CHAPTER – 2

FOREIGN DIRECT INVESTMENT [FDI] BETWEEN NIEs AND THE ASEAN

Introduction

In the economic climate of the globe and unbalanced distribution of resources it has become imperative that in order to sustain balanced economic growth new avenues of investment should be sought. The ASEAN (excluding Singapore as it is taken as an NIE) comprising of Brunei, Indonesia, Malaysia, the Philippines and Thailand have enjoyed robust economic growth and since 1980's these countries adopted an outward looking development strategy which emphasizes the role of foreign trade and FDI. Vietnam, which joined the ASEAN in July 1995 was showing trends of fast economic growth because of the FDI and its adaptability to new economic development.

Foreign Direct Investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy. FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates both incorporated and unincorporated FDI may be undertaken by individuals, as well as, business entities.  

FDI inflows and outflows comprise capital provided (either directly or through other related enterprises) or capital received from a FDI enterprise or capital received from a FDI enterprise by a foreign direct investor. There are three components in FDI:-

1. Equity capital is the foreign direct investor’s purchase of shares of an enterprise in a country other than its own.

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1 Sanjaya Lall and Paul Streeten, Foreign Investment, Transnationals and Developing Countries, English Language Book Society, London, 1980, p. 4
2. Reinvested earnings comprise the direct investor's share of earnings which is reinvested.

3. Intra-company loans or intra-company debt transactions refer to short or long term borrowing and lending of funds between direct investors [parent enterprises] and affiliate enterprises.²

In the 1980's the ASEAN region has become one of the most attractive investment locations in the developing world and attracted a disproportionately large amount of FDI, particularly in the post-1985 period.³ This reorientation of the ASEAN economic cooperation is consistent with the national policies of most member countries i.e., economic development through market based growth and greater participation of the private sector. The adoption of more outward-oriented industrialisation strategies based on international trade and greater direct foreign investment are now being pursued in all the ASEAN member, including previously inward looking countries like Indonesia. The greater internationalisation of the ASEAN economies has rendered them more sensitive to changes in international economic policies and trends. Concerns about rising protectionism in developed countries, the increase in bilateral trading blocs, and the outcome of Uruguay Round of General Agreement on Tariffs and Trade [GATT], have important implications for the economic growth prospects of the ASEAN.⁴

The most pertinent question is, why such an upsurge in FDI to the ASEAN which has a heterogeneous population and authoritative regimes in most of the member countries, The reason would be that as developing countries are liberalizing their foreign investment regimes and are seeking FDI not only as a source of capital funds foreign exchange, but also more importantly as a dynamic and efficient vehicle to secure much needed

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² Ibid, pp. 5-6
industrial technology, managerial expertise and marketing know-how and networks to improve on growth, employment, productivity and export performance.

Also certain agreements among the ASEAN countries and the establishment of World Trade Organisation in 1995 added to increased FDI, namely
1. Agreement on ASEAN Preferential Trading Arrangements, Manila 24 February 1977
2. ASEAN Customs Code of Conduct, Jakarta, 18 March 1983
3. Agreement among the Govt. of Brunei Darussalam, Singapore and Thailand for the Promotion and Protection of Investments, Manila, 15 December 1987.
7. Protocol to Amend the agreement among ASEAN nations for the Promotion and Protection of Investments, Jakarta, 12 September 1996.
8. Framework Agreement on the ASEAN Investment Area [AlA], Manila, 7 October 1998.5

The World Trade Organisation replacing the GATT system emphasizes fairness in trade and requires a more strict adherence to the trade rules, which may have more beneficial effects to the industrialized countries than developing countries. Intra-regionally, competition has increased among the countries in Asia. ASEAN-4 countries namely Indonesia, Malaysia, the Philippines and Thailand along with China are no longer

5 www.ASEAN.id
exporters of primary commodities. They are rapidly catching up with the Asian NIEs – Hongkong, Korea, Singapore and Taiwan – in labour intensive industry. The NIEs are also replacing Japan in low-tech and medium tech industries and they are playing an active role in the regional economy through increased capital investment and absorption of labour intensive goods. South Asia and Indo-China States especially India and Vietnam are not far behind this multi-layered catching up process occurring in Asia. Accompanied with this competition in Asia in growing economic interdependence through trade, investment, technology transfer and even labour migration. The hierarchical structure of trade and investment reflects different economic and technological levels between countries in East Asia. For example: Japan and The NIEs are now short of unskilled labour, while China and ASEAN-4 have an abundant supply of cheap labour. China, ASEAN-4 and Indochina States (Vietnam, Laos, Cambodia and Myanmar) need capital and technology, for which Japan and the NIEs can be relied on.

The new reality in Asia, summarized as “competition with cooperation” has brought significant changes in the structure of industry, trade and economy in general. Confounded by economic turbulence such as oil price shocks, exchange rate volatility, and the political economy of trade, East Asian economies have been facing restructuring pressure, in sequential order from Japan in the 1970s on to the NIEs in the 1980s on and ASEAN-4 and China in the 1990s. For the more advanced economies such as Japan and the NIES, restructuring involves industrial upgrading toward a more technology-intensive structure, while shedding low value added, labour intensive manufacturing to ASEAN-4, hosting these labour intensive industry in their major cities, ASEAN-4 and China face the task of improving infrastructure and institutions. While recognizing a short duration of comparative advantage in labor intensive industry. ASEAN-4 and China also pursue industrial upgrading through technology transfer from Japan and
the NIES and human capital investment. Intra-regional trade has intensified in the 1980s and continues to grow. Japan was the catalyst in the 1970s and the NIES in the 1980 and early 1990s. Unlike European integration, East Asian integration is less formal and more complex because East Asian does not form an exclusive economic bloc and it contains multiple types of cooperation: North-North, North-South and South-South.

**Foreign Direct Investment in ASEAN: Policies & Protocols**

The main regional instruments on direct investment in ASEAN are:

i) The 1987 ASEAN Agreement for the Promotion and Protection of Investments

ii) The 1996 Protocol to Amend the 1987 Agreement for the Promotion and Protection of Investments

iii) The 1996 Protocol on Dispute Settlement Mechanism

iv) The Framework Agreement on the ASEAN Investment Area

The investment agreements in ASEAN are binding instruments and they can be divided into two categories

(i) Agreements relating to Investment Protection

The Agreements cover protection against expropriation, guaranteeing repatriation of capitals, profits and dividends and modalities for settlement of investment dispute. The existing ASEAN agreements in this category are:

(a) The 1987 ASEAN Agreement for the Promotion and Protection of Investments;

(b) The 1996 Protocol to Amend the 1987 Agreement for the Promotion and Protection of Investments;

(c) The 1996 Protocol on Dispute Settlement Mechanism

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6 www.excl.city.kobe.jp/kic/anick/Newsletters/No.21

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(ii) Agreements Enhancing Investment cooperation, Facilitation, Promotion and Liberalisation.\(^7\)

This type of agreement aims to develop ASEAN into a highly competitive and conducive investment area by providing investors with greater opportunities for economies of scale, synergies and lower transaction cost environment.

The relevant agreements are, the "ASEAN Industrial Complementation" (AICO) Scheme, the ASEAN Free Trade Area (AFTA) and the ASEAN Investment Area (AIA) agreement. It must be emphasized that the AIA Agreement is not a scheme but an arrangement; it has wider scope of implications related to investment. This suggests that the arrangement is made up of a number of schemes, action plans and specific programmes.

Although there are other ASEAN agreements that could relate to FDI activities, it is the AIA Agreement which is now the key instrument governing and promoting FDI flows in the region.

Under the framework Agreement on the ASEAN Investment Area the ASEAN countries are committed to, among other things, further liberalising the investment regime in the region through the opening up of industries, granting national treatment, enhancing transparency and removing investment barriers. The signatories to the Agreement will also jointly promote ASEAN for FDI through coordinated investment promotion programme and undertake investment facilitation measures that will help lower transaction cost of investing and operating in the region. The two types of investment agreements are complementary to each other. Together, they provide investors with an enhanced investment environment. It is important that the objectives of the respective instruments are fully appreciated and the provisions clearly understood by investors.\(^8\)

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\(^7\) Handbook on ASEAN Agreement, ASEAN Secretariat, Jakarta, 1999

\(^8\) Ibid, p. 32
The 1987 ASEAN Agreement for the Promotion and Protection of Investments contains provisions which extend protection to investment against expropriation and guarantees repatriation of capital, profits and earnings and direct investment activities, from the nationality (legal or natural person) of the Contracting Parties. In situations where expropriation, which is an unlikely event, becomes necessary and under due process of law, investors will be compensated adequately and paid without reasonable delay. This means that compensation will be based on the market value of the investments affected before such expropriation took place. Specifically, the Agreement [Article IV (i)] stipulates that "Investment of nations or companies of any contracting party shall not be subject to expropriation or nationalisation or any measure equivalent thereto, except for public use, or public purpose, or in the public interest upon payment of adequate compensation. Such compensation shall amount to the market value of the investment affected, immediately before the measure of dispossession became public knowledge and it shall be freely transferable in freely usable currencies from the host country. The compensation shall be settled and paid without unreasonable delay. Article IX and X of the Agreement refer to investment dispute or arbitration. The former relates to the disputes between the contracting parties (i.e., state and state), while the latter cover disputes between state and investor of the contracting parties. In the event that any investment dispute should arise, the dispute is to be firstly settled amicably between the concerned parties. Failing this, however, either party to the dispute could be brought before any of the following bodies:

(i) the International Centre for Settlement of Investment Disputes (ICSID)
(ii) the United Nations Commission on International Trade Law (UNCITRAL)
(iii) the Regional Centre for Arbitration based in Kuala Lumpur or
(iv) any other regional centre for arbitration in ASEAN
Through Article VII of the Agreement, investors of the Contracting Parties can freely repatriate profits, dividends, royalties, technical assistance and technical fees, interests and other income accruing from any investments in the region. The Article also relates to repayment of intra-company loans and proceeds on liquidation of companies. It should be remembered that the 1987 Agreement does not apply to matter on taxation, which is a complex subject matter. However, double taxation matters are covered in the Avoidance of Double Taxation Treaties between the parties to the Agreement. Most ASEAN countries have bilateral double taxation agreements between themselves and with non-ASEAN countries. One analysis that should be noted from the 1987 Agreement is that it encourages the granting of national treatment among the Contracting Parties. This spirit was captured in Article IV (4) which states that "Any two or more of the Contracting Parties may negotiate to accord national treatment within the framework of this Agreement. Nothing herein shall entitle any other party to claim national treatment under the "most-favoured-nation (MFN) principle."

The 1996 Protocol to Amend the 1987 Agreement for the Promotion and Protection of Investments before the signing of the 1996 Protocol, the 1987 original Agreement was known as the "Agreement Among the Governments of Brunei Darussalam – the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore and the kingdom of Thailand for the Promotion and Protection of Investments".

With the Protocol, the 1987 Agreement is referred to as the "The ASEAN Agreement for the Promotion and Protection of Investments". The intentions of the ASEAN Members countries to continue with the 1987 Agreement is obvious.

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9 ASEAN Agreement for the Promotion and Protection of Investments 1987, ASEAN Secretariat, Singapore, p. 1-5
10 Protocol to Amend the 1987 Agreement for the Promotion and Protection of Investments 1996, ASEAN Secretariat, Singapore p. 1
The reasons for this are well captured in the preamble of the Protocol and the subsequent signing of it, on 12 September 1996 in Jakarta. With the signing of the protocol, the Lao People Democratic Republic and the Union of Myanmar acceded to the 1987 Agreement and the 1996 Protocol by depositing their instruments of accession with the Secretary-General of ASEAN. To this end, the nine contracting Parties entered into an agreement to protect and guarantee investment from the signatory countries.

Given the rapid development of the global as well as the region’s investment environment, coupled with strengthened investment corporation among the ASEAN countries, the 1987 Agreement was amended to improve and to make it a more appropriate instrument. The Protocol added the following elements and the commitments of the member countries to:

(i) endeavour to simplify and streamline investment procedures and approval process to facilitate investment flows

(ii) ensure the provision of up-to-date information on all laws and regulation pertaining to direct investment and take appropriate measures to ensure that such information be made as transparent, timely and publicly accessible as possible

(iii) include the ASEAN Dispute Settlement Mechanism as an alternative modality for the settlement of investment disputes.\[11\]

The Protocol on ASEAN Dispute Settlement Mechanism (DSM) was signed on 20 November 1996 in Manila. In so far as it relates to investment, the ASEAN DSM provides an alternative mechanism for the hearing of investment disputes should any of the parties to the dispute agrees to use it for conciliation or arbitration. Notwithstanding the existence of the ASEAN DSM, a party to a dispute can resort to other fora for the settlement of disputes at any stage before the Senior Economic Officials Meeting has made a ruling on the panel report of the disputed case. The ASEAN DSM encouraged consultation first for resolving disputes in an amicable manner.
between the parties concerned. If the dispute cannot be resolved at the consultation stage, the matter will be raised to the senior Economic Officials Meeting (SEOM) who will either establish a panel to assess the case and make an appropriate report for SEOM’s ruling on the case or the case will be raised to the special body in charge of the special or additional rules and procedures. A party to the dispute can appeal to the ASEAN Economic Ministers [AEM], the ruling of SEOM, on the case. The decision of the AEM on the appeal will be final and binding on all parties to the dispute. Aside from its application to investment disputes, the ASEAN DSM also covers and applies to other existing as well as future ASEAN economic agreements. A list of existing agreements is annexed to the Protocol. For instance, the ASEAN DSM will apply to the following Agreements

i) Basic Agreement on ASEAN Industrial Projects, Kuala Lumpur, 6 March 1980;

ii) Supplementary Agreement of the Basic Agreement on ASEAN Industrial Projects – ASEAN Urea Project (Indonesia) Kuala Lumpur, 6 March 1980,

iii) Basic Agreement on ASEAN Industrial Complementation Manila, 18 June 1981;

iv) Basic Agreement on ASEAN Industrial Joint Ventures, Jakarta, 7 November 1983

v) Memorandum of Understanding on the Brand-to-Brand complementation on the Automotive Industry under the Basic Agreement on ASEAN Industrial Complementation (BAAIC), Pattaya Thailand, 18 October 1988.

vi) Protocol to Amend the Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area (AFTA) Bangkok, 15 December 1995; and

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12 (Protocol) n. 10, p. 6
vii) ASEAN Framework Agreement on service, Bangkok, 15 December 1995.13

The Framework Agreement on the ASEAN Investment Area (AIA) has produced another milestone achievement in the region’s economic cooperation. The AIA Agreement was signed on 7 October 1988 in Manila at the 30th ASEAN Economic Ministers Meeting.

Under the Agreement, the AIA is to be realised by 1 January 2010 through the implementation of three broad-based pillars of investment programmes. These are cooperation and facilitation, promotion and awareness and liberalisation programmes. The key objective of AIA is to substantially increase the flow of direct investment from ASEAN and non-ASEAN sources by making the region a more competitive, open and liberal investment area. This will entail, among others, the following key activities:

(i) Opening up all industries, with some exceptions as specified in the Temporary Exclusion List (TEL) and Sensitive List (SL) for investment to ASEAN investors by 2010 and to all investors by 2020

(ii) granting national treatment, with some exceptions as specified in the TEL and SL, to ASEAN investors by 2010 and to all investors by 2020

(iii) involving the private sector actively in the AIA development process.

(iv) undertaking joint investment facilitation activities that will help bring down transaction cost and adopting co-ordinated investment promotion programme to facilitate greater awareness of the opportunities within the AIA.

(v) Promoting freer flow of capital, skilled labour and professionals and technology among the ASEAN countries;

(vi) providing transparency of investment policies, rules and procedures and administrative processes.

(vii) providing a more streamlined and simplified investment process.

13 ASEAN Briefing paper on Dispute Settlement Mechanism, ASEAN Secretariat, Jakarta, pp. 2-5
In sum, the AIA will bind the member countries to the aim of eliminating investment barriers, liberalising investment rules and policies, granting national treatment and opening up industries, initially in the manufacturing sector and later to cover other sectors under the Agreement. The implementation of the Framework Agreement will be reviewed every two years by the AIA Council, a ministerial body, to ensure that the objectives of the AIA are met. Recognising the different Stages of development and the late entry of new member of the ASEAN Family, the newer member countries will be accorded flexibility in the implementation timeframe. In this regard, Vietnam will phase out the Temporary Exclusion List (TEL) by 2013, Lao PDR and Myanmar by 2015 while the other ASEAN countries will phase out their TEL by 2010. The TEL relates to industries that will be opened up and the granting of national treatment in accordance with specific schedules and action plans that member counties had submitted to the AIA council by March 1999. The AIA Agreement recognised that there may be certain industries or measures in which the Contracting Parties may not be able to open up or accord national treatment for reasons such as the need to protect national security; public morals, human, animal or plant life or health. In view of this, the member countries are allowed to place limited list of industries and limited areas where national treatment cannot be granted in a Sensitive List (SL). The SL will be reviewed by the AIA council by 1 January 2003 and at subsequent periodic interval to be determined by the council.

The SL will be short because by 2003 or earlier, the regions market can be serviced through exports where the internal tariff rates will be at 0-5% and the non-tariff barriers eliminated. In this situation, it will be meaningless for countries to have industries placed in the SL of the AIA arrangement while these industries are opened for free trade under the AFTA Agreement.
Basic benefits of AIA to investors is that all these agreements as discussed and viewed together will have significant implications for new and existing investments in ASEAN. They will enhance investors confidence for locating and operating in the investment area. Under the AIA Agreement, investors will have greater investment market access through the opening up of industries for investment and enjoyment of national treatment. Investors will benefit from lower cost of investment and operation in the region as a result of a liberal investment regime, the elimination of investment impediments, steps taken to enhance transparency, co-ordinated promotion programme and a greater private sector role in the AIA process. The implementation of facilitation measures will bring about a more effective and efficient investment environment and these benefits are available to all investors. Coupled with the ASEAN Free Trade Area arrangement and the AICO scheme, investors can enjoy greater synergies and economies of scale and scope of production, whether their operations are aimed at the regions expanding market or whether they are using the region as an export platform to service global demand. Together with the AFTA programme, the AIA will give investors, existing and new framework highly conducive for regional integrated production activities, procurement, manufacturing and resource based investment activities.\textsuperscript{14}

In order to forge better ties with the NIES, many initiatives have been taken but with Singapore as a member of ASEAN and Republic of Korea which was a Sectoral Dialogue partners till July 1991 and later on elevated to the status of Dialogue partner in July 1991. As Hongkong SAR has become a part of China and Taiwan has been a bone of contention vis-a-vis China so ASEAN nations do continue trade and economic relations but have not given any special status to Taiwan.

The new developments which took place are Cambodia’s admittance into ASEAN on 30\textsuperscript{th} April 1999. On 30 November 1999, the third Informal Framework Agreement on the ASEAN Investment Area, ASEAN Secretariat, Jakarta, 15 Dec. 1995, p. 1-6
ASEAN summit is held in Manila. The ASEAN leaders decided to speed up efforts to achieve AFTA, to initiate a Troika of ASEAN Foreign Ministers as a useful means of attending to urgent regional peace and security concerns and to intensify cooperation with ASEAN's Northeast Asian neighbours: China, Japan and the Republic of Korea within the ASEAN + 3 framework of East Asian Cooperation.

In the same pursuit the first meeting of the ASEAN Economic Ministers and Minister's of the People's Republic of China, Japan and the Republic of Korea was held in Yangon, Myanmar on 2 May 2000. The Ministers recognised the importance of cooperation and collaboration in industry, trade, investment and other economic areas among ASEAN, People's Republic of China, Japan and Republic of Korea against the background of the deepened economic interdependence in the region spurred by globalisation and the rapid development Information and Communications Technology (ICT).15

The Ministers shared the view that the meeting could provide a valuable opportunity for further collaboration, promote a cohesive response to the challenges of globalisation and recover the region's role as a growth centre in the world. The Ministers noted the large flow of trade between ASEAN and the three Northeast Asian countries, which in 1998, totalled US $ 122 billion.16

Among the major areas of cooperation discussed and agreed to at the meeting were:

(i) strengthening efforts in accelerating trade, investment and technology transfer

(ii) Encouraging technical cooperation in information technology and e-commerce.

(iii) Encouraging active participation in the development of growth areas involving ASEAN, including the Mekong River Basin.

15 ASEAN Briefing Paper, The ASEAN Secretariat, Jakarta, Nov. 2000, p. 3
(iv) Heightening cooperative efforts on Human Resources Development.

(v) Promoting broader private sector participation through networking initiatives such as East Asian Business Council and industries specific business fora.

(vi) promotion of agriculture, industrial cooperation and tourism

(vii) Strengthening small, medium enterprises and supporting industries

(viii) cooperation in scientific and technological development and

(ix) coordination and cooperation in various international and regional fora.

It is stated that the upsurging in investment in mid-1980s in Southeast Asia from Japan and Asian NICS is caused by the macro economic factors rather than by the institutional arrangement of ASEAN. Table – 1.1 depicts the continuous increase in FDI inflows in the ASEAN nations barring few exceptions like Brunei, Laos. In fact most of the ASEAN nations showed increase FDI inflows till 1996 when market instability and financial turmoil had taken its toll on FDI. Apart from that countries like ASEAN – 4 (Indonesia, Malaysia, Thailand & Philippines) along with Vietnam have shown remarkable FDI inflows with the increase in FDI ranging from 2% to 10% from the previous year. Though in the same period, the NIEs have shown a perceptible increase in FDI outflows (Table 1.2) with Hongkong shows increase in FDI outflows till 1997 because of the fact that British financial institutions and investors wanted to take flight of capital prior to the handover of Hongkong to China by Britain. On the same period, the FDI outflows from ASEAN nations has not been very impressive barring Malaysia which was showing signs of an investor country in the region.17

Table 1.1
FDI inflows, by host region and economy, 1987-1998
(Millions of dollars)

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<td>328,862</td>
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<td>79,397</td>
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<td>Brunei Darussalam</td>
<td>1</td>
<td>14</td>
<td>6</td>
<td>13*</td>
<td>11*</td>
<td>5*</td>
<td>4*</td>
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<tr>
<td>Cambodia</td>
<td>-</td>
<td>54</td>
<td>69</td>
<td>151</td>
<td>294</td>
<td>204</td>
<td>140*</td>
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<td>Hongkong, China</td>
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<td>3657*</td>
<td>4131*</td>
<td>3279*</td>
<td>5521*</td>
<td>6000*</td>
<td>1600*</td>
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<td>6194</td>
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<td>96</td>
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<td>91</td>
<td>115</td>
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<td>1500</td>
<td>2000</td>
<td>2500</td>
<td>2950</td>
<td>1900</td>
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a-estimates
e-Annual average from 1989 to 1992

## Table 1.2
**FDI outflows, by host region and economy, 1987-1998**
*(Millions of Dollars)*

<table>
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<tr>
<td>Brunei Darussalam</td>
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<td>50^a</td>
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<td>20^a</td>
<td>40^a</td>
<td>10^a</td>
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<td>Cambodia</td>
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*a-estimates  
e-Annual average from 1989 to 1991

Source: Ibid, p. 483-486

FDI and the rapid economic growth in ASEAN countries from the mid 1980s to 1990s has been attributable to the surge of the FDI from Japan and the NIES. The influx of foreign direct investment, as percentage of gross domestic product played a more important role in Indonesia and Malaysia but a less one in the Philippines and Thailand. Singapore was the most favourable host of FDI because it created a favourable local business environment for foreign investors e.g. free trade and financial flows, a finely tuned investment incentive system based on tax breaks and heavy public investments in infrastructure and education which resulted in overall institutional efficiency and a highly skilled labour force. By contrast, the other four ASEAN countries lack efficient infrastructures and skilled labour forces, but have low labour costs to make up for such disadvantages.

Of the other ASEAN countries, Malaysia has long been considered prior to 1997 financial crisis as the most likely next Asian NIC in terms of
its income level and industrial structure, Thailand is stated to be poorer than Malaysia, the Philippine and Indonesia are behind both Malaysia and Thailand in industrial development and manufacturing exports. The earlier phases of industrialization in Malaysia and Thailand were characterised by import substitutions but, due to the increasing saturation of domestic markets and other reasons, import substitution has been replaced by export substitution. In recent years, the manufacturing sector has overtaken agriculture as the leading economic sector and is expected to maintain its current preeminent position to become the engine of growth in both countries. In Malaysia, where the local private sector lacks political influence while the state is strong and relatively autonomous, there are few restrictions on foreign investment (unless it competes with state itself), thus there has been substantial FDI.

By contrast, foreign investment in Thailand until very recently has been much more restricted except where it was complementary to rather than competitive with local capital, as in joint-venture automobile plants and in export-oriented electronics-manufacturing.

Thailand has been elevated to near NIC status virtually because of heavy investment first by Japanese in the export-oriented manufacturing beginning in 1987 and later, Taiwanese. Until then the country had been only a modest recipient of foreign investment (see Table 1.1) Its development since 1986 has been remarkable.

Both Malaysia and Thailand generally welcome foreign investments and have fairly liberal policies towards FDI as well as generous tax and other incentives to promote investment in the country. In general, both countries were advantageously placed to receive foreign investments in the 1980s and even in 1990s because their currencies were maintained at appropriate levels and they had vast investment potential, social and political stability, highly attractive investment incentives and adequate economic development including suitable infrastructures combined with an easily trainable and relatively inexpensive labour force. The experience of these
two countries holds a lesson for richly endowed developing countries that recognise the contribution foreign investment can make to their development.

ASEAN was able to attract to fairly good amount of FDI in the 1990s because of improving economic development and the region’s competitive, conducive investment climate for international business operations. Also, ASEAN provides high profitability factor which is one of the region’s strengths in attracting FDI and it will be an important force influencing future FDI location decision in favour of ASEAN. The cost effectiveness of ASEAN in terms of low unit labour costs, including skilled labour, a more conducive investment environment and low transaction costs. The favourable experience of many multinational enterprises (MNEs) operating in the region will lend further support in inducing investors of the region for investments in ASEAN.\(^\text{18}\)

The major investor countries in ASEAN-9 are Japan, US and EU (European Union) along with NIEs but intra-ASEAN investment have also become important source of FDI in the region in the 1990s. In case of NIEs (as given in Table 1.3) the maximum FDI inflow in destined to Hongkong and Singapore till 1997 but after 1997 it is mainly Korea and Singapore which have registered phenomenal growth in FDI in flows, nearly 10 fold increase in case of Korea from 1993 ($588 million) to 1998 ($5,143 million) while for Singapore it rose from $4,686m in 1993 to $9,710 m in 1997 while dropping to $7,2187 m in 1998 due to financial crisis. With regard to ASEAN, (barring Singapore) it rose from $1,308 million in 1993 to $18,103 million in 1997 which dropped to $14,182m in 1998 because of crisis.\(^\text{19}\)

Even if we scan the countrywise data in this regard, Indonesia was the biggest FDI location in ASEAN but it plummeted to a low of $356 million in 1998 because of political uncertainty and floating exchange rate.


\(^\text{19}\) Calculations made from ASEAN FDI, Database 1999, ASEAN Secretariat, Jakarta, 1999.
Malaysia was another lucrative destination for FDI which remained from $5,006 million in 1993 to $5,078 million in 1996 which dipped to $3,727 million in 1998. The other major countries vying for FDI are Thailand, Vietnam, Philippines and other Indo-China countries.  

Even if we analyse the date with regard to US, China, Japan and NIEs, FDI flows to ASEAN for a period of four years (1995-1998) as given in Table 1.4, in fact in 1995 the FDI in ASEAN was $2,741.19 million from Japan, $2,266.45 million from USA, $5,116.23 m from NIEs and a mere $46.41 million from China. In 1996, it was $3,707.85 million, $3,049.09 million $4,522.14 million and $63.64 million respectively for Japan, US, NIEs and China. In 1998 after the financial crisis, the investment scenario was $2,317 million $1,827.26 million $1,995.34 million, and $241.68 million, by Japan, US, NIEs and China respectively. But one interesting thing to note was that even at this juncture the FDI inflow in ASEAN from Japan and NIEs was at a parity and the maximum FDI came from NIEs to ASEAN came in the year 1997 when it touched a new high of $6,270 million much higher than that of US, Japan and China.  

The very interesting part of the finding in that if Singapore is taken as a country of ASEAN for analysis purposes then Japan remains the largest direct investor in ASEAN, accounting for about 21% of the cumulative net FDI flow in the region between 1995-1999 (Ist half). FDI originating from other NIEs (Taiwan, Korea and Hong Kong) and from within ASEAN have increasingly prominent sources of FDI to the region. Intra-ASEAN direct investment and FDI from NIEs accounted for about 15% and 33% share of the cumulative net FDI flows in ASEAN, respectively in the period 1995-1999 (Ist half). In 1995, intra-ASEAN direct investment accounted for 23% of the total FDI flows into the region as compared to 2% in 1998. If we take, data given in Table 1.5, FDI originating from Singapore accounted for more than 50% of the total ASEAN investment between 1995-1999 (Ist half).
half). If we take year-wise FDI from NIEs (Taiwan, Korea, Hong Kong and Singapore) then for Korea the favourite destinations for FDI was Indonesia, Vietnam and Malaysia in descending order in 1995 while in 1996 it was Indonesia and Vietnam but in 1997, suddenly Cambodia became a lucrative destination though at that time it was not a member of ASEAN. In 1998, it was Indonesia, closely followed by Vietnam and Thailand in FDI composition of Korea to ASEAN. For Hong Kong on analysis it is found that Philippines, Thailand, Vietnam and Indonesia were important FDI destination in 1995.22

In 1996, it was Malaysia, Thailand, Vietnam and to a lesser extent Indonesia were recipients of Hong Kong’s direct investment. Later in 1997 and 1998, Thailand was the biggest benefactor of Hong Kong FDI owing to property boom but even after financial crisis, Thailand was getting a larger share of Hong Kong FDI than other ASEAN nations. With regard to Taiwan, it was Malaysia and Vietnam garnered a major chunk of Taiwanese FDI and till 1998 it sustained the trend. For Singapore, Vietnam, Brunei, Thailand and Cambodia. In fact, Singapore has been shown a keen interest in investment in Brunei (except in 1997). In fact, Cambodia is slowly emerging as an important FDI destination for the four NIEs.23

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22 Ibid.
23 Ibid.
### TABLE 1.3: GEOGRAPHICAL DISTRIBUTION OF GLOBAL FDI FLOWS TO SELECTED COUNTRIES, 1987-1998

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Source: ASEAN FDI Database 1999, ASEAN Secretariat, Jakarta 1999,

a-Estimates

### TABLE 1.4: NET FDI IN ASEAN BY COUNTRY / GROUP OF ORIGIN (DIFFERENT YEARS)

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<th>Laos</th>
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<th>Thailand</th>
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* Figures in brackets for disinvestment.
### TABLE 1.5: NET FDI IN ASEAN BY COUNTRY OF ORIGIN (1995-1999st HALF)

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<td>19.50</td>
<td>21.00</td>
<td>--</td>
<td>47.31</td>
<td>137.90</td>
<td>286.01</td>
<td>0.03</td>
</tr>
<tr>
<td></td>
<td>1997</td>
<td>44.38</td>
<td>7.70</td>
<td>129.00</td>
<td>--</td>
<td>19.67</td>
<td>178.80</td>
<td>377.32</td>
<td>--</td>
</tr>
<tr>
<td></td>
<td>1998</td>
<td>144.25</td>
<td>6.90</td>
<td>78.00</td>
<td>--</td>
<td>50.90</td>
<td>83.00</td>
<td>277.12</td>
<td>0.12</td>
</tr>
<tr>
<td></td>
<td>1999st half</td>
<td>31.84</td>
<td>7.30</td>
<td>12.00</td>
<td>--</td>
<td>3.72</td>
<td>32.90</td>
<td>41.24</td>
<td>0.08</td>
</tr>
<tr>
<td>Singapore</td>
<td>1995</td>
<td>108.23</td>
<td>585.60</td>
<td>1,496.00</td>
<td>42.00</td>
<td>75.48</td>
<td>136.30</td>
<td>239.20</td>
<td>262.05</td>
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<tr>
<td></td>
<td>1996</td>
<td>35.46</td>
<td>48.50</td>
<td>1,322.00</td>
<td>55.50</td>
<td>19.59</td>
<td>275.20</td>
<td>233.00</td>
<td>298.84</td>
</tr>
<tr>
<td></td>
<td>1997</td>
<td>15.12</td>
<td>134.50</td>
<td>2,154.00</td>
<td>132.00</td>
<td>67.39</td>
<td>284.80</td>
<td>347.00</td>
<td>91.21</td>
</tr>
<tr>
<td></td>
<td>1998</td>
<td>49.14</td>
<td>21.60</td>
<td>543.00</td>
<td>307.50</td>
<td>51.30</td>
<td>523.00</td>
<td>319.00</td>
<td>1,733.88</td>
</tr>
<tr>
<td></td>
<td>1999st half</td>
<td>1.02</td>
<td>240.10</td>
<td>62.00</td>
<td>87.90</td>
<td>15.31</td>
<td>644.80</td>
<td>68.90</td>
<td>1,410.92</td>
</tr>
</tbody>
</table>

ASEAN Trade: Intra ASEAN and ASEAN-NIES

The 1992 agreement to set up the ASEAN Free Trade Area (AFTA) was the organisation's first breakthrough towards creating an integrated ASEAN Economic Region. The main implementing mechanism for AFTA is the Common Effective Preferential Tariff (CEPT) Scheme, also adopted in 1992. Under the CEPT, tariffs on a wide range of products traded within the region are progressively either lifted totally or limited to a maximum of 5 percent. Quantitative barriers – limits on the volume of certain products a country imports and other non-tariff barriers such as prohibition and unnecessary technical requirements are being eliminated.

AFTA's final goal is to eliminate altogether import duties on all products, to create a truly free-trade, or tariff-less, region. The Third ASEAN Informal Summit in Manila in 1999 advanced the timetable for this goal to 2010, ahead of the original schedule of 2015, for the six original signatories to the CEPT scheme – Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand. The newer ASEAN members – Cambodia, Laos, Myanmar and Vietnam have committed themselves to eliminating all import duties by 2015, with some sensitive products to follow these members' original target of 2018. In the year 2000 in compliance with the Bold measures 85 percent of the Inclusion List of the six original signatories is already in the zero to 5 percent zone.

Product Classifications:

For the orderly reduction and eventual lifting of tariffs, the CEPT classifies products into three lists – Inclusion List, Temporary Exclusion List and Sensitive List, stipulating tariff-cutting schedules for each. Those on the Inclusion list make up the bulk of ASEAN products. By 2002, all qualitative and non-tariff restrictions on these products will be removed, and tariffs will be either eliminated or limited to a maximum of 5 percent. Rates on at least 85 percent of each of the first six signatories' Inclusion List must be no more than 5 percent by 1 January 2000. This objective has already been achieved.
By 2001, 90 percent of tariff lines on the Inclusion List will have rates in the 0 to 5 percent range. The newer ASEAN members have been given more time for this; 2006 for Vietnam, 2008 for Laos and Myanmar, and 2010 for Cambodia. Those on the Inclusion List make up about 85 percent of the tariff lines of all ten ASEAN countries.\(^{24}\)

Products on the Temporary Exclusion List are exempt from tariff reduction for a temporary period. However, they have to be gradually moved to the Inclusion List, and their tariffs eventually reduced to the 0 to 5 percent range. By 2001, 8,660 tariff lines will be on this list representing only 13 percent of ASEAN & Singapore total tariff lines.\(^{25}\)

In October 2000 the ASEAN Economic ministers endorsed a protocol allowing a member country facing real difficulties in meeting its CEPT obligations to delay the transfer of products from its Temporary Exclusion List to the Inclusion List or suspend the concession on products already transferred. The same protocol however limits the application of the modification to manufactured products that were on the Temporary Exclusion List on 31 December 1999 or other applicable dates in the case of Cambodia, Laos, Myanmar and Vietnam.

Items on the Sensitive List are some unprocessed agricultural products. These will not be included in AFTA's coverage until 2010. New ASEAN members are given even more time: 2013 for Vietnam, 2015 for Laos and Myanmar and 2017 for Cambodia.

The ASEAN Free Trade Area Council noted that progress is already well ahead of schedule when they met in Chiang Mai on October 4. This ministerial level body, responsible for the implementation of the CEPT scheme announced that 85% of products in the Inclusion List have tariffs of no more than 5%. This figure will increase to 90% by 2001 for the six original signatories to the scheme.\(^{26}\)

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\(^{24}\) ASEAN Briefing Paper, ASEAN Free Trade Area, ASEAN Secretariat, Jakarta, 2000.

\(^{25}\) Ibid.

\(^{26}\) ASEAN Briefing Paper, Economic Integration, ASEAN Secretariat, Jakarta, Nov. 2000, pp 3-7
The average tariff rate in ASEAN has gone down from 12.76% in 1993 to 4.43% in 2000 and by 2001. It is expected to be reduced further to just 3.96%. Benefits are now being seen in the increasing volume of intra-ASEAN trade. Total exports amongst ASEAN members grew by 7.7% from the 1998 to reach $341.1 billion in 1999. As regional economies bounced back from the crisis, demand for imports reached a total of $279.5 billion, an increase of 7.7% from 1998 to 1999.

ASEAN exports to its traditional global markets also began a strong recovery last year. Exports to its traditional global markets also begun a strong recovery last year. Exports to EU countries increased by 18.7% to $55.7 billion in 1999 and exports to Japan grew 7.2% to $37.6 billion. Exports to US, ASEAN’s biggest market increased from $64.6 billion in 1998 to $70 billion in 1999.

Table 1.6: 1997 Exports to (Millions of US Dollars) Countries

<table>
<thead>
<tr>
<th>From</th>
<th>Brunei</th>
<th>Cambodia</th>
<th>Indonesia</th>
<th>Laos</th>
<th>Malaysia</th>
<th>Myanmar</th>
<th>Philippines</th>
<th>Thailand</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>To</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>24</td>
<td>71</td>
<td>917</td>
<td>9</td>
<td>1,721</td>
<td>71</td>
<td>2,209</td>
<td>1,867</td>
<td>635</td>
</tr>
<tr>
<td>Korea</td>
<td>-</td>
<td>-</td>
<td>3,542</td>
<td>-</td>
<td>4,361</td>
<td>-</td>
<td>2,604</td>
<td>2,247</td>
<td>1,607</td>
</tr>
<tr>
<td>Singapore</td>
<td>1,395</td>
<td>420</td>
<td>2,384</td>
<td>35</td>
<td>21,871</td>
<td>706</td>
<td>2,947.4</td>
<td>5,783.6</td>
<td>1,665.5</td>
</tr>
<tr>
<td>Taiwan</td>
<td>19</td>
<td>79</td>
<td>1,796</td>
<td>4</td>
<td>3,760</td>
<td>61</td>
<td>2,471</td>
<td>2,861</td>
<td>1,431</td>
</tr>
<tr>
<td>Asia Total</td>
<td>2,037</td>
<td>756</td>
<td>12,236</td>
<td>387</td>
<td>30,399</td>
<td>2,145</td>
<td>16,377</td>
<td>17,572</td>
<td>8,755</td>
</tr>
<tr>
<td>World Total</td>
<td>3,946</td>
<td>1,114</td>
<td>43,016</td>
<td>409</td>
<td>80,263</td>
<td>2,675</td>
<td>48,433</td>
<td>62,875</td>
<td>14,163</td>
</tr>
</tbody>
</table>

Source: Direction of Trade Statistics Yearbook, 1999 IMF Washington D.C.
Table 1.7: 1997 Imports to (Millions of US Dollars) Countries

<table>
<thead>
<tr>
<th>From Countries</th>
<th>Brunei Darussalam</th>
<th>Cambodia</th>
<th>Indonesia</th>
<th>Laos</th>
<th>Malaysia</th>
<th>Myanmar</th>
<th>Philippines</th>
<th>Thailand</th>
<th>Vietnam</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>1</td>
<td>33</td>
<td>1,669</td>
<td>2</td>
<td>4,909</td>
<td>51</td>
<td>1,269</td>
<td>3,368</td>
<td>265</td>
<td>11,567</td>
</tr>
<tr>
<td>Korea</td>
<td>-</td>
<td>4,090</td>
<td>3,276</td>
<td>704</td>
<td>1,279</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>9,349</td>
</tr>
<tr>
<td>Singapore</td>
<td>212</td>
<td>59</td>
<td>19,949</td>
<td>173</td>
<td>1,982.3</td>
<td>6,813.2</td>
<td>542.4</td>
<td>29731.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>68</td>
<td>19</td>
<td>1,830</td>
<td>-</td>
<td>3,424</td>
<td>27</td>
<td>1,250</td>
<td>1,563</td>
<td>356</td>
<td>8539</td>
</tr>
<tr>
<td>Asia Total</td>
<td>369</td>
<td>456</td>
<td>18,265</td>
<td>36</td>
<td>36,468</td>
<td>602</td>
<td>7028</td>
<td>21698</td>
<td>2,156</td>
<td></td>
</tr>
<tr>
<td>World Total</td>
<td>2375</td>
<td>624</td>
<td>52,179</td>
<td>192</td>
<td>78,750</td>
<td>1,178</td>
<td>28,510</td>
<td>57,518</td>
<td>8,722</td>
<td></td>
</tr>
</tbody>
</table>


In fact the trade with NIES, in case of ASEAN has been substantial as shown (in table 1.6 and 1.7) the exports from NIEs to ASEAN has been concentrated mainly to ASEAN – 4 with Indonesia being at the bottom of the series. In case of trade between NIEs and ASEAN, the imports from ASEAN to NIEs has been dominated by Malaysia and Thailand because of the Telecom sector, Computer industry, semi-conductors and footwear.

Even in the case of the top 25 developing economy exporters, ranked by export values in 1997, the ASEAN countries namely Malaysia, Thailand, Philippines and Indonesia are in the top 25 high-technology manufactures, Medium technology and low technology manufactures. Even in the case of total merchandise exports, the ranking of ASEAN – 4 has been quite impressive as shown in (Table 1.8 and 1.9).

In the new context of changing global scenario, the relations between ASEAN and NIEs has been on the upward swing. As Singapore, is a part of ASEAN so the country is reaping all the benefits of a member-nation and this was one of the main reasons for the discussion of intra-ASEAN projects and programmes. Analysing ASEAN and South Korea relationship, the first meeting was convened of the Joint Planning and Review Committee (JPRC) in April 1999 to improve the use of the ASEAN-ROK Special Cooperation Fund (SCF). A revised Project proposal Approval procedure and other
measures were adopted to ensure timely project implementation and effective use of the SCF. At the same time, the ASEAN – ROK Eminent Persons Group submitted its report on the future direction of ASEAN – ROK cooperation.\textsuperscript{17}

At the second meeting of the JPRC, in May 2000, ASEAN and South Korea agreed on the importance of matching development cooperation with ASEAN’s priorities, including facilitating the integration of newer ASEAN members into ASEAN’s economic cooperation schemes. In this context, South Korea indicated that it would consider positively projects that would facilitate ASEAN’s economic integration.\textsuperscript{18} Two sides have agreed that the ASEAN – ROK dialogue would include an exchange of views on political and security issues in the region.

In fact, ASEAN + 3 Process has the countries like China, Japan and the Republic of Korea to be inculcated into broader ASEAN perspective. As Hongkong has become Special Administrative Region [SAR] of China and Taiwan being the erstwhile part of China so there is a likely understanding between ASEAN and Taiwan so as not to grant it a dialogue partner status to pacify China in the region but the volume of trade between Taiwan and ASEAN speaks for itself.

In fact the ASEAN + 3 process and ASEAN dialogue partner system has been used to urge that the world’s largest markets be kept open for the products of ASEAN members and to promote investments from them. Advances have been made in financial cooperation among them, and the way has been charted for deeper economic cooperation in East Asia – in trade, investment, technology transfer, information technology and small and medium enterprises. ASEAN at the height of the East Asian financial crisis of 1997-98, it had seemed as though the ASEAN countries, like the rest of East Asia, had no future at all and that the ASEAN idea of community had come to nothing. The economic impact of the crisis was

\textsuperscript{17} ASEAN Briefing Paper, External Relations, ASEAN Secretariat, Jakarta, Nov. 2000, p. 1-8
\textsuperscript{18} ASEAN Briefing Paper, Infrastructure for Growth, ASEAN Secretariat, Nov. 2000 p. 8
severe; it returned millions into poverty and cut down the emerging Southeast Asian middle class. The prognosis of many was that it would take a decade for ASEAN economies to recover and that the member countries would eventually go their separate ways. ASEAN recovered quickly and one reason for the quick recovery and endurance of ASEAN is that the highly diverse countries of Southeast Asia have become more cohesive throughout ASEAN’s 33 years. The ASEAN is now preparing itself for the ASEAN vision 2020 but in the financial sector reforms are needed which will be discussed in the next chapter.
<table>
<thead>
<tr>
<th>High-technology manufactures</th>
<th>Medium-technology manufactures</th>
<th>Low-technology manufactures</th>
<th>Resource-based manufactures</th>
<th>Total manufactures</th>
<th>Total merchandise exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Singapore</td>
<td>72 925</td>
<td>Republic of Korea</td>
<td>33 033</td>
<td>92 955</td>
<td>13 852 China</td>
</tr>
<tr>
<td>2 Taiwan Province of China</td>
<td>40 682</td>
<td>Mexico</td>
<td>31 724</td>
<td>35 447 Singapore</td>
<td>13 412 Republic of Korea</td>
</tr>
<tr>
<td>3 Republic of Korea</td>
<td>39 246</td>
<td>China</td>
<td>24 030</td>
<td>32 230 Republic of Korea</td>
<td>12 548 Singapore</td>
</tr>
<tr>
<td>4 Malaysia</td>
<td>37 455</td>
<td>Malaysia</td>
<td>21 503</td>
<td>20 661 Malaysia</td>
<td>11 544 Taiwan Province of China</td>
</tr>
<tr>
<td>5 Mexico</td>
<td>34 061</td>
<td>Bangladesh</td>
<td>10 163</td>
<td>10 101 Indonesia</td>
<td>9 045 Mexico</td>
</tr>
<tr>
<td>6 China</td>
<td>31 534</td>
<td>Brazil</td>
<td>12 145 Hong Kong, China</td>
<td>13 304 Thailand</td>
<td>7 172 Thailand</td>
</tr>
<tr>
<td>7 Thailand</td>
<td>18 235</td>
<td>Malaysia</td>
<td>10 336</td>
<td>10 372 India</td>
<td>7 045 Brazil</td>
</tr>
<tr>
<td>8 Hong Kong, China</td>
<td>7 720</td>
<td>Brazil</td>
<td>7 308</td>
<td>11 774 India</td>
<td>5 928 Hong Kong, China</td>
</tr>
<tr>
<td>9 Philippines</td>
<td>6 976</td>
<td>Argentina</td>
<td>4 554</td>
<td>9 277 Venezuela</td>
<td>6 211 India</td>
</tr>
<tr>
<td>10 Indonesia</td>
<td>3 052</td>
<td>Indonesia</td>
<td>3 563</td>
<td>9 101 Argentina</td>
<td>5 928 Taiwan Province of China</td>
</tr>
<tr>
<td>11 Brazil</td>
<td>2 630</td>
<td>Indonesia</td>
<td>3 332</td>
<td>8 282 Mexico</td>
<td>5 757 Turkey</td>
</tr>
<tr>
<td>12 India</td>
<td>1 986</td>
<td>Hong Kong, China</td>
<td>3 145</td>
<td>6 402 Kuwait</td>
<td>5 757 Turkey</td>
</tr>
<tr>
<td>13 Turkey</td>
<td>1 518</td>
<td>Malaysia</td>
<td>2 727</td>
<td>6 969 Taiwan Province of China</td>
<td>5 928 Argentina</td>
</tr>
<tr>
<td>14 Slovenia</td>
<td>1 214</td>
<td>Pakistan</td>
<td>2 718</td>
<td>2 612 Turkey</td>
<td>5 928 Korea</td>
</tr>
<tr>
<td>15 Argentina</td>
<td>713</td>
<td>Tunisia</td>
<td>1 199</td>
<td>2 697 Algeria</td>
<td>5 928 Tunisia</td>
</tr>
<tr>
<td>16 Croatia</td>
<td>510</td>
<td>Slovenia</td>
<td>1 002</td>
<td>2 627 China</td>
<td>2 627 Philippines</td>
</tr>
<tr>
<td>17 Tunisia</td>
<td>497</td>
<td>Argentina</td>
<td>1 075</td>
<td>2 221 Philippines</td>
<td>1 624 Pakistan</td>
</tr>
<tr>
<td>18 Colombia</td>
<td>290</td>
<td>Macau</td>
<td>1 014</td>
<td>1 918 Egypt</td>
<td>1 285 Kuwait</td>
</tr>
<tr>
<td>19 Pakistan</td>
<td>175</td>
<td>Philippines</td>
<td>933</td>
<td>1 570 Hong Kong, China</td>
<td>1 998 Tunisia</td>
</tr>
<tr>
<td>20 Costa Rica</td>
<td>142</td>
<td>Colombia</td>
<td>858</td>
<td>1 484 Colombia</td>
<td>1 211 Chile</td>
</tr>
<tr>
<td>21 Oman</td>
<td>141</td>
<td>Venezuela</td>
<td>814</td>
<td>1 027 Colombia</td>
<td>4 150 Slovenia</td>
</tr>
<tr>
<td>22 Venezuela</td>
<td>126</td>
<td>Trinidad &amp; Tobago</td>
<td>686</td>
<td>1 052 Trinidad &amp; Tobago</td>
<td>1 176 Peru</td>
</tr>
<tr>
<td>23 Chile</td>
<td>101</td>
<td>Morocco</td>
<td>641</td>
<td>1 014 Morocco</td>
<td>7 877 Algeria</td>
</tr>
<tr>
<td>24 Guatemala</td>
<td>63</td>
<td>Mauritius</td>
<td>371</td>
<td>784 Peru</td>
<td>667 Malaysia</td>
</tr>
<tr>
<td>25 Uruguay</td>
<td>67</td>
<td>Chile</td>
<td>349</td>
<td>784 Peru</td>
<td>667 Malaysia</td>
</tr>
</tbody>
</table>

**Source:** Calculated from United Nations Comtrade data, based on technological classification described in box VIII.1.

**Notes:** Several countries, exporters of medium- and low-technology manufactures, whose data were not available for 1997, were excluded. Hong Kong, China's figures exclude re-exports. Singapore's data includes re-exports. Data for Taiwan Province of China refer to 1995.
<table>
<thead>
<tr>
<th>High-technology manufacturers</th>
<th>Medium-technology manufacturers</th>
<th>Low-technology manufacturers</th>
<th>Resource-based manufactures</th>
<th>Total manufactures</th>
<th>Total merchandise exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Singapore</td>
<td>5 572</td>
<td>4 252</td>
<td>3 900</td>
<td>33 852</td>
<td>Singapore 36 343</td>
</tr>
<tr>
<td>2 Taiwan Province of China</td>
<td>1 419</td>
<td>2 546</td>
<td>3 325</td>
<td>4 841</td>
<td>Kuwait 8 158</td>
</tr>
<tr>
<td>3 Malaysia</td>
<td>723</td>
<td>1 697</td>
<td>549</td>
<td>4 064</td>
<td>Macau 4 755</td>
</tr>
<tr>
<td>China</td>
<td>511</td>
<td>1 492</td>
<td>503</td>
<td>4 064</td>
<td>Hong Kong, China 4 370</td>
</tr>
<tr>
<td>4 Republic of Korea</td>
<td>622</td>
<td>1 367</td>
<td>287</td>
<td>3 654</td>
<td>Slovenia 4 355</td>
</tr>
<tr>
<td>5 Sloven</td>
<td>ia</td>
<td>492</td>
<td>Maurit</td>
<td>us 888</td>
<td>274</td>
</tr>
<tr>
<td>6 Thailand</td>
<td>492</td>
<td>1 001</td>
<td>249</td>
<td>7 535</td>
<td>Malaysia 3 745</td>
</tr>
<tr>
<td>7 Mexico</td>
<td>404</td>
<td>Barbados 330</td>
<td>229</td>
<td>1 485</td>
<td>Republic of Korea 2 978</td>
</tr>
<tr>
<td>8 Macau</td>
<td>311</td>
<td>Belize 278</td>
<td>152</td>
<td>1 052</td>
<td>New Caledonia 2 839</td>
</tr>
<tr>
<td>9 Croatia</td>
<td>307</td>
<td>Uruguay 165</td>
<td>158</td>
<td>1 167</td>
<td>Costa Rica 1 140</td>
</tr>
<tr>
<td>10 Barbados</td>
<td>249</td>
<td>Chennai 219</td>
<td>158</td>
<td>1 167</td>
<td>Mexico 1 140</td>
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<tr>
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<td>219</td>
<td>Cyprus 199</td>
<td>158</td>
<td>1 167</td>
<td>Oman 1 140</td>
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<td>199</td>
<td>Ecuador 188</td>
<td>157</td>
<td>1 167</td>
<td>Uruguay 998</td>
</tr>
<tr>
<td>13 Saint Kitts and Nevis</td>
<td>188</td>
<td>Sao Paulo 164</td>
<td>155</td>
<td>1 167</td>
<td>Thailand 982</td>
</tr>
<tr>
<td>14 China</td>
<td>164</td>
<td>Panama 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>15 Peru</td>
<td>135</td>
<td>Panama 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>16 Brazil</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>17 Argentina</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>18 Uruguay</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>19 Saint Lucia</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>20 Costa Rica</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>21 Yemen</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>22 Jordan</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>23 Saint Lucia</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>24 Tunisia</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
<tr>
<td>25 Trinidad and Tobago</td>
<td>135</td>
<td>Tonga 135</td>
<td>154</td>
<td>1 167</td>
<td>Colombia 565</td>
</tr>
</tbody>
</table>

Source: Calculated from United Nations Comtrade database and United Nations population data.

Notes: see previous table.
To understand a new process or the new system being presented to us,

it is important to first understand the context of the new system or process. In this case, the context is the development of a new method for solving a particular problem. The new process involves several steps, including:

1. Identifying the problem or issue that needs to be addressed.
2. Researching and gathering information about similar processes.
3. Developing a plan for the new process.
4. Testing the new process to ensure it meets the required standards.
5. Implementing the new process.
6. Monitoring and evaluating the effectiveness of the new process.

It is important to note that the success of any new process depends on how well it is implemented and monitored. Therefore, it is crucial to have a clear understanding of the context in which the new process is being developed and implemented.

In conclusion, understanding the context of a new process is critical to its success. By taking the time to understand the context, we can ensure that the new process meets the needs of the organization and its stakeholders.
capital controls, permitting many investors to diversify to their advantage. In any case, the trend picked up the momentum from the 1980s, leading to a US$ 1,250 billion daily foreign exchange market by 1997, and the proliferation of new financial instruments. Yet, many of the alleged benefits of financial liberalisation have not been realised, as the following summary of recent findings by Lord Eatwell shows:

1. Financial liberalisation was expected to move resources from capital rich to capital-poor countries, when in fact, new flows of finance-and or real resources-have been very modest and mainly towards the capital rich. Of course, most net flows and mainly to the "capital-poor" were mainly to "emerging markets" such as those in East Asia, which arguably contributed to asset price bubbles and eventually, to financial panic and currency and stock market collapse.

2. Liberalisation though was expected to enhance opportunities for savers and lower costs to borrowers, savers have benefited most from higher real interest rates.

3. The new financial derivatives — expected to improve risk management - have actually generated new systemic risks, especially vulnerable to sudden changes in sentiment.

4. Improved macroeconomic performance - with greater investment and growth expected from better allocative efficiency - has not been realised, in fact, overall macroeconomic performance has been worse than before liberalisation.

5. Financial liberalisation has introduced a persistent deflationary bias on economic policy as governments try to gain credibility to avert destabilising capital flows, instead of the "healthy discipline" on governments expected to improve macroeconomic stability.

Financial markets seem to function in such a way as to impose their own "expectations" on the real economy, thus defining their own "fundamentals" and login, which in turn become self-fulfilling prophecies. A sophisticated liberalised financial

---

system, prioritising flexibility or the possibility of easy exit, is necessary fragile, as reflected in:
1. liquidity crises, reducing real output
2. private sector risk aversion, encouraging short-termism,
3. public sector risk aversion, resulting in a deflationary policy bias,
4. persistent pressure for ever greater flexibility, increasing the ease of exit.4

It is stated that the lack of capital in the fundamental problem of development. Thus, accumulation of capital occupies the central position in the process of economic growth. The process of capital accumulation entails three steps. First, the volume of real savings must increase. According to Arthur Lewis, the crux of the development problem was to raise the proportion of national income saved from 4-6 percent to 12-15 percent, so that additional resources become available for investment. Therefore, the second step was to channel savings to investors and the final stage in the process of capital accumulation was the act of productive investment.

The most common factors that are cited as reasons for the failure to raise the saving rate, channel investible funds properly and invest them efficiently are financial repression and the absence of a developed financial sector. Financial repression means that the financial sector is not allowed to function according to the interplay of market forces. In the past, it was commonly believed that high real interest rates (due to scarcity of capital) would discourage investment and hence hamper growth. Therefore, most developing countries followed a policy of interest rates ceiling which was much below the market equilibrium, the low nominal interest rates together with high inflation produces very low (often negative) real interest rates, which are believed to generate the several adverse effects.

First, it encourages people to hold their savings in real assets such as land, gold, real estates etc. whose prices normally rise at a faster rate than general price level and hence offer a better hedge against inflation. Savings in an act of deferred consumption. By not

4 (Jomo K.S.) n. 1, pp. 12-13
consuming now, people save resources to be used for investment which raises future consumption. But savers (households) are not the same people as investors (producers). Furthermore, commodities not being consumed may not be directly suitable for investment. This is a problem of the lack of double coincidences. Therefore, in monetary economy financial institutions (banks and securities market) perform the job of:
1. Intermediating between savers and investors and
2. Converting real savings into financial savings

Savings in real assets thus reduce the amount of financial savings available for transferring to investors and impede the development of the financial sector. The absence of a developed financial sector itself has adverse effects. A "shallow" financial sector means that there is a lack of alternative financial assets in which people can save and this in turn can adversely affect the saving rate.

Second, a below equilibrium interest rate implies an excess demand for investible funds. As a result, funds must be allocated by credit rationing. This raises the question of what criteria to use in allocating investible funds. Normally, the funds are allocated to the "priority" industries. It has been argued earlier and hence the allocation of funds may be inefficient. Furthermore, regulations governing credit rationing may induce rent-seeking activities resulting in economic waste.

Third, the negative real interest rate encouraging the potential investors to be indulgent. The result is not only an inefficient investment profile but also a capital intensive industrial structure which is out of line with the country's factor endowments.

Therefore, a developed and efficient financial sector should play an important role in economic growth. The World Development Report, 1989 highlighted the importance of financial system in economic development. It summarises the importance of the financial sector in the following words:

A financial system provides services that are essential in a modern economy. The use of stable, widely accepted medium of exchange reduces the costs of transactionis. It
facilitates trade and therefore, specialization in production. Financial assets with attractive yield, liquidity and risk characteristics encourage saving in financial form. By evaluating alternative investments and monitoring the activities of borrowers, financial intermediaries increase the efficiency of resource use. Access to a variety of financial instruments enables economic agents to pool, price and exchange risk. Trade, the efficient use of resources, saving and risk taking are the corner stones of a growing economy.\(^5\)

Thus, financial development and liberalisation are seen to be crucial elements in promoting economic growth. A developed financial sector performs two growth-promoting functions:

1. it facilitates trade and specialisation
2. it facilitates capital accumulation

The spectacular financial development and growth performance of the East Asian NIEs are regarded as vindicating this hypothesis.\(^6\) This chapter examines the second aspect of the role of financial systems, i.e. the link between the financial sector and capital accumulation in light of the experience of East Asian NIEs and ASEAN.

The ASEAN financial sector has grown and evolved into a more sophisticated financial system due to technological innovation, rise of non-traditional modes of service production and delivery, growth of the real sector, greater internationalisation, deregulation and greater mobility of financial resources within the region. Based on standard micro-economic theories, deregulation and greater mobility of financial resources can lead to an efficient allocation of savings and real capital increase the supply of savings by increasing the rate of return and eliminating the non-price disincentives to savings. These allow individual assets holders to diversify their portfolio investments and enjoy a higher risk return trade-off. They can also broaden and deepen the financial markets and increase liquidity in secondary markets, lower the cost of borrowing and


improve the matching between the borrowers and lenders.

The role of government has been crucial in the ASEAN's financial development by establishing a favourable macroeconomic environment in terms of low inflation. The stable environments of Malaysia and Thailand have been particularly important in instilling confidence in holding cash and quasi-money holdings. On the other hand, the less predictable environment of the Philippines and Indonesia once hindered financial development. Further, their respective governments have taken the lead in deregulating their financial sector. Prior to the 1980s, Indonesia and Philippines had the most heavily regulated formal banking sectors. They later recognised the self-defeating nature of financial regulation and in the 1980s started deregulating their financial sector.

They had also directly participated in the financial sector through ownership of banks. Bank ownership has been part of a deliberate strategy of economic development in the more regulated environments of Indonesia and Philippines. In Indonesia and Malaysia state-owned banks are a key instrument of ethnic redistribution and promotion of indigenous business. But over time there has been a trend towards privatisation, and the share of state-owned banks in the total financial sector has shrunk, or has grown slower compared to their private competitors.

**ASEAN financial cooperation**

The ASEAN cooperation in the area of financial services has contributed to the growth and development in their financial sector by fostering greater mobility of financial resources within the region through the standardisation and harmonisation of rules and regulations governing the banking and financial practices in ASEAN and the reduction of the "ability and willingness barriers" to financial integration. Among ASEAN's notable achievements include the ASEAN Swap Arrangement to assist member countries bridge temporary international liquidity problems in times of crisis and the increased use of ASEAN currencies in the settlement of intra-ASEAN trade.

On the government level, the Committee of Finance and Banking (COFAB),
established in 1976, is in charge of exploring and monitoring the possible area of financial co-operation. The major activity of COFAB is to supervise the meetings of ASEAN insurance commissioners, tax administrators and ASEAN working group on customs matters. The major accomplishments of COFAB include the agreement on the need for bilateral investment guarantees and avoidance of double taxation and its ability to act as a vehicle for ASEAN-third party dialogue in financial matters.7

COFAB is responsible for the creation of the ASEAN Swap facility in 1977. The ASEAN swap arrangement is included for short-term liquidity crisis. The fund was US$200 million in 1979 which members can borrow in times of short term liquidity crisis. The borrowing limit was up to US$80 million repayable in 3 months, renewable once for 3 months.8 In 1983, four swap transactions took place and in the same period Benigno Aquino was assassinated causing a large outflow of capital from the Philippines.

On the private sector level, there was the creation of the ASEAN Bankers Association in 1976. Membership consists of member countries' banking industry association: conference (ASEAN Banking Conference), council [ASEAN Banking Council] and secretariat. ASEAN Banking conference major accomplishment include the formulation of policy for co-ordination of ASEAN co-operation among ASEAN Bankers, financing of agriculture and agro-based industries and banking education and cooperation in investment, trade and finance, ASEAN Banking Council's major accomplishment is the establishment of ASEAN Financial Cooperation [AFC]. As a joint venture among the private banks of the ASEAN member countries, it is intended as a vehicle for the pooling of resources required to finance regional development projects. It specific objectives are to promote industrial development, intra-regional trade, financial cooperation and mobilisation of financial resources.9 A number of proposals were proposed in the late 1970s and early 1980s such as the setting up of an ASEAN Trading and Investment Corporation [ATIC] and an ASEAN Bankers Acceptance (ABC), but were not successful due to the lack of interest and financial non-viability. It was only after the financial crisis of 1997 that serious thought about financial integration

8 Ibid, pp. 176-190
9 www.aseanbankers.org
in this region was envisaged the details are discussed in the latter part of the chapter.

Prospects for ASEAN integration

As is implied above that ASEAN financial cooperation has played an important and supportive role in the growth and development of their financial sector and in facilitating trade and investment in the region. ASEAN financial co-operation, however, is one of the factors responsible for the robust growth of their financial sector. Individual countries, uncoordinated policies of deregulation, stable macroeconomic environment and growth of their real sector have also played a very important role.

The prospects for greater ASEAN financial cooperation depends on how the ASEAN countries can influence the following factors or determinants affecting the level of financial integration:

1. Comparative levels of financial development. Domestic financial development is a prerequisite for international financial integration.
2. Level of intra-ASEAN banking linkage. The ASEAN Finance Corporation and ASEAN Banking Council are formal links between ASEAN banking industries.
3. Level of real economic integration. Intra-ASEAN trade and other forms of economic cooperation lay the essential groundwork for financial integration. As real economic linkages increase, the demand for financial cooperation will increase.
4. The degree of foreign exchange/capital controls.
5. Exchange rate variability which relies on the adoption of a common unit of account and the strength of the existing forward markets.
6. Tax treatment neutrality
7. Comparative regulatory policies for domestic financial institutions, particularly in relation to the asset and liability structure of banks,
8. Conformity/non-conformity with acceptable commercial standards. Non-compliance with certain regulations may form barriers to financial integration if significant loss of confidence results. Financial crises or scandals can undermine both the domestic and international financial systems.\footnote{Jose L. Tongzon - The Economies of Southeast Asia: The Growth and Development of ASEAN Economies, Edward Elgar, Cheltenham, UK, 1988, pp. 79-80}
Financial Crisis in Asia

The financial crisis in Asia broke at the weakest links in the, Asian economies i.e., the liberalised and deregulated private domestic banking systems. Weakness in the financial sector in Indonesia was evidenced by its first private bank failure in 20 years in 1992, and the rescue of major state bank in 1995. In Thailand, where the expansion of the banking sector has been the most rapid, the central bank had since 1996 been practising a policy of "forbearance" [frequently used by developed country central banks, I in particular the Federal Reserve], that is, central banks leading to support banks in difficulty in the hope that they can be rescued without public notice and without creating market panic. Given the degree to which Thai banks and finance companies had been financed through foreign currency leading to their new offshore banking centre, this meant using foreign exchange reserves for their internal function of lender of last resort.

A similar process appeared to have been at work in Korea from the spring of 1996. However, in Korea the first signs of difficulty were in a run of bankruptcies starting with Hanbo Steel in January 1997. But, despite increasing information of difficulties in Asean Banks [for example, both Korea First and Seoul Bank were known to be in difficulty as a result of corporate bankruptcies in early 1997. Figures for the end of 1996 showed 12.36 percent of the loans of the weight nation-wide Korean Commercial banks were impaired and International rating agencies had issued warnings on Thai Banks and at least one international organisation had noted that the Southeast Asian economies were "vulnerable to interruptions of capital inflows". There were reports about a Thailand Development company failing to meet a foreign debt payment, and numerous bankruptcies in Korean corporation, foreign capital inflows into Asia continued unabated during the first half of 1997 [see Table 2.1].

But the failure by the Bank of Thailand to arrange the rescue of the country's largest finance company, Finance One, in the spring of 1997 concentrated the attention of international lenders and feared reversal of short-term lending started. In

Table 2.2, it is given that the lending within South Korea, Indonesia, Malaysia, Philippines and Thailand has been on the rise with South Korea on the top of the ladder while Philippines at the bottom. The aftermath of the crisis saw the South Korea, Indonesia, Thailand and Malaysia seeking for IMF bailout package. Also, apart from Korea, the ASEAN-4 has the maximum lending to the non-bank private sector financial institutions. The failure took on special importance because it occurred against the background of increased uncertainty in international capital markets concerning the evolution of international interest rate differentials. At the beginning of May 1997, the view that the Japanese economy was engaged in a full-fledged recovery gained increasing support (although there was virtually no hard evidence to support this belief) and there was a sharp

Table 2.1
Distribution of Loans by Country of origin - End June 1997 (US$ million)

<table>
<thead>
<tr>
<th>Country</th>
<th>Grand Total</th>
<th>France</th>
<th>Germany</th>
<th>Japan</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>58,726</td>
<td>4,787</td>
<td>5,610</td>
<td>23,153</td>
<td>4,332</td>
<td>4,591</td>
</tr>
<tr>
<td>South Korea</td>
<td>103,432</td>
<td>10,070</td>
<td>10,794</td>
<td>23,732</td>
<td>6,064</td>
<td>9,964</td>
</tr>
<tr>
<td>Malaysia</td>
<td>28,820</td>
<td>2,934</td>
<td>5,716</td>
<td>10,489</td>
<td>2,011</td>
<td>2,2400</td>
</tr>
<tr>
<td>Philippines</td>
<td>14,115</td>
<td>1,678</td>
<td>1,991</td>
<td>2,109</td>
<td>1,076</td>
<td>2,816</td>
</tr>
<tr>
<td>Thailand</td>
<td>69,382</td>
<td>5,089</td>
<td>7,557</td>
<td>37,749</td>
<td>2,818</td>
<td>4,008</td>
</tr>
</tbody>
</table>


Table 2.2
Lending by BIS Reporting Banks by Country and by Sector - End June 1997 (US$ million)

<table>
<thead>
<tr>
<th>Country</th>
<th>Total</th>
<th>Banks</th>
<th>Public</th>
<th>Non-Bank Private Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Korea</td>
<td>103,432</td>
<td>67,290</td>
<td>43,900</td>
<td>31,680</td>
</tr>
<tr>
<td>Indonesia</td>
<td>58,726</td>
<td>12,393</td>
<td>6,506</td>
<td>39,742</td>
</tr>
<tr>
<td>Malaysia</td>
<td>28,820</td>
<td>10,486</td>
<td>1,851</td>
<td>16,460</td>
</tr>
<tr>
<td>Philippines</td>
<td>14,115</td>
<td>5,485</td>
<td>1,855</td>
<td>6,772</td>
</tr>
<tr>
<td>Thailand</td>
<td>69,382</td>
<td>26,069</td>
<td>19,68</td>
<td>41,262</td>
</tr>
</tbody>
</table>

13 (Jose L. Tongzon) n. 11, pp. 84-86

appreciation of the yen and a sudden rise in Japanese short-term interest rates on expectations that the Bank of Japan would move quickly to raise its discount rate."

As a result, funds that had been borrowed at low interest rates in Japan and Hong Kong, and invested at substantially higher rates in Asia, were quickly withdrawn and returned to Japan [in Table 2.2, shows that barring Korea and Philippines, Japan as given fairly large amount of loans to Indonesia, Malaysia and Thailand, 39.42 percent, 36.39 percent and 54.40 percent respectively, supporting the appreciation of the yen and putting increasing pressure on Asian reserves and exchange rates.

The Thai financial crisis could not have avoided becoming an exchange rate crisis, given the degree to which foreign reserves had already been used to shore up banks through the "lender of last resort" function and the fact that the reserves were not nearly sufficient to meet the liquidation of the entire amount of foreign lending while the foreign balance was continuing to deteriorate. In Table 2.3, as it is shown that South Korea and Thailand has the largest amount of loans having a maturity of upto 2 years, and this thus contributes to the reason that the crisis struck these two economies at the first instance. A domestic banking crisis, which could have been handled by the central bank through creation of domestic currency in a relatively closed capital market, became a foreign exchange crisis because of the open capital market and the size of foreign capital inflows into the Thai Banking System through the Bangkok International Banking Facility [BIBF],

<p>| Table-2.3 Maturity Distribution of Lending BIS Banks-up to June 1997 (US$ million) |
|----------------------------------------|----------------|----------------|----------------|----------------|</p>
<table>
<thead>
<tr>
<th>Country</th>
<th>June 96</th>
<th>Dec 96</th>
<th>June 97</th>
<th>June 96</th>
<th>Dec 96</th>
<th>June 97</th>
<th>June 96</th>
<th>Dec 96</th>
<th>June 97</th>
<th>June 96</th>
<th>Dec 96</th>
<th>June 97</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>49306</td>
<td>55523</td>
<td>58726</td>
<td>29587</td>
<td>34248</td>
<td>34661</td>
<td>3473</td>
<td>3589</td>
<td>3541</td>
<td>14177</td>
<td>15331</td>
<td>17008</td>
</tr>
<tr>
<td>South Korea</td>
<td>88027</td>
<td>99953</td>
<td>103432</td>
<td>62332</td>
<td>67506</td>
<td>70182</td>
<td>3438</td>
<td>4107</td>
<td>4139</td>
<td>13434</td>
<td>15884</td>
<td>16366</td>
</tr>
</tbody>
</table>

Malaysia

<p>| | | | | | | | | | |</p>
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<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20100</td>
<td>22234</td>
<td>28820</td>
<td>9991</td>
<td>11178</td>
<td>16268</td>
<td>834</td>
<td>721</td>
<td>615</td>
</tr>
<tr>
<td>Philippines</td>
<td>10795</td>
<td>13289</td>
<td>14115</td>
<td>5948</td>
<td>7737</td>
<td>8293</td>
<td>531</td>
<td>565</td>
<td>326</td>
</tr>
<tr>
<td></td>
<td>3710</td>
<td>4111</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>69409</td>
<td>70147</td>
<td>69382</td>
<td>47834</td>
<td>45702</td>
<td>45567</td>
<td>4083</td>
<td>4829</td>
<td>4592</td>
</tr>
<tr>
<td></td>
<td>14931</td>
<td>16344</td>
<td>16491</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Bank for International Settlement (BIS) the Maturity, Sectoral and Nationality Distribution of International Bank Lending, First Half 1997, Basle, January 1998

Since the Bank of Thailand could not print dollars, it could not act as lender of last resort for its own domestic banks exposure in US dollars, while its use of its foreign exchange reserve to do so made it helpless to support the exchange rate.¹⁵

Thus, even though Thailand had a savings ratio of around 40 percent, foreign exchange reserves that were three times the size of the 1996 current account deficit, showing import growth as well as domestic consumption, and predominantly long-term capital inflows, the baht was floated on July 2, 1997 and the IMF called in at the end of the month to formulate a bail-out.

The crisis could be explained as a case of "market failure" of two different types. First, a failure of free, competitive international capital markets to produce the optimal allocation of capital. Funds continued to flow to Asian financial institution after it was clear that financial instability was widespread. In the words of Alan Greenspan: "In retrospect, it is clear that more investment monies flowed into these economies than could be profitably employed at modest risk."¹⁶ Second, is a failure of privatised free-market "banking systems [that] were not up to the task of effectively absorbing and channelling to productive use large foreign capital inflows as well as the large amount of domestic savings of these economies..............Such weakness led to the misallocation of resources".¹⁷

On the other hand, Stanley Fischer notes that "the maintenance of pegged exchange rate regimes for too long .... encouraged external borrowing and led to excessive exposure to foreign exchange risk—which suggests that international bankers and

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¹⁵ Ibid, p.35
¹⁶ Alan Greenspan "Statement Before the US House of Representation Committee on Banking and Financial Services, Washington DC., 1997
businessman are incapable of identifying exchange rate misalignments.\textsuperscript{18}

The major accelerators of the financial crisis had been the floating of Thai baht, closing down of Finance One, Thailand's largest finance company along with other finance companies. Later, the Philippines central bank allows the peso to move in a wider range against the dollar. Indonesia abolishes its system of a managed exchange rate and the rupiah tails. The IMF agreed on a rescue package of SI 7.2 billion for Thailand and $23 billion for Indonesia. Later on, Korea also signs an agreement with the IMF for a support package, which could ultimately provide $57 billion.\textsuperscript{19}

This currency and stock market turmoil during the fourth quarter of 1997 has left many of South-East Asia's financial institutions technically bankrupt. Among other issues, the crisis has again highlighted that the globalisation of finance, capital and trade flow increases the vulnerability of countries to financial shocks from other countries. Developing countries, in particular, should thus strengthen their banking systems, since the banking industry invariably forms the core of their financial systems.

Significant financial weakness of South East Asian banks in general can be ascribed to:-

- Deficient banking systems and a lack of lending prudence which led to a dramatic escalation of bad debts.
- The virtual non-existence of credit evaluations.
- Defective and non-performing corporate accounts.
- The influence of personal relations on transactions
- Inadequate capital of counter-party companies.
- Bank's inadequate capitalisation for the risks they assumed
- Rapid growth cancelled and even encouraged the existence of many poorly run and poorly regulated banks.
- Governments were slow to accept that tough remedies are needed to avert banking

\textsuperscript{18} Stanley Fischer "The Asian Crisis: A view from the IMF" address by the First Deputy Managing Director of IMF to the Midwinter Conference of the Bankers association for Foreign Trade, Washington DC 22 Jan 1998, p.2
\textsuperscript{19} OECD Economic Outlook, June 1998, Box 1.2
The crisis in South-east Asia has re-emphasised the need for sound banking practice and effective supervision. Particular anecdotes in this regard include the following:-

- Corporate affiliations or structure should not expose a regulated bank to undue risk or hinder effective supervision.
- Sound corporate governance policies are required in order to ensure that banks are managed prudently by fit and proper persons, who are held accountable.
- Transactions with related parties should be scrutinised and managed with a high degree of care, in order to avoid undue concentration of risk and reduce the risk of abuse.
- Diversity in the asset structure should be encouraged in order to avoid overinvestment in certain sectors and instruments, or large exposures, especially to related parties.
- Adequate procedures should be employed for the management and evaluation of the quality of assets (particularly loan portfolios) and the adequacy of provisions for potential losses.
- Banks need to maintain adequate and comprehensive systems of internal control in accordance with the risks inherent in their activities.
- Banks require a comprehensive risk-management process in order to identify, measure, assess, manage and control the risks inherent in their on and off balance sheet activities, both on an organisational and a group basis.
- Deviations from sound risk management and banking practice (such as excessive leverage) should be identified and corrected promptly.

As a result of the crisis, Taiwan—even though it has a massive trade surplus, massive foreign exchange reserves, a budget surplus and no visible speculative pressure on its position in the region and devalued its currency by 10 percent only October 1997. This quickly extended the crisis from Southeast Asia to the newly industrialised economies. Given the pivotal role of Hong Kong between Taiwan and China and its change to special Administrative Region status under Chinese control, the

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20 Ibid, p. 203
result of the devaluation in Taiwan was to raise the possibility of a devaluation of the Hong Kong dollar, or even the Chinese renminbi.

In turn, investors in Hong Kong now ran the risk of a depreciation of the exchange rate or of a collapse of the prices of their financial assets, or both. The depreciation of virtually every other currency in the region suggested that there would be pressure on competition and thus on the exchange rate. Peregrine, the largest investment bank in Hong Kong collapsed as a victim to massive bad loans to Indonesian borrowers. Shares fell sharply in Hong Kong and subsequently in Singapore.\(^\text{21}\)

In case of Korea, despite the bankruptcies of large manufacturing conglomerates (Chaebols) and increasing concern for the Korean banks that had lent to these firms, given that many chaebols carried ratios in excess of percent (i.e. borrowed funds were five times owner's equity capital), markets continued to treat these are as purely internal difficulties, Korean bank credit ratings were reduced and market focussed on the viability of the Korean produces in conditions of global depression. Since the largest proportion of lending to Korea was from Japan, it was feared that they would recall their loans to Korean conglomerates, forcing more bankruptcies in Korea. The Bank of Korea tried to salvage the situation by releasing is foreign exchange reserves but later allowed the won to float.

In these changing situation, Singapore allowed the depreciation of Singapore dollar on 17 July 1997 and because of its strong financial structure suffered the least but still vis-a-vis US$, the Singapore dollar plummeted from 1.45 to 1.59 by April 1998.\(^\text{22}\)

**Post Crisis Reforms**

At the ASEM Finance ministers meeting in Bangkok on 19 Sept, 1997, Japan proposed "an Asian Monetary Fund" (AMF) to prevent the repetition of the financial


\(^{22}\) (Jomo K. S.) n. 1, pp.52-56
crisis and to build institutional linkages among the countries within the region. To discuss the details of the proposed AMF, an undisclosed meeting of Deputy Finance Ministers from twelve Asian nations was held on 21 Sept at the behest of Japan during the IMF/World Bank annual meeting. The twelve nations participating in this meeting were Korea, Japan, China, Hong Kong, Malaysia, Indonesia, the Philippines, Thailand, Australia, Singapore and New Zealand. The US and a representation of the IMF attended the meeting with observer status.

At the meeting, Japan’s Finance Minister Hiroshi Mitsuzuka outlined the plan for the establishment of an AMF. He also expressed willingness to contribute one half of the initial funding. The United States and IMF may weaken the existing international financial architecture under the IMF. Since there were Singapore differences in opinions regarding the establishment of an AMF, the meeting adjourned without agreeing on the details.23

To continue the ongoing process, fourteen deputy finance ministers and central bank representatives as well as IMF, World Bank and Asian Development Bank (ADB) representatives gathered in Manila in November 199724 to discuss the ways to stabilize the regional financial markets (which was called the Manila Framework). In the push and pull tactics, a compromise plan was reached to strengthen the ability of the IMF to provide funds through an early approval of the New Arrangements to Borrow (NAB) and co-operative lending agreements. The plan also included introducing a regional surveillance mechanism to strengthen the IMF’s global surveillance capacity.

Later, Rodolfo C. Severino, Secretary General of ASEAN in his remarks at the 55th ASEAN –CCI council meeting, Kuala Lumpur, 10th April, 1998 stated.

"ASEAN leaders, minister and officials have been meeting intensively to address the crisis and devise measures to deal with it. They have sought and obtained the support of the international financial institutions, APEC, the government of the Group of 7, China and the European Union...ASEAN’s finance ministers in their meeting in Jakarta on the 28th of Feb agreed on two specific measures to deal with the financial problem. One is the

24 ibid,p.209
use of ASEAN currencies in the settlement of intro-ASEAN trade, which had been proposed by two or more of ASEAN’s leaders. The other is the establishment of an ASEAN monitoring mechanism to serve as an early warning system for future financial problems obviously, ASEAN’s governments and central banks must make it attractive for the private sector to accept regional currencies in place of US dollars, but the private sector needs to make clear what it would take to make it worthwhile for them to do so.

The other initiative is the setting up of the monitoring mechanism. This had been recommended in the Manila Framework drawn up last Nov by Finance Ministry and Central Bank deputies of Six ASEAN counties, Canada, China, Hong Kong, Japan, Korea, New Zealand and the US, plus the IMF, the World Bank and the Asian Development Bank.25

Again, at the Keynote address at the opening of the Seventh ASEAN Editors Conference, Wisma Antara, Jakarta, 12 April 1999, Rodolfo C. Severino stated.

“The first report of the surveillance process was submitted by the so-called select committee of finance ministry and central bank deputies last month. The report carried a tone of cautious optimism, forecasting that growth in the region will resume later this year, but warning about potential developments elsewhere in the world that can obstruct growth.

More importantly, the report carried accounts of what each ASEAN country was doing to stimulate domestic demand, project the poor, revitalize the financial and corporate sectors, improve transparency and corporate governance, and mobilize resources to finance growth. The finance ministers reviewed these policies and actions.

ASEAN realizes, of course, that much of the global financial turmoil arises from weaknesses elsewhere in the world and in the global financial system itself. The ASEAN Finance ministers and their deputies have started close and frequent consultations with their counterparts from China, Japan and Korea, countries, which are in ASEAN’s immediate vicinity and share many of its problems. Some ASEAN minister have been active in the financial forums of APEC, ASEM, the Manila framework group, the Group of

22, that is reviewing the international financial architecture and the Group of 15 developing countries. 26

Later again Rodolfo C. Severino, at the meeting of the standing committee of the Pacific Economic Cooperation Council, (PECC), Canberra, Australia, 15 April, 1999 added.

"ASEAN is determined to build the ASEAN information infrastructure and studies on its shape and contents are to be carried out .............

......In the new area of financial cooperation, studies, are being proposed on capital account liberalisation, the monitoring of short term capital flows, and the development of common financial practices and standards. An exchange rate system and even an ASEAN currency are to be explored. Networking among development banks in the regions envisioned. 27

Based upon the understanding that in order to reduce the risk of currency and financial crises it was thought of as necessary to reform the international financial system, G-7 Finance Ministers issued a report entitled "strengthening the International Financial Architecture" at the Cologne Summit held in June 1999. 28 This report covered the following matters:-

- strengthening and reforming the international financial institutions and arrangements
- Enhancing transparency and promoting best practices
- strengthening financial regulation in industrial countries
- strengthening macroeconomic policies and financial systems in emerging markets
- capital control in emerging markets
- improving crisis prevention and management and involving the private sector and
- promoting social policies to protect the poor and most vulnerable.

26 Address of Rodolfo C. Severino, Secretary, C. Severino, Secy. General at the opening of the seventh ASEAN editors conference, Wisma Antara, Jakarta, 12, April, 1999

27 Address by Rodolfo C. Severino, Secretary General of ASEAN at the meeting of the standing committee of the Pacific Economic Cooperation Council, (PECC), Canberra, Australia, 15 April, 1999

ASEAN Finance Ministers had agreed on a framework for closer consultations of economic policies called the ASEAN Surveillance Process (ASP) at a special meeting on 4 October 1998. The Surveillance Process has two major elements—First is the monitoring of global as well as regional and national economic and financial development?. The outcome of the monitoring exercise is reported to the ASEAN finance ministers twice a year. The ASEAN Surveillance Report highlights recent economic and financial trends and recommends policy measures for the ministers to discuss their peer review. The peer v-review, as second element, provides the forum at which ASEAN finance ministers exchange views and information on developments in their domestic economies including policy measures carried out and the progress of structural reforms.29

At the regional level, the special ASEAN Finance Ministers Meeting in Manila on 30 April 1999 adopted few resolutions:-

1. ASEAN shall adopt a more proactive role at various international and regional fora to ensure that its interests and priorities are given due consideration in any proposal reform the international financial architecture.

2. While the purpose of any international reform is to enhance efficiency and stability in financial markets and to promote global economic activity. Due priority must be accorded to measure to protect the poor and most vulnerable sections of society.

3. Measures to strengthen the international financial architecture would need to include a review of the roles of the international financial institutions (IFIs), as well as the international regulatory bodies, in order to enhance their capacity and capability to certain and resolve crises.

4. The dissemination of necessary information will help investors to make better decisions and not rely solely on the information of rating agencies.

5. These must be closer and more co-ordinated monitoring of short-term capital flows.30

Even before that, in 1998 at their summit in Ha Noi the ASEAN leaders had

29 ASEAN Briefing Paper "Finance Cooperation" 9 Nov. 2000, ASEAN Secretariat, Jakarta, pp. 1-4

30 Joint Communiqué, Special ASEAN Finance Ministers Meeting, 30 April, 1999 Manila, pp. 1-5
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NIEs role in ASEAN financial structure

Apart from the initiatives like ASEAN + 3, NIEs also hold a substantial portion in the few economies of ASEAN as given in table 2.4. As is seen in a sizeable number of economies, a number of banks from Taiwan, Singapore, Korea and Hong Kong operate.

The financial crisis, emerging transnational problems the expansion of ASEAN's membership and the increase in the areas of ASEAN committees and other bodies. The directives handed down by the ASEAN leaders in the Hanoi Plan of Action and the Bold measures specify many of these responsibilities. They seek the course firmly toward broader and deeper regional economic integration by breaking down barriers to trade and investment and making easier and more efficient and by tying national economies together through transportation, communication and infrastructure linkages. They lay down the foundations for the region's future competitiveness by pushing the development of science and technology and the training of people for the skills required by the industries in the future.
Table 2.4
Largest affiliates of foreign transnational corporation of NIEs in Finance & Insurance in the host economy, 1997
(Millions of Dollars)

<table>
<thead>
<tr>
<th>Company / Host Country</th>
<th>Home Economy</th>
<th>Industry</th>
<th>Sales/ Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cambodia</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Singapore commercial Bank Ltd.</td>
<td>Singapore</td>
<td>Banking</td>
<td>-</td>
</tr>
<tr>
<td><strong>Indonesia</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Hong Kong &amp; Shanghai Banking Corp. Ltd.</td>
<td>Hong Kong, China</td>
<td>Banking</td>
<td>-</td>
</tr>
<tr>
<td><strong>Laos</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Vientiane Commercial Bank Ltd.</td>
<td>Australia/ Taiwan/ Thailand</td>
<td>Banking</td>
<td>-</td>
</tr>
<tr>
<td><strong>Malaysia</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Hong Kong Bank Malaysia Bhd.</td>
<td>Hong Kong, China</td>
<td>Banking</td>
<td>24016 Ringgit</td>
</tr>
<tr>
<td>b) OCBC Bank (Malaysia) Bhd</td>
<td>Singapore</td>
<td>Banking</td>
<td>17366</td>
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<tr>
<td>c) Pacific Bank Bhd</td>
<td>Singapore</td>
<td>Banking</td>
<td>10985</td>
</tr>
<tr>
<td>d) Overseas Union Bank Malaysia Bhd.</td>
<td>Singapore</td>
<td>Banking</td>
<td>4525²</td>
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<tr>
<td>e) Chung Khiaw Bank Malaysia Bhd.</td>
<td>Singapore</td>
<td>Banking</td>
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<tr>
<td><strong>Myanmar</strong></td>
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<tr>
<td>Development Bank of Singapore Ltd.</td>
<td>Singapore</td>
<td>Banking</td>
<td>-</td>
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<tr>
<td>Keppel Bank of Singapore Ltd.</td>
<td>Hong Kong, China</td>
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<tr>
<td><strong>Philippines</strong></td>
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<td>Dao Heng Bank Inc.</td>
<td>Hong Kong, China</td>
<td>-do-</td>
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<tr>
<td>Hong Kong and Shanghai Banking Corp.</td>
<td>Hong Kong, China</td>
<td>-do-</td>
<td>-</td>
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<tr>
<td><strong>Thailand</strong></td>
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<tr>
<td>Securities One Co. Ltd.</td>
<td>Taiwan</td>
<td>Finance</td>
<td>148,142</td>
</tr>
<tr>
<td>Hong Kong and Shanghai Banking Corp. Ltd.</td>
<td>Hong Kong</td>
<td>Banking</td>
<td>-</td>
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<tr>
<td>Overseas China Banking Corp. Ltd.</td>
<td>Singapore</td>
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<tr>
<td><strong>Vietnam</strong></td>
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<tr>
<td>First Vina Bank</td>
<td>Republic of Korea</td>
<td>Banking</td>
<td>147</td>
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<tr>
<td>Shinhan Bank</td>
<td>Republic of Korea</td>
<td>-do-</td>
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