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DISCUSSION PAPER NO. 108

Southeast and East Asia in 1980

by

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December, 1979

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I. The countries in East and Southeast Asia have always been the bright spot in generally gloomy picture of underdeveloped economies in the world. A readily available summary table of the world economy, Table 1, shows this fact both in terms of growth rate and inflation rate (CPI) in the recent years. This is true also for foreign trade. See Table 2.

Table 1. World Economic Summary\*

	Real GNP				Inflation (CPI)		
	1979 (\$ bil)	1978 (percent change)	1979 (percent change)	1980 (percent change)	1978 (percent change)	1979 (percent change)	1980 (percent change)
World	\$9,268	4.0	3.3	3.0	11.1	12.3	11.5
North America	2,688	4.0	2.0	-0.4	8.2	11.3	10.4
U.S.	2,359	4.0	1.7	-1.1	7.7	11.2	10.4
Western Europe	2,830	3.0	3.2	2.9	8.6	10.1	9.1
Eastern Europe	1,140	4.3	4.0	4.0	N.A.	N.A.	N.A.
Latin America	422	4.3	4.4	4.8	56.3	44.8	35.8
Asia	1,601	5.8	5.2	5.0	4.9	7.3	7.3
Middle East & North Africa (OPEC)	275	4.0	4.0	4.0	15.0	15.0	20.0
Middle East & North Africa (non-OPEC)	120	5.0	5.0	5.0	24.0	20.0	20.0
Sub-Saharan Africa	192	4.0	2.5	2.5	25.0	20.0	25.0

\*Bank of America estimates for 1979; forecasts for 1980.

Table 2. World Trade\*

	Exports				Imports			
	1979 (\$ bil)	1978 (percent change)	1979	1980	1979 (\$ bil)	1978 (percent change)	1979	1980
World	\$1,363	15.6	16.2	13.1	\$1,367	16.3	17.5	13.2
North America	242	15.7	24.7	15.9	269	15.1	18.9	11.9
U.S.	182	17.7	28.4	16.0	210	16.1	20.0	11.0
Western Europe	614	21.0	14.6	12.1	613	15.3	16.9	12.9
Eastern Europe	40	10.0	10.0	10.0	50	10.0	5.0	8.0
Middle East & North Africa	156	-4.0	27.0	19.1	122	18.0	23.0	23.0
Sub-Saharan Africa	51	10.0	8.0	8.0	56	22.0	15.0	15.0
Latin America	47	2.1	5.9	8.4	48	13.1	7.0	7.4
Asia	213	18.2	9.4	11.5	209	18.7	21.3	12.6

\*Bank of America estimates for 1979; forecasts for 1980.

2. This is even more conspicuous if we look back over the performance in the 70's. Despite the oil crisis and the world stagflation the countries and areas in East and Southeast Asia (Korea, Taiwan, Hong Kong, Singapore, Malaysia, The Philippines, Thailand and Indonesia) performed very well during the last eight years, averaging the growth rate around 7 to 12 percent. The exceptionally high pace of growth is likely to slow down in 79 and 80: nevertheless no country is expected to go below 5% a year. Some countries like Korea and Singapore may achieve the growth rate of 8% in 79 -, and somewhat lower in 80. At the same time, however, all the countries appear to concert the effort in beating the inflation caused by the recent jerk in oil price, which will make their growth rates about 5 to 7.5% in 80. Inflation is particularly serious in

Indonesia and Korea, reaching as high as 20% a year in 79 and perhaps around 15% in 80.

All these seem to demonstrate the impressive economic performance in this part of the world, particularly the so-called 'Gang of Four' in Asia or 'New Japans' (South Korea, Taiwan, Hong Kong, and Singapore). As Singapore's rate of growth exceeded 10% in early 70's but slowed down to 7 to 8% now, the remaining newly industrializing countries also look like taking the same path and converging to the rate around 5 to 7%. This change of pace seems to have come somewhat earlier than it did in the case of Japan. The difference may be explained by the lower propensity to save, slower technical progress in industries, the smaller size of domestic market, and the changing international environment. For these reasons, their growth rates in the 80's may not be as rosy as most government's development plans prognosticate. For example, the actual performance of The Philippines economy around 5 to 6% seems to fall short of the target of 7.5% in the five year plan. Table 3 and Table 4 summarize the performance of these countries in Asia.

Table 3. GDP Growth Rate (%)

	Korea	Taiwan	HK	Singapore	Malaysia	Phil.	Thailand	Indonesia
71	9.0	11.5	3.2	12.5	8.2	4.9	8.2	7.0
72	7.4	11.9	7.2	13.4	6.6	4.8	4.3	9.4
73	17.1	12.0	14.2	11.5	12.3	8.7	10.3	11.3
74	8.8	0.5	2.2	6.3	6.7	5.3	6.7	7.6
75	8.8	3.1	2.9	3.9	3.5	6.6	7.7	5.0
76	15.0	11.8	16.9	7.5	12.0	7.3	8.2	7.0
77	10.3	8.4	11.4	8.1	7.7	6.2	6.2	7.5
78	12.5	12.6	10.5	8.5	7.5	5.8	8.7	7.0
79	( 8.5)	( 8.0)	( 6.5)	( 8.0)	( 7.0)	( 5.5)	( 7.0)	( 6.5)
80	( 7.5)	( 6.0)	( 5.0)	( 6.0)	( 6.0)	( 5.0)	( 6.0)	( 6.5)

Table 4. Rate of Inflation (GDP-deflator)

	Korea	Taiwan	HK	Singapore	Malaysia	Phil.	Thailand	Indonesia
71	11.5	3.6	8.9	4.4	△ 3.9	4.3	△ 1.7	6.2
72	14.5	5.0	7.4	5.4	2.9	6.8	9.1	13.6
73	9.5	12.7	11.4	12.1	14.3	17.8	19.0	33.0
74	26.8	34.6	12.2	15.6	12.3	31.8	19.8	47.3
75	24.6	3.4	2.7	3.3	0	8.0	2.0	12.5
76	15.6	4.9	8.6	1.0	11.6	8.2	3.6	14.4
77	13.6	5.3	3.0	1.9	4.7	9.3	5.0	11.8
78	18.0	6.0	10.0	4.5	5.0	7.5	6.0	12.0
79	(20.0)	(9.0)	(9.0)	(8.5)	(6.0)	(9.0)	(8.0)	(20.0)
80	(15.0)	(7.0)	(7.0)	(6.0)	(4.0)	(7.0)	(6.0)	(14.0)

3. Needless to say, they all have many difficult problems. In particular, most countries in this region are now going through the difficult stage of development between per capita income of 500 and 1,500 US Dollars, where social pressure mount up and political conflicts become very acute. Realizing these socio-political problems, the government of Korea, The Philippines, Thailand, Malaysia and Indonesia have shifted emphasis to the projects in the rural area and 'Socially-Oriented' undertakings in order to mitigate the social grievances and fill the gap between urban and rural incomes. This certainly adds an extra burden on the government budget, so that the prevailing deficit finance becomes harder to overcome and inflation less controllable.

Inspite of the government effort, it is by no means easy to reduce income inequality around the income per capita level of 1,000 US Dollars. For instance, the Bangkok Bank recently revealed in its semiannual report that the poorest 20% of the population or about 8 million people had less

than 3% of the national income in 73, which is even less than the share in 63. The similar study by national economic and social development board have also shown that farmers earn only one fourth of wage-earners and salarymen who earn only half of self-employed proprietors and property owners income. The regional gap is also significant: income in Bangkok is about 600 US Dollars: whereas that in northwest is only 90 Dollars. Anyone admits that this has always been a major obstacle in Thai society. But the rural poverty in Thailand due to recent floods and drought in 77 was not rescued in any way due to official neglect. This has been pointed out by Prime Minister Kriensak himself. This must be regarded and indeed is regarded as a cause of political instability, if not so imminent as urban unemployment especially in the capital city. The situations in other countries except for Taiwan and Singapore do not differ very much. It is feared that poverty may breed communism. This is an aspect very important in judging the future of the country risks in East and Southeast Asia. The recent political turmoil in Korea may be an unfortunate outcome of instability of this nature.

4. Another aspect of economic instability which can easily lead to socio-political disturbance is inflation. Dilemma between balanced budget and stable food price can be solved either by good harvest or excellent performance of export industries which permit the import of necessary food stuffs. Indonesia benefitted from good crops when she was suffering from the inflation due to the bold devaluation of rupiah from RP 415 to 625 to one US Dollar on November 15, 1978. Malaysia could overcome the damage on food and plantation products due to the drought in 77 and 78 by

an enormous growth of about 14% per annum in 76-78 in the manufacturing sector. The agricultural production in Southeast Asia seems to be increasing its fluctuations, and its upward trend is tapering down. Hence the manufacturing production and its exports are becoming more and more important even for Indonesia and Malaysia as well as Thailand or The Philippines.

This is all the more important for the countries in East and Southeast Asia, because their imports are greatly increasing due to the expansion of domestic demand for raw materials and capital goods, anti-inflationary measures of increasing import of consumption goods and the rising trend of import prices for goods from Japan and U.S. As a result, except for Taiwan, all the countries are going to suffer from the unfavorable balance of trade in 1979 and 80.

5. The third aspect of difficulty is the problem of exchange-rate. It has an aspect which can excite the nationalistic sentiment of the people and government officials. Continual inflation, however, makes the hefty devaluation inevitable. Indonesia offered a remarkable experiment. Her inflation has abated in recent years, but has been consistently higher than those in her main trade partners. She last devalued the rupiah in 1971. By 1978 local producers had to compete with imports at a cost-price disadvantage of 40 to 60%. The dualistic picture of the Indonesian economy was very obvious: a strong oil economy carrying the burden of subsidizing its ailing non-oil manufacturing and other sectors. Of course this cannot go on. Dr. Widjojo Nitisastro, the Coordinating Minister for the Economy, Finance, and Industry, justified the policy by saying,



"If devaluation had been postponed, the state of the economy would have caused a speculative outflow of funds. This in turn would have caused disruption of economic growth and endangered national stability. When the world economy was saddled with a new oil crisis with a slide in the US Dollars, and Indonesian products were not able to compete in the international market, devaluation is a necessity." In East and Southeast Asia where most national currencies are virtually fixed against US Dollars, more flexible exchange rate must be considered as an effective policy instrument in the future. It must be recognized that devaluation gave a favorable effect on the government revenue in terms of rupiah. Fortunately the rising trend of the prices of Indonesian non-oil export commodities increased the export value soon after the devaluation, and the balance of payment improved the question is whether the government succeeds in maintaining the tight control of money supply and suppress inflation below 20%. Private enterprises are pressed to get more loans as a result of wage increase and raw materials price rise. Exporters are worried whether the governments continue to place the quantitative controls on raw materials export and even processed goods export in order to stabilize domestic prices. Unless the exports of these countries show a substantial increase in the coming years, devaluation of their currencies seems unavoidable in view of the expected rise in oil price and the import of petroleum.

6. On the other hand, prospects for the increase in foreign capital inflow seem to have brightened slightly as a result of new attempts of oil explorations in Indonesia and government encouragement of foreign investment like lowering corporate income tax. Similar policies have been taken by other government as well.

Indonesia not only reduced corporate income tax but also reduced import duties and import sales tax on agricultural commodity, and also revised the transfer tax for export promotion. Malaysia simplified procedure for investment permit, and promised not to nationalize the joint venture. Thailand gave promotional privilege for shipbuilding and repair industry, and created investment promotion zone. South Korea liberalized the import of about 300 items. Taiwan permitted tax exemption for export enterprises to import machinery and revised more favorably the statutes of foreign investment. In fact there have been a sign of decline in US and Japanese investment in Southeast Asia. There was a worry that the US and Japan's capital may move more toward China. A number of steps have been taken by almost all governments in the region to stimulate foreign investment. All these seem to help the high growth rate of this region keep its pace in the 80's. Despite the expected slow-down of US economy (2 % or below) and Japan (3 to 4%). Moreover the continuing high growth of exports from this region to the US may cause the concern of US business circles and induce protective measures. Diversification of industries is the only way out of newly industrializing countries in this region to overcome this difficulty in the transitory period.

7. The rapid growth of this region described above, however, does not hold in the case of socialist countries like North Korea, Burma, Vietnam, Cambodia and Laos, whose economic performance impressed nobody in recent years. North Korean economy seems to have slowed down significantly due to the shortage of foreign exchange caused by poorly planned

industrialization policies in recent years; Burma seems to have emerged out of inward-looking closed economy type of policies and may be able to maintain the growth rate of 4 to 5% for some years to come. Vietnam and its satellites can only maintain the present level of per capital income at best.

Such a contrast between "Gang of Four" and the rest of Southeast Asian countries including the socialist countries has sometimes made some experts assert that the Sino-cultural countries in the western periphery of the Pacific have certain advantageous socio-cultural characteristics suitable for economic development. But the existence of tardy growth of socialistic economies suggests that it is a hasty deduction. What seems to have been proven is that a combination of western private enterprise and outward-looking open economy type of policies with Sino-cultural and social tradition is capable of following up the Japanese precedent, even without any significant supply of natural resources endowment. It remains still to be seen whether or not they can go beyond the middle income level and really reach the European or Japanese standard of living as fast as Japan did. Needless to say, this remarkable performance was possible only under the very favorable international, political as well as economic environment. For one thing an enormous amount of international aid and loans made available throughout the post-World-War-II years has been really essential to supporting their economic development and even political stability. The People's Republic of China, the mother country of these East Asian Sino-cultural nations, may be learning the lessons now. Somewhat optimistic projections of the Chinese economy above 5% a year

in 1979-80 had better be viewed with caution. It is a big question mark in Asia in the 1980's.