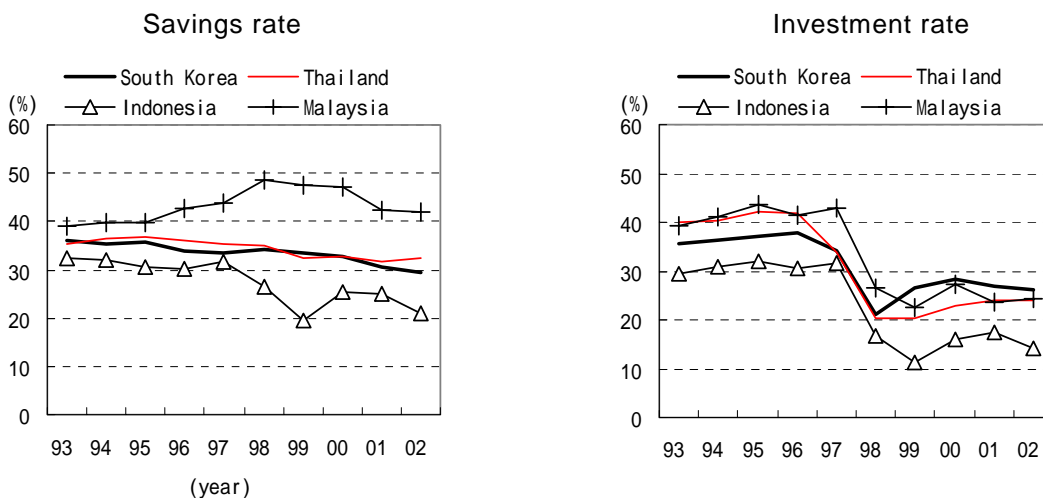
The high-growth mechanism in ASEAN, which had functioned before the crisis, had comprised of two major factors. One was vigorous investment, supported by ample domestic savings and massive funding from overseas investors. The other was expansion of exports centering on industrial products, which was supported by active injections of direct investment, mainly by Japanese corporations.

However, as a result of the outbreak of the turmoil, the region witnessed a rapid capital exodus. The outflow of funding was particularly noticeable in securities investment and bank loans. The influx of direct investment, so essential to promoting growth, has slowed since the crisis. The value of direct investment into the five major ASEAN members was less than one-quarter that of China, which practically became the world's largest recipient of direct foreign investment in 2002.

Abundant savings and utilization of direct investment

ASEAN economies are advancing and demand for investment in the construction of plants and the improvement of infrastructure is potentially strong. However, demand has not been actualized since the financial brokerage function, which directs abundant savings to such demand, is not working. As shown in the figure below (*1), investment rates have declined sharply, although savings have remained steadily high and largely unaffected by the financial crisis. The problem in ASEAN is that domestic funds are not funneled into investment. To accomplish sustainable growth, ASEAN countries should harness domestic and overseas funds and utilize them more efficiently.

Figure Savings rates and investment rates in South Korea and ASEAN members



(Source): "Key Indicators" of Asian Development Bank

Following the turmoil, not a few foreign corporations have been considering relocating production and administrative/supervisory bases from ASEAN countries to China. According to the results of a questionnaire conducted by JCER in July 2003 (*2) covering Japanese corporations operating in Asia; 60% of the companies operating in ASEAN nations and considering relocating their bases outside the region said they were thinking of moving their bases to China. The problems faced by foreign-based companies in ASEAN countries include among others: increases in wages and production costs; incomplete infrastructure; underdeveloped supporting industries; lack of proper legal systems; control of operations; and political and social risks. The roles ASEAN member governments should play in resolving these problems are great. They are urged to promote deregulation, improve legal systems and enforce laws.

Sound financial and corporate sectors are indispensable to the efficient utilization of funds. ASEAN nations have positively worked on establishing the soundness of these two divisions since the turmoil. Thanks to their efforts, the ratio of bad loans (which stood at 15.7% in Thailand in June 2003—a plunge from the post-crisis high of 46.5%) has dropped, while capital ratios (which rose to 12.5% in Thailand in June 2003 from the post-crisis low of 9.2%) and profit margins went up. However, banks are not willing to extend loans, not fulfilling their role in the finance brokerage function. Soundness should be further improved through the enhancement of loan screening capabilities, the promotion of sound competition among banks and the introduction of foreign capital.

Strengthening of the corporate sector is vital to the efficient utilization of funds. While inefficient corporations left the market after the crisis, surviving companies have pushed forward through the improvement of management systems. However, the issue of incomplete supervisory functions has remained unsolved. The supervisory function had tolerated inefficient use of funds by corporations which brought about the turmoil. Various issues should be surmounted in order to realize a sound corporate sector. These include thorough disclosure of information, the creation of a competitive environment and the utilization of competent individuals.

Though the utilization of IT is effective in boosting the efficiency of the corporate sector, serious limitations to realizing these benefits are extant throughout ASEAN countries. For example, while the ratio of Internet users to the population in Japan and South Korea stands at around 50%, it is less than 10% in Thailand, Indonesia and the Philippines. These countries need to upgrade their information and telecommunications

infrastructures and enhance education in IT fields.

Creation of an environment in which human resources, assets and finances move freely and actively within the region will make contributions to the growth of East Asia. Of particular importance is regional cooperation in currency and finance sectors and the conclusion of FTA and economic partnership agreements (EPA).

Another factor of the crisis was that ASEAN nations pegged their currencies to the U.S. dollar, while their economic relations with countries other than the U.S. were deepening. Since the stability of the currency of each nation is essential to the promotion of trade and investment, it is desirable to adopt a common-basket peg system (*3) to include not only the U.S. dollar, but also the yen and euro. Since fluctuations in the currency of each country would not be subject to movements of the U.S. dollar alone, a foundation for stable expansion of trade and investment would emerge under this system. Countries in the region need to work out macroeconomic policies in concert with one another and devise a surveillance system effective in maintaining such a system.

Japan, ASEAN urged to sign FTA

Important to the revival of investment- and trade-oriented growth is the conclusion of comprehensive FTAs encompassing unencumbered trade and investment, as well as economic cooperation with many other countries. Though ASEAN members completed the ASEAN Free Trade Area (AFTA) in 2002, tariffs have been reduced only by 5%. Tariffs in the region should be abolished as soon as possible to raise the competitiveness of ASEAN corporations. ASEAN will also benefit from the realization of closer economic relations with China by quickly signing an FTA with that country.

Though it has been pointed out that many Chinese exports directly compete with ASEAN exports, there has been activity toward a horizontal division of labor in the electronic and electrical machinery categories in recent years. With regard to the import and export of articles included in Chapter 85 (electronic machinery, equipment, parts, etc.) of the International Convention on the Harmonized Commodity Description and Coding System (HS)(*4); according to Chinese customs statistics China's exports of such articles to the five major ASEAN members stood at 5.7 billion dollars in 2002, accounting for 28% of the total exports from China to the five countries, while China's imports of such articles from the five nations amounted to 10.3 billion dollars, or 35% of the total imports from the

five countries. These figures attest to an advance in the division of labor in this sector.

Since Beijing is encouraging Chinese corporations to make overseas investments as a measure to utilize its sharply increasing foreign currency reserves, there is a possibility that direct Chinese investment in ASEAN will become active. ASEAN nations should take advantage of such moves for their own growth. They can also expect the signing of FTAs with Japan to bring about sustainable growth through expansion of exports to Japan and direct investment from Japan.

Although ASEAN members are recognizing such issues, they have lacked a sense of urgency about the rapid rise of China partly because they had accomplished a temporary, export-driven recovery since the crisis. As a result, the pace of reform in various categories is slow in these countries. ASEAN nations have a great possibility to regain high growth if they work swiftly on issues that must be tackled to benefit from the growth of China.

For the realization of sustainable growth of the ASEAN economies, Japan should revitalize its own economy by expediting structural reforms in the financial and corporate sectors. Tokyo is also urged to ink a comprehensive FTA with ASEAN to boost Japan's exports to these markets, expand its direct investment in the region and, thus, contribute to Japan's ongoing structural reforms.

(The original Japanese article appeared in the November 7, 2003 issue of The Nihon Keizai Shimbun.)