Chapter 4

The State and Issues of the ASEAN Economy

Ryuichi Ushiyama
Principal Economist, Japan Center for Economic Research

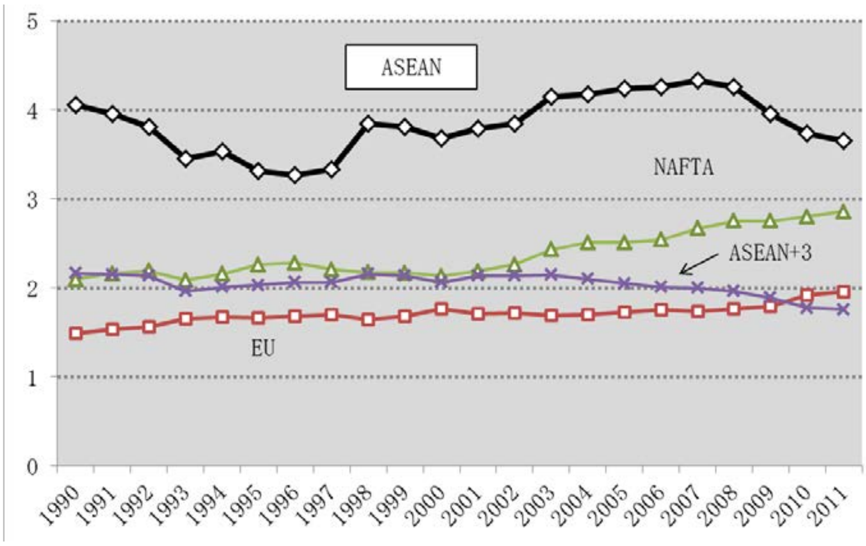
Key Points

- The scale of ASEAN's GDP has expanded to around 40% of that of Japan. The value of exports from ASEAN is already of a magnitude exceeding that of Japan, and it is becoming a globally powerful trade entity. It has many countries having continued population expansion, and is an appealing destination of business expansion to Japanese corporations.

- While furthering trade liberalization from the 1990s, ASEAN has strengthened its trade ties. Behind this lies an expansion in trade of intermediate goods. ASEAN is sourcing much of the intermediate goods it needs from within the region, and there is the likelihood that autonomy is increasing in this area.

- Regarding the future of the ASEAN economy, the discussion over the "middle-income trap" among international organizations stands out. Among the middle-income countries in the region that are Malaysia, Thailand, Indonesia, and Vietnam, there is a widening movement to aim to increase productivity through technological development, strengthening the cultivation of human capital, and the like. However, difficulties lie ahead.

ASEAN has closer trade relations than the EU, or NAFTA
(changes in trade intensity index)



Note: The EU is 25 countries.
Source: Produced from the IMF, Direction of Trade

Introduction

ASEAN is a major player in the surging emerging Asian economies. The middle class is rising rapidly due to high growth, the launch of an economic community in 2015 is drawing closer, a free trade agreement (FTA) network is extended among Japan, China, South Korea, India, and the like, and the least developed countries in the region, the CLMs (Cambodia, Laos, and Myanmar), are starting to stir. The ASEAN economy is drawing attention for a variety of aspects.

In this chapter, the major sources for companies to expand revenue and the state of the ASEAN economy that is hoped for will be confirmed once more. Specifically, statistics for past growth rates, GDP magnitudes, trade, investment, population, and the like will be examined. Based on that, there will be a detailed analysis of the trade statistics, the degree of integration of the ASEAN economy will be examined, and the "presence" of ASEAN in the production networks in East Asia will be discussed. Furthermore, in light of the fact that there is a debate among international organizations and the like pertaining to the "middle income trap," for which ASEAN is a major subject, the mid- to long-term issues that each country needs to overcome will be mentioned, and initiatives in each country towards overcoming issues will be introduced. Finally, the nature of the economic relationship between Japan and ASEAN, with its abundant growth potential, will be touched upon.

1. The overall condition of the ASEAN economy

An economy 40% the size of that of Japan

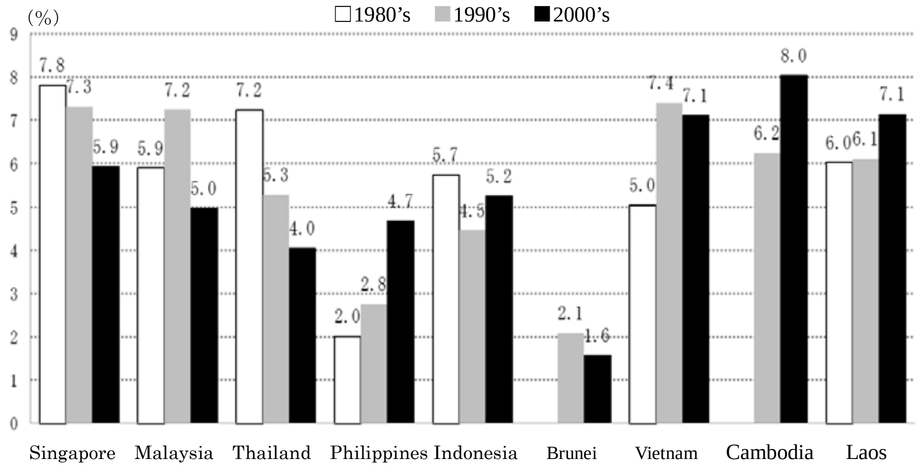
Looking at the changes in the real economic growth rate of ASEAN[1] across more than the past 20 years, there was marked negative growth in 1998 due to the effects of the Asian Currency Crisis, but overall there has been steady growth. The average growth rate since 1990 has been 5% (excluding 1998, it is 5.7%). Although this is not as high as China's 10% and India's 6.5%, the global average is 3.4%, and this exceeds the 2% value for the G7, which comprises advanced nations including Japan, the US, and Europe.

Looking at the ASEAN member countries individually, the major countries of Singapore, Thailand, Malaysia, and Indonesia had enjoyed high growth until around 1997 when the currency crisis struck. In the decade up to that year, Malaysia had a growth rate of at least 9% eight times, while Singapore and Thailand each did at least six times. Within this, Thailand achieved a double-digit growth rate for three years running in 1988-1990.

[1] Here, ASEAN comprises the five countries of Malaysia, Thailand, the Philippines, Indonesia, and Vietnam.

After entering the 2000s, the growth rate of the primary ASEAN countries slowed overall, from 5.3% in Thailand in the 90s to 4.0%, and from 7.2% in Malaysia to 5.0%.[2] However, Vietnam maintained its value from the 1990s of 7%, and Cambodia and Laos accelerated their growth from the 6% level in the 1990s to the 7-8% levels (Figure 1). It is difficult to apprehend the state of the economy in Myanmar, but after the announcement of the new administration in March 2011, a reform and opening policy was being spurred on, and so high growth is expected in the future.

Figure 1: Changes in average real GDP growth rate for each ASEAN country

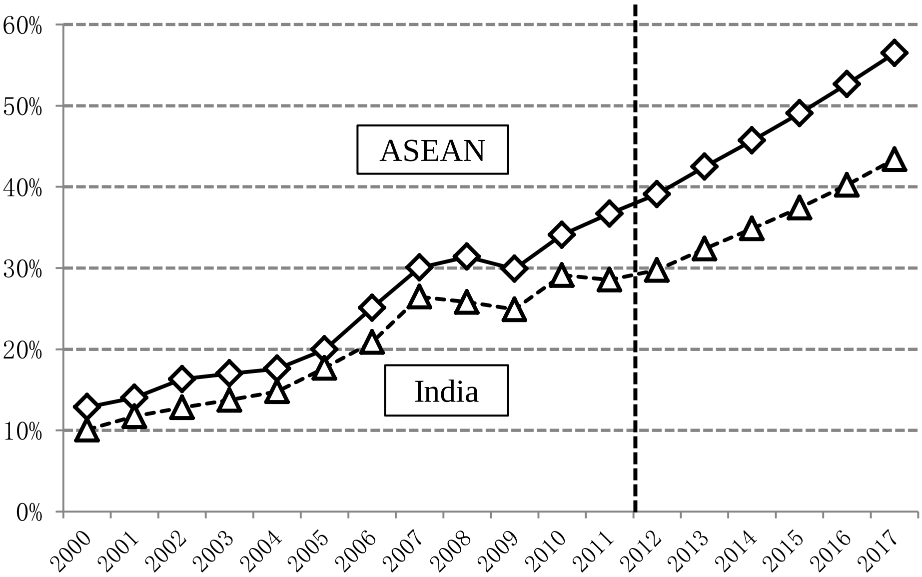


Note: The value for the 2000s is the average through 2011. There is little raw data for Brunei and Cambodia during the 1980s, and so these are not calculated here. Myanmar is not included.
Source: Produced from IMF statistics.

Compared to the stagnant Japanese economy, the energy of the ASEAN economy is clear. The ratio of ASEAN's nominal GDP total to Japan's nominal GDP rose from about 13% in 2000 to about 37% in 2011. This is expected to exceed 50% in 2016 (Figure 2.) There are even projections that, with the increase in income level, individual consumption by value in the ASEAN region will rise to $2.22 trillion in 2020, an increase by a factor of 2.6 compared to the 2008 performance.[3] The ardent gaze by the corporations of the world at ASEAN are for no other reason than growing expectations for the internal demand of the region.

[2] Specifically the average growth rate for 2000-2011. The same is true for the growth rates below for Vietnam, Cambodia, and Laos.
[3] Ministry of Economy, Trade and Industry. (2010)

Figure 2: Ratio of ASEAN and India to Japan's nominal GDP



Source: Produced from IMF data.

<u>ASEAN's exports rank "fourth in the world"</u>

Next, the direction of trade in goods will be examined. Exports from ASEAN have been growing almost completely consistently for the past two decades, but exports from China jumped in the 2000s triggered by the country's membership in the World Trade Organization (WTO) and surpassed ASEAN in 2004. However, amidst China's rise to become the top exporter in the world, ASEAN's share of the total value of exports for the whole globe has not decreased, remaining at the 6% level for the 2000s and rising to a record high of about 7% in 2010, 2011, and 2012.

Figure 3: Global export ranking

Rank	Country	Exports ($billion)	Share	Average growth rate 2005-11(%)
1	China	1,899	10.4	16
2	US	1,481	8.1	9
3	Germany	1,474	8.1	7
	ASEAN	**1,244**	**7.0**	**11**
4	Japan	823	4.5	6
5	Neth.	660	3.6	8
6	France	597	3.3	4
7	ROK	555	3.0	12
8	Italy	523	2.9	6
9	Russia	522	2.9	14
10	Belgium	476	2.6	6

Note: ASEAN refers to all 10 members.
Source: Produced from WTO and UN statistics

In the export rankings of the world based on WTO statistics (2011), four ASEAN countries appear in the top thirty places: Singapore at 14th, Thailand at 24th, Malaysia at 25th, and Indonesia at 26th. The total value of exports in the same year for the ASEAN-10 exceeded $1.2 trillion , exceeding Japan, and reaching 4th place in the world after China, the US, and Germany (Figure 3).

In 2011, the FDI introduction (international balance of payments basis, net) of ASEAN was about $116.5 billion, which was nearly the same level as China (about $123.9 billion) and about four times the value for India. By ASEAN country in decreasing order, these were Singapore (~$64 billion), Indonesia (~$18.9 billion), Malaysia (~$11.9 billion), and Thailand (~$9.6 billion), these four constituting about 90% of the total value of FDI introduced to ASEAN overall.

<u>The population of ASEAN, seven times Japan in 2050</u>

According to UN population statistics, the total population of ASEAN (2010) was about 600 million people, or 8.6% of the global total (~6.9 billion).[4] Although this is an increase from the 6.8% of 1950, it is of course smaller than the East Asian giant of China, at 23% or 1.34 billion, and the South Asian giant of India, at 25% and 1.22 billion.

However, the multiplication factor of the ASEAN population compared to Japan's population has consistently risen from 2.1 in 1950 to 3.1 in 1980, and then 4.7 in 2010. In ASEAN there are countries in which the decline in birthrate is accelerating, like Singapore and Thailand. It is predicted that the total ASEAN population in 2050 will be about 170 million more than it is at present, and reaching a scale seven times greater than Japan.

2. Analysis of the ASEAN economy based on trade data

In this section, the current state of the ASEAN economy will be examined in detail on the basis of trade statistics. The subject of analysis here is ASEAN intra-regional trade. Below, whether or not the ASEAN countries have strengthened their trade ties amidst the progress in liberalization of intraregional trade since the first half of the 1990s will be examined first. Next, ASEAN intraregional trade will be analyzed by item, and the current state of ASEAN as a "production base" will be sought.

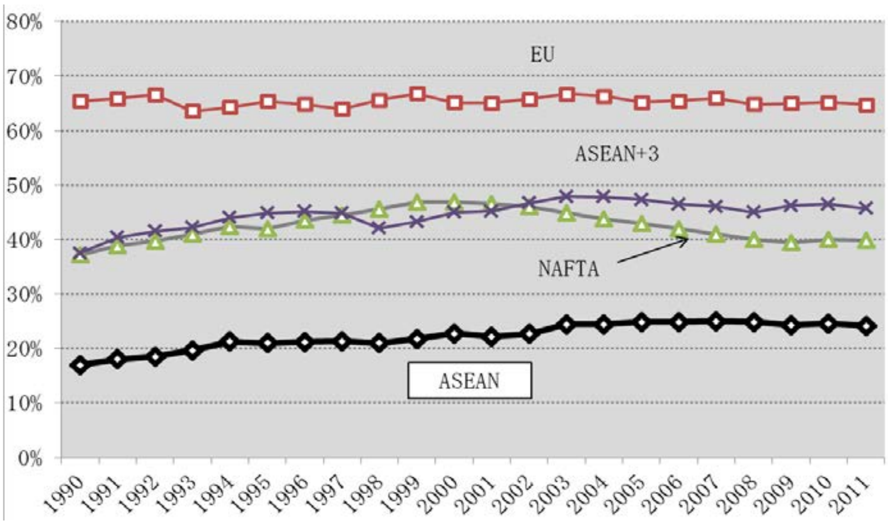
2.1 Analysis of ASEAN intraregional trade

ASEAN has engaged in liberalization of intraregional trade since the first half of the 1990s. Have the ASEAN countries strengthened their ties in the area of trade alongside this progress in trade liberalization? Looking at the changes in intraregional trade by value, it has increased nearly sevenfold from when AFTA started in 1993 to 2011, but intra-regional trade by value as a share of the overall trade of ASEAN (intra-regional trade rate), has not risen much, and has recently been stagnating around the mid-20% level (Figure 4).

[4] The values that appear later are all based on the UN population statistics. Here, ASEAN includes East Timor.

These figures give the impression that trade ties in ASEAN are weak despite the progress of AFTA, but it is not possible to draw a hasty conclusion. According to Lapadre (2006), this percentage naturally grows higher the larger the scale of trade in the region is, and so it does not necessarily explain the degree of closeness in terms of trade.[5] For example, the higher intra-regional trade rate in the EU compared to ASEAN is obvious considering the larger total value of trade of the EU to begin with, and so it would be improper to compare the two on the basis of this rate.[6]

Figure 4: Changes in intra-regional trade rate



Note: The EU is 25 countries.
Source: Produced from the IMF, Direction of Trade

Based on these points, the "degree of closeness" in the trade relations within the ASEAN region will be measured using the "trade intensity index." This index is calculated using the following formula:

$$\text{Trade intensity index of region i} = \left(\frac{T_{ii}}{T_i}\right) / \left(\frac{T_i}{T_w}\right)$$

Where T_{ii} is the intraregional trade value of region I, T_i is the total value of trade of region I, and T_w is the total value of trade of the world.

When the trade intensity index exceeds 1, the trade relations in the region are considered to be "close," and if it is lower it is determined that the trade relations are "not close."

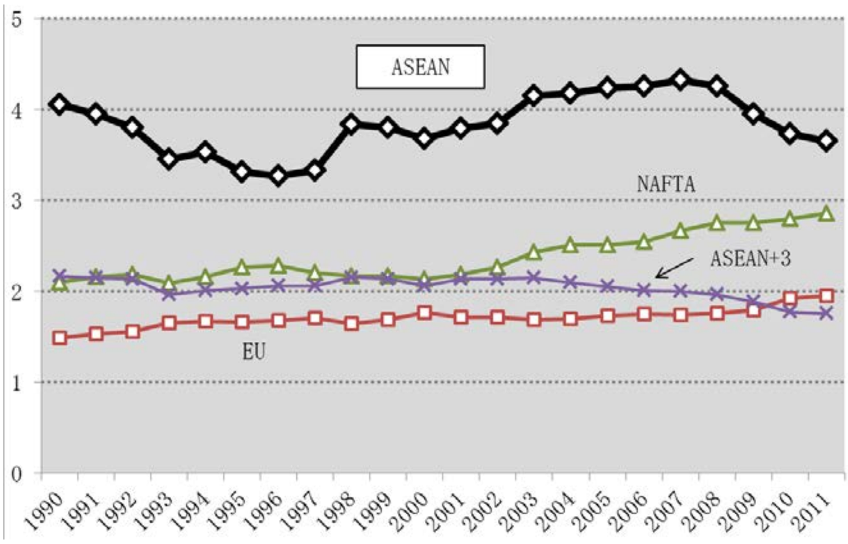
[5] Lapadre (2006) notes that as a defect of "intra-regional trade rate," the more countries are included in the region, the higher the rate.

[6] The EU is a powerful trading partner to the world, and so naturally is a powerful trading partner to itself (i.e. has a high intra-regional trade rate). However, this is not sufficient to make the argument that trade relations within the EU are close-knit.

Figure 5 depicts the changes in trade intensity index from 1990-2011 for ASEAN, the EU, NAFTA, and ASEAN+3. The index exceeds 1 for all four regions, and among them ASEAN consistently has the highest value. Since the launch of AFTA in 1993, the trade intensity index has generally followed an upward trend, peaking in 2007.

Meanwhile, looking at the other three regions, although NAFTA rose during the 2000s, it did not reach the level of ASEAN. The EU does not exhibit a clear upward trend, and ASEAN+3 is stagnating. From these results, it can be understood that ASEAN had closer trade relations than other regions to start with, but has further increased in degree of closeness since the 1990s when AFTA was introduced.[7]

Figure 5: Changes in trade intensity index



Note: The EU is 25 countries.
Source: Produced from the IMF, Direction of Trade

2.2 Analysis of trade in intermediate goods in the ASEAN region

What lies behind the increased closeness in the trade relations of ASEAN?

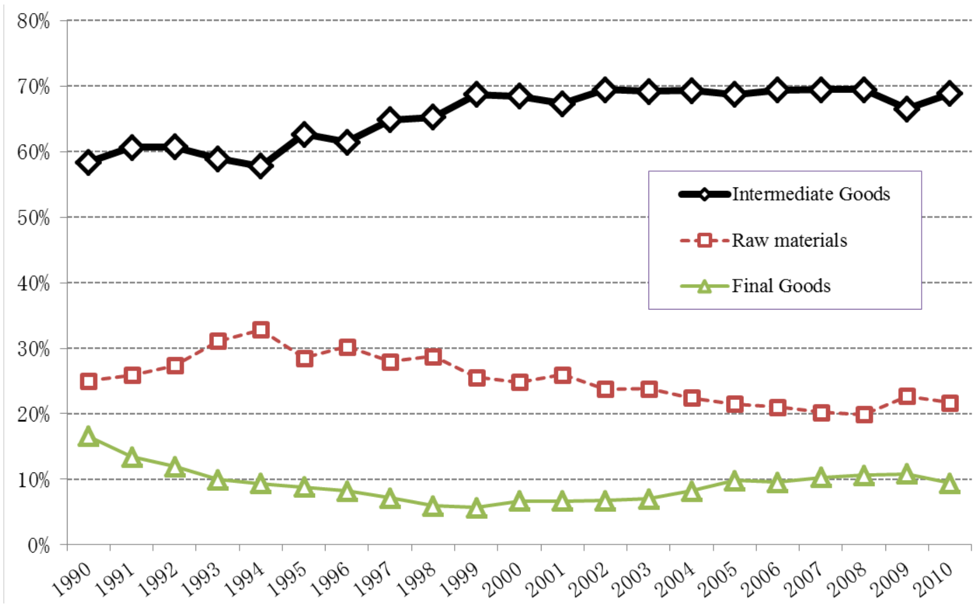
Next, the answer to this will be sought from the structure of intra-regional trade. Figure 6 classifies the goods traded in the ASEAN region by production step into the three categories of "raw materials," "intermediate goods," and "final goods," and shows the changes in breakdown by value since the 1990s for each category.

The category with the highest percentage was "intermediate goods," which rose from around 60% at the beginning of the 1990s to about 70% at the end of the 1990s, and then continued to

[7] The meaning here is that there is an overlap between the time following the introduction of AFTA and the time during which the trade intensity index rose. It is not possible to judge whether AFTA itself caused the rise in the index. Also, it must be kept in mind that after peaking in 2007, the index has been decreasing.

trend at the same level after that. Also, the contribution rate of intermediate goods to the increase in ASEAN intra-regional trade from 1990-2010 was high at around 70%, truly illustrating how the driving force behind the expansion in intra-regional trade was an increase in trade in intermediate goods.

Figure 6: Breakdown of ASEAN intraregional trade by item type



Note: ASEAN is configured from the 8 countries of Singapore, Malaysia, Thailand, the Philippines, Indonesia, Brunei, Vietnam, and Cambodia.
Source: Produced from the RIETI-TID2011.

Intermediate goods are broadly classified as "processed goods" or "parts and components."[8] ASEAN intra-regional trade (2010, import value basis) comprised 56% of the former and 44% of the latter. Parts and components were more common until 2005, but since 2006, processed goods have taken the lead. The top three processed goods in order are "petroleum and coal products," "chemical products," and "iron and steel, nonferrous metal and metal products," and the top item of "petroleum and coal products" constitutes over 30% of all processed goods. Meanwhile, in the breakdown of parts and components, "electrical machinery" related goods stood at constituting about 70% of the total. The most common component among these is integrated circuits (ICs). The value of ICs traded in the ASEAN region (2010) ranked second among all traded items, after petroleum products. The production centers for ICs are concentrated in Singapore and Malaysia, and these countries are leading IC suppliers.

[8] The names for the component classification below is based on RIETI-TID.

As seen above, ASEAN has been increasing its imports of intermediate goods every year, and moreover the fact that much of this is being supplied from within the region indicates that the demand for intermediate goods within ASEAN is swelling, and that the supply capacity for intermediate goods is also increasing. As discussed in the following chapter, intra-regional and extra-regional corporations have been actively augmenting their production bases in various industries including automobiles, electrical/electronics, food, and the like in ASEAN in recent years, and it is believed that this pushed up demand for intermediate goods. Also, as exemplified by the Thai automobile industry, manufacturers of raw materials and parts are investing one after another in lockstep with the finished product manufacturers in the region, and supporting industries that supply intermediate goods are also maturing. Accordingly, looking at the supply and demand of intermediate goods, it can be said that ASEAN is increasing its autonomy in the East Asian production network. [9]

3. Issues in the ASEAN economy

Even while being visited with the currency crisis, ASEAN has continued to expand the scale of its economy in largely a steady manner. It has expanded intra-regional trade centered on intermediate goods, and has strengthened mutual ties. ASEAN can be described as having matured both quantitatively and qualitatively, but regarding future prospects, a variety of issues can also be noted. These can be broadly divided into what ASEAN as a unit will face, and what each country within ASEAN will need to handle. The latter will be discussed below.

3.1 The warning of international organizations

With regards to the future of the ASEAN (or Asian emerging countries including ASEAN) economy, a number of international organizations have expressed concerns while at the same time noting the high growth potential. The common keyword here is “middle-income trap.”

In a report primarily analyzing the East Asian middle-income countries, specifically China, Indonesia, Malaysia, the Philippines, and Thailand, the World Bank (2007)[10] notes the situation of being “squeezed between the low-wage poor-country competitors that dominate in mature industries and the rich-country innovators that dominate in industries undergoing rapid

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9 Although ASEAN’s share as the origin of imports of intermediate goods has stagnated since the 2000s, it has risen compared to the beginning of the 1990s before the launch of AFTA. However, further analysis is required regarding how much of the final goods produced using intermediate goods sourced from within the ASEAN region are being shipped to ASEAN, in other words, ASEAN’s position and the size of its role as a final area of demand.

10 Report by Intermit and Kharas (2007) presented by the World Bank.

technological change." It also states, "During [the last 50 years], outside of Europe, only a handful have gone from low-income [through middle-income] to high-income status. The part of the world that has been most disappointing is Latin America, where many countries reached middle-income levels and then, essentially, stopped growing." The report calls on East Asia to avoid this "middle-income trap."

The ADB (2011) predicted that if Asia[11] continues its steady growth, its share of global nominal GDP would rise from 23% in 2010 to more than half at 51% in 2050, giving rise to an "Asian century." However, it warned that middle-income countries such as Malaysia and Thailand are "facing the risk of being trapped." In the "trap" scenario, Asia's share of GDP in 2050 would be 32%, nearly 20 points lower than the "Asian century" scenario.

3.2 The "middle-income trap"

What exactly is the "middle-income trap"? Ono (2008) divides the stages of economic development of a country into a "first stage (low-income)" during which foreign-capitalized manufacturing industries arrive, and simple work and simple labor is performed, a "second stage (middle-income)" during which foreign-capitalized corporations accumulate, and supporting industries such as parts manufacturers are formed, a "third stage (middle-/high-income)" during which acquisition of technology progresses, and it becomes possible to manufacture high-quality products unassisted, a "fourth stage (high-income)" during which the country becomes a global industry leader with the ability to innovate, and the like, and explains that the barrier between the second and third stages, namely when transitioning from middle-income to high-income, is the "middle-income trap."[12]

Taking into account the World Bank (2007) report mentioned above as well, the following explanation is possible. Namely, a least developed country actively introduces foreign capital and takes advantage of its own abundant natural resources and inexpensive labor force to become a middle-income country relatively easily. However, in order to then transition to a high-income country, a new growth pattern is called for, including raising productivity, promoting heightened added value of industry, and the like. If this is not achieved, the country falls into the "middle-income trap," and the risk of stagnating growth heightens.

Based on the World Bank classification, ASEAN has six middle-income countries (Malaysia, Thailand, Indonesia, the Philippines, Vietnam, and Laos), and one low-income country (Cambodia).

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[11] Here, "Asia" is the 49 countries of Asia and Oceania. This includes the 10 ASEAN member countries.

[12] If these levels of development are matched to the Asian countries/regions, Vietnam would be at the first stage, Thailand and Malaysia would be at the second stage, South Korea and Taiwan would be at the third stage, and Japan, the US, and Europe would be at the fourth stage.

Thus, it can be understood that a majority of ASEAN countries are not unconnected to the risk of the "trap."

3.3 Initiatives of each ASEAN country

Amidst continuing discussion about the "middle-income trap," as seen above, the ASEAN countries are attempting to strengthen their policy efforts to avoid the "trap." Below, the two countries of Malaysia and Thailand are examined.

Malaysia: A sense of crisis over the "middle-income trap"

This country announced a mid- to long-term economic policy called the "New Economic Model" (NEM) in 2010. At that time, the government indicated the awareness of the situation that Malaysia had achieved middle-income country status by 1992, but "the steps after that have been sluggish"[13] and that "we are caught in a 'middle-income trap'" and "future growth prospects are extremely severe."[14] Malaysia has the large goal of becoming a high-income country by 2020.[15] To this end, the NEM was announced to break through the current state of suffering in the "trap," and to add momentum to meeting the goal. Malaysia is clearly aware of the "trap," and can be said to be the country that has the strongest sense of risk about future prospects among the ASEAN countries.

As reasons why growth has become sluggish, the NEM cites: 1) low value added industries, 2) stagnating productivity growth (Figure 7), 3) lack of human capital, 4) insufficient innovation, 5) difficulties of doing business, and the like. It indicates a policy for, in the future, promoting: 1) the re-energizing of the private sector, 2) the reduction in the reliance on (low wage) foreign labor, 3) the strengthening of the cultivation and development of human resources, 4) the management of the economy in a manner that is transparent and puts importance on market mechanisms, and the like. Regarding this series of policies, Oizumi (2011) explains that they shift the policy goals from "capital accumulation" to "increasing productivity," from being "government-led" to being "private-led," and from "favoring specific industries/corporations" to "favoring industries/corporations having high technological abilities."

For promoting the NEM, the Malaysian government also put together an investment promotion plan called the Economic Transformation Program (ETP) in 2010. The plan invests a total of 1.4

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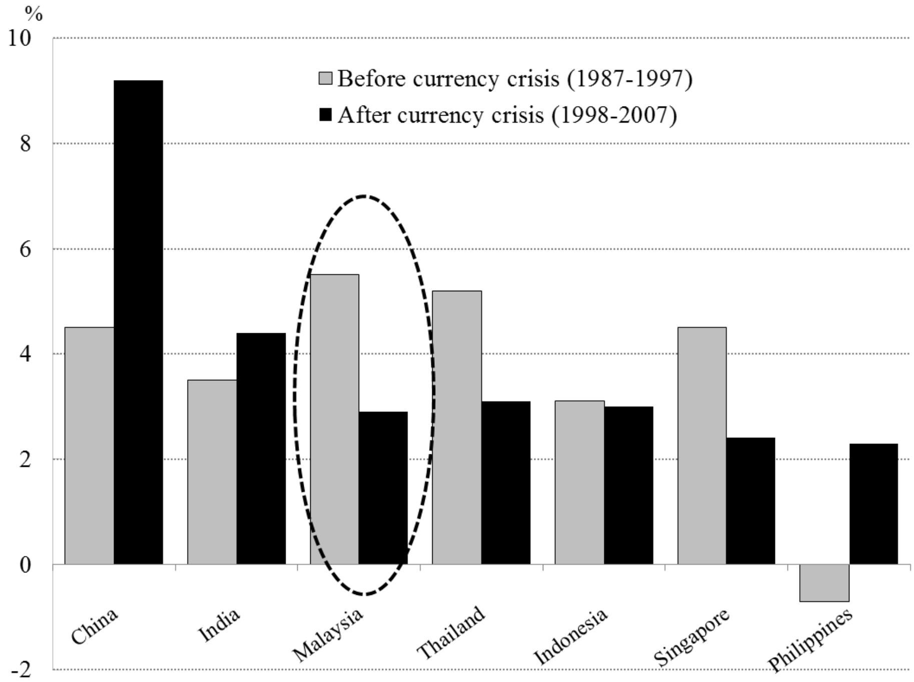
13 With Malaysia's real GDP growth rate viewed as a line graph from the IMF statistics, the average for 1980-1997 is 7.4%, and the average from 1999-2011 is 5.1%, and so the growth rate slowed with the boundary year being 1998, when the value was negative 7.4% due to the effects of the Asian Currency Crisis.

14 National Economic Advisory Council (2010).

15 The numeric target is for the income level per capita to become $15,000-20,000 (in 2010 it was about $8,400) by 2020.

trillion ringgit by 2020 in 12 key areas including finance, electronic/electrical, health/medical, education, infrastructure in the capital zone, and the like. It "aims to renew the industrial structure, which had been dependent on [labor-intensive] manufacturing, and to cultivate a high value-added service industry and the like." Of the 1.4 trillion ringgit, about 90% is for businesses, and the remainder being envisioned for government funds. Almost 30% of the former is allocated for investing in foreign businesses. The necessary business investments until 2020 are an average of 130 billion ringgit per year, a scale double the pre-ETP 2009 actual spending value (65 billion ringgit).

Figure 7: Average growth rate in labor productivity by country in Asia



Source: Produced based on National Economic Advisory Council (2010).

Thailand: Emphasizing "developing people with knowledge and skills"

A 5-year plan for 2012-2016 was developed called "The Eleventh National Economic and Social Development Plan. In it, there is the analysis, "In the past, the country's economy relied mainly on foreign investment and exports based on financial capital and low-wage labor that then became constraints for increasing competitiveness." Amidst the rise of least developed countries having lower-cost labor forces, a policy was indicated that, similar to Malaysia, puts energy into increasing productivity and increasing the value added of industries. Specifically, there is the numeric goal of raising the growth rate of total factor productivity (TFP) to at least 3%[16]. Also, it states that

[16] According to Asian Productivity Organization (2012), TFP growth of Thailand was 1.1% during the period of 2005-2010.

“the public and private join together and put energy into promoting technology” and indicates the intention towards creating a legal framework pertaining to competition policy and intellectual property protection, tackling the strengthening of infrastructure and distribution systems, and improving the business environment overall.

Thailand experienced unprecedented wide-scale floods in the fall of 2011, which had major effects, including damage to Japanese corporations many of which had expanded to Thailand, and the severing of the supply chain. In response, the Thai government released a “Strategy for Reconstruction and Future Development” in January 2012, and in addition to reconstruction aid due to the flood damage, indicates the idea of promoting structural reforms for increasing the competitiveness of the Thai economy. This strategy cites “enhancing the competitiveness of the production and service sectors” and maintaining the international competitive level and leadership as an important future strategy. As a specific plan for production, it describes “encouraging development based on innovation” in order to further develop industries that are strengths for Thailand such as automobiles, electrical/electronics, food processing, and the like, and for the service industry, it indicates the idea of “providing tax and financial supports to par with competitors, [and] searching and penetrating new potential markets.”

A common aspect to the economic strategies of both countries above is aiming to “increase productivity.” Both aim to turn to a growth pattern putting emphasis on quality instead of quantity, to reduce the risk of the “trap,” and to pursue further development. However, it is unclear whether these attempts will proceed as intended. This is because structural reforms are accompanied by opposition and backlashes from vested interests. For example, Malaysia is continuing the “Bumiputra [meaning son of the land in Malay] Policy,” which economically favors the majority Malay people and businesses. Also, if the “management of the economy that places importance on market mechanisms” in the NEM is to be accomplished, a revision would be unavoidable, but the Malay opposition would be deep-rooted, and success would be difficult. It is necessary to continue to be watchful about whether or not each country will be able to produce policies that can be implemented.

Conclusion

This chapter surveyed the current state of the ASEAN economy from the perspectivs of growth rate, economic scale, trade, FDI, population, and the like, and the fact that to Japanese corporations, ASEAN is an attractive destination for business expansion was seen. Furthermore, the economic relationship of the ASEAN countries was analyzed from the perspective of intra-regional trade, and it was observed that the degree of closeness is increasing through an expansion in trade of intermediate goods, or put another way, the situation was observed that ASEAN is firming up the foundation as a regional economic zone. Based on this, the fact that there is discussion about the "middle-income trap" was mentioned in regards to the future of the ASEAN economy, and the mid- to long-term economic strategies of multiple countries were surveyed. The "middle-income trap" is a major problem to the ASEAN countries, in order to reduce its risk, international organizations note that it is necessary to increase productivity, increase the value added of industries, strengthen human resources by expanding higher education and job training, promote R&D, develop distribution infrastructure, and the like. Quite a few of these are areas where the Japanese government and Japanese corporations can make a contribution through public assistance and investment activities. The achievement of sustained high growth by ASEAN would certainly be desirable to Japan, which has deep economic connections, including trade and investment, to the area. Japan should further assist the efforts by the ASEAN countries to overcome challenges.

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