Southeast Asia in the global economy: a selective analytical survey

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This paper selectively surveys Southeast Asian economic development over the past half-century and anticipates some of the region’s challenges if it is to progress to the ranks of developed countries. In the long sweep of development, three key features stand out. First, the region’s “initial conditions” in the early post-independence period appeared to be quite unfavorable. The literature at this time reflected the resulting pessimism. But, second, several countries belong to the very small group to have achieved historically unprecedented growth since the 1960s. The drivers of rapid growth remain contested. But the common feature has been a strong commitment to reasonably broad-based economic growth. Moreover, third, the propensity for growth in the region has spread as countries have progressively joined the regional and global mainstream. Policy regimes that favored outward orientation and prudent macroeconomic management have generally resulted in faster growth. The accurate forecasting of crises and growth decelerations has proven to be elusive, reinforcing the view that an eclectic, historical, and multi-disciplinary framework is necessary to understand the region’s long-term development dynamics.

JEL classification: N15, O53, P52.

Keywords: economic growth, global economy, Southeast Asia Association of Southeast Asian Nations
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1. Introduction

The concept of “convergence” is a well-established—if obvious—proposition in modern development economics. That is, in a world of technological diffusion, ceteris paribus, countries behind the global frontier will over time converge towards that frontier. This is premised on the notion that, in a globalized world,
technologies, broadly defined, will spread from the more to the less advanced economies, directly through trade, investment, and migration, and indirectly through learning by doing, emulation, and other means of diffusion.

Of course, what lies in the *ceteris paribus* clause is crucial. As leading economic historians have reminded us, for much of the past two centuries and more, the advanced economies have tended to pull away from poorer countries. Colonial subjugation was a key reason for the absence of convergence. But, not unrelated, in the post-colonial era, the absence is generally attributed to a set of inter-connected factors sometimes summarized as “geography, institutions, and policies” [Rodrik 2003].

The variable economic outcomes in the post-colonial era led to major refinements to the concept of convergence, between absolute and conditional convergence. That is, some developing countries have been “catching up”, as proxied by the difference between their per capita incomes and that of the United States. The fact that relatively few developing countries have been converging consistently over the past half-century in turn led to the challenge of unpacking this “conditionality”, that is, the search for explanations for differences in long-term growth rates. In the words of one of the key figures in this literature, Robert Lucas, “The consequences for human welfare…are simply staggering: Once we start to think about them, it is hard to think about anything else”. Moreover, as databases became richer and econometric techniques more sophisticated, economists were able to “run two million regressions” (and a lot more), the title of one of the most cited papers in this literature [Sala-I-Martin 1997].

As the most dynamic region of the world over the past half-century, East Asia has been central to the elusive quest for explanations for economic growth, and why it has differed so much between countries.1 The purpose of this paper, written in memory of the late Professor Amado Castro, is to situate the Southeast Asian economies in this broader literature on development dynamics. Section 2 sets the scene with a brief examination of long-run East Asian economic dynamics. In section 3, the main part of the paper, we look back, briefly surveying economic trends, including the identification of turning points and their causes that marked the onset of sustained economic growth in the modern era and also the interruptions to this process of growth. Section 4 looks forward and identifies some of the key future challenges.

Three additional points need to be emphasized at the outset. First, the inclusion of the phrase “in the global economy” in our title is a deliberate one. It is central to our narrative, as it is our contention that well-managed economic openness has been one of the keys to Southeast Asia’s economic success. Second, this paper

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1 Perkins [2013] provides an accessible analytical account of much of the relevant literature.
is an attempt—perhaps a heroic one!—to compress a vast amount of material on a book-length topic into a relatively short paper. The discussion is therefore highly abbreviated, attempting to selectively highlight elements of the big picture. Third, as historians emphasize, “Southeast Asia” is a relatively recent construct, dating from the early 20th century [Reid 2015], and its geographical boundaries perhaps still remain fluid. Do its eastern boundaries extend to the Melanesian region, for example, to include the state of East Timor? We put aside this question by simply adopting the current Association of Southeast Asian Nations (ASEAN) 10-nation definition.

2. Setting the scene

Our main narrative centers on Southeast Asia’s economic dynamism in the post-colonial era. In spite of the early pessimism and the prolonged economic stagnation in several of the economies, Southeast Asia has been one of the most dynamic regions in the world over the past half-century. Figure 1 and Table 1 set the scene over the long run.

The processes of long-run economic development and convergence are best illustrated with reference to a country’s per capita income relative to the global “frontier”. For convenience, the United States is typically employed as the proxy for the frontier. Figure 1 richly displays three main features of the region’s dynamism: the general process of Asian convergence; the diversity of country experiences; and the episodic nature of economic development. We briefly elaborate on each aspect, drawing attention in particular to the Southeast Asian record.

The first point to note is the difference in initial conditions in the early post-colonial period. Despite the massive wartime destruction, Japan in 1950 had one of the region’s highest per capita incomes, along with the two city states and the then Malaya. At the other end of the spectrum, the populous states of China, India, Indonesia, and Pakistan (which then included Bangladesh) had among the lowest incomes. The Philippines was ahead of all of its neighbors except for Malaya and Singapore.

The second observation is the diversity of outcomes. It is convenient to identify four main groups of economies. As is well-documented, the early stars comprise Japan and the four Asian Newly Industrialized Economies, which had all graduated to high-income status by the 1990s. Beset by a prolonged recession since the early 1990s, Japan has been overtaken by the two city states, while on current trends Korea and Taiwan may also overtake Japan. Next are the consistent

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2 It is important to note a caveat concerning the rudimentary state of national accounts data for most countries around 1950. Greater confidence attaches to the data from around 1960, which therefore provides us with a little over half a century of accurately recorded economic development.
performers, Malaysia and Thailand which, while never growing as fast as the first group, are now well into the upper middle-income group. A third group consists of the high-growth late developers. Along with the early growth of Japan, which demonstrated the possibility of Asian economic success, this has been a landmark achievement in Asian development as rapid growth took root in the three very poor Asian giants: China, India, and Indonesia. During the 1950s and 1960s, they had slipped further behind the frontier. Then followed three fairly distinct turning points, as the leadership itself in each country committed to growth: 1978 in China; 1966-1967 in Indonesia; and 1991 in India. The immediate trigger in India and Indonesia was an economic crisis (in Indonesia’s case in the context of traumatic political turbulence). Authoritarian regimes implemented the reforms in China and Indonesia, while India remained democratic throughout the period.3 Vietnam after the late 1980s Doi Moi reforms also joined the growth club, while the smaller Indochina economies—Cambodia and Laos—followed in its wake.

The remaining economies are more difficult to characterize. Ironically, in the early development literature, three of them were expected to be success stories: Pakistan, the Philippines, and Sri Lanka. But they have all slipped further behind the frontiers for extended periods. Sri Lanka would marginally qualify for inclusion in the late-developing high-growth club, following its successful reforms in the late 1970s.5 The Philippines would also need to be graduated to this club if its current growth momentum is sustained [Clarete et al. 2018].

Comparative global analyses confirm East Asia’s pre-eminence in the international growth stakes. The World Bank’s [1993] East Asian miracle study drew global attention to the region’s spectacular growth. The Bank’s Growth Commission [WB 2008] report confirmed these findings, asking in particular which economies over the preceding century had achieved sustained and rapid economic growth. The benchmark chosen was average annual growth of at least seven percent for at least a decade. The results are reported in Table 1.

3 Although the common feature was a growth acceleration, the turning points, the reforms, and their drivers differed considerably across the three countries. See, for example, Naughton [2006] on China, Joshi [2017] on India, and Hill [2000] on Indonesia.
4 See Morawetz [1977] for an illuminating survey of the early literature on thinking about developing country prospects—and how wrong several of the key forecasts were!
5 In fact, Sri Lanka does not fit easily into any of the groups. It enjoyed favorable initial conditions, including good social indicators, a sound administrative structure, a functioning political system, and a relatively painless transition to independence. It then progressively turned inward for the first three decades of independence until the 1977 liberalization reforms re-energized the economy. Growth accelerated, only to be held back subsequently by almost 20 years of increasingly destructive civil war. See Athukorala et al. [2017].
FIGURE 1. Ratio of real GDP per capita (PPP), selected Asian economies relative to the US, 1995-2013

Source: Armstrong and Westland [2016:209] based on Maddison Project data. (I am grateful to the authors for permission to use the data.)
Several points warrant emphasis. First, rapid growth is a highly unusual phenomenon, with less than 10 percent of the economies surpassing the benchmark. Second, East Asia clearly dominates, with nine out of the 13 economies. Third, the non-East Asian four are also unusual, perhaps atypical. Three of them are very small, with populations of less than five million people. The one major country, Brazil, has had spectacular but erratic growth. Following the period of rapid growth observed in the table, per capita income in aggregate did not increase over the following two decades. During the 21st century commodity boom, its performance again attracted global attention as a member of the so-called BRICS (Brazil, Russia, India, China, and South Africa) countries, only to experience a sharp contraction and a deep political-economic crisis as commodity prices fell.

Finally, if the analysis were being undertaken a decade later, there would be additions to the group, including Chile, India, Vietnam, and Cambodia. Importantly, the East Asian ascendancy is now spreading to South Asia, particularly as India began to “look East”.

Over the long run, a further hierarchy emerged, notably within the high-growth club. Although these economies were growing quickly, annual differences of two to three percentage points, compounded over decades, resulted in large differences between the very high and moderately high growth economies. Table 2 shows the multiples by which per capita income grew in selected East Asian economies over the half-century from 1960-2010. The differences are stark. Per capita income in China and the Newly Industrialized Economies rose by at least 12 times over this period. The China record is particularly notable as most of the very high growth occurred in the second half of this period. By contrast, in the Southeast Asian states, the increase was a still respectable five- to eight-fold, about half that of the first group. As with China, Vietnam’s inclusion is notable for the fact that its reforms and growth really only impacted in the last 20 years.

6 We use the term “economy” here advisedly, consistent with current parlance as applied to Hong Kong and Taiwan.
7 In passing, the contrast with Indonesia is striking: Indonesia was not included in the grouping of Brazil, Russia, India, China, and South Africa, but it has maintained healthy growth after the commodity boom.
8 For convenience here, Singapore is placed analytically in the Northeast Asia group.
The Philippines is the clear East Asian outlier, as would be Myanmar if accurate national accounts data were available.

**TABLE 2. East Asian per capita income, 1960-2010 (ratio of GDP per capita, 2010/1960)**

<table>
<thead>
<tr>
<th>Nation</th>
<th>Ratio 2010/1960</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>12.4</td>
</tr>
<tr>
<td>Korea</td>
<td>15.6</td>
</tr>
<tr>
<td>Singapore</td>
<td>12.4</td>
</tr>
<tr>
<td>Malaysia</td>
<td>7.9</td>
</tr>
<tr>
<td>Thailand</td>
<td>8.2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5.5</td>
</tr>
<tr>
<td>Vietnam</td>
<td>5.0</td>
</tr>
<tr>
<td>Philippines</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Source: Perkins [2013:2]

3. **Looking backwards**

We develop our narrative looking backwards, from 1945 onwards, with reference to four points in time which capture the prevailing mood of each period.

3.1. **1945: Hope**

In spite of the terrible wartime destruction, this was a period of hope for the region, based on the unexpectedly rapid decolonization process that occurred in the wake of the Japanese surrender. This is not the place to discuss the legacies of centuries of colonial rule, other than to make the general observation that colonial rule had obviously suppressed indigenous aspiration and entrepreneurship. During the earliest days of colonialism, many local economies deliberately turned inwards as a means to avoid Western aggression. The result, as described by Acemoglu and Robinson [2012:250], drawing on Reid’s work, was that “… colonialism fundamentally changed (Southeast Asia’s) economic and political development. The people … stopped trading, turned inward. … In the next two centuries, they would be in no position to take advantage of the innovations that would spring up in the industrial revolution”.9

Ironically, in the early post-colonial era, even after many of them had thrown off the colonial yoke, many Southeast Asian countries, like the Third World in general, would again turn inward, for various reasons and in different ways. A common element was that the anti-colonial struggle had also led to a rejection of the liberal capitalist model more generally among much of the elite nationalist leadership. The prevailing theories of the time also favored import substitution and planning, the former articulated comprehensively by the Argentinian economist Raúl Prebisch, the latter supported by the widespread appeal of the Soviet model, especially in India.10

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9 See also Booth [2015] and Williamson [2015] and references cited therein for detailed analyses of the Southeast Asian economies in the late colonial era.
10 See Arndt [1987] for a survey of development thinking over this period.
The process of global economic disengagement, or at least retreat, took various forms and was reinforced by the territorial separation imposed by the Cold War. In Burma, General (later President) Ne Win declared the “Burmese Road to Socialism” in 1962, a decision that held back the country’s development for the ensuing half-century. Its ideology was of such “purity” that the country even withdrew from the Non-Aligned Movement, then the pre-eminent forum for developing country discourses following the pioneering 1955 Afro-Asian Summit in Bandung.11 A driver of the Burmese retreat was the lingering effects of what nationalists saw as the country’s “double colonialism”, imperial Britain administering the colony with an Indian civil service [Thant 2011].12 The ethnic complexities introduced during colonial rule, particularly when they resulted in segmented occupational structures and large wealth disparities, were also to trouble other countries in the early post-colonial period, particularly Indonesia and Malaysia.

By contrast, the Philippine retreat was more or less accidental, in that a severe foreign exchange crisis precipitated the imposition of wide-ranging import controls, around which powerful industrial lobbies quickly emerged that would take decades to dismantle. As Power and Sicat [1971:33] observe: “The adoption of a strategy of encouraging manufacturing behind protection was more or less inadvertent … and what began as an emergency tactic in balance of payments policy became the principal instrument for promoting industrialization over the decade of the 1950s”.

It is no coincidence that the two countries that experienced the most difficult paths to independence, Indonesia and Vietnam, also had the most severe economic problems. These problems cast a shadow over the entire region. In Vietnam’s case, the 1955 peace settlement that divided the country in two resulted in one of the most protracted and serious conflicts in Southeast Asia. In turn, it led to the widespread belief that its neighbors would become “dominoes” that would eventually be engulfed by communism’s southward thrust. Indonesia was significant owing to its size—about 40 percent of Southeast Asia’s population— and the fact that its domestic political instability spilled across the border. In the early 1960s, the country had joined the “Peking-Pyongyang-Hanoi-Phnom Penh-Jakarta axis of newly emerging forces”. It had withdrawn from the United Nations and the Bretton Woods institutions. In May 1964, President Sukarno memorably told western donors they could “go to hell with their aid” [Legge 2003]. Beginning in 1963, he also embarked on a strategy of Konfrontasi in opposition to the establishment of Malaysia. This led to armed skirmishes on

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11 Mackie [2005] provides a useful retrospective on the Bandung summit, including its enduring philosophical appeal.
12 It is important to note, however, that turning inwards was not a natural state of affairs for the country, a point emphasized by the country’s most eminent living economist [Findlay 2013].
the island of Borneo and sporadic attempts to destabilize Singapore. Beginning with
the nationalization of Dutch property in 1957-1958, in opposition to the Dutch
reluctance to relinquish control of the western half of Papua island, by 1964 all foreign
property had been expropriated. Harassment of the small but commercially dominant
ethnic Chinese business community also intensified.

Southeast Asia’s global retreat is clearly evident in Figure 2. Its share of the global
economy declined in the 1950s. Particularly notable is the sharp fall in its trade share,
from just over six percent in 1950 to two percent by the late 1960s. The relativities
revealed by these shares are also significant: in 1950, and reflecting its historic export
orientation, the region’s global trade share was more than double its GDP share and
not far short of its population share. By the late 1960s, its export share had fallen below
the GDP share. Some of the region’s major exports, such as rice from Burma and
Vietnam and rubber from Indonesia, began to dwindle. The population and gdp shares
also illustrate the region’s poverty— per capita income was about one-third the global
average.13

**FIGURE 2. Southeast Asia: global shares, 1950-2013**

Table 3 provides a picture of socio-economic indicators around 1960 for the four
main non-communist Southeast Asian countries. Malaysia led on economic indicators,
with Indonesia and Thailand significantly poorer. The Philippines had a clear edge in
education, while its health indicators were similar to Malaysia’s. Indonesia was well
behind its neighbors with regard to social indicators. Both

13 It does need to be noted that the trade share decline in Figure 2 is overstated, for two
reasons. First, commodity prices generally declined in the 1950s, in part owing to the bust after
the Korean war boom. Second, Indonesia’s unofficial (and hence unrecorded) trade rose rapidly
in response to the imposition of multiple exchange rates, and thus the decline reported in the
official trade statistics is overstated.
its years of schooling and infant mortality rate were among the poorest in the developing world at that time.

### TABLE 3. Comparative socio-economic indicators for the Southeast Asian Four, circa 1960

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP per capita (constant 2010 $)</th>
<th>Trade (% of GDP)</th>
<th>Years of schooling, for aged 15 and above</th>
<th>Years of schooling, for aged 25 and above</th>
<th>Life expectancy at birth (years)</th>
<th>Infant mortality (deaths per 1,000 lives)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>577</td>
<td>11.6</td>
<td>1.57</td>
<td>1.11</td>
<td>47.0</td>
<td>166.7</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1,408</td>
<td>85.7</td>
<td>2.83</td>
<td>2.26</td>
<td>57.9</td>
<td>81.1</td>
</tr>
<tr>
<td>Philippines</td>
<td>1,059</td>
<td>38.3</td>
<td>3.46</td>
<td>3.01</td>
<td>57.1</td>
<td>86.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>571</td>
<td>34.9</td>
<td>2.55</td>
<td>2.07</td>
<td>53.3</td>
<td>108.9</td>
</tr>
</tbody>
</table>

Source: World Development Indicators

3.2. 1965: Gloom

These developments contributed to the region’s generally disappointing decade of the 1950s. In some respects, the nadir was reached in the mid-1960s. In 1965, the short-lived Malaysia-Singapore union broke up, the Vietnam War intensified, and Indonesia entered a period of deep political turmoil. Even relatively rich Singapore appeared vulnerable, with instability at its doorstep, rising pan-Malay nationalism, high unemployment, and the imminent withdrawal of the UK bases, which then contributed both security reassurance and about five percent of GDP [Lee 2001]. The literature at the time reflected the uncertainty, Southeast Asia in turmoil was a best-seller, while the more scholarly Asian drama [Myrdal 1968] was sober in its assessments.

Since the Indonesian story is central to the region’s progress, it is useful to briefly refer to analytical assessments by two of the most knowledgeable international researchers.

According to Benjamin Higgins [1968:678], “Indonesia must surely be accounted the number one failure among the major underdeveloped economies … a chronic economic dropout”.

Heinz Arndt [1984:29] reached a similar conclusion: “A decade of ever-increasing economic mismanagement had brought a degree of economic breakdown with few parallels in modern history. The country was literally bankrupt, unable to meet payments due to foreign debt. … Export earnings had fallen to a level where they were barely sufficient to finance half the country’s minimum requirements, excluding debt service.”

Alongside this gloom, however, and putting aside the special case of the Philippines invariably following its own trajectory, three high-growth economies were beginning to emerge. The first scholar to systematically draw attention
to, and explain, this development, coincidentally then arguably the region’s foremost academic economist, Hla Myint [1972], classified the countries into the “inward-looking and outward-looking economies”. Only Singapore and Malaysia fully qualified for the latter group, and Thailand nearly so. Subsequently, more comprehensive research on economic openness by Sachs and Warner [1995] reinforced Myint’s argument. Among the large number of economies for which data were available, they concluded that only six developing economies could be regarded as “always open” according to their six technical criteria. The fact that these three Southeast Asian economies—so very different in many respects—also had a history of prudent macroeconomic management goes a long way to explaining why they have been the region’s high-growth trio for the past half-century. Moreover, as the macroeconomic literature has emphasized, prudent macro-management and openness tend to go hand in hand and are mutually reinforcing [Little et al. 1993].

Regional prospects began to change for the better surprisingly quickly from the late 1960s. Again, Indonesia occupied center stage, in one of the most dramatic reversals of fortune in the 20th century. President Soeharto came to power in 1966-1967 in controversial circumstances and against a backdrop of terrible bloodshed. He immediately signaled Indonesia’s intention to return to the regional and international mainstream, to abandon its hostility to Malaysia, and to emphasize economic orthodoxy. With support from the major western donors and international development agencies, the economy responded positively and these developments set the stage for the next three decades of rapid growth.14

The new regime in Indonesia in turn created the opportunity to initiate regional cooperation through the establishment of the ASEAN in August 1967, initially comprising the five anti-communist states: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Although formal cooperation proceeded very slowly, and the first round of economic integration measures following the 1976 Bali summit were purely cosmetic in nature, the sense of regional identity progressed, and with it neighborly confidence building [Severino 2006]. The reunification of Vietnam in 1975 at least ended the region’s most bitter and protracted conflict. But the Cold War divide, if anything, intensified. Vietnam embarked on a costly strategy of centralized planning and agricultural collectivization and parted company with its long-time supporter China [de Vylder and Fforde 1988]. The regimes in neighboring Cambodia and Laos also fell, in Cambodia’s case resulting in one of the most brutal administrations the region has ever witnessed.

During the 1980s, there were four major developments that all signified major turning points in country trajectories.

14 For detailed analytical monitoring of the transition, see the four-monthly “Survey of recent developments” in the Bulletin of Indonesian Economic Studies.
First, globally, this was viewed in some quarters as the triumph of the market, the Reagan-Thatcher era of deregulation and liberalization, culminating later in the decade in the collapse of the former Soviet Union. It was also the decade of Third World debt crisis, triggered by low commodity prices and higher interest rates, the latter driven by the US Fed’s assault on inflation under Chairman Paul Volcker. These ideas and events had resonance and impact in Southeast Asia, to which we allude shortly. While undeniably liberalism became more popular in this decade, astute observers of Southeast Asia provided a more nuanced interpretation. Even for the region’s most pro-market government, Singapore, Linda Lim [1983], commenting on a prominent speech by Milton Friedman, argued that it was a “myth” to refer to its economy as a *laissez-faire* model. Political scientists also drew attention to the relatively narrow policy space occupied by the reformers, most of whom, in any case, would not be regarded as market fundamentalists [Robison et al. 2012].

Second, the Philippines was overwhelmed by the deepest economic and political crisis in its post-independence history, and a harbinger of what was to come for its neighbors, particularly Indonesia, 12 years later. The essential facts have been analyzed in detail elsewhere (Remolona et al. [1986]; Sicat [2014]). Its severity—GDP falling by about 15 percent over two years—was explained by the interplay of four factors. First, mounting fiscal problems, the result of adventurous borrowings in the 1970s (sanctioned by the international financial institutions, it should be noted, to recycle the then-emerging “petrodollars”), for uneconomic projects that by the early 1980s required repayment. Second, adverse international circumstances, including rising real interest rates, low prices for key agricultural exports, and (for a while) high energy prices. Third, the absence of accommodating monetary policies, in particular adherence to a rigid exchange rate regime that precluded relative price adjustments that could have boosted the competitiveness of the tradables sector. Finally, there was a political crisis, with President Marcos presiding over an increasingly kleptocratic, unpopular, and authoritarian administration.

The crisis confirmed the “outlier” status of the Philippines. It meant that the country missed out on the massive relocation of economic activity from Northeast to Southeast Asia in the wake of the Plaza Accord. But the Philippines could at least take solace from the fact that, in the process, it became the first reasonably contestable democratic state in ASEAN. Moreover, the painful lessons learnt translated into significant economic policy reform, especially in macroeconomic management.

Third, Vietnam decisively re-entered the economic mainstream. While remaining a one-party state, its *Doi Moi* reforms from 1986 constituted an economic policy turning point as significant as that of Indonesia’s two decades earlier.15

This was one of the most successful cases of transition from plan to market in the 20th century. The trade and foreign investment regime was liberalized. Agriculture was de-collectivized. The price mechanism was progressively restored. After a brief period of hyperinflation, the result of soft budget constraints within the state sector, macroeconomic control in a more decentralized economy was achieved. While the imminent withdrawal of Soviet funding was reportedly the main driver of reform, in other respects the reforms were virtually a carbon copy of the successful Chinese model on which it was based. The similarities extended to ambivalence on ownership issues. While there were reforms in the dominant state-owned enterprise sector, including marketization of their activities and the imposition of some sort of budget discipline, the government was reluctant to relinquish control, as much for political as economic reasons. The government continued to view the domestic private sector with considerable reservation, at least until the 2000 Enterprise Law that regularized their status. This reservation applied particularly to businesses in the south, and those connected to the Viet Kieu (diaspora) who had fled the country after 1975. Notwithstanding the dramatic success for the past three decades, this ambivalence on ownership issues and interrelated microeconomic reform issues has arguably continued to hold the country back.

Vietnam’s reforms quickly spilled over to its small Mekong neighbors, Cambodia and Laos. Both had turned communist in 1975, Cambodia in dreadful circumstances. With its “New Economic Mechanism”, Laos adopted a replica of the Vietnamese model, including its political system, although it opened up to foreign investment less aggressively. Its macroeconomic policy settings also differed, as it had to manage a very large Dutch disease resulting from its mining and electricity exports. Cambodia’s transition commenced with the signing of the 1991 Paris Peace Accords which ended almost a quarter of a century of terrible conflict. The new regime faced a tabula rasa in terms of its policy options, owing to the complete destruction of its institutions (and much of its educated class) during the murderous Khmer Rouge period. With extensive international support, it pragmatically opted for open economic policies. The result has been, along with the southern African state of Rwanda, one of the fastest recorded post-conflict economic growth rates. Reflecting their histories, their small size, and the public’s lack of trust in the government, both Cambodia and Laos have remained heavily dollarized (in the Lao case, the Thai baht is widely used). Governments have periodically attempted to suppress the use of foreign exchange, for reasons of national pride and to gain an additional policy lever, but in practice the hybrid system has operated quite effectively.16

See Menon and Warr [2013] and Hill and Menon [2013] for analyses of the economic performance and policy challenges in Laos and Cambodia respectively.
Fourth, although this was the decade of debt and recession for much of the commodity-exporting third world, the two major Southeast Asian resource exporters, Indonesia and Malaysia, successfully avoided a crisis through effective reform and adjustment in the mid-1980s. Indonesia in particular appeared vulnerable as global energy prices fell sharply. These commodities accounted for two-thirds of government revenue and three-quarters of merchandise exports. In the event, it experienced only a mild and relatively brief slowdown in growth. At the margin, external financial support was helpful during this “near-emergency” period. But the main explanation is the prompt and effective policy response (Gelb and Associates [1987]; Hill [2000]). Prior to the period, the government had invested the windfall gains from the oil boom quite effectively, in agriculture, infrastructure, and education. Indonesia’s debt levels were moderate owing to its self-imposed “balanced budget” rule. As the terms of trade fell sharply, the authorities quickly depreciated the currency while maintaining prudent fiscal policy. The result was a very large and durable real exchange rate depreciation. Major deregulatory reforms were also introduced, freeing up the business environment and triggering a rapid supply-side response in manufactured exports. The Indonesian record over this period compares starkly with that of its traditional comparator, Nigeria, which experienced a disastrous decade in the wake of lower oil prices [Bevan, Collier, and Gunning 1999].

Moving into the 1990s, Southeast Asia attracted global attention with the publication of the World Bank’s [1993] influential East Asian miracle study. Four of the seven “miracle” economies were from ASEAN—Indonesia, Malaysia, Singapore, and Thailand. The main contribution of the report was to document the region’s dramatic economic and social success, and its policy and institutional underpinnings. Its explanations for the success were largely conventional—high investment, export orientation, prudent macroeconomic management, inclusive social development, financial development, and infrastructure. It walked a middle line between markets and the state, reflecting both its parentage (substantial Japanese funding) and the fact that several East Asian economies hardly corresponded to textbook cases of neo-classical economics.

If there was one omission in the study it was that the agricultural foundations of rapid growth were downplayed [Mellor 2017]. With the emphasis on Japan and the four resource-poor Newly Industrialized Economies, this omission was perhaps understandable. But for the relatively resource-rich Southeast Asian countries, agricultural resilience and dynamism was a significant feature of

17 Although its circumstances were very different, there are parallels in the Malaysian adjustment experience during the 1980s, in its macroeconomic adjustments and microeconomic reforms, the latter including a scaling back of the ambitious ‘Look East’ heavy industry policies and a de-emphasis in the affirmative action objectives under the New Economic Policy. Here also there is a stark difference in outcomes with its traditional comparator, Ghana [Lim 2011].
their growth. Malaysia established itself as the world leader in tropical cash crops, rubber, and palm oil [Barlow 1997]. Thailand, a traditional rice exporter, had rapidly diversified its agricultural sector [Warr et al. 1993]. Indonesia’s dramatic transformation from the world’s largest rice importer to self-sufficiency by the mid-1980s was internationally recognized by the Food and Agriculture Organization [Timmer 2015].

3.3. 1995: Optimism?

The mid-1990s was a period of unparalleled optimism in Southeast Asia. For the first time in its recorded history, all six major economies were growing strongly. The Cold War divisions and enmities had all but disappeared. Growth in the two economies not included in the “miracle” group, the Philippines and Vietnam, now looked secure. The ideology of markets and liberalism was in the ascendancy. ASEAN was strongly moving forward, with the progressive expansion from six to 10 members, realizing the founders’ dreams of “One Southeast Asia”. Its earlier cosmetic attempts at regional cooperation were replaced by a serious program of regional integration in the form of the ASEAN Free Trade Agreement, signed at the leaders’ Manila summit in 1992 [Severino 2006]. All merchandise trade was to be included under the agreement, unless countries explicitly removed the items. The leaders signaled their intention to move beyond merchandise trade to services, investment and even labor. They also adopted a flexible and pragmatic approach to the newer Mekong members, with phased in trade arrangements. Importantly, though less obvious, the ASEAN countries began to multilateralize their concessions [Soesastro 2006]. In effect, ASEAN became the first significant regional grouping to practice “open regionalism” [Bhagwati 2008].

But history has a habit of throwing curve balls. During periods of exuberance, business and government are seduced into believing that “this time is different”, in the words of the seminal study by Reinhart and Rogoff [2009], that a new paradigm has been created that defies conventional economic laws. So it was in the case of Southeast Asia, in an event the origins and management of which still remain contested.

The Asian financial crisis of 1997-1998 was the region’s first serious economic setback in the post-colonial era. It resulted in deep economic crises in three of the economies, Indonesia, Malaysia and Thailand, where the growth collapse (that is, from pre-crisis growth rate to economic contraction in the crisis year) was in the range of 15 percent to 20 percent. Growth rates in the neighboring economies that weathered the crisis, including the Philippines, Singapore and Vietnam, were at least halved. The major non-ASEAN economy to be affected was Korea.

Two key features of the crisis were, first, that, unlike the Philippines in the previous decade, it was completely unanticipated and unexpected, by
governments, markets, and scholars; and, second, that it was comprehensive in its impact. That is, there was not just an economic crisis but also a financial crisis (the implosion of the modern banking sector) and a foreign exchange crisis (an uncontrollable currency collapse). In Indonesia, there was also a political crisis, which had remarkable parallels with the Philippines—the end of a long-lived authoritarian regime, and the sudden transition to what in both countries turned out to be a workable democratic system.

A useful analytical framework for dissecting the causes and consequences of the Asian financial crisis consists of the following four elements.

**Prelude and vulnerabilities:** With the benefit of hindsight, were there key indicators that might have forewarned that a crisis was imminent? (Of course, it is easy to be wise in retrospect!) While country circumstances differ, two key interrelated factors stand out. First, international capital markets had been changing more rapidly than had domestic policy settings. The major development was increased international capital market integration and volatility and rising short-term capital flows into emerging markets like Southeast Asia in search of higher yields. Second, these economies had opened their capital accounts and liberalized their domestic banking sectors. But there were two remaining gaps in the policy settings: the prudential regulations needed to supervise an open financial sector were generally not in place and, pace Mundell-Fleming, policy makers continued to attempt to pursue the “impossible trinity” of an open capital account, an independent monetary policy and a managed exchange rate. Although the policy settings varied across the three countries, these key elements were common to them.

Ironically, the countries that had been growing more slowly prior to the crisis, and which had less favorable rankings in the international investment assessments, were “saved” by the fact that they did not experience capital inflows on the same scale. This argument—sometimes characterized as “no boom means no bust”— has some relevance to the Philippines [Noland 2000]. An additional point to emphasize is that this was not an old-fashioned crisis sometimes characterized as the “Latin American” model, of fiscal deficits being monetized, resulting in higher inflation which, in the context of a fixed exchange rate, resulted in an appreciating real rate and loss of competitiveness.

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18 Except, of course, by the ever-present “crisis and gloom” club, which has for years been predicting the collapse of Southeast Asian (and other) regimes, owing to their capitalist development path, their corruption, their political contradictions, looming environmental catastrophe, and various other alleged ills attributed to them.

19 There is a very large literature on all aspects of the Asian Financial Crisis. The first serious cross-country study was by McLeod and Garnaut [1998]. Corden [2007] and Ito [2007] provide insightful retrospectives. Ito also summarizes other country studies in the same issue of *Asian Economic Policy Review*. Haggard [2000] probes institutional and political economy dimensions.

20 See Athukorala and Warr [2001] who examine how the various vulnerability indicators performed in retrospect.
The trigger: On July 2, 1997, the Bank of Thailand exhausted its foreign exchange reserves defending the baht, which had a soft peg to the US dollar. Thailand was in fact the one country where growth and export earnings had been slowing prior to the crisis [Warr 1999]. It had also opened its capital market the most aggressively, in an attempt to rival Hong Kong and Singapore as a regional financial market. Relative to the size of its economy, the short-term capital inflows, and hence the current account deficit, were the largest in the region. A slowing economy and a mini financial crisis created nervousness among foreign investors, with the result that capital outflow commenced in late 1996. But just as the baht was not allowed to appreciate during the boom years, so it remained fixed in the face of these outflows, at least until foreign exchange resources were depleted. When the forced float occurred, it was dramatic, with the value of the currency falling by more than one-half in a few months. This in turn revealed the fragility of the policy settings: borrowers assumed that the Bank of Thailand would maintain the peg, as it had for several decades with occasionally minor adjustments. But this policy was from a bygone era when international capital flows were relatively small and partially regulated.

The crisis quickly turned regional through the now familiar contagion channels. Global capital markets in far-off financial centers began looking at the “fundamentals” of each country and discovered some similarities. Ironically, Indonesia, which in a formal technical sense looked somewhat more secure than Thailand—“why Indonesia is not Thailand” was a popular phrase in Jakarta in July-August that year—experienced the most serious crisis. To understand why, we need to understand how the crisis was managed in the last quarter of 1997.

Management of the crisis: As the crisis deepened, an international support program was mounted. This involved country pledges orchestrated by the International Monetary Fund (IMF). Japan, Europe, and the US were the major players, although the US did not participate in the initial Thai rescue package. These and other donors made their pledges conditional on the approval of an IMF package, a letter of intent (LOI) that contained detailed policy reform prescriptions. From the outset, the Lois were contentious. Owing to their sound macroeconomic management, these countries did not have a close working relationship with the IMF, and the IMF’s immediate reaction was to impose the traditional “medicine” of fiscal austerity, along with various additional reforms. Although deeply unpopular, and inappropriate in the circumstances, Thailand quickly signed an Loi with the IMF, as did Korea a little later.

But in both Indonesia and Malaysia, the governments were reluctant to sign on. Prime Minister Mahathir was railing against an international Jewish conspiracy that was undermining his economy. In addition to the nationalist sentiment, he reportedly feared that the country’s affirmative action programs would have to
be dismantled. In spite of its close and cooperative relationship with the IMF over the previous decades, Indonesia had a fractious relationship with it in the second half of 1997. The government also closed several allegedly fragile banks in the early stages of the crisis, which triggered a general bank run. The origins of this major misstep remain obscure. A standoff between the government and the IMF developed at a critical juncture when financial markets above all else required reassurance. Eventually, an loi was signed in January 1998. But the damage was done: the infamous signing ceremony shocked the Indonesian public, and President Soeharto effectively disowned the agreement shortly after. The rupiah went into free fall, at one stage falling to one-seventh of the pre-crisis us dollar rate. As with the Marcos regime, though not to the same extent, Soeharto’s popularity was sliding, principally owing to the egregious greed of his children’s business interests. In the face of mounting political protests, he stepped down in May 1998, although unlike his Philippine counterpart he remained in the country and was subject to only limited harassment.

**Consequences:** “It is easy to be wise after the event”, as Arthur Conan Doyle, the creator of Sherlock Holmes, once remarked. All parties suffered reputational damage as a result of the crisis. Financial regulators and central banks had not introduced the requisite supervision when they opened up the banking sectors. The international financial institutions were not prepared for this type of modern financial crisis, and the major donor countries blindly followed the IMF’s prescriptions. The region’s leaders had developed a sense of complacency that this new “Asian development model” was immune to crisis. Academics had developed analytical models such as the “efficient financial markets hypothesis”, according to which market prices fully reflect all available information.

The medium and longer-term consequences have been diverse and complex. First and most important has been that, while the Asian financial crisis was a V-shaped crisis, growth in the three crisis-affected economies has never returned to the rates enjoyed prior to the crisis. And interrelated, investment levels have remained below those in the pre-crisis period. Second, there were various policy lessons learned from the crisis. The key reform was the gradual adoption of modern central banking practices, in particular inflation targeting and flexible exchange rates. Central banks throughout the region have greater autonomy and are now mostly “insulated” from the political processes. Most countries have also enacted (or reinforced) some sort of cap on fiscal deficits, while financial supervision has been strengthened. It is important not to overstate these reforms, a point emphasized by one of the region’s foremost central bank officials [Grenville 2017]. But at least reform has moved in the right direction. Additionally, the

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21 Blustein [2002] nicely covers some of these issues.
economies did not close up in the wake of the crisis, a traditional response to earlier crises.

Third, the deep unpopularity of the IMF in the wake of the crisis has meant that it has been unable to play its traditional role as international financial guarantor. ASEAN countries, in conjunction with the three larger Northeast Asian economies, have sought to establish alternative financial safety net arrangements, notably in the form of the enhanced Chiang Mai Initiative. But these arrangements are untested, and may in fact never be used. Countries have therefore sought alternative sub-optimal solutions, mainly resort to various bilateral swap agreements and a costly build-up in foreign exchange reserves [Menon and Hill 2014].

Fourth, there have been broader institutional and political consequences, although separating cause and effect and identifying counter-factuals is inherently hazardous. The most obvious effect was the removal of the Soeharto regime and the sudden swing to democracy in Indonesia. There is a school of thought that posits that the trajectory of Thai politics was also fundamentally altered after the Asian financial crisis. According to this thesis, the rising nationalism facilitated the rise of Thaksin-style populism, that in turn exposed deep but hitherto latent fissures in Thai society, between the ruling Bangkok elite and the poorer periphery regions, especially the populous northeast.

Ironically, the country from which the most strident anti-IMF (and anti-Western) rhetoric originated, Malaysia, arguably was the most adroit in its crisis management. Unlike Indonesia and Thailand, it did not enter into an IMF agreement, although its policy response was “IMF-like” in the first year. Then in September 1998 it broke ranks with the prevailing orthodoxy: it closed the short-term capital account, pegged the ringgit, and then implemented a program of fiscal and monetary stimulus. There is a lot to be said about the Malaysian policy experiment.22 It came rather late in the crisis and so hardly constituted an immediate crisis-response measure. It faced a particular challenge in the form of a large offshore currency market (known as the Central Limited Order Book) that severely restricted its monetary policy freedom. And as a recommended policy approach, capital account restrictions (or more accurately limitations) are better imposed ex ante not ex post. It is doubtful that neighboring countries with weaker institutions could have adopted this approach. Moreover, the Malaysian recovery path was not all that different from that of Thailand, which had pursued the conventional IMF route. But undeniably the Malaysian experience was enormously important. Above all else, it demonstrated that the IMF was not the sole repository of wisdom.

22See Athukorala [2001] who comprehensively examined this episode.
3.4. 2015: The end of “exceptionalism”?

Several features define the Southeast Asian economies in the early 21st century. First, Myanmar (Burma) finally, albeit hesitantly, rejoined the mainstream politically and economically. In 2015, the country’s first genuinely open elections were held, and resistance hero Aung San Suu Kyi’s National League for Democracy swept into power with a super majority. A series of bold liberalizing reforms were introduced, including the unification of the exchange rate. However, in a blow to democracy, the military was unwilling to cede authority to the National League for Democracy and its leadership. The economic reforms have proceeded erratically, understandably given the country’s half-century of isolation and the destruction of its intellectual and entrepreneurial classes. Politically, the country’s ethnic mosaic has proven to be extremely difficult to manage, most notably as one of the region’s worst humanitarian crises suddenly erupted in 2016-2017, with the forced and brutal exodus of more than half a million Rohingya Muslims across the border into neighboring Bangladesh. At the time of writing (late 2017), the euphoria of these dramatic reforms was fading rapidly, although it appears unlikely that the country will revert to its isolationist past.

Second, the global financial crisis of 2008-2009 introduced new policy challenges and development hierarchies. Unlike during the Asian financial crisis, the ASEAN economies were “innocent bystanders”. In fact, they were affected, deeply in some cases, by a crisis that originated principally in the rich “Anglo” economies of the UK and the US which, ironically, had been the main source of lecturing advice that emerging market economies needed to reform to maintain growth and avoid crises. In terms of impact in Southeast Asia, the clear demarcation line was between the more and less open economies. Thus, the three traditionally open economies, Singapore, Malaysia and Thailand, experienced moderately severe recessions in 2009 owing to the collapse in world trade that year. The now very open Cambodian economy was also severely affected. By contrast, Indonesia, the Philippines, and Vietnam were only mildly affected. Importantly, there was minimal financial contagion from the Anglo financial centers, while the flexible exchange rate regimes that had been put in place after the Asian financial crisis worked effectively. Central banks and financial regulators also became ever more alert to the dangers of global financial volatility.

A third key challenge has been managing the rise of China, as the region’s pre-eminent economic and political power. Long accustomed to a global order and set of rules largely created and underwritten by the United States, countries are facing the sometimes uncomfortable reality that the old geo-strategic certainties are

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23 Odaka [2016] provides a comprehensive assessment of the pre-reform economy and policy options.
24 The effects of the global financial crisis and its aftermath are examined in the country studies contained in Gochoco-Bautista and Hill [2013].
disappearing. The rise of China, of course, offers exciting potentials. Economic growth in the region during the global financial crisis was maintained largely by China’s massive fiscal stimulus and resulting continuing high growth. Dynamic global production networks are increasingly China-centered. China has indicated a willingness to employ its very large current account surpluses constructively, including through the Belt and Road Initiative and the establishment of the Asian Infrastructure Investment Bank. But the changing political parameters are entering new territories. This was starkly illustrated in the case of the (successful but subsequently discounted) Philippine request for arbitration under the UN Convention on the Law of the Sea over China’s aggressive pursuit of new maritime boundaries in the South China Sea. Economically, China’s economy is now of such scale that its trade composition has large implications for the region. The major commodity boom over the decade 2004-2014 was substantially China-driven. Resource exporters like Indonesia enjoyed historically very high terms of trade, but the resulting Dutch disease required major domestic policy adjustment [Garnaut 2015]. Also, in some mid-range manufacture, developing country exporters have been squeezed by the effects of China’s market entry in lowering global prices, of course, to the great benefit of consumers.

Fourth, the ASEAN countries have been central to the global debates about the so-called middle-income trap. This is the notion that it is somehow easier for countries to graduate from low to middle-income ranking than it is to move from the middle to the high-income group. This is essentially an empirical observation in search of a theory. There are elements of a possible analytical construct. For example, countries need to transition their public policy settings as incomes rise, to invest more in advanced education and R&D, to develop more sophisticated institutions to support a modern capitalist economy, and so on. Yet the country evidence suggests a range of factors that hardly fit within a parsimonious theory that attempts to shed light on countries as diverse as Argentina and Malaysia. Moreover, for the two relevant Southeast Asian countries, Malaysia and Thailand, their slowdown over the past decade points to complex domestic political economy factors at work. In Malaysia’s case, the country has adhered too long and too rigidly to its affirmative action programs. These were clearly necessary in the wake of the 1969 ethnic disturbances and the glaring inter-ethnic inequalities. But they have since come to dominate all aspects of the country’s commercial and political life. And while they have been successful in reducing inter-ethnic inequality, overall inequality has remained high and little changed. In effect, reduced inter-ethnic inequality has been achieved at the cost of increased intra-Bumiputra inequality. The Thai case appears to reflect the impasse between two powerful elements of the country’s polity: the wealthy, traditionally dominant

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25 See Hutchison and Das [2016] for a general review of the evidence with reference to Asian developing countries. See also Hill, Tham, and Rogayah [2012] for a Malaysian case study.
Bangkok-centered palace-military-business coalitions; and poorer majority constituencies outside the capital.

Both Malaysia and Thailand have at least graduated to the ranks of the upper-middle income group. Indonesia, the Philippines, and Vietnam are still in the lower-middle group. Reflecting the changing hierarchy of regional dynamics, the latter two especially are growing at historically rapid growth rates. It remains to be seen whether they will encounter problems at higher incomes. But meanwhile the middle-income trap thesis does not provide much analytical guidance for how these countries might avoid a slowdown.

A fourth feature of the 21st century is that ASEAN as an institution has remained intact, but in some respects has struggled for an identity in a rapidly changing commercial and strategic environment. In 2015, the ASEAN Economic Community was promulgated with the intention of expanding regional integration beyond merchandise trade to services, investment, labor, and the regulatory framework. It remains to be seen whether and how the compelling vision statement will be realized [Das 2015]. The relative importance of intra-ASEAN trade has increased, although much of this has to do with trade within global production networks, trade in which is governed by the global Information Technology Agreement. The deeper analytical thinking that is required to guide future directions continues to be mainly outsourced to regional think tanks and research institutes, reflecting the desire of the member countries to cede very limited authority to the supra-national ASEAN Secretariat. Understandably, ASEAN has struggled to define its relationship with the China juggernaut. On crucial issues like regional borders, China has refused to negotiate with the group as a whole, preferring bilateral resolutions. The “ASEAN Way” of non-interference in the domestic affairs of member states has meant that its voice has also been largely silent on the Rohingya tragedy.

3.5. Looking back

Looking back over the longer term, what are the salient observations about the region’s development dynamics?

First, putting aside the stellar case of Singapore, for the four middle-income countries for which we have reliable long-term national accounts—Indonesia, Malaysia, Thailand, and the Philippines—there is a “club of three” for most of the 20th century, and then convergence to very similar growth rates in the 21st century (Table 4). Over the period 1960-2015, per capita income in the first three rose rapidly, by multiples of 6.6, 7.7, and 10.1 respectively. As noted, the Philippines was the outlier. But since 2000, the growth rates of the four have been virtually

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26 My thanks to J.C. Punongbayan for preparing these data, and also those that appear in Tables 3 and 6, which appear in the forthcoming volume co-edited with Professors Ramon Clarete and Emmanuel Esguerra [2018].
identical. In fact, in the recent period the Philippines has been the clear leader.

**TABLE 4. Comparative economic growth in the ASEAN four, 1960-2015**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>3,834</td>
<td>1.8</td>
<td>3.5</td>
<td>6.6</td>
</tr>
<tr>
<td>Malaysia</td>
<td>10,878</td>
<td>1.6</td>
<td>3.3</td>
<td>7.7</td>
</tr>
<tr>
<td>Philippines</td>
<td>2,640</td>
<td>1.6</td>
<td>1.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>5,775</td>
<td>1.7</td>
<td>4.1</td>
<td>10.1</td>
</tr>
</tbody>
</table>

Source: World Development Indicators

Second, as noted above, it is important to keep in mind the Northeast/Southeast Asian growth divide. While the ASEAN economies clearly belong to the “miracle” club of growth economies, there is a hierarchy within the club, and one that broadly follows geographic lines. Placing Singapore analytically within Northeast Asia, this group has clearly grown more rapidly over the long term than even the most successful Southeast Asian economy. This is not the place to explore this fascinating topic. The short answer is, of course, that at crucial junctures, the leaders were more “committed” to growth and placed it as an issue of overriding national importance.

This relates to the broader issue of the elusive search for explanations of success. Growth econometrics, exemplified by the “two million regressions” (Sala-I-Martin [1997]; see also Hill and Hill [2006] for an ASEAN application), is suggestive but not conclusive. That is, the “usual suspects” have been at work: reasonably prudent macroeconomic management; broadly open economies; a measure of broad-based development; and institutions that provide at least a moderately predictable and secure investment environment.27 But these tell an incomplete story. They are too general to be convincing on their own. For example, during its years of hyper-growth, Korea was in important respects a quite closed economy with adventurous macroeconomic policy settings. In Soeharto’s Indonesia and in China, corruption was widespread and legal institutions were controlled by the state, but business flourished. Thus, theory and empirics are guides to understanding the Southeast Asian development record. But they need to be supplemented by analytical country narratives such as those contained in Coxhead [2015] and Rodrik [2003].

27 The political scientist Ruth McVey once cleverly observed that debates about East Asian success are over the relative importance of what she termed the “magic of the market”, the “strong state”, and “Confucian culture”.

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The political scientist Ruth McVey once cleverly observed that debates about East Asian success are over the relative importance of what she termed the “magic of the market”, the “strong state”, and “Confucian culture”. 

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The various attempts to measure institutional quality remind us that, notwithstanding the regional similarities and synergies, there is no “ASEAN development model”, and that a nuanced approach is needed to understand the region’s development dynamics. Consider, for example, the attempts to measure governance quality as reported by the World Governance Indicators (Table 5). The series includes six measures of governance, and the data are presented as percentile rankings. There is a clear divide between the “effectiveness” of governments and their voice and accountability. In 2014, Indonesia and the Philippines scored the highest on the latter indicator. This is as would be expected, as both countries have reasonably open and credible democratic processes, including orderly regime change. But with respect to government effectiveness, control of corruption, rule of law, and regulatory quality Singapore ranks by far the highest and very near the top by global standards. Yet in its 52 years as an independent nation, it has been ruled continuously by a dominant political party, the People’s Action Party, and two family members have been prime ministers for three-quarters of its independent history. Although ranking lower, Malaysia presents a similar picture on these indicators, again with continuous one-party rule in its 60-year history. Vietnam is closing the gap with its middle-income neighbors with respect to effectiveness and related indicators, while scoring lowest on voice and accountability. Cambodia and Laos lag behind the others, but their rankings are at least improving, especially in the case of Cambodia.

**TABLE 5. Governance indicators, Association of Southeast Asian Nations, 2005 and 2014**

<table>
<thead>
<tr>
<th>Country</th>
<th>Government effectiveness</th>
<th>Voice and accountability</th>
<th>Control of Corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>99</td>
<td>100</td>
<td>51</td>
</tr>
<tr>
<td>Malaysia</td>
<td>84</td>
<td>84</td>
<td>43</td>
</tr>
<tr>
<td>Brunei Darussalam</td>
<td>70</td>
<td>82</td>
<td>24</td>
</tr>
<tr>
<td>Thailand</td>
<td>67</td>
<td>66</td>
<td>46</td>
</tr>
<tr>
<td>Philippines</td>
<td>56</td>
<td>62</td>
<td>49</td>
</tr>
<tr>
<td>Indonesia</td>
<td>39</td>
<td>55</td>
<td>45</td>
</tr>
<tr>
<td>Vietnam</td>
<td>49</td>
<td>52</td>
<td>9</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>10</td>
<td>39</td>
<td>6</td>
</tr>
<tr>
<td>Cambodia</td>
<td>17</td>
<td>25</td>
<td>19</td>
</tr>
<tr>
<td>Myanmar</td>
<td>3</td>
<td>9</td>
<td>-</td>
</tr>
</tbody>
</table>
What these indicators tell us about Southeast Asian development is another matter. Democratic accountability is of course inherently desirable, and therefore Indonesia and the Philippines have progressed the farthest on this indicator. Arguably the less democratic states will eventually make the democratic transition; whether this is a smooth or disruptive process remains to be seen. The indicators also remind us that voice and accountability are no guarantee of responsive and effective governance. The “Singapore model” illustrates a broader dimension of East Asian governance, where citizens have been prepared to tolerate circumscribed individual liberty in exchange for rapidly rising living standards. Here also it is not clear whether continued authoritarian governance is a secure long-term path to rising prosperity.

4. Looking forward

So much for the past. What of the future? Is Southeast Asian economic dynamism likely to continue? We drew attention above to the hazards of crystal ball gazing, in the region and elsewhere. In this concluding section we speculate on where these economies might be headed and identify some of the challenges to sustain the economic momentum.

A baseline scenario would be to simply project forward on the basis of the recent past. Such an approach implicitly assumes away major deviations in country economic trajectories, both the major U-turns in economic policy alluded to above on the upside, and conflict and political crises on the downside. The results are presented in Figure 3 in terms of total GDP in PPP terms. The estimates suggest that, globally, the big three will continue to be China, the US, and India, with some minor reordering. But Southeast Asia enters the picture with the fourth-largest economy, Indonesia, by 2050. In effect the country’s demographic and economic rankings are projected to align. The weight of demography is also
evident in the entry of several other populous developing countries into the top 10, including Brazil, Mexico, and Nigeria. Four other ASEAN states are ranked between 20 and 25, led by the Philippines, which climbs rapidly owing to its renewed economic vigor and faster population growth. As a group, if the ASEAN countries maintain their current dynamics they will collectively have an economic heft not far short of the European Union by 2050.28

FIGURE 3. GDP projections through to 2050

Source: IMF estimates for 2014, PwC projections for 2030 and 2050

See also the forward-looking analysis published by the ADB [2011]. Note, however, that the Philippines, the top-ranked ASEAN economy after Indonesia in the figure, is not grouped with the dynamic economies.
So much for speculative projections. What are some of the major challenges that the region will have to address if it is to maintain the momentum? It needs to be emphasized that these are problems of success. Virtually all the economies have demonstrated the capacity to grow quickly and durably. We draw attention to some cross-cutting issues that are common to at least several of the major economies, recognizing again the region’s diversity, from Laos to Singapore.

4.1. Prudent macroeconomics and an open economy in an age of uncertainty

While economists typically assert the primacy of domestic policies, the global environment has a crucial bearing on the region. The Southeast Asian economies are export-oriented, in the sense that their export/GDP ratios exceed the global average, in some cases by a large margin. Their export success therefore depends on a stable, open, rules-based growing global market place. Yet these pillars are under threat as never before. The historic post-war trend of global trade growing faster than global GDP appears to be at an end, at least for now (Figure 4). The world community has been unable to agree on a new global trade deal for over a decade. The global financial crisis triggered beggar-thy-neighbor protectionist responses. The era of the US presiding over a largely benign global commercial policy environment appears to be coming to an end. Behind the strident “America First” rhetoric is the first transition from one global superpower to another in almost a century. What the “Beijing” rules of engagement will be in this new global order has yet to be fully spelled out.

**FIGURE 4. Annual growth of global GDP and trade, 1990-2015**
The weakening of the global rules-based system has resulted in the proliferation of bilateral and regional preferential trade agreements. While pronouncing “free trade”, in practice, most of the agreements have little substance owing to exemptions of sensitive items and non-trade measures such as quarantine standards that blunt the effectiveness of the agreements. There is little likelihood that the “Spaghetti Bowl” of hundreds of bilateral preferential trade agreements (see Figure 5) will ever evolve into a plurilateral agreement. The major economies set the rules in these agreements, and each of the majors imposes a different set of “trade plus” measures and exemptions. These “termites” [Bhagwati 2008] are further eroding the multilateral system.

**FIGURE 5. Mapping the spaghetti bowl**

Trade is only part of the external picture. For a decade, the global economy has witnessed a highly unusual period of monetary policy in the major economies. With nominal interest rates at or near zero in the US, the EU, and Japan, the monetary expansion has led to spikes in asset prices and volatile capital flows to those emerging markets with positive interest rates that are considered credit-worthy. The dilemma for monetary authorities in these economies with open capital accounts has been how to manage these inflows. The “taper tantrums” in the wake of US Fed Governor Ben Bernanke’s remarks in May 2013 reminded policy makers that capital could exit at very short notice.
on the basis of apparently innocuous statements. While a reversion to fixed but adjustable exchange rate regimes is unlikely, the debate over how, and how much, short-term capital movements should be regulated continues. The absence of a secure international financial safety net, as noted above, adds to the urgency of this debate.

Beyond commerce, the world community has also struggled to take collective action on pressing environmental measures. The Paris Climate Agreement of 2016 may have 195 signatories, but the subsequent US withdrawal and the perceived inequities in a system that allowed the now rich economies to grow with unrestrained CO2 emissions cast doubt over its future. The Southeast Asian economies have a huge stake in this global issue. Domestically, rapid growth and lax environmental standards have contributed to the problem, at least at a local level, and on occasion globally. During years of heavy deforestation and fires, for example, Indonesia has been the fourth largest CO2 emitter in the world [Seymour and Busch 2016]. Southeast Asia includes the two largest archipelagic states in the world. Both have fragile marine ecologies that have not only been subject to rampant over-fishing but are also highly vulnerable to rising sea levels. Southeast Asia's megacities are all coastal, and they are therefore similarly vulnerable, a problem exacerbated by excessive use of ground-water supplies.

4.2. Ensuring broad-based growth in the age of inequality

Historically, elite capture results in a persistent tendency to rising inequality [Scheidel 2017]. The Southeast Asian economies continue the struggle to ameliorate the unequalizing effects of colonialism, which had its origins in the divide between the colonial powers and their subjects, and in the enclave economies that were constructed. The agrarian origins of inequality persisted in Malaysia and the Philippines in particular. Revolutions and asset expropriations elsewhere—especially in Cambodia, Indonesia, Myanmar and Vietnam—sharply reduced these inequalities, albeit at the cost of general immiserization.

In the last half-century, for all the rhetoric about social justice, inequality levels in Southeast Asian countries have tended to converge to the higher levels that have persisted in Malaysia and the Philippines. In Thailand, inequality was historically low but began to rise quickly from the late 1970s. In Indonesia, the increase became evident from the mid-1990s, was delayed by the effects of the Asian financial crisis, and then rose quickly in the first decade of the 21st century, perhaps paradoxically coinciding with the arrival of democracy. Inequality rose in the three Indochina economies in the transition from plan to market. The good

29 For a cabinet-level Indonesian perspective on the episode, see Basri [2017].
30 See, for example, Roumasset et al. [2018] for a case study of environmental challenges in the Philippines, which is also illustrative of the problems facing neighboring countries.
news is that poverty incidence has fallen rapidly throughout the region. But almost all the reduction has been due to economic growth [Warr 2015].

Moreover, accompanying the poverty decline have been quite dramatic improvements in social indicators. A comparison of the education and health indicators in Table 3 above and Table 6 underline this point for the ASEAN four. Over a little more than two generations, for example, six years of schooling have been added on average for Indonesian citizens (1.6 to 7.6 years), infant mortality is just one-sixth what it used to be, while more than 20 years have been added to life expectancy. Remarkable improvements have occurred in the other three countries, even to a lesser extent in slower-growing Philippines.

**TABLE 6. Comparative socio-economic indicators for the Southeast Asian four, circa 2015**

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP per capita (constant 2010 $)</th>
<th>Trade (percent of GDP)</th>
<th>Years of schooling, for aged 15 and above</th>
<th>Years of schooling, for aged 25 and above</th>
<th>Life expectancy at birth (years)</th>
<th>Infant mortality (deaths per 1,000 lives)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>3,834</td>
<td>41.9</td>
<td>7.61</td>
<td>7.26</td>
<td>68.6</td>
<td>25.0</td>
</tr>
<tr>
<td>Malaysia</td>
<td>10,878</td>
<td>134.2</td>
<td>10.44</td>
<td>9.75</td>
<td>74.5</td>
<td>6.8</td>
</tr>
<tr>
<td>Philippines</td>
<td>2,640</td>
<td>63.0</td>
<td>8.43</td>
<td>8.18</td>
<td>68.0</td>
<td>23.2</td>
</tr>
<tr>
<td>Thailand</td>
<td>5,775</td>
<td>126.8</td>
<td>7.99</td>
<td>7.30</td>
<td>74.1</td>
<td>11.2</td>
</tr>
</tbody>
</table>

Source: World Development Indicators

It is also important to view these trends in global perspective. As best as can be estimated, inter-personal global inequality has actually been declining since the late 1980s. Milanovic [2016:11] demonstrates this pattern with his so-called “elephant curve”: by estimating global income distribution (that is, combining data on inter- and intra-country inequality) over the period 1988-2008, he concludes that “… the great winners (from globalization) have been the Asian poor and middle classes” [2016:20] in China and other dynamic Asian economies, including most of Southeast Asia. His results are reported in Figure 6.31

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31 The second part of this quote reminds us why globalization is unpopular in many advanced economies: “… the great losers the lower middle class of the rich world”.
The policy mix to ameliorate inequality while maintaining growth is well known, and it was demonstrated effectively in the post-war experience of Japan and the Asian Newly Industrialized Economies. The poor have only their labor to sell. Therefore, on the demand-side labor-intensive growth transforms the labor market. That is more likely to be achieved through export orientation since poor countries will then exploit their comparative advantage by specializing in the production of goods and services that intensively embody their abundant factor, that is, unskilled and semi-skilled labor. On the supply side, governments need to equip their workforce with the requisite education and health services that enable them to participate in the global economy. This strategy needs to be supplemented with a range of distributional tax and transfer measures. Asset redistribution is also potentially in the policy mix, while recognizing the political and implementation complexities.

The puzzle in Southeast Asia is that such an approach is widely understood in policy and academic circles and readily evident from neighborhood experiences. But governments, both democratic and authoritarian, that are competent in other respects are unwilling or unable to tackle the problem. Perhaps the increasing adoption of targeted social welfare nets in the wake of the Asian financial crisis will remedy this deficiency. But as long as the tax effort remains weak, the capacity for government social policy on any scale will remain limited.
4.3. Government failure versus market failure in an ideologically polarized world

The data in Table 5 might suggest that progress towards the construction of strong and durable institutions in Southeast Asia that represent the public interest has been very slow. Corruption remains a very serious problem, indeed an endemic one in some cases [Kis-Katos and Schulze 2013]. There is an ongoing debate as to whether Southeast Asian capitalists are “rent-seekers” or “real capitalists”, to quote the subtitle of a seminal study of Malaysian business [Searle 1999] or “ersatz” in the words of another popular study [Yoshihara 1988]. Organs of the state, from the judiciary to the police, do not yet serve the poor well in most of these countries [Deinla 2017]. Reforms to achieve a more professional and responsive civil service proceed very slowly.

But there is gradual, if uneven, progress. Central banks are now more independent and professionally staffed than they were before the Asian financial crisis. The checks on blatant cronyism and corruption are now stronger, thanks to more open economies, the establishment of competition commissions, and social media. The delegation of administrative authority and financial resources to sub-national governments has enabled “islands of excellence” to emerge, at least on a limited scale. Export and industrial zones, while inherently second-best, at least enable local reforms to proceed more quickly than at the national level. Greater population mobility (including exit in some cases) and social awareness put pressure on governments to perform at the standard set by regional benchmarks. As former Minister Mari Pangestu put it, “competitive liberalization” is at work. Rudimentary social safety nets are being constructed in most countries, and the conditional transfer payments systems are becoming more sophisticated. Much work remains to be done in all these areas. But at least the signs are hopeful.

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