

ARTICLE FOR THE EDGE

WHERE IS ASEAN HEADING?

It's been a good year for the Association of Southeast Asian Nations, ASEAN, as it celebrated its 50th anniversary in style and enjoyed an upside surprise to economic growth. In the past month, a series of political conclaves saw the high and mighty of global politics presenting themselves at ASEAN-sponsored summits, in seeming recognition of ASEAN's centrality in regional affairs. Geo-political risks within the region appeared to have abated as the world's attention shifted northwards to the Korean peninsula where North Korea's nuclear and missile tests proved to be far more alarming than any problems the ASEAN region faced.

Is ASEAN really on a sustained upswing? We believe that, twenty years after its terrible crisis, ASEAN has a chance to once again establish itself as one of the premier poles of economic excellence in the world. It can even regain its position as one of the most popular destinations for foreign investment. However, while the economic fundamentals are on balance supportive, it is not clear whether the potential political obstacles can be overcome – which means that, unless ASEAN political leaderships get their acts together, the region's chance for glory might be missed.

Big cyclical uptick underway in region

There is little doubt that the ASEAN economies are strengthening. Recent data on economic growth in the third quarter were exhilarating, with most countries reporting faster than expected growth rates which were at multi-year highs. Countries most exposed to global demand such as Thailand, Vietnam, Malaysia and Singapore led the pack but the Philippines is also generating strong growth of close to 7% while Indonesia appears to be gradually putting a bad patch behind it and seeing growth north of 5%. Encouragingly, where lead indicators are available, they point to a sustained improvement.

Underpinning this rebound are both external and domestic factors:

First, demand for ASEAN's exports is turning around strongly:

- That has helped commodity prices to firm, boosting rural incomes, something quite clearly evident in Thailand for example.
- But exports of manufactured goods are also turning up smartly and that trade activity is spinning off benefits for a range of support services such as transportation, finance and logistics.
- Tourist arrivals are also surging, adding further impetus to growth.

Second, domestic drivers of growth are also contributing to the turnaround, so growth is broad-based:

One important factor is that the initial ill-effects of much-needed policy reforms have worn off while the benefits of these policy changes are now beginning to flow.

- Malaysia's introduction of the goods and services tax in 2015 is one example. The initial effect was to hurt consumer confidence but now that is wearing off while the boost to government revenues has allowed the government to step up social spending while still keeping the budget deficit on a downward trajectory.
- Another example is the reduction in fuel subsidies in Indonesia in early 2015, which again hurt consumer confidence for a while.
- Moreover, the middle years of this decade saw central banks in countries such as Thailand, Malaysia and Singapore, becoming concerned about the rapid rise in household debt. The range of macro-prudential measures they brought in to rein in excessive borrowing had the effect of slowing spending.

The good news is that these negatives have been absorbed by now and are no longer depressing spending as they once did.

But the improvements, thankfully, go beyond just such cyclical factors.

The really encouraging story is the structural factors that are in play, which will help raise long term growth potential. Two factors in particular stand out – a rising investment rate and signs of improving supply side prowess, especially in terms of competitiveness.

A rising investment rate, or the share of national output being devoted to investment to expand productive capacity, is a powerful positive because it leads to higher economic growth. There are several forces which will drive this rise:

- First, infrastructure spending is set to surge. In the Philippines, long a laggard in building infrastructure, the Duterte Administration is launching its “Build, Build, Build” initiative – already the share of government infrastructure investment in GDP has risen by one percentage point, just within a year. It will rise further. In Thailand, contracts for planned mega-projects in roads, railways, mass transit and agricultural extension works are being given out which means that there will be a burst of construction activity from early 2018 onwards which will support higher growth. Malaysia continues to step up infrastructure spending on mass transit and new highways. Indonesia, which in the past struggled to get infrastructure projects off the ground is gradually overcoming this record – transportation and power-related infrastructure projects have been initiated.
- Second, China's Belt and Road Initiative (BRI) will soon be accelerated, now that the ruling Communist Party has completed its 19th Party Congress and installed a new set of leaders under President Xi Jinping who created the BRI vision. Chinese-sponsored projects in the Mekong Region and in Malaysia are set to launch soon.

- Third, private sector investment is likely to be “crowded in” as businesses realise that the higher growth generated from the above will create plenty of money-making opportunities for themselves.

Then there is improving competitiveness – which stems from several sources. One development that we find especially encouraging is that governments across the region are working hard to improve supply-side conditions, which by making the eco-system more friendly to business should raise investment and growth opportunities. The most exciting example is Indonesia where President Joko Widodo’s untiring efforts to slash red tape and corruption has seen the country’s ranking in the World Bank’s Ease of Doing Business study improve from a woeful 130th in the world in 2012 to 91st in 2017 and 72nd in 2018. This is one of the most dramatic improvements in a country’s performance ever reported. But improved rankings were also seen for Thailand and Vietnam.

Another reason for improving competitiveness is that China’s currency and cost structures have increased relative to the average ASEAN economy. This should help ASEAN countries gain shares in global exports as well as in foreign direct investment.

A final factor is the better conceived and coordinated economic plans to boost long term growth. Malaysia’s Economic Transformation Programme was an early example of this and now we see Thailand stepping up to the plate with its Eastern Economic Corridor initiative which will see a cluster of globally competitive industrial and service emerge extending from Bangkok down the eastern seaboard to Pattaya. In Singapore, the report of the Committee for the Future Economy is also being implemented.

But more needs to be done for ASEAN to surge

If economics were all that mattered, ASEAN should be surging. Sadly, ASEAN also needs certain political pre-conditions to enable its full potential to be realised. This is where there are some reservations.

First, there are two sets of country-specific risks. General elections are due in several countries in 2018 and 2019.

- Indonesia’s presidential and parliamentary elections are only due in April 2019 but the political temperature is already rising, with President Joko Widodo’s opponents working hard to undermine him. Some of these efforts involve the incitement of religious sentiments which could create tensions.
- Next year, Malaysia will hold its 14th general election, with its political scene more fragmented than ever following splits in major parties such as the dominant UMNO party as well as the Islamic party, PAS. While the resurging economy, large government handouts and the government’s tough political measures have put the opposition on the defensive, there is still considerable uncertainty over the outcome of the elections. Many critics worry

about allegations of large-scale corruption while others are discomfited by politicians cynically exploiting racial and religious grievances.

- To the north, Thailand has just completed a year of mourning for its revered late King – with the end of the mourning period, the period of political restraint has ended and political tensions could erupt again. The general election slated for November next year could also be a flashpoint, particularly if Thais believe that the military government is determined to hang onto power through indirect means.

Another set of risks relates to the continued power of vested interests and their capacity to skew national policies to benefit themselves at the expense of the country as a whole. In Indonesia, for example, President Joko Widodo has struggled to overcome the influence of such vested interests in certain ministries and in parliament. Across the region, and all too often, such interest groups have resisted economic reforms that could benefit the general populace.

The second political challenge is a regional one. Southeast Asia has become the cockpit of big power rivalries as China flexes its muscles and the United States and its allies such as Japan and Australia re-engage in the region. The South China Sea territorial disputes have only quietened down temporarily – the fundamentally irreconcilable territorial claims remain. This situation demands a strong ASEAN that can confidently take the lead in resisting the big powers and collectively standing up to those powers who seek to impose their will on the region, whether it is regarding territorial disputes or in other areas.

Yet, ASEAN has disappointed. It is increasingly disunited on key issues such as how to face up to an assertive China which renders it ineffective in securing the interests of the region's smaller countries. Neither can its members agree on what multilateral trade arrangements to support. Some ASEAN members such as Brunei, Malaysia, Singapore and Vietnam, are prioritising the Comprehensive and Progressive Trans-Pacific Partnership while the others favour the Regional Comprehensive Economic Partnership which China favours. ASEAN's own efforts at regional integration have disappointed business leaders who complain that the much-vaunted ASEAN Economic Community has not made much difference to the way they trade and invest across boundaries.

The bottom line

ASEAN economies have moved into a new phase of potentially faster economic growth, underpinned by improving supply side fundamentals. However, political risks could let the region down. Domestic political challenges in some countries could morph into instability. At the regional level, where there are growing challenges that require collective action by a united ASEAN, ASEAN is failing to deliver. If the once-in-a-generation chance to return ASEAN to the high growth and prominence it once enjoyed is to be missed as a result, that would be very sad indeed.

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