

CHAPTER 2

ECONOMIES OF THE ASEAN COUNTRIES

Traditionally, ASEAN economies are endowed with a range of natural resources, both renewable and non-renewable. With the exception of Singapore, ASEAN countries export the bulk of the world's rubber, palm oil, rice, cocoa and coconut products, in addition to a significant amount of other commodities of mineral, including petroleum and natural gas. All of these commodities are the main source of capital formation for their economic growth in 1970.

In the early part of 1980, ASEAN countries faced a general slump in the world commodity market. This event really hurts ASEAN's economic well-being badly. During the first part of 1980's almost all ASEAN countries experienced a high rate of unemployment, and recession. This event prompted the ASEAN economies to undertake some structural adjustment within their economy. This included stepping up the efforts to expand their non-traditional exports like manufacturing. By the late 1980's, with the exception of Brunei and Indonesia, manufactured exports have overtaken primary exports as the main engines of ASEAN economic growth.

Ever since ASEAN changed their main economic activities, the region as a whole has become one of the fastest growing regions in the world.

According to Delphos International, ASEAN had over US\$ 300 billion in annual gross regional product with an average growth rate of 7% over the past 10 years. Also ASEAN nations recorded double-digit growth in manufacturing resulting from increase foreign and domestic investment in industry and manufacturing.¹³ Table 2.1 on page 22 shows that industry and manufacturing contribute a higher GNP distribution per economic sector for the majority of ASEAN states.

When looking at ASEAN in general, it seems that all the member states enjoy about the same economic growth. In fact, the scenario will be different if each individual country is being analyze specifically. ASEAN nations are actually different from one another in term of size, resource endowment, and economic development. A brief information about the ASEAN nations's government is stated in Appendix 1.

Brunei Darussalam

Brunei Darussalam is the smallest country in terms of size and population in ASEAN. It has only 0.2 million people with a per capita income of US\$ 19,400. This per capita income is the highest in the region. A major portion of it's GNP is contributed by the petroleum and natural gas industry (secondary). The petroleum industry employs about 10 percent of the country's labor force. About 50 percent of the labor force works for the government, the largest employer by far. In addition to that, Brunei also has

¹³Michelle Dalton. *ASEAN Show Potential, But Beware of Pitfalls*. Global Trade and Transportation Vol 114 August 1994 p. 15-18

a small agricultural, fishing, forestry, and manufacturing industries. Though Brunei enjoys the highest per capita income, it is expected that Brunei will be experiencing a negative Growth Domestic Product in 1996 (-0.5%) on account of the weak oil prices. In other words, if Brunei wants to have a positive rate of GDP, the country has to venture into an alternative industry so that they are not totally dependent on oil industry.

The country has to venture into alternative industries as soon as possible not only due of the weak oil prices but also because the country's petroleum reserves are expected to last only until the early 2000's. When Brunei runs out of petroleum and gas, the government may not be able to afford to pay the large number of employees it now has. Currently, the government is encouraging the creation of more jobs in private business and in agriculture. Brunei's chief trading partners include Japan, Singapore, and the United States.

Indonesia

Indonesia is the largest country in ASEAN in terms of size and population. It has a population of 189.14 million and per capita income of US\$661. Indonesia is rich in a variety of natural resources. Much of the country's soil is especially fertile because it contains volcanic ash. Therefore, agriculture is Indonesia's major economic activity. Indonesia exports coffee, palm oil, rubber, sugar can, tea, and tobacco. Indonesia is also one of the chief producers of petroleum in the Far East. Petroleum and natural gas are Indonesia's chief exports. Its is also a leading tin-mining country and has one

of the world's largest fishing industries.

Indonesia's current gross domestic product is more than US\$ 126 billion and an expected growth of around 6 percent until the year 2000. Manufacturing is a relatively small industry in Indonesia. The products manufactured in Indonesia meets only a small part of the country's need for manufactured goods. Most Indonesian factories process farm products or produce such consumer goods as cigarettes, cotton cloth and other textiles, glassware, and soap. Several plants assemble cars and trucks, using imported parts and machinery. Indonesia also produces cement, chemical, paper, petroleum products, small ships, and wood products. In terms of the contribution to total GNP, the manufacturing sector contributes only 42 percent of Indonesia's total GNP. Since Indonesia is in the process of shifting its industry from secondary to tertiary, the country is expected to continue experiencing a deficit in balance of payments. In 1995, Indonesia's balance of payment is estimated around US\$ -3.6 billion.

Malaysia

Malaysia has a population of 19.5 million people and per capita income of about US\$ 3000. In other words, Malaysia has one of the strongest economies in Southeast Asia. Its economy depends heavily on the products such as petroleum, rubber, timber, and tin. But the country also produces a variety of farms corps and manufactured goods. Agricultural sector plays a major but declining role in the Malaysian economy. Its contribution to the gross domestic product (GDP) decreased during the 1980's. Malaysia is the

world's largest producer of natural rubber and palm-oil. It is the fourth largest producer of cocoa. In addition, Malaysia is the third largest producer of tin and ranks 13 in the world in natural gas reserves.

The major manufacturing activities are electronics, plastics, textiles, rubber, and wood products. Chemicals, petroleum and high technology industries are playing an increasingly important role in the economy. Malaysia's major trading partners are the ASEAN countries, Japan, the U.S.A., and the European Community. These partners account for 75 percent of the total value of trade.

Malaysia's real gross domestic product (GDP) grew an estimated 8.5 percent. Factors behind this growth have been political stability, a successful export substitution strategy, encouragement for foreign investment, development of country's infrastructure and human resources and growth of a large middle class.¹⁴ Like Indonesia, 42 percent of Malaysia's GNP comes from tertiary industry. Malaysia will continue experiencing a deficit in its current account balance due to the continued large outflow in its freight and insurance payments.

The Philippines

The Philippines has a population of 64.26 million with a per capita income of US\$ 692. The country's economy traditionally depends heavily on the production of crops and timber. Agricultural accounts about a quarter of the GDP. Philippines produces most of the food needed to feed its entire

¹⁴Jean Kelly. *Commercial Opportunities in ASEAN*. 8

population. The country is rich in mineral resources and minerals are important for exports. The estimated reserves of copper and nickel are among the richest in the world.

Manufacturing accounts for a third of the GDP. The manufacturing of food and beverages is the largest single industry in the manufacturing sector. Other major industries of the Philippines produce cement, chemicals, cigars, clothing, electrical machinery, refined metals, petroleum products, sugar, textile, and wood products. In terms of GNP, 43 per cent is contributed by this industry.

Philippines's GDP grew an estimated 5.0 percent in 1995. The Philippines is expected to do well in terms of economic growth due to the political stability being enjoyed presently. The Philippines major trading partners are the United States.A., Japan, Australia and the European Community.

Singapore

Singapore is the most developed of the ASEAN nations, with a per capita income of approximately US\$ 14,000. With a population of only 2 million people, Singapore is enjoying a highest standard of living in ASEAN. Its real GDP growth is around 6.3 percent. Singapore served as the center for import and export of goods in Southeast Asia. It is also a warehousing and distribution center for the region. However, Singapore is the only nation in ASEAN which does not has any natural resources.

Singapore is also a major manufacturing center in the region. Its

factories produce chemicals, clothing and textiles, electrical and electronic equipment, household appliances, machinery, optical and scientific apparatus, and rubber and plastic products. It is also a major center for food processing, petroleum refining, and shipbuilding and repairing. In short, the manufacturing industry is very important to the country's economic growth. The industry contributes 70 percent of its total GNP. Singapore's main trading partners are the European Community, Japan, Malaysia, and the United States.

Thailand

Thailand has a population of almost 65 million, Thailand's per capita income is about US\$ 1,780. Thailand's GDP growth is expected to reach 8.6 percent in 1996. Its economy depends mainly on agriculture and manufacturing. Over 63 per cent of the nation's workers make their living by farming. Thai farmers cultivate 25 percent of the nation's land, mostly to grow rice. Other leading crops include cassava, maize, pineapples, rubber, sugar cane, and tobacco.

Only 11 percent of the workers are involved in manufacturing. Though the percentage of the workers involved in manufacturing is low, the industry contributes 51 percent of Thailand's total GNP. Since late 1980's manufacturing, wholesale and retail trade, and service industries are the most rapidly growing sectors. The leading industries in the nation are cement, food products, paper, plywood, and textiles. Many international companies operate factories in the Bangkok area. These plants assemble cars and electronic equipment, and manufacture drugs and other products.

Tin is Thailand's most important mineral, and the nation ranks among the world's leading tin producers. Mines in Thailand also provide large amounts of bauxite, iron ore, lead, manganese, precious stones, and tungsten. Tourism is an important source of income for Thailand. Thailand's most important trading partners are Japan and the United States.

Vietnam

Vietnam, which is the newest member of ASEAN is actually not at par with other ASEAN nations in terms of economic development. The country's per capita income is only about US\$ 200. The population is about 63.4 million people and about 70 percent of work force is employed in the agricultural sector (primary). Vietnam's chief products are rice, cassava, coffee, coconuts, cotton, jute, maize, peanuts, soya beans, sugar cane, sweet potatoes, tea, tobacco, and rubber. Fishing is also important to Vietnam's economy. This agricultural and fishing industry contribute 48 percent of Vietnam's total GNP.

Though Vietnam has a socialist economy, the government has begun an economic restructuring that encouraged some forms of private enterprise and competition. Vietnam lacks the natural resources needed for heavy industry because it only has a small iron and steel industry. In terms of manufacturing industry, Vietnam is currently venturing into industries like cement, fertilizer, food processing, paper, and textiles.

Vietnam is expected to experience a very rapid economic development and growth rates since it joined ASEAN and open its market to the world. Currently, Russia is Vietnam's chief trading partner.

TABLE 2.1
The Economies of ASEAN

Country	Area (mi/000)	Population (million)	GNP (US\$/000)	Per Cap GNP (US\$)	GNP Distribution (%) per economic sector		
					Primary	Secondary	Tertiary
Brunei	2	0.2	5.04	19,400	2.0	76.0	22.0
Indonesia	752	189.14	101.15	661	20.0	38.0	42.0
Malaysia	127	19.05	41.36	3,009	18.0	40.0	42.0
Philippines	116	64.26	46.20	692	24.0	33.0	43.0
Singapore	.2	2.82	33.60	13,848	1.0	29.0	70.0
Thailand	198	57.79	79.80	1,780	16.0	33.0	51.0
Vietnam	127	63.4	13.40	200	48.0	27	25

Source: The Europa World Yearbook 1994; Economic Intelligence unit, World Development Report 1990; Ministry of Finance 93/94

PRE-AFTA ARRANGEMENT

ASEAN economic cooperation actually started after the summit of ASEAN heads of government in Bali, Indonesia in February 1976. The Declaration of ASEAN Concord which was signed at the summit established the *modus operandi* of subregional economic cooperation. In the summit four major areas of cooperation were identified to be the instruments of the cooperation. First, cooperation in basic commodities particularly food and energy. In this area of cooperation, each member country agrees to allow each other priority access to supplies and markets in critical circumstances.

Second, in industrial cooperation, where member countries will establish large scale regional industrial projects. Projects that are able to contribute to the basic needs of the region and utilizing local raw materials will be ventured. Third, cooperation in trade where member countries will have to promote intra-ASEAN trade through preferential arrangements and greater access to extra-regional markets. Fourth, joint approaches to international commodity problems where member countries are encouraged to take a common decision in dealing with any problem regarding the international commodity and other world economic issues.

Cooperation in Basic Commodities

ASEAN members agreed to cooperate in the establishment of large scale industrial plants to produce essential commodities, particularly to meet regional requirements. The instruments, known as the ASEAN Industrial

Projects (AIP), provides for the allocation of a project to member country. The aim of establishing this project is to permit maximum utilization of potential scale of economies as well as comparative advantages within the organization.¹⁵ Therefore, only one or two plants of a kind will be built in the region and that particular plant should serve all member countries. Projects that had been identified for AIP in 1976 were: urea projects for Indonesia and Malaysia, superphosphate projects for the Philippines and soda-ash projects for Thailand. In 1977, projects like heavy duty rubber tires for Indonesia, metal working machine tools for Malaysia, newsprint and electrolytic tin-plating for Philippines, TV picture tube for Singapore and potash and fisheries for Thailand were identified.

In terms of equity or ownership of each plant, ASEAN members agreed to divide the equity among the members. The Host country will take up 60 percent of the total equity and the remaining 40 percent being equally shared among the other member countries.

Cooperation in Industrial Projects

Industrial cooperation holds the key to the continuing growth of ASEAN economy. The cooperation is hoped to increase ASEAN countries to pool their scarce resources to provide a critical mass for the development of large scale industries. It will also allow the members to reduce capital costs and enable maximize use of limited skilled manpower resources. Therefore, the member

¹⁵Han C. Blomqvist. *ASEAN as a Model for Third World Regional Economic Cooperation?*. ASEAN Economic Bulletin, Vol.10 Number 1. July 1993

countries agreed to set up ASEAN Industrial Complementation (AIC) and ASEAN Industrial Joint Venture (AIJV).

The objective of AIC was to promote exchange of industrial products among members in order to facilitate an economic scale of production. The projects was also aimed to achieve simple horizontal specialization in production by which member countries specialize in producing different components as parts for the same projects.¹⁶

AIJV, on the other hand, was introduced to promote joint investment among the private sector of the member countries. Unlike AIC, the latter can proceed even with only two private sector partners from ASEAN. AIJV investors are free to locate their operations in any of the participating countries.

Cooperation in Trade

On February 24, 1977, the Foreign Ministers of ASEAN signed on agreement on Preferential Trading Arrangement (PTA) to promote intra-ASEAN trade. The agreement was to be achieved through preferential tariff, long-term quantity contracts, preferential terms for the financing of imports, preferential procurement by government agencies, and the liberalization of non-tariff barriers.¹⁷

PTA's are intended to promote intra-ASEAN trade in basic commodities

¹⁶Linda Martin. ed. *The ASEAN Success Story: Social, Economic, and Political Dimensions*. (Honolulu: East-West Center, 1988) 102

¹⁷Gerald Tan. *Trade Liberalization in ASEAN: AERU Research Notes and Discussion Paper* (Singapore: Institute of Southeast Asian Studies, 1982) 32.

as well as in industrial products besides enabling the member countries to attain scale economies in production.

Joint Approaches to International Commodity Problem

In terms of joint approaches, ASEAN members have been taking a common stand in ensuring that the price of their primary commodity exports will not fluctuate drastically. Normally the efforts have been exercised through the United Nations Conference on Trade and Development (UNCTAD), the nonaligned movement like the G15, and dialogues with major economic power in the world; the United States and Japan.

ASSESSMENT OF PRE-AFTA ECONOMIC COOPERATION

One of the benefits of promoting economic cooperation among the member states is that a supranational body which produces "public goods" will emerge. In the 1970s, this supranational body was really needed by all the member states due to their inability to produce everything that is needed to develop the country. Therefore, cooperation of this kind is desirable in many cases from an efficiency point of view. In terms of political economy, the basic reason for the existence of supranational organizations is that they produce an "output" that the member countries cannot or will not produce or can produce less efficiently. Though the objectives are good, but in reality there are lots of obstacles to be encountered. This is because behind all aspects of economic cooperation lies the political will to cooperate.

The political will of the member countries towards economic regionalism can be gauged by the degree of willingness to share markets and pool resources through special or preferential economic relations. Such arrangements imply a degree of discrimination against nonmembers of the regional group. ASEAN, in general, is willing to pool resources, but not ready to share market. Though there are lot of plans established to strengthen the regional economic cooperation, national priorities and sovereignty will always come before regional priorities.

Constraints to ASEAN Economic Cooperation

The ASEAN countries are similar in many respects and yet different in others. It is these similarities and differences which pose obstacles to have greater cooperation in trade among them. There are at least six reasons on why the ASEAN economic cooperation is not fruitful. First, there are a fundamental regional differences. Due to difference in ethnic composition, religion, culture, and language, there are differences in the approach to life and the setting of priorities. Since goals for development and priorities differ from country to country, conflicting situations are inevitable .

Second, regional interest were only accorded priority if they coincided with or promoted national interest. Therefore, decision made by any ASEAN foreign minister will affect the national interest of his country, excessive bureaucratic procedures is needed at both the ASEAN and national level. This will result delays of a year or more for approvals of any projects which ultimately have weakened the attraction of the various schemes. Third, there

is a lack of commitment to implement the schemes. In every decision made by the ASEAN Secretariat, there is no follow up with thorough promotion. Therefore the attractiveness and feasibility of each project is not clearly known to third parties especially the private sector. Fourth, the private sector is not involved in the decision making process at a regional level. In other words, the private sector is not given any substantive role under the scheme although there is a lot of emphasis on private-public sector cooperation. Fifth, government leaders were more concerned with the cost associated with cooperation than rather the spillover of benefit, and therefore were reluctant to pursue greater cooperation. Lastly, the member countries have relatively similar production structures and compete for the same export markets. With an exception of Singapore, the other ASEAN countries are predominantly primary producers specializing in the export of food, raw materials and minerals. Due to this reason, obviously they have to compete among themselves in order to maximizing the nations wealth. Though basically all ASEAN members are primary producers, the level of development differ significantly. This is because of the differences in terms of the value of the primary goods that each country produces. Therefore, the less developed members are reluctant to open their economies to competition from the more advanced countries even if the country is from the same region..

BACKGROUND OF AFTA

The commitment of creating ASEAN Free Trade Area (AFTA) in the region was shown by the Head of States of ASEAN on January 1992 when they met in Singapore for the Fourth ASEAN summit. According to the agreement, ASEAN will be a free trade area in 15 years or by the year 2008. However, at the 26th ASEAN Economic Minister meeting in September 1992, they decided to move the expected establishment of AFTA to the year 2003. This event indicates that all the member states are really committed in forming a free trade area in the region. After about 25 years of slow progress in ASEAN economic cooperation, the consent of all the member states to form a free trade area is a tremendous step forward.

The idea of creating AFTA came into existence because the members of ASEAN are confident that its establishment will enhance intra-ASEAN trade and contribute to the openness of the ASEAN economy. There are at least four reasons or factors that lead the ASEAN member states to form AFTA. First, AFTA can serve as a safeguard to the member countries in terms of their economy stability. All member states want to have an economic reform as a result of hardship they suffered from external circumstances in 1980s.

Second, AFTA will stimulate foreign and ASEAN investments. AFTA may attract foreign investment in two ways. First, it is attractive for transnational companies seeking production and marketing bases using a mix of strategic location, cheap labor, adequate natural resources, skilled professionals and efficient infrastructure provided by almost all of its members.

AFTA Agreement and Scheme

There are three short documents issued by the Fourth ASEAN Summit for the creation of AFTA: (1) Singapore Declaration of 1992; (2) Framework Agreement on Enhancing ASEAN Economic Cooperation; and (3) Agreement on the Common Effective Preferential Tariff (CEPT). The CEPT scheme was being implemented from January 1, 1993. The summary of the contents are as follows:

- * Generally, import tariff rates for all products excluding of agricultural products will be cut to 0-5 percent within 10 years (by 2003) if the current import tariff rates is below 20 percent. But if the current import tariff is above 20 percent, then the member countries have to cut the tariff to 20 percent within 5-8 years (2000). Finally, the tariff will be further reduced to 0-5 percent by 2003.
- * For product groups identified to be included for accelerated tariff reductions under CEPT, the import tariff rates will be reduced to 0-5 percent in seven years if currently they are above 20 percent. For products which have import tariff above 20 percent, then tariff will reduced to 0-5 percent in ten years. Products that are included for the accelerated tariff programs are: Vegetable oils, cement, pharmaceutical, fertilizers, plastics, rubber products, leather products, pulp, textiles, ceramic and glass products, gems and jewellery, copper cathodes, electronics and wooden and rattan furniture.
- * In terms of the rules of origin, preferential tariff rates will only be applied

to products which have 40 percent ASEAN content and at least 25 percent local content produced in the exporting country.

- * All non-tariff barriers to be removed on products whose imports tariff are being reduced under CEPT. Also, all restrictions on quantities such as import bans or quotas are to be replaced by tariffs and reduced according to the CEPT schedules. Finally, import or export licences on these products are also outlawed, as are foreign-exchange licences.¹⁸

In short, the CEPT formula will be used for cutting tariff and creating the AFTA by the year 2003. Recently, the AFTA council has endorsed the new tariff reductions scheduled for CEPT which will be implemented from January 1996. The council had decided to include 40,960 tariff lines in the 1996 CEPT list. In addition, the council also noted the reduction in average tariff rates for those products in the inclusion list from a ASEAN average of 7.76 percent in 1996 to 2.95 percent by 2003.¹⁹ The movement of the tariff reduction in all the ASEAN countries is as shown in Table 2.2

¹⁸Wolfgang Moellers and Rohana Mahmood eds. *Asean: Future Economic and Political Cooperation*. (Kuala Lumpur: Institute of Strategic and International Studies Malaysia, 1993), 6

¹⁹Lim Hock Chye, "Rafidah Amenable to Afta by 2003," Star, 7 September 1995.

TABLE 2.2
Average Common Effective Preferential Tariff Rates

	1996	1997	1998	1999	2000	2001	2002	2003
Brunei	2.46	2.29	1.91	1.74	1.39	1.39	1.39	1.39
Indonesia	11.63	10.61	8.84	7.91	5.81	5.70	5.00	4.25
Malaysia	5.93	5.15	4.42	3.67	2.90	2.83	2.83	2.83
Philippines	9.17	8.33	7.16	6.53	5.42	4.90	4.89	3.73
Singapore	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Thailand	14.10	12.69	10.15	9.28	7.00	6.99	5.78	4.63
ASEAN	7.76	7.00	5.79	5.19	3.97	3.88	3.47	2.95

Source: Azhar Abu Samah, "Afta 2003 Sasaran ASEAN," *Berita Harian*, 15 September 1995.

The table above indicates that if the program schedule goes as planned, the ASEAN average common tariff rates scheme will be around 2.95 percent. Only three countries will have an average common tariff higher than ASEAN's average. They are Indonesia, Philippines and Thailand. Despite that, all the countries will have common tariff rates of 0-5 percent on all products traded between themselves. Within the phase-in of 10 years, the preferential tariff rates will be at the same level among ASEAN members and are expected to fall altogether with some minor difference according to the agreed program. Of course, if ASEAN commits itself to the benefit of a pre-set schedule for tariff reduction, then the stakes of AFTA will be assured a greater chance for success.

implementation, he said that many member countries do not worry too much on reducing tariff on all the products. He added by saying that many countries will include the products that they would protect in the exclusion lists. He believed that countries like the Philippines, Indonesia and Vietnam need more time in implementing the AFTA agreement in their country.