

# Executive Summary

## **The Asian Economies in 1996**

Table 1 shows that 1996 was the first year of the present decade in which nearly all the nine Asian economies covered by this study recorded (in some cases estimated) a decline in exports and a slowing growth rate, with a particularly disappointing year-on-year performance in the cases of Korea, Thailand, China, Malaysia, Taiwan and Singapore.

Although the average growth rate of 7.4% recorded by these economies in 1996 is still quite high compared to other parts of the world, there is growing disquiet, both international and domestic, about the economic outlook for these economies. The principal cause of this disquiet is the fact that, although the sustained and uniformly high growth they have achieved since the mid-1980s was dependent on export-led development, they are now showing signs of macroeconomic instability at the very time that their export growth is slackening. Much of the stagnation in exports is due to stock adjustment by export-oriented manufacturing industry and this means that it is only a matter of time before manufacturing industry and then exports are able to effect a spontaneous recovery. Singapore did show signs of export recovery after only about eight months of stagnation (fig. 1) but it is worth noting that, even in the case of Singapore, this recovery was quite weak, and in mid-1996 Thailand had still not broken out of the export slump (fig. 2). It is evident from these statistics that, in all the export-led national economies, structural causes are responsible for impeding recovery, not only of exports but also of business in general.

The situation is different in the Philippines and Indonesia, which have just begun to follow the path of genuine export-led development. Although the effect of stagnant exports on their economies is still slight, there are nevertheless several important issues which need to be addressed if growth is to be sustained.

**Table 1 Rates of Economic Growth, Rates of Export Growth and Trade Balance in the Nine Asian Economies**

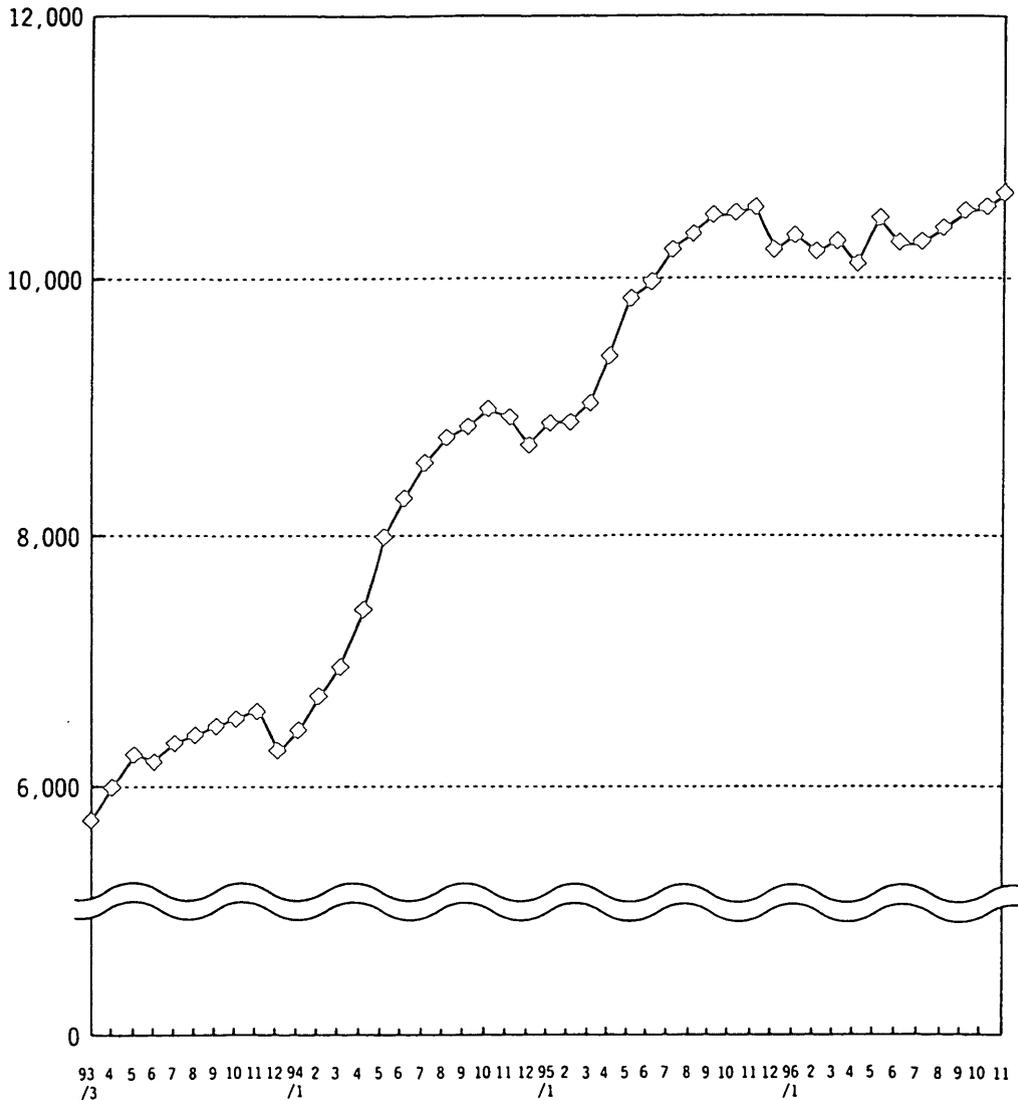
	Actual Economic Growth (%)			Rate of Export Growth (%)		Trade Balance (\$ million)	
	Average of 1986-95	1995	1996	1995	1996	1995	1996
Korea	8.9	9.0	7.1	30.3	3.8	-4,328	-15,278
Taiwan	7.8	6.0	5.7	20.1	3.9	8,109	14,704
Hong Kong	6.8	4.7	4.7	14.9	4.0	-19,001	-17,800
Singapore	8.3	8.8	7.0	22.5	5.8	-6,208	-6,320
Malaysia	7.8	9.5	8.2	25.8	5.9	-3,778	-196
Thailand	9.4	8.6	6.7	24.7	-1.3	-14,335	-17,245
Indonesia	7.2	8.0	7.6 <sup>(1)</sup>	13.4	9.7	4,760	6,991
Philippines	3.5	4.8	5.5	29.3	18.3	-9,168	-11,786
China	9.6	10.5	9.7	20.3	1.6	16,692	12,270

Source: Economic statistics published by each country

Note 1: According to a projection announced by the head of the National Planning and Development Agency

**Fig. 1 Singapore's Export Growth: Monthly Exports Shown as a Five-month Moving Average**

(Unit: \$ million)

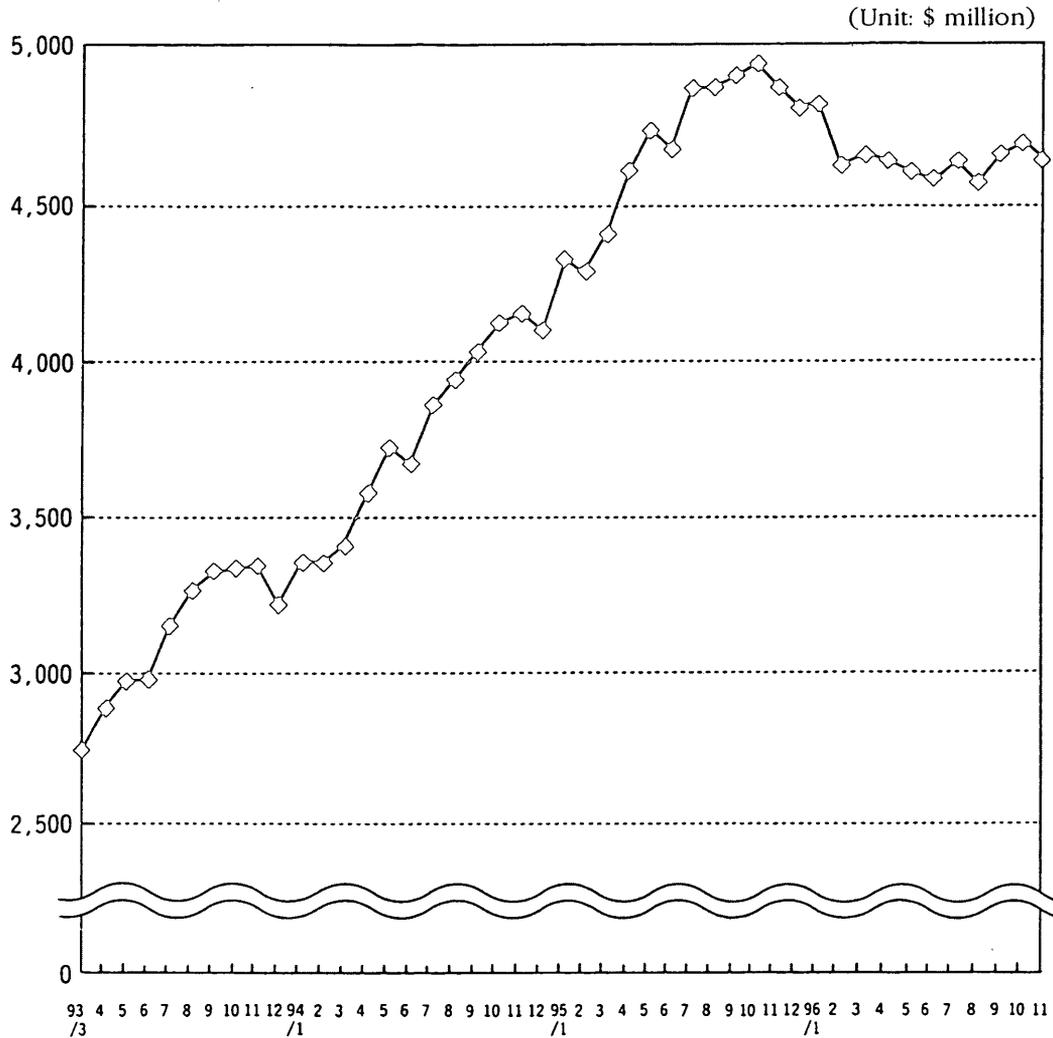


## ***Causes and Implications of Slackening Export Performance***

### **1. Slowing Exports of Electronic Goods**

The NIEs, China and Malaysia, have suffered an abrupt decline in export growth, due in large part to a weak semiconductor market and stagnant demand for computers and other electronic products in Europe and the USA. The decline in the export of electronic products has had significant consequences on the economy, since its effects have gradually spread to related domestic industries such as plastics and metal working, as well as to the production and export of components industries which play such a pivotal role in the intra-regional export trade. This phenomenon has brought about a renewed appreciation of the fact that their economies so heavily depend upon production and exportation of electronic goods which are by their very nature cyclical. The distinctive trading pattern of the electronics industry – characterized by the import of parts from other Asian countries, the assembly of finished goods and their eventual export to the European and American markets – leads to synchronization of the business cycle in the countries of the region and considerably widens the range of business fluctuations. As most manufacturers of electronic goods are foreign

**Fig. 2 Thailand's Monthly Exports Shown as a Five-month Moving Average**



affiliates, it has become apparent that the activities of foreign affiliates are playing an increasingly dominant role in the economies of the countries concerned.

**2. End of the Golden Age of Labor-intensive Export Industries**

Several countries (Thailand, Hong Kong, China, Indonesia and others) depend to a large degree upon the export of labor-intensive goods including assembled electrical products, textiles, garments and plastic goods. Such exports have been hard hit by increased manufacturing costs, the trade diversion effect caused by the formation of the North American Free Trade Area (NAFTA) and stagnant export prices due to intensifying competition. This suggests that, in all nine countries, the golden age of labor-intensive export industries, over-reliant on the comparative advantage of low wage costs, has virtually come to an end.

**3. A Low Yen Rate and other 'Dark Changes' in the Export Environment**

In 1995, the Asian countries enjoyed their highest rate of export growth in the last ten years, thanks to the high yen rate which brought about increased competitiveness and burgeoning demand within the region. But in 1996 there was a sudden and unexpected change in the export environment, caused by a depreciation of the yen against the currencies of all the countries involved in this study, a decline in demand within Asia, and other factors.

The low yen rate increased competition with Japanese goods in the Asian and other markets and also decreased exports to Japan, dealing a severe blow to the export performance of several countries, Korea in particular. Many companies in the NIEs and China, which had increased their productive capacity as a result of the high export growth they had enjoyed in 1995, were left with excess inventory and sharply reduced corporate earnings.

#### **4. Asian Economic Integration and Its Consequences**

The events of 1996 demonstrated that, because the Asian economies had succeeded in achieving growth through the development of export industries, each country had become subject to the direct influence of fluctuations in demand in both global and regional markets. In addition, labor-intensive industries suffered a slump in exports. This showed that, under the impact of progressive globalization, constant changes in the international division of labor led to constant changes in each country's competitiveness as well as comparative advantage which prescribes it. It is worth noting in particular that, although Asia achieved rapid economic integration through intraregional industrial reorganization and expansion of trade, so it can be claimed that a so-called "self circulating mechanism" is being established, in reality, the effect of integration was to augment the impact of business fluctuations or changes in the economic policy of individual economies in the region, with a resulting expansion of the range of business fluctuations.

The concrete examples of this phenomenon can be seen in the leveling-off of intraregional trade, resulting from such factors as sluggish imports of components due to stagnant exports of electronic industry, changes in China's trade and economic policies, and slackening domestic demand in Malaysia and Thailand due to a financial squeeze in those countries.

This slowdown in intraregional trade is a sign that the process of horizontal division of labor among the Asian countries has yet to reach full maturity and demonstrates that NIEs which have achieved the economic level of the advanced countries have so far failed to make the transition from external to internal demand-led development.

#### ***Fragility of the Economic Base***

1. It is apparent from the economic conditions in 1996, of each of the economies covered by this study that they are faced with a number of new problems including (1) stagnation in leading industries that have acted as the engines of economic growth, (2) declining exports, (3) slowing down of economic growth, (4) increasing current account deficits and (5) currency instability. In view of the fact that economic development in each country has until now relied on (1) creation and development of leading industries, (2) expanding exports of manufactured goods and (3) increasing investment, it is clear that prospects for future development depend upon industrial restructuring through the creation of new growth industries. Unfortunately, however, stagnant export performance has revealed the underlying weakness of each country's industrial base and a number of structural impediments that had been tolerated during the preceding period of high growth. The countries covered in this report are now faced with the difficult challenge of simultaneously achieving industrial restructuring and strengthening their economic base.

#### **2. Rising Corporate Indebtedness and the Asset Value Bubble**

The development of each of the Asian economies has been dependent to a large extent on their ability to meet investment needs through the mobilization of domestic and foreign capital. In the early stages, domestic savings, supplemented by foreign direct investment and official development assistance, provided the motive force for industrialization. Later on, as the process of globalization made the transnational movement of capital more active, each of the countries became acutely aware of the urgent necessity to cope with the more sophisticated needs for financial services by building up appropriate financial systems and promoting deregulation and liberalization. But in 1996, faced with increasing corporate indebtedness and a dramatic fall in asset values, it became clear that the existing financial

framework could not adequately cope with the real economy. In Korea and Indonesia, the increasing level of private debt as well as bad debt by financial institutions has become a matter of concern. In nearly all the countries, there has been excessive investment in real estate, particularly by financial institutions. In order to cope with this situation, various counter-measures such as financing regulation have been implemented, but in Thailand there is already a growing sentiment of financial unrest due to the collapse in real-estate values and management failures by non-bank financial institutions. All of the countries must try to stabilize their financial systems on the basis of market liberalization, and to achieve this, it is essential to draft new rules and regulations and set up supervisory regimes.

### 3. Growing Current-account Deficits

Growing trade deficit or reduced trade surplus characterizes Asian economies, with the exception of a few countries such as Taiwan and Indonesia. In Thailand and Malaysia, there are deficits in both trade and investment income accounts, and the current account deficit as a proportion of GDP has risen to the 8% level. It can be argued that their current account deficit problem is the result of pursuing economic growth policies which made the occurrence of such deficit inevitable. This is because the assumption was made that, in order to achieve export-oriented industrialization, it was unavoidable to go through a period when both capital goods and intermediate goods would have to be imported. The policies resulting from this assumption were tolerant of trade deficits and even included such positive measures as tax exemption arrangements for imports. In the 1990s, the situation worsened as both indigenous companies and foreign affiliates spearheading the process of export-led industrialization strove to improve their competitive position by increasing their dependence on imported plant and machinery. The results of this could be seen even in China, which enjoyed rapid growth from the late 1980s through the aggressive introduction of foreign investment to finance the expansion of processing trade on consignment basis in light industrial and consumer goods. Because these export industries are highly dependent on imports, they deprive domestic manufacturers of producer goods of sales opportunities (the so-called 'by-pass effect' of export industries) and contribute to the poor performance of state enterprises responsible for such goods. A further negative consequence of this export-led policy is that improvement in personal income leads to greater demand for imported products and, in particular, for luxury goods. The countries covered in this report are trying various ways to eliminate their trade deficits, through such industrial policies as promoting import substitution and imposing more stringent conditions on foreign investment, as well as through restricting the import of luxury goods. Despite these steps, however, the effects of the industrial policies they have pursued so far are hard to discern, because the progress of trade liberalization renders them less effective. Dampening consumer demand by import restriction goes against the grain of the trend towards trade liberalization and also runs the risk of suppressing the expansion of domestic demand which is now seen as the new engine of growth for the NIEs in particular.

### 4. High-cost Structures and the Decline in International Competitiveness

In all the countries in this report, slackening export performance dictates that the fundamental structures underpinning international competitiveness must be re-examined and reformed. Especially in the NIEs and near-NIEs (Malaysia and Thailand), increases in production costs are outstripping improvements in productivity. Productivity improvement of companies and industries is further held back by a combination of factors including high interest rates, and high real-estate, distribution and other social and infrastructural costs. These 'high-cost structures' cause domestic enterprises to increase their overseas investments and discourage new foreign direct investment. In all the NIEs and near-NIEs, the emphasis is now on the review of financial systems, upgrading of service industries through deregulation, and the need for rapid infrastructural provision. Stress is also being placed on improving value-added of existing industries through R&D and training, as well as on corporate restructuring to counterbalance the adverse effects of the 'high-cost structure,' and industrial restructuring through the creation of new leading industries.

## ***Search for a New Development Strategy***

Although the nine Asian countries studied in this report are at different stages of development, they have many structural problems in common. Many of them – and especially NIEs which have developed to the level of the advanced countries – are expected to go through a painful period of structural adjustment after the period of high growth they have enjoyed to date. In the course of this process, some of them will no doubt suffer further decline in growth. But such fundamental characteristics of Asian economies as positive investment in education, a high savings ratio, and the relatively stable management of macroeconomic policies are largely intact. At the moment, there are no major changes in the flow of foreign direct investment and there is still great interest, from both inside and outside the region, in Asia's latent potential for further development, indicating that the region has still not lost its allure as an investment market. For all these reasons, it is unlikely that there will be an acute and irrevocable downturn in their economic performance.

However, we are now entering a period when less developed countries are one after another joining in the competition to attract investment and to achieve export-led industrialization. Furthermore, as we have already seen in the case of information and communication technologies, new technologies are lending a new urgency to the global race to upgrade industrial structures. Each country's prospects for sustained growth will depend both on its ability to come up with new development strategies in tune with the times and on its determination to spare no effort in modernizing its industries, seeking out new comparative advantages and putting new technology to effective use. In this context, special attention should be paid to countries like Singapore, Malaysia and Taiwan, since they show strong potential for further development through their commitment to modernize their economies by fostering their fast-growing information and communications industries and developing an appropriate infrastructure to support those industries. In other countries too, new development strategies in tune with the demands of a new era should be promptly formulated.