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## Six development paths in Southeast Asia: Three plus three

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WIDER Working Paper 2018/94

## **Six development paths in Southeast Asia**

Three plus three

Manuel F. Montes\*

August 2018

**Abstract:** Six Southeast Asian countries (Cambodia, Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, and Thailand) defied Gunnar Myrdal's pessimistic prognosis in his 1968 volume, *Asian Drama*, regarding their prospects for development. In the past half-century, these countries raised agricultural productivity faster than population growth and displayed sufficient state capability to direct change towards a respectable level of industrial development. In this period, the contrasts in achievements among the six countries can be understood from the variations in their initial conditions, socio-political contexts, international relations, and economic policies. These contrasts are investigated across four areas: agriculture, industry, foreign trade and investment, and social development. By using a more socially grounded analytical approach à la Myrdal, it is possible to understand how unorthodox economic policies have been effective in overcoming developmental disadvantages. However, shortfalls in social development could make further progress difficult in the future.

**Keywords:** agricultural reform, development, foreign investment, industrial policy, inequality, poverty reduction, soft state, trade

**JEL classification:** O13, O14, O15, O19

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# 1 Introduction

This paper examines the development experiences of Six Southeast Asian countries, Malaysia, the Philippines, Thailand, Cambodia, Lao People's Democratic Republic (hereinafter 'Lao PDR'), and Myanmar—here collectively called 'the Six'—50 years after Gunnar Myrdal's (1968) *Asian Drama* (hereinafter referred to as 'AD').

In AD, Myrdal took a unambiguously pessimistic view of Asian prospects for development on the basis of (1) obstacles to raising agricultural productivity and (2) the low perceived level of capability of governments to intervene effectively in favour of industrial development, the latter being a handicap that included the extensive incidence of corruption at all levels of government.

For the most part, the record of the Six defied Myrdal's prognosis, raising agricultural productivity faster than population growth and displaying sufficient state capability to direct change towards a respectable level of industrial development.

The Six comprise a diverse grouping of countries in terms of natural endowments, historical precedents, and politics. Five, all except Thailand, are former colonies. Three—Cambodia, Thailand, and Malaysia—are constitutional monarchies. Three—Malaysia, the Philippines, and Thailand—are long-running market economies. Two—Myanmar and Lao PDR—are formally socialist economies; at the other end of the scale, free enterprise is deemed as the foundation of the Philippines' democratic way of life (Myrdal 1968: 387). Three states—Cambodia, Malaysia (until May 2018), and Myanmar (until 2016)—have been de facto one-party states.

In terms of standard categories, there are two distinct groups within the Six. There are the three middle-income economies—Malaysia, the Philippines, and Thailand—and three least-developed countries (LDCs)—Cambodia, Lao PDR, and Myanmar—sometimes also referred to as the Socialist Three. The Socialist Three spent part of the post-AD period overcoming economic isolation and embargo, but managed to develop and expand the international dimensions of their economies.

A memorable contribution of Myrdal's AD is the idea of the 'soft state', introduced in the 'value premises chosen' section at the start of AD. He categorized Asian countries as having 'all "soft states"' (Myrdal 1968: 66). For Myrdal, a soft state comprises two faces of a coin: (1) policies, whether or not they are actually decided, are poorly enforced and (2) authorities 'are reluctant to place obligations on people'.

Subsequently, a discussion arose on the indispensable role of a 'strong state' or a 'developmental state', based on an interpretation of the record of successful East Asian economies.<sup>1</sup> According to this view, as 'strong states', East Asian states engineered state-led development. This view was an antidote to the rapid rise of the view—propagated by Bretton Woods staff and Official Development Assistance (ODA) agencies in the wake of the developing country debt crises of the 1980s—that an interventionist state is the main obstacle to development. According to the donor networks' views, if a society is saddled with a soft state susceptible to elite capture, it might as well let domestic and international market forces discipline both the state and the private sector.

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<sup>1</sup> See, for example, Wade (1990).

The Six threaded the space between these two exhortations, with the exception of two countries. The Philippines has been reducing state intervention since 1984 and Myanmar has long relied on a planned economy with direct state control over the enterprise sector, despite efforts at reform since 1988. In between, the other four, despite not being ‘strong states’, exhibit relatively better performance despite widespread state interventions, governance weaknesses, and gradualist reform paths. These contrasts could suggest that one does not have to choose between corner solutions to obtain some measure of structural change.

Table 1 presents the broad contours of overall growth among the Six. For the three LDCs (Cambodia, Lao PDR, and Myanmar), per capita growth rates are distinctly lower in the conflict-ridden 1970–90 period; per capita growth rates more than doubled in the 1990–2015 period. Starting from below the average in 1970, by 2015 these three had caught up and exceeded the average per capita income of LDCs. Among the three market economies, Malaysia and Thailand achieved high growth in the first half of the post-AD period, until 1990, subsiding in the second half, while the Philippines shows an upturn from low levels in the first period. On per capita income comparisons, Malaysia and Thailand are clearly strong performers. Malaysia’s per capita income is practically double that of average developing country per capita income; Thailand’s per capita income is 20 per cent higher than average developing country per capita income. The Philippines has lost ground in per capita income comparisons among developing countries.

Table 1: Economic growth indicators (per cent)

	Per capita GDP growth <sup>a</sup>		GDP growth rate <sup>a</sup>		Per cent of ‘group’ <sup>b</sup> per capita income	
	1970–1990	1990–2015	1970–1990	1990–2015	1970	2015
Cambodia	–2.3	5.0	–1.0	7.4	78.0	119.0
Lao PDR	2.5	5.0	4.8	6.9	31.5	220.9
Myanmar	0.5	8.0	2.7	9.1	72.4	122.1
Malaysia	4.9	3.5	7.7	5.7	162.6	198.0
Philippines	1.0	2.2	3.8	4.2	94.1	59.1
Thailand	5.0	3.4	7.3	4.2	90.9	119.4
Developing countries	2.2	3.6	4.5	5.2		

<sup>a</sup> Growth rates are compounded growth rates calculated from end-points based on real values.

<sup>b</sup> Per capita incomes are based on current prices at current exchange rates; for Cambodia, Lao PDR, and Myanmar, the ‘group’ denominator is LDC per capita income; for Malaysia, the Philippines, and Thailand, the ‘group’ denominator is developing country per capita income.

Source: author, based on data from UNCTADStat Economic Trends dataset.

A discussion of the underlying factors behind this overall pattern will be grouped around four issues:

- 1 How did these countries raise agricultural production and manage to transition out of a dependence on agriculture needed to sustain high growth rates?
- 2 How did they develop their industrial sectors and what role did their state play in this effort?
- 3 What was the role of openness, external trade, and foreign investment in the restructuring of their economies and their place in the international economy?
- 4 What was the impact on employment, inequality, and social development?

## 2 Raising agriculture output and transitioning from agricultural dependence

Variations in the record among the Six uphold the view that strong progress in agriculture is an essential element of structural change. There were two vital dimensions in this record: (1) institutional reform and (2) output increases mainly but not solely enabled by the dissemination of ‘high yielding varieties’ (HYV) of rice.

Within these two dimensions, the record suggests that markets and private incentives, while having a necessary role, are insufficient for the purpose of agricultural development and diversification. While the introduction of HYV in rice was fortuitous to the agricultural challenge, successful cases among the Six point to the larger role of institutional changes traceable to state policies and interventions.

### 2.1 Institutional reforms

For the Six, these reforms concerned issues of tenancy and collectivization and the role of foreign, indigenous, and state-owned enterprises. Except for Thailand, which was never colonized, plantations for export on one hand and farming for local consumption on the other were the two main production modes in agriculture. As independent states, the Six faced the problem of sustaining commodity export earnings while responding to the inequities in access to land in the rural areas bequeathed by colonial trade.

#### *The Socialist Three*

In the period under review, collectivized farming was the starting institutional form in the then ‘Socialist’ Three of Cambodia, Lao PDR, and Myanmar. Collectivization was an element of the anti-colonial blueprint, put in place with the expulsion of foreign control. However, the extent of achieved collectivization can be disputed because of the limited capability among the new states to effectively implement it in remote rural settings. Agrarian reform, meaning a deliberate withdrawal from collectivized farming, during the 1980s after the failure of initial attempts to secure food security through collective farms, constituted the crucial event in institutional reform in Lao PDR and Cambodia (van Arkadie 1995). Success in restoring and upgrading agricultural production underpinned medium-term growth in these three economies.

In 1986, Lao PDR began encouraging a return to family farms, de-emphasizing collectives that had generated resistance and restricted farmers’ direct involvement in trading, ‘leading many to retreat into subsistence’ (van Arkadie 1995: 31). Families obtained long-term leases and, subject to approval by district authorities, the right to transfer access to children or others. With state ownership of land, Cambodian non-plantation agriculture in principle was organized in cooperatives, but, in practice, the rules did not displace family farming. By 1989, private property ownership had replaced collective production.

In Myanmar, where all land is the property of the state, formal agrarian reform efforts began after 2010. There has been a trend towards increasing landlessness as a consequence of land alienation for commercial purposes, including in the tribal areas, since the start of market-oriented reforms in 1988. Forty-seven million people, about one-third of the country’s rural residents, are landless labourers—many working and building up debt on land nominally owned by the government (Hiebert and Nguyen 2018). Giving private companies access to land in this situation has spawned social tensions. In early 2018, the government enacted two new laws to provide a legal framework that offers a path to widening land ownership: the Farmland Law and the Vacant, Fallow, and

Virgin Land Management Law. It is too early to speculate on the prospects and the impact of these reforms.

### *The Market Economy Three*

In the three market economies of Malaysia, the Philippines, and Thailand, arguments of equity, tinged with the possibility of raising agricultural productivity by unleashing individual initiative, underpinned various state efforts to expand farmer families' access to agricultural assets.

In Malaysia, a post-colonial disposition promoted indigenizing commodity processing and the resettling of landless rural households in rubber and palm oil estates in the 1960s. The Bumiputera programme after 1969, which set targets for increases in ownership in enterprises—through state ownership as a first step—intensified these trends. Aside from expanding credit availability and robust provision of agricultural extension and research, the Bumiputera programme found opportune targets in private, foreign-owned plantations so that by the early 1980s, the state had gained control of the whole plantation sector (Lim 1985). State ownership preserved the highly commercial character of the plantation sector, including through the hiring of foreign managers, and opened doors for the entry of well-connected Malays into the sector. This sector had also been relatively successful in integrating smallholders in export production, including through contract farming.

In the Philippines, tenancy-based production—and a matching social structure ('pre-capitalist' (Khan 2018) or 'feudal' (Myrdal 1968)) from the Spanish colonial period—held sway in all major crops of rice, sugar, coconut, and banana. Since the 1930s and irrespective of prevailing development strategy, the Philippines have attempted a major 'land reform' programme in every decade.<sup>2</sup> Implemented through the colonially shaped social structure, these programmes have been limited in scope and poorly implemented, and consequently ineffective, despite high ambitions (Borras 2007; Evans and Heller 2018).

Thailand's political history afforded a much less skewed distribution in access to land. For example, in 1874, the Thai monarch set a maximum ownership limit of four hectares in a context of low population pressure. In the 1930s, in the aftermath of a political contest between the monarchy and nobility, the rights of small farmers were enhanced by royal decree.

At the national level, the contrast in tenancy incidence between two market economies of the Philippines and Thailand, just as the Green Revolution technology was being rolled out, was stark. In 1971, 21 per cent of total farming in the Philippines was under pure tenancy and 79 per cent under share tenancy (Otsuka and Runge 2011: 156, table 9.2); in Thailand, the corresponding figures were 16 and 29 per cent.<sup>3</sup> Owners and financiers have to take greater responsibility in spreading and sustaining new technology where tenancy is dominant. Large landowners control not only production but also local labour markets. The next section explores how these kinds of differences in institutional resources shaped the speed and the impact of efforts to raise agricultural productivity.

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<sup>2</sup> Including the forcible land takeovers implemented by the anti-Japanese resistance in the 1940s in the main rice-growing area.

<sup>3</sup> However, tenancy rates comparable to the Philippine national average can be observed in farmland located near Bangkok; tenancy in the north is very low.

## 2.2 The Green Revolution

The propagation in HYV rice, the first of which was introduced in 1966, two years before Myrdal's volume, played a significant part in raising agricultural production and attaining food security in the Six. HYV technology was input-intensive in terms of water, fertilizer, and pesticide, and induced its own pressures on institutions and on state provisioning. Rural institutions and the capabilities of the state in turn affected how increases in agricultural output were shared among members of society.

### *Raising agricultural production and yields*

There is a vast literature on the positive impact of the Green Revolution in the economies of Southeast Asia, and it suffices to touch on the highlights. In the Philippines, Malaysia, and Thailand, the spread of the Green Revolution and HYVs proceeded at a strong pace in the 1970s. By 1976/77, HYVs accounted for 7 per cent of crop area planted in Myanmar, 37.4 per cent in west Malaysia, 68.1 per cent in the Philippines, and 11.3 per cent in Thailand (Dalrymple 1979: 708).

For rice, the most telling impact of HYVs was to allow two rice crops per year in irrigated areas. The increase in output was significant enough to turn the terms of trade against agriculture (Bautista 1986; Dalrymple 1979), greatly benefiting consumers, especially in the lower-income strata that spend more on food. The negative impact of the terms-of-trade reversal was offset partly by increases in off-farm and on-farm (labour exchange) employment opportunities.

For the whole of Southeast Asia between 1961 and 2010, the record shows that total agricultural production grew by 3.44 per cent per year, substantially faster than population (Timmer 2015: 99), a record that includes not just the Green Revolution in rice, but diversification in production and consumption as incomes rose.

In the period 1970–80, real agricultural value-added in Malaysia was growing at 5.0 per cent per year, in the Philippines by 4.0 per cent, and in Thailand by 4.4 per cent. In the subsequent period of 1980–93, growth moderated to 3.2 per cent per year in Malaysia, 3.8 per cent in Thailand, and declined noticeably to 1.2 per cent in the Philippines (Bautista and DeRosa 1996).

Cambodia achieved rice self-sufficiency in 1995. Production targets for rice incorporate a surplus for export (Chhair and Ung 2016). In recent years, the EU's trade preferences, including the *Everything but Arms* programme, allows Cambodia to export rice, vegetable products, rubber, and other foodstuffs duty-free. Inadequate infrastructure to transport agricultural produce hampers further investment in productivity and crop diversification. Lao PDR achieved rice self-sufficiency in 1999. However, with 70 per cent of the population living in rural areas, agricultural productivity per worker remains low: 90 per cent that of Cambodia and 41 per cent that of Thailand (World Bank 2014: 26). These two cases argue for sustained state investment in agriculture at low income levels.

### *Impact on society*

The impact of the Green Revolution on farmers themselves depended on whether the 'technology enabled their costs of production to decline more than prices declined' (Evenson 2004: 548). Farmers that could use the technology were positively affected; those farmers without access to the technology were negatively affected since they sold their produce at lower market prices.



The technology was not neutral with respect to existing inequities, favouring larger farms and farmers with affordable access to financing input costs. It favoured landowners as it increased land prices and rents. When the technology ‘was introduced in areas characterized by great inequality in the distribution of resources, the productivity impact has been weak and the pattern of inequity has been reinforced’ (Ruttan 1977: 20; see also Wong (1987) for Malaysia), while it could have had a positive impact on both productivity and equity if the starting status of equity was favourable. In the literature, pre-existing inequality is seen as the main determinant of the distribution of gains from the Green Revolution.

The Green Revolution in rice was not a revolution in terms of ‘massive betterment in the lot of rural residents’ (Ruttan 1977: 724) or a solution to food problems in the future. Its reliance on input intensification has raised questions about its sustainability.

On the consumer side, in the context of Myrdal’s warning of a reinforcing interaction between low agricultural productivity and low labour productivity, Timmer (2015: 91) finds that, compared with the rest of the world, Southeast Asia as a whole made substantial progress in reducing food insecurity in the two decades since 1990, with the region transforming a ‘large negative gap of 12.3 per cent to a very large positive gap of 15.7 points’. The underlying process Timmer implicates is the rise in the productivity of agricultural labour, which, in the standard narrative is a precondition for the transition from agriculture to industry.

## 2.3 Transitioning out of agricultural dependence

Led by Malaysia and Thailand, the Six have managed creditable transition in shifting of the weight of economic activity from agriculture to industry and services. In Southeast Asia, ‘this sectoral transformation occurred at a rate far higher than comparable changes in Western Europe, the United States, and Japan and matched and exceeded rates achieved a generation earlier by the Northeast Asian “tiger” economies, Taiwan and South Korea’ (Coxhead 2015: 4).

Table 2 shows that all of the Six have reduced the sectoral contribution of agriculture to gross domestic product (GDP); all, except Myanmar, see the proportion of GDP in services rise, with the Philippines showing the greatest increase.

Table 2: Structural change (sectoral value-added as a percentage of GDP, end-point)

	Agriculture			Industry (manufacturing)			Services		
	1970	1985	2015	1970	1985	2015	1970	1985	2015
Cambodia	46.6	47.0	28.2	13.5 (8.3)	13.6 (8.3)	29.4 (17.0)	39.9	39.4	42.3
Lao PDR	41.6	39.1	19.7	14.5 (3.9)	16.2 (4.0)	31 (9.2)	43.9	44.7	49.4
Myanmar	41.5	48.2	26.8	13.3 (10.2)	13.1 (9.9)	34.5 (20.8)	45.2	38.7	38.8
Malaysia	29.8	20.3	8.6	28.2 (15.2)	39.2 (19.7)	39.6 (23.1)	41.9	40.5	51.8
Philippines	26.0	21.2	10.3	34.9 (27.0)	38 (26.7)	30.9 (20)	39.1	40.8	58.8
Thailand	25.9	15.8	8.7	25.3 (15.9)	31.8 (21.9)	36.4 (27.6)	48.8	52.3	54.9
Developing countries	24.5	16.7	9.0	32.4 (14.8)	36.6 (16.1)	35.6 (21)	43.1	46.7	55.4

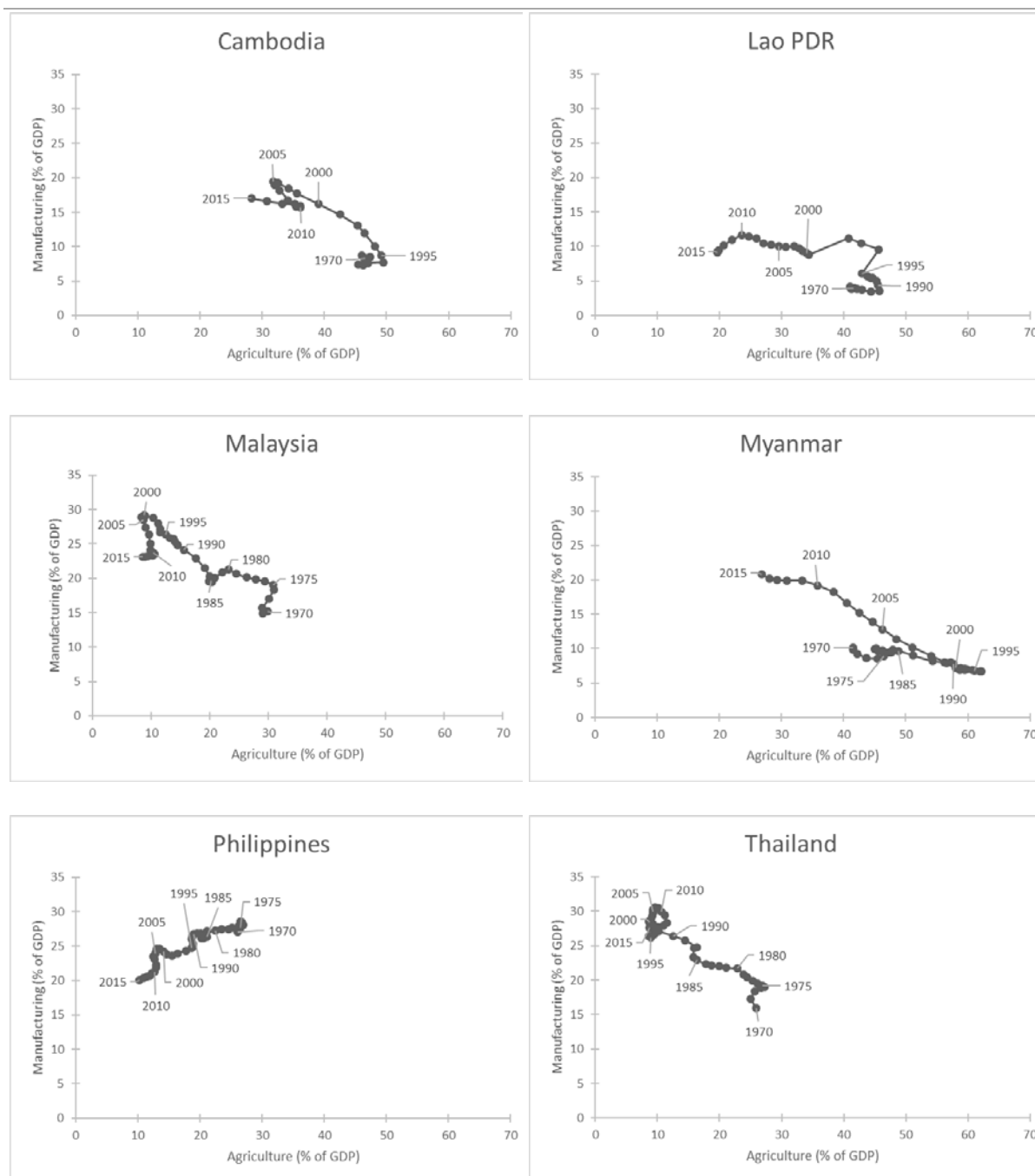
Source: author, based on data from UNCTADStat Economic Trends dataset.

The extractive industries represent a high proportion of GDP in Cambodia, Lao PDR, and Myanmar; for these countries, the bulk of the difference between the proportion of GDP in industry and the proportion in manufacturing is associated with the extractive industries. These countries have the advantage of relatively low population densities and thus much room to rely on this sector. But relying on the extractive sector will require policies for translating earnings from extractive sectors into human and industrial development, a manoeuvre many developing countries have not managed to complete.

Figure 1 depicts the steep shift of value-added proportions from agriculture to manufacturing, particularly most recently in Myanmar and Cambodia, with a more moderate but steady long-run reallocation for Malaysia and Thailand. Between 1993 and 2007, the share of manufacturing in Cambodia increased from 12 to 25 per cent. In most countries, the growth rate of manufacturing subsided after the Asian financial crisis.

In the case of the Philippines, the long-term trend has been a declining share of agriculture with no perceptible increase in manufacturing as a proportion of value-added; services, especially in recent years, have absorbed the declining proportion from agriculture. A portion of the Philippines' increase in services contribution comes from its capturing second position to India in the international business process outsourcing sector.

Figure 1: Structural change in Southeast Asia (percentage of GDP in agriculture and manufacturing)



Note: three-year moving averages, except for end-points.

Source: author, based on UNCTAD Economic Trends dataset.

### 3 Industrial development, the state, and the private sector

There is a policy controversy<sup>4</sup> over whether the state had any positive role in the Six's industrial development. At a basic level, one side of the debate holds that successful Southeast Asian states did *not* intervene significantly and that the unsuccessful ones intervened too much; the other side holds that evidence of extensive intervention on the part of successful economies cannot be ignored. Then, suppose one starts from accepting the presence of significant state intervention. One side of the argument takes the view that state policies did not have significant impact on industrial upgrading in the successful cases and that external trade, foreign investment, and macroeconomic stability<sup>5</sup>—a distinctly Southeast Asian advantage in the 1980s but not in the 1990s—were the decisive important factors. The opposite view is that state policies played an indispensable role in structural change.

The evidence presented here is that successful economies among the Six did intervene—both as industrial policy and as state-led investment. This contradicts the view detailed in the 'East Asian miracle' study by the World Bank (1993), that the successful economies relied mainly on macroeconomic stability to drive structural change.

Except for the Philippines,<sup>6</sup> which underwent the rigours of a structural adjustment programme starting in the mid-1980s, industrial policy regimes in the countries in all economies have persisted, albeit evolving, since 1968. State-led investment played a significant role in the early stages. Instead of being dismantled, industrial policies expanded to benefit export sectors beginning in the 1980s. The rest of this section develops this narrative in three subparts: (1) a review of the actually existing policies among the Six; (2) the role of state-led investments; and (3) the role of the state and the large domestic private sector. Much of the discussion in this section will be on the three middle-income countries. The three LDCs can be seen as following the path of the successful three middle-income countries, with state-led investments in early stages and state-enabled efforts to penetrate export sectors in extractives and light manufacturing.

#### 3.1 'Actually existing' industrial policies in Southeast Asia

In 1968, import-substituting policies were unchallenged among the three Southeast Asian market economies (Malaysia, the Philippines, and Thailand), while state dominance over the economy in the three LDCs (Cambodia, Lao PDR, and Myanmar) was inescapable in their conflict-ridden and embargo-restricted contexts.

A system of exchange controls, cascading tariffs, multiple exchange rates, tax incentives, and subsidies lay at the heart of industrial policy for Southeast Asian countries. Industrial policy is distinguished from other government economic intrusions in that these are sectorally targeted. These interventions were implemented through preferential exchange rates, import controls on

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<sup>4</sup> This unsettled question applies not only to Southeast Asia, but to the Northeast Asian successes of the Republic of Korea, Taiwan, China, and Japan as well. While the market-defying extensive state interventions in Northeast Asia are not in doubt, the contrary view (Bhagwati 1988) holds that, by being export-oriented, market conditions were simulated, thereby enforcing market conforming behaviour on both state and the enterprise sector. The 'simulation' characterization is Wade's (1990).

<sup>5</sup> Except for the Philippines.

<sup>6</sup> The economic reforms instigated by the later financial crisis of 1997–98 were more about corporate governance than about trade and industrial policy; these would have been uncalled for, since current account fiscal deficit levels were at benign levels (Montes 1998) when the 1990s crisis struck.

competing final goods or intermediate inputs, tariff exemptions on imported equipment, tax holidays, restrictions on entry of new capacity in the industry, preferential interest rates, and access to credit. In the operation of these programmes, industrial targeting and boards of investments played a critical role, even though in earlier periods central banks, through the allocation of import allocations, had taken a lead role in industrial policy (Montes 1993: 12–13).

#### *Developing while import-substituting*

Before 1969, Malaysia intervened mainly in infrastructure investment and in agriculture (Salleh et al. 1992) in order not to alienate Chinese supporters of the ruling party with roots in trading and light manufacturing. After the racial riots of 1969, as part of its Bumiputera programme, Malaysia state protectionist intervention became widespread. However, these programmes sought also to strengthen competitiveness in key export industries, including palm oil. State intervention paved the way for the extensive relocation of US semiconductor companies to Malaysia, exploiting the country's supply of low-cost, semi-skilled female labour (Montes 1993: 15). The net effect of these interventions involved an economy whose degree of price distortion did not differ significantly from that in the Philippines or Korea in 1975 (Salleh et al. 1992: 20).

Thailand has maintained significant import protection for selected industries. Among the most highly favoured sectors were textiles, automobiles, and pharmaceuticals. Incentives provided by the Board of Investments included import bans and surcharges on competing imports and exemption from import duties on machinery and raw materials (Montes 1993: 16). Industrial promotion benefited capital-intensive manufactures in defiance of the country's static comparative advantage as a resource-rich, labour-abundant economy. Industrial policy discriminated against agriculture, especially through export taxes. Thai industrial policy was particularly heavy-handed in the 1970s, effecting an increase in the proportion of heavy manufacturing industries from 32 to 43 per cent (Montes 1993: 17).

#### *Contrasting approaches to external liberalization*

The 1980s saw a decided shift towards external liberalization among the Six. However, there were contrasts in degree and strategy among these countries. For the Socialist Three, privatization and exchange rate consolidation were critical elements of outward reorientation. For Thailand, this meant the redeployment of import-substituting policies in support of export promotion. For the Philippines, outward reorientation involved import liberalization.

In 1981, the threat from the international debt crisis and the fall in commodity prices exposed the vulnerability of the Thai economy. Industrial policy shifted to incorporating export promotion. The government devalued the currency, removed most export taxes, and reformed the tariff system (reducing the highest rates from 100 to 60 per cent). Even with these reforms, Christensen et al. (1992) report the Thai effective protection rate for manufacturing to be 52 per cent, still higher than Korea (28 per cent), Malaysia (23 per cent), and the Philippines (23 per cent). Thailand reduced its sectoral interventions starting in 1991, with a more comprehensive liberalization strategy when, facilitated by foreign investment, a strong trend in manufactured exports was already underway (Montes 1993: 17).

The Philippines chose a different path towards an internationally competitive industrial sector. While the other five countries were reorienting their economies through state intervention in the mid-1980s, it embarked on an ambitious trade and import liberalization programme, starting in 1984, setting a new trajectory grounded on long-running domestic debate aimed at eliminating the disincentives imposed by protection (Hill 2015). Coincidentally, the Philippines was the only Asian country swept into the 1982 developing country debt crises. In a series of structural adjustment

programmes under the aegis of the Bretton Woods institutions, the programme progressively reduced quantitative restrictions and tariff rates, seeking to spur private sector adjustment. A thoroughgoing programme of privatization of state enterprises and utilities was also launched. However, the programmes, in line with other such programmes in other debt-distressed countries, did not afford additional financing specifically for industrial adjustment.<sup>7</sup> While the politically restrained pace of liberalization is the source of constant dissatisfaction for its domestic supporters, the development narrative has decisively shifted from worrying over development gaps to lamenting the gulf between the current state of affairs and a genuinely market-driven economy.

Lao PDR introduced the New Economic Mechanism in 1986, to begin the transition from a centrally planned to a market-oriented economy. In a ‘step by step’ gradual manner, price controls were removed, the exchange rate system was unified, and the government’s monopoly on trade ended, with the number of state enterprises reduced and the establishment of private firms. With the achievement of peace in 1992, the re-introduction of private ventures in Cambodia began.

With the support of international financial institutions, Cambodia and Lao PDR expanded their infrastructures and utilities. Lao PDR benefited from multilateral programmes to develop the Mekong region and the market for hydropower to Thailand. Cambodia became a big player in contract production in textiles and clothing. Myanmar’s industrial sector was under state control throughout this period but in 1988 the registration of private ventures was opened. Table 2 indicates that Cambodia, Lao PDR, and Myanmar doubled the contribution of manufacturing to GDP between 1985 and 2015, after stagnating for the previous 25 years.

### **3.2 State-led investments and state-owned enterprises**

Among the Six, rapid transitions to industry and manufacturing were enabled by high national investment rates. Except for Myanmar, a socialist state, private investment rates played a key role. However, what distinguishes the successful economies is the sizeable role of government investment.

Before the Asian financial crisis in 1997, national investment rates exceeded 20 per cent of GDP in Malaysia and Thailand, with government investment at over 8 per cent (Table 3); the exception was the Philippines, where government investment never exceeded 3 per cent. An acceleration of investment rates after 1997 is evident in Cambodia and Lao PDR.

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<sup>7</sup> State financing directed specifically for industrial adjustment is a standard tool of industrial policy and thus analytically incompatible with a liberalization-based reform effort, which is predicated on a private discovery of international competitiveness.

Table 3: Investment rates (percentage of GDP)

	Total investment <sup>a</sup>		Private investment		Government investment	
	1970–96	1997–2015	1970–96	1997–2015	1970–96	1997–2015
Cambodia	12.0	17.8	6.3	10.9	5.7	6.4
Lao PDR	8.8	28.6	–	19.8	–	8.8
Myanmar	–	27.3	–	22.2	–	8.3
Malaysia	30.2	24.6	26.2	13.6	12.6	11.0
Philippines	22.1	20.7	17.5	17.6	4.8	3.2
Thailand	29.9	24.9	22.7	17.8	7.2	7.1

<sup>a</sup> Total investment is gross domestic capital formation.

Source: author, based on data UNCTADStat Economic Trends.dataset.

With various levels of effectiveness and through bouts of nationalization and privatization, all of the Six deployed state-owned enterprises (Myanmar exclusively until 1988) and none permanently collectivized agriculture. All of the Six engaged in a fluctuating degree of national economic planning.

Among the Six, the variation in the record of state enterprises mirrors the same range of success and disappointment in the developing world—with Myanmar’s experience uniformly stagnant across sectors at one end (Booth 2003a; Tin 2006), and successful cases such as palm oil processing in Malaysia at the other (Teoh 2002). What deserves mention is how the private sector in successful cases such as Malaysia achieved productivity increases and industrial development while exploiting state-provided economic subsidies and protection.

Malaysia’s extensive ‘government-linked companies’ (GLCs) replicated the complex web of ownership and control of the country’s large Chinese groups (Gomez et al. 2017: 95). Like the sprawling Chinese groups that control enterprises in a great variety of sectors, Malaysian GLCs are found in a variety of economic activities, from trading to media. Seven government-linked financial companies under the jurisdiction of the Minister of Finance control the largest publicly listed GLCs.

The Thai public enterprise sector was not as extensive as in Indonesia or Malaysia, and was mainly found in public utilities, though there were some hotels and agricultural mills. In the external crisis in the mid-1980s, Thailand undertook a programme of partial divestment and deregulation, which was strongly resisted by Thai trade unions. As in other instances, the extent of privatization was also constrained by the lack of interest on the part of private investors to take over the public companies on offer.

### 3.3 The role of the state and the private sector

In Southeast Asian development, it is not realistic to discuss the role of the state without addressing the nature of ‘the’<sup>8</sup> indigenous private sector. Large business conglomerates dominate the economic landscape in Malaysia, the Philippines, and Thailand. Linked politically, including through state and military control, large enterprises play a leading role in basic sectors, such as in food and trade, in Cambodia, Lao PDR, and Myanmar. How this configuration in most of the Six

<sup>8</sup> There is a variety of indigenous private sectors, distinguished by size, market control, and political impact. The analysis focuses on the large segment with a significant economic role and political influence.

(except for Myanmar and the Philippines) has not proven an obstacle to respectable, if not vigorous, rates of economic growth in Southeast Asia is a key question.

This section discusses Myrdal's 'soft state' concept in an economy with a small set of elites operating large business conglomerates. It explores how network enforcement within this elite and 'relational contracting' might have substituted for rigid state-led development as in Northeast Asia and facilitated three decades of growth. In Section 5, we discuss how this approach of a beholden state apparatus diverted attention from longer-term issues of national and social development.

Akyüz and Gore (1996) pose one rudimentary element of private behaviour from the observation that effective East Asian industrial policy depended on a profit–investment nexus: high profits led to high investment. East Asia managed to discipline favoured companies to ensure that super profits or 'policy rents' (Khan 2018) were reinvested to expand operations and employment.

In contrast, Southeast Asian states were 'too soft' to impose accountability for their economic actions on favoured elites. Southeast Asian growth based on delivering economic advantages to political 'cronies' has been called 'ersatz capitalism' (Jomo 2003a; Yoshihara 1988). Another term in the analytical literature is 'state mediated capitalism' (Jones 2013). Under ersatz capitalism, favoured enterprises and businessmen strongly influenced the setting of priorities and the corresponding scale of benefits from government intervention.

### *Relational contracting*

Among the successful economies of the Six, the nurturing of a rentier incentive structure through industrial policies can be seen as a dimension of their soft state status. Myrdal (1968: 957) was profoundly sceptical of such a configuration, pointing to the 'liquidation of the craft guild system' and the indispensability of a 'liberal interlude between Mercantilism ... and the modern welfare state ... during which the strong state came into being'. Myrdal considered such a liberal interlude indispensable to achieving 'relative integrity in politics and administration ... when state activity was reduced to a minimum' (Myrdal 1968: 958).

A soft state would be predisposed to rent-seeking and predation by non-state actors. During the Middle Ages in Europe, feudal lords would have been exposed to predation by non-state actors but had 'the power to withhold protection or confiscate private wealth, undermining the foundations of the market economy' (Greif et al. 1994: 746). One way to explain how trade could have expanded with unstable private ownership is the possibilities that rulers employed medieval guilds as commitments against arbitrary feudal power; these guilds, in turn, could enforce contracts among their membership. The term 'relational contracting' is a shorthand for this kind of governance approach. In game-theoretic terms: in a repeated game, community enforcement and protecting a reputation can substitute for state regulation, contract enforcement, and coordination. Greif (1993) gives the example of Maghribi traders' networks in the eleventh century.

The social effectiveness of relational contracting must be evaluated in terms of the ability to facilitate trade and economic expansion. The effectiveness of guilds in turn depended on well-defined identities of parties involved and exclusivity as its tool of enforcement. Among the Six, the role of business conglomerates, including those created by the state, is well known. The question is how did soft states manage to nudge these conglomerates' *private orderings* towards the *public orderings* needed to sustain growth—to use Williamson's (1983) formulation.

In the Six, conglomerates, led by well-connected businessmen, many with foreign partners, operated in the leading and most profitable sectors of the economy, which for the most part were located in the region's growing external sector. For the successful economies, the downside to the



chosen soft development path based on a strategy of coddling large conglomerates was that this did not create indigenous technological learning capabilities (see also Section 5 for a discussion on shortfalls in investment in education).<sup>9</sup>

The domination of economic policy by a state-connected clique provided an infrastructure for coordination. Accountability on the part of privileged businesses consisted of political support for the regime and continued commercial success, including the timely servicing of subsidized financing. Political leaders had the role of managing competition for state-provided advantages among an exclusive group known to each other, many from the same ethnic minority.

The clique-based configuration has periodically spawned spectacular corruption episodes, such as the scandals associated with the Port Klang Free Zone (Juego 2015) and the 1MDB holding company in Malaysia. Mainstream analyses associate these breakdowns with the inherent folly of state intervention. An alternative view is that these events are instances of a breakdown in the internal accountability mechanisms of relational contracting among a privileged group.

#### *Business dominance by a minority of a minority*

The dominant role of business minorities is also a common phenomenon among the Six. The irony is that Myrdal (1968: 691) found that '[O]nly India and the Philippines have the nucleus of a national entrepreneurial class... In all the other countries industry and business had been almost entirely in the hands of European, Chinese, and Indian minority groups.' Business conglomerates are led by a minority within a minority, with prominent businessmen sharing their ethnicity with many other residents who are not wealthy at all. Intermarriages and business coalitions among prominent business families helped maintain exclusivity and coherence by these conglomerates in dealings with the state and foreign business entities.

The pervasiveness of Chinese minority groups in business endures to this day in Southeast Asia. In Malaysia, while constituting 30 per cent of the population (as estimated in 2001 by *The Economist* (2001: 5)), Chinese-descended businessmen account for 69 per cent of market capitalization in large conglomerates; in the Philippines, Chinese constitute 2 per cent of the population and control 50–60 per cent of the market capitalization; in Thailand, the comparable numbers are 14 per cent of the population and 81 per cent of the market capitalization. Chinese businesses have been associated with 'much capital accumulation ... regardless of, or even despite, rather than because of state intervention' (Jomo 2001: 7).

The dominance of large minority-owned enterprises in critical areas of the economy imparted an ominous aspect for development prospects. 'In south-east Asia, the energies of entrepreneurs were directed towards fooling politicians rather than exporting' (Studwell 2013: 62). In the case of Malaysia, unlike in South Korea, conglomerates were never pressed to go into manufacturing or exporting construction services (Studwell 2013: 111). In Malaysia, of course, the industrialization effort under the Mahathir government was directed at building up Bumiputera-controlled businesses in competition with those controlled by Chinese. Thailand suppressed Chinese businesses, while the Philippines had restrictions on the sectors in which ethnic Chinese could participate. In Thailand, Chinese families in the 1930s took Thai names and achieved some integration into society.

In Thailand, industrial policy started out as the sandbox for wealthy, mostly Chinese-descended, businessmen. Industrial policy, parcelled out and uncoordinated among different government

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<sup>9</sup> See Amsden (2008) and Lim (2010) on the development imperative of building indigenous technological capabilities.

agencies, created public sector patrons for specific private actors. Thai export promotion was built on top of the conglomerates from the import-substitution era, with the specific red line that foreign participation in domestic markets is effectively at the ‘consent’ of the indigenous business (Rock 2001). In a review of Thai legislation, National Development Plans, and Board of Investments rulings from the 1970s to the present, Montes and Cruz (2017) find that, while Thai restrictions against foreign participation have been liberalized progressively since the 1980s, these have ‘reserved’ the most lucrative domestic market for Thai business companies.

Thai business conglomerates have enjoyed stable access to state-provided commercial advantages. In contrast, in the Philippines, Montes and Cruz (2017) suggest that outcomes of political contests have caused significant reallocations of state-provided privileges, while in Thailand the protected private sector remained stable even through military coups. In the Philippines, US-style elections, which facilitated non-violent transfers of political power, have become arenas for intense struggles over state-provided privileges. Through the legal<sup>10</sup> system and bureaucratic actions, the state was ‘strong’ enough to withdraw rents from businesses seen to have supported losing politicians, a feudal reallocation of privileges by democratic means. Political contests became (and continue to be) proxy struggles for state privileges among business conglomerates, spending for which, including in the maintenance of a coterie, is counted as consumption in the national accounts. Such consumption expenditures represent forgone investment spending by business conglomerates (Montes 1995). Forgone investment, in turn, is consistent with the lacklustre levels of private investment prior to the liberalization period, as observed by de Dios and Williamson (2013). It has taken until the 2000s for private investment rates to begin to approach Southeast Asian levels.

In contrast to Thailand, where large conglomerates dominated policy design, in non-socialist Malaysia the business sector faced a coherent state which ‘sought to guide industrial change through a detailed sector-by-sector strategy laid out in the Industrial Market Plan 1986–95’ (Felker 2001: 135)—during the height of Reagan–Thatcher policy revolution. This plan provided ‘(a) guidelines specifying where foreign investment would be prohibited or restricted; (b) reserving import-substitution opportunities for locally owned industries in various mature consumer goods industries; (c) applying an obligatory export requirement ratio on further foreign investment’, and so on.

In the Philippines, the most prominent businessmen have moved out of manufacturing and trade sectors into property development and retail marketing to shelter capital made obsolete by import liberalization (Montes and Cruz 2017). Strong inflows of overseas workers remittances, reaching about 10 per cent of GDP by the 2000s, secure the foreign exchange cover for the dynamic of this economy. De Dios and Williamson (2013) suggest that with the large proportion of workers in their peak employment years based abroad, the Philippines does not have the low-wage labour force required to venture into light manufacturing for export at this point in time.

Myanmar, whose commodity-exporting potential is enormous, is in the early stages of creating an indigenous business class. In Cambodia and Myanmar, the rapid rise of garment export industry relies primarily on investment and loans from ‘Greater China’ (a term that includes the People’s Republic of China, Taiwan, China, and the Special Administrative Region) to local businessmen, many of minority descent.

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<sup>10</sup> For example, through the processing and investigation of corruption cases and of claims of contract violations.

‘Family-style’ management of domestic conglomerates, instead of precipitous capital account liberalization, was diagnosed—erroneously<sup>11</sup>—as the ‘Asian’ governance failure behind the Asian financial crisis. Nevertheless, it bears asking whether this structure can mobilize capital and operations of sufficient scale to continue to play a prominent role among those economies of the Six seeking to escape the middle-income trap. The contrast is with China, where large state-sponsored corporations are becoming global players. In contrast to those in the Republic of Korea, these family-based conglomerates are not known for technological development and innovation.

## **4 Openness, trade, and foreign investments**

Most of the Six are renowned as successful globalizers. While it is undisputed that international trade and foreign investment played and continues to play an indispensable role in the Six’s growth and economic diversification, scepticism remains about the manner in which these economies integrated internationally. One side<sup>12</sup> of the debate holds that openness in the customary sense of low tariffs, minimum application of quantitative restrictions, and unrestricted foreign investment were decisive in Asian, including Southeast Asian, development. The alternative view<sup>13</sup> is that successful economies integrated themselves internationally without dismantling their industrial policies or abruptly exposing their domestic enterprises to foreign competition.

The record reviewed here is consistent with the second view. Successful economies among the Six did rely heavily on foreign investment to expand and diversify their trade beyond commodity exports; up to the present they seek to continue to do so. However, associating the influx of foreign investment with customary notions of ‘openness’ is inaccurate in the case of the successful cases among the Six. It is necessary to differentiate between the role of external developments (sometimes called ‘luck’) and the domestic policies involved in the hosting of foreign investment. Domestic hosting policies in Southeast Asia made it possible to benefit from foreign investment, while retaining industrial policies.

### **4.1 Performance and diversification in external trade**

It is proper to start by presenting a general outline of the role of trade in the Six’s overall economic performance. Estimates from Phung et al. (2015: 76–77) suggest that external sources of growth played an important part in the subregion’s development. They report that of Malaysia’s 3.8 per cent annual growth in output per worker in the 1980s and 1990s, 1.75 percentage points is from world economic growth, the rest coming from domestic investment, resource endowments, and openness. The spillover to the Six from external sources is particularly pronounced from Northeast Asia, indicating the ‘luck’ component of the Six’s success, with the Philippines especially advantaged. The element of luck appears to be so strong that ‘the influence of schooling on growth is lower in the region than the world as a whole’ (Phung et al. 2015: 74).

The rapid increase in exports as a proportion of GDP in the subregion would be the envy of other parts of the world. Between 1985 and 2005, Lao PDR increased goods exports as a proportion of GDP from 2.3 to 20.2 per cent; for Malaysia from 41.8 per cent in 1965 to 99.7 per cent in 2005.

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<sup>11</sup> See Montes (2017) for the set of analyses that took the view that the 1997–98 crisis was principally due to governance failures and the evidence of the rapid ebbing of the crisis before the governance weaknesses were resolved (see also Section 4.2).

<sup>12</sup> See, for example, Krueger (1992), a piece which gained attention in transition economies when it was published.

<sup>13</sup> See, for example, Amsden (2008) or Wade (1990).

In the 1990s, Malaysia export volume was growing at 14.2 per cent, the Philippines at 15.1 per cent, and Thailand at 11.2 per cent.<sup>14</sup>

Even accepting the susceptibility of the numbers to commodity price cycles, at the end of the period in 2015, the trade outcomes among the Six fell into two groups: (1) the hyper-traders of Cambodia, Malaysia, and Thailand, whose goods exports-to-GDP ratios are near or exceed 50 per cent; and (2) the slower traders of Lao PDR, Myanmar, and the Philippines, with goods exports-to-GDP ratios at or below 20 per cent (Table 4).

Table 4: Exports of goods (as a proportion of GDP)

	1965	1975	1985	1995	2005	2015
Myanmar	–	–	–	–	31.5	18.3
Lao PDR	–	–	2.3	17.6	20.2	19.2
Philippines	12.1	15.4	15.0	23.6	40.0	20.1
Cambodia	12.1	–	–	24.8	49.1	47.3
Thailand	14.2	14.8	18.3	33.3	58.6	53.7
Malaysia	41.8	41.3	49.5	83.3	98.7	67.2
Low income	–	–	16.7	19.0	18.0	15.9
Middle income	9.2	12.9	14.7	18.0	28.1	20.6

Source: author, based on data from the World Bank's World Development Indicators.

Each of the Six began their transition to more outward-looking policies in the 1980s. In the fashion of the times, government authorities labelled these programmes as 'liberalization' or 'market-oriented' reforms. Except for the Philippines, it would be inaccurate to propose that the Six began practising openness in the mid-1980s through the path of import liberalization. The persistence in the 1980s and beyond of—costly and inefficient—industrial policies belies this view. Background studies for the World Bank's (1993) publication about Asia's 'miracle economies' do not suggest orthodox openness on the part of Malaysia and Thailand in the 1980s. In Nayyar's (2013: 118) telling, two countries 'were non-conformists without being liberalizers' whose economies performed well.

Starting in the 1980s, the Six followed varied transition paths out of import-substitution industrialization. The Socialist Three ended state monopolies in key areas such as external trading, undertook a controlled opening to foreign investment, and relaxed price controls, with Myanmar moving more slowly than the other two. Among the three market economies, Malaysia and Thailand retained industrial policies and refined these tools to apply them to export promotion. These two were the initial beneficiaries of the relocation of labour-intensive manufacturing from Japan. The salubrious outcomes for both investors and host countries of these projects established the international reputation of and the standards of foreign investor hosting of Southeast Asia.

As a sharp contrast, the Philippines, beginning in 1984, embarked on a classic liberalization programme; within 25 years, private investment rates were restored<sup>15</sup> to levels before the start of

<sup>14</sup> These growth rates declined to single digits in the 2000s, confirming an earlier warning that dependence on exports cannot be long sustained (Akyüz et al. 1999).

<sup>15</sup> As it happens, in 2018 the Philippines is on track to achieve a 'growth acceleration'<sup>15</sup> episode fuelled by consumption expenditures. A growth acceleration is a period of eight years in which annual per capita income growth exceeds 3.5 per cent. Hausmann et al. (2004) find the incidence of growth accelerations fairly frequent, with a 25 per cent

liberalization. Myanmar maintained the dominant position of state enterprises even after embarking on gradual liberalization in 1988; the reform process has accelerated in response to revived foreign investment interest after the 2016 transfer of parliamentary power to the opposition.

In Southeast Asia in the 1980s and to the present, the spectacular growth in exports has been strongly driven by foreign investment inflows. In the 1980s, the mode of operation of the incoming investors necessitated two-way trade with their home countries: parts and components were imported into the host country for assembly, then the assemblies were re-exported to the home country for incorporation into the final product. Low-cost, pliant labour was the main host-country input; the operation required no important industrial input from the host country. At a later stage, final assembly activities were relocated to host countries; final products could be shipped directly to the global consumer markets of multinational companies. In both stages, because Southeast Asian host countries imposed negligible performance requirements,<sup>16</sup> the foreign investor was under minimal obligation to source inputs domestically or to share technology with the host country.

The investment-driven trade expansion enabled the diversification of the host country's export structure; components for electronic and electrical goods were the key sector. Southeast Asian trade still relies more heavily on component production than East Asian trade. For example, in 1992–93, 32.9 per cent of the Philippines' manufacturing trade was parts and components, and by 2009–10 this had increased to 71.2 per cent; for Malaysia, corresponding numbers are 27.7 and 65.5 per cent; for Thailand, 14.1 and 44.5 per cent (Athukorala and Kopaiboon 2015: 147, table 7.3). These rising numbers reflect learning-by-doing, reputational advantages, and the impact of China's late entry into global production networks. China captured much of the final assembly activities that had begun migrating to Southeast Asia earlier, reinforcing Southeast Asia's specialization in component exports.

It is also appropriate to highlight the distinct experience of Thailand in the structure of its external trade and domestic production. Thai manufacturing export trade is less concentrated in electrical and electronic products than the other five due to the greater trade contribution of automobile components. The relocation of production activities by US and Japanese automobile firms to Thailand (which accelerated after the Asian financial crisis) was a response to Thai industrial plans and the country's geographical advantage as a future hub for this sector in a growing region (Orihashi 2010).

Cambodia, Myanmar, and Lao PDR are the 'late-traders' among the Six. Like Bangladesh, Cambodia seized the opportunity of the termination in 1985 of the World Trade Organization's Agreement on Textiles and Trade (the 'ATC', more popularly known as the 'multi-fiber agreement') to build a garment exports industry, collaborating with the international network of clothing jobbers. In the closing years of the ATC, Cambodia and the United States signed a bilateral

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unconditional probability that a country will experience one in a decade. Moreover, 'growth accelerations tend to be highly unpredictable: the vast majority of growth accelerations are unrelated to standard determinants such as political change and economic reform, and most instances of economic reform do not produce growth accelerations' (Hausmann et al. 2004: 3). That the elevated sequence of growth rates since 2010 has not led to a balance of payments crisis can be attributed to: (1) abundant international liquidity from the crisis response measures of developed countries to the Great Recession starting in 2009; and (2) strengthened public finances from Philippine tax reforms and prudent public spending levels.

<sup>16</sup> This is not surprising because in the 1980s the great majority of foreign investments landed in export-processing zones.

textile agreement which utilized an International Labour Organization certification that its exports were not produced under sweatshop conditions, otherwise they could not be exported within the quota. However, while this was extended for three years after the quota expired, the enforceability of the labour protection effectively ended after the ATC.

Natural gas represents the most dynamic element of the export sectors in Myanmar and Lao PDR. These exports do not absorb much labour, being capital-intensive and highly dependent on foreign investment, but provide foreign exchange. Lao PDR has been leasing agricultural land to foreign enterprises for export crops while supporting the emergence of organic agriculture for export among local farmers and cooperatives. Myanmar has stimulated much foreign investment interest in expanding mining projects beyond those that have been entering since 1988. Myanmar's potential for entering the international rice market has received attention, but it is not yet an important player.

## **4.2 Policies towards foreign investment**

There are possibly two ways to interpret the origin of Southeast Asia's reputation as a platform for foreign investor activities. A widespread view is that 'market-friendly'<sup>17</sup> government policies by host countries led to the region's attractiveness to foreign investment and its success in globalization. The alternative view<sup>18</sup> is that external events and decisions had greater impacts than domestic policy in explaining the large-scale inflows into the region.

In the mid-1980s, domestic policy on the part of Southeast Asian states cannot be considered the main driver of the enormous inflow of foreign direct investment (FDI). The unexpected advantage from FDI initially flowed from Japanese companies seeking low-cost labour following the abrupt<sup>19</sup> realignment of the world's major currencies in the mid-1980s from the Plaza–Louvre agreements. In that decade, because of perceived instability on the part of investors, these flows did not land in Hong Kong,<sup>20</sup> the least regulated economy in the region, nor in the Philippines, with an internationally sophisticated work and management force. FDI landed in economies populated by highly protected domestic enterprises—both state-controlled and private. Success in exploiting FDI, instead, depended on state policies to provide these investments with a reliable location to profitably operate production activities for export. Nayyar (1978: 77) found that, in location decisions of such activities for export, political stability and labour docility are the most critical factors.

From the side of the incoming investment, the choice to fragment production was driven by Japan's own imperatives to protect its growing ascendancy in global markets in automobiles and electronics by moving labour-intensive tasks offshore in the face of an abrupt exchange rate adjustment. This, however, resulted in a rapidly diversifying<sup>21</sup> export mix in the subregion. Malaysia

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<sup>17</sup> There is no standard definition of 'market-friendly' policies, of course. The usage of the phrase here is as a shorthand for economic liberalization and deregulation. See, for example, World Bank (2002).

<sup>18</sup> See, for example, Jomo (2003b).

<sup>19</sup> The currency realignment included the German Deutschmark. The adjustments required in the Plaza–Louvre agreements owed as much to German success, which received less public attention.

<sup>20</sup> Athukorala and Kohpaiboon (2015: 141) point to China's Cultural Revolution occurring at that time. Apropos, almost a decade earlier, Nayyar (1978: 68) quotes as typical a statement from a multinational executive that 'We wanted a site where we could have the US Navy between us and Mainland China.'

<sup>21</sup> See Athukorala and Kohpaiboon (2015) for documentation of the extent of diversification of the Southeast Asian export product mix.

and Thailand were the initial beneficiaries, propelled first by the relocation of labour-intensive production from Japan, and subsequently from Hong Kong, Taiwan, and South Korea. The Philippines, with a diversified economy and a developed business sector, could have ‘gotten lucky’ but was caught up in political and policy instability (de Dios 2011) occasioned by the fall of the Marcos dictatorship in 1986 and the uncertainties accompanying its trade liberalization programme.

The key element of the domestic ‘hosting’ strategy was the expansion of special economic zones for foreign investors, a tool from the 1960s intended originally to facilitate non-traditional exports while preserving the industrial protection of domestic enterprises. Standard economic analysis deemed this strategy costly in terms of domestic resource costs.<sup>22</sup> Whether in special zones or not, a contrary view is that countries do not need a liberalized economy to productively host FDI, but instead require a certain level of political and policy stability, provide affordable utilities and infrastructure, and flexibly assist multinational enterprises (MNEs) in reducing variable costs, especially in the sourcing of inputs, including through lower tariffs, duty-free importation, and tax deductions for various categories of costs (Montes 1997a: 178). State engagement in these zones also provides orderly access, avoiding price gouging by locals for example, of foreign relocators of production to land and utilities.

Malaysia’s Penang export zone was the early demonstration of this strategy. In 1972–75, eight multinationals mostly in electronics, including Advanced Micro Devices, Hewlett Packard, Intel, and National Semiconductors, installed assembly plants on the island.

In non-special zones, Malaysia and Thailand eventually removed restrictions on 100 per cent-owned foreign ownership, but with sectoral- and market-restricted conditions. In Felker’s (2001: 130) view, ‘liberalization in Malaysia and Thailand comprised more a reformulation of the state’s role in regulating growth than a decisive retreat in the face of globalization and rising domestic business power’. By 1992–93, net FDI into Malaysia as a proportion of the gross fixed capital formation reached 7.3 per cent (Rasiah 2001: 95). Over three decades, double-digit growth of the assembly low-value-added components among the clusters of foreign electronics manufacturers was consistent with the Malaysian political objective of establishing a counterweight to the Chinese dominance in the business sector under the Bumiputera national programme (Jomo 2003b: 8).

In Thailand, since the 1959 inception of import-substitution, domestic sectoral groups operating in large conglomerates had been capitalizing on a triad of (1) government promotional/protectionist provisions; (2) financing from large indigenously owned commercial banks operated meticulously along commercial lines, meaning no politically directed lending; and (3) technology sourced from foreign, mainly Japanese, companies (see Rock 2001: 268–270). Among the key sectors were agro-processing and textiles, later in capital goods sectors. Access to foreign technology and, after the yen revaluation, the entry of foreign investment, basically followed the private channels established during import-substitution.

The transitions to outward orientation in Lao PDR and Cambodia began about a decade later in the 1990s and in Myanmar in 2016, after the lifting of the trade embargo by advanced economies.

In the international garment industry, the supply-side aspects of foreign investment-driven trade remains a powerful force among the second-tier Southeast Asian countries, benefiting Cambodia

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<sup>22</sup> In a widely circulated empirical study for the World Bank, Warr (1989: 85) found the domestic resource cost of such zones high enough to ‘impede the development of efficient domestic industries’ and argued that export zones should not be called ‘engines of development’.

and Myanmar. In an arrangement originally necessitated by the quota dispersion for developed country markets during the era of the ATC, the international garments trade became dependent on subcontractors organized by the main supplier companies, originally based around textile companies in Hong Kong, Taiwan, and more recently China. The main supplier companies in turn serviced the brand name global clothiers. This network remains profitable to this day for the main supplier companies in global garments production by affording lower labour costs and flexible production. The rise of garment subcontracting companies facilitated rapid employment absorption of rural labour. In Cambodia, 91 per cent of industrial establishments in 2011 were micro-firms employing fewer than five workers (Chhair and Ung 2016), mainly in the garment business. In Myanmar, the garment sector grew rapidly even in the midst of the international embargo in the 2000s (Myint et al. 2015).

While the garment sector is only one of the trade-investment areas (though a dynamic one) among the three LDCs, its dependence on relational contracting and network enforcement between indigenous and foreign parties in Southeast Asia appears to also apply in other sectors, such as rice trading, timber exports, and construction. It is true that price is an unavoidably basic variable in international trade; for example, Myanmar's deficiencies in sustaining commercially sensible exchange rates and domestic rice procurement prices have oft-mentioned explanations for its relatively poor long-term performance.<sup>23</sup> However, having the 'right prices' by itself does not secure foreign trade expansion. The pervasive role of these international informal trade networks suggests that liberalization and deregulation do not guarantee strong trade growth. In fact, Myanmar's own experience during the embargo in building some export sectors while subject to trade restrictions suggests that liberalization itself is not a necessary strategy for export success. States in developing countries with trading ambitions will have to consider a more expansive role for themselves beyond getting prices right, including assisting local firms to engage with international supply networks.

### **4.3 Balance-of-payments financing and the Asian financial crisis of 1997–98**

Following the normal pattern, elevated current account deficits and cumulating external indebtedness accompanied high national economic growth rates among the Six. Fragile balance-of-payments conditions<sup>24</sup> and periodic commodity price slumps, including almost simultaneous payments crisis episodes in the 1980s, are part of the Six's growth record. Table 5 shows the patterns in accumulated current account deficits in five of the economies through the period leading up to the Asian financial crisis of 1997. These ten-year deficits are not higher than an annual rate of 3 per cent of GDP, but leave the economies vulnerable to commodity slumps. After the 1997 Asian financial crisis, the middle-income countries' current accounts have switched to surpluses.

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<sup>23</sup> See, for example, Mieno and Kubo (2016).

<sup>24</sup> Writing before the Asian financial crisis, Corden (1996) found macroeconomic management in Southeast Asia interventionist but with abrupt adjustments and felt compelled to characterize the approach as 'pragmatic orthodoxy'. For the example of the fiscal bases of the Lao PDR current account deficit, see Memiş et al. (2006).



Table 5: Cumulative 10-year current account balances (percentage of GDP)

	1975	1985	1995	2005	2015
Cambodia			(5.1)	(4.3)	(8.0)
Lao PDR		(5.7)	(8.2)	(4.8)	(5.1)
Myanmar				(0.7)	(0.3)
Malaysia	(2.0)	(4.3)	(3.6)	8.2	9.0
Philippines		(5.1)	(2.9)	(1.2)	3.41
Thailand	(0.7)	(5.4)	(5.5)	1.9	3.0

Note: figures in parentheses are deficits, other figures are surpluses.

Source: author, based on the World Bank's World Development Indicators.

In good times, natural resource exports have moderated pressures for export performance. The Philippines has had a sugar quota for the US market since 1946. Lao PDR relies heavily on the natural resources export sector as a source of growth; this sector is capital-intensive, relying on only 22,000 workers to produce 18 per cent of GDP (World Bank 2014: 11), and exerts pressure towards currency appreciation while bidding up urban wages. In Myanmar, in 2010–13, over 30 per cent and over 40 per cent of approved foreign investment were in the power sector and oil and gas sector, respectively; this was before the end of the embargo in 2016. Cambodia can afford its recent ban on the export of raw logs.

In Thailand, '[S]ustained paddy exports provided funds for industrial development' (Baron-Gutty 2010: 239). The commodity price slumps in the 1980s compelled short periods of exchange rate and fiscal adjustment and gradual moves towards outward policy orientation. Thailand's *gradual* outward reorientation avoided widespread production dislocations (and possible bankruptcies) on the part of protected sectors, unlike those experienced by debt-distressed countries under structural adjustment programmes in the same decade.

These harrowing episodes paled in comparison with the Asian financial crisis of 1997–98. Unlike previous crises whose locus was the current account, the 1997–98 crisis came from sudden reversal of flows in the capital account. Current account deficits do not just signify poor net export capabilities but also a marvellous attractiveness to foreign investors and creditors. In the 1990s, Malaysia, the Philippines, and Thailand<sup>25</sup> succumbed to the siren call of capital account deregulation starting in the late 1980s as part of their outward reorientation programme.<sup>26</sup> The unprecedented portfolio inflows and currency strengthening induced by the opening compelled authorities to intervene against currency appreciation to defend their built-up export competitiveness, a policy that further fed short-term capital inflows (Montes 1997b). The domestic impact was a financial sector laden with long-maturity receivables in property development funded by volatile, short-term, hard currency liabilities; thus, the seeding of a financial crisis with foreign characteristics.

The sudden stop and reversal of flows sparked by the Thai baht devaluation on 2 July 1997 triggered the deepest and most widely shared economic crisis among the Six. The flight of portfolio

<sup>25</sup> The Philippines had also undertaken the same reforms but was not as attractive as a portfolio destination as Thailand and Malaysia (Montes 1997b) and did not accumulate external liabilities to the same extent.

<sup>26</sup> Even as the IMF staff was constrained by its Articles of Agreement from advocating capital account liberalization, the World Bank had a unit to assist Asian countries to expand their access to international portfolio flows. Claessens and Glaeser (1998) and Caprio and Honohan (2001) are some of the publications of the staff of this unit.

funds out of the region only ended in the last quarter of 1998 in conjunction with a series of financial crises in Russia, Brazil, a New York stock market selloff, and the bankruptcy of the large US hedge fund Long Term Capital Management (Montes 2017: 131). These events signalled to portfolio investors that the subregion was not such a bad bet, within a choice set rife with bad portfolio bets.

Rapid economic recovery in Thailand ensued in 1999, after a fall in output of 10.2 per cent through 1997 and 1998. Malaysia, which had responded to the crisis with effectual capital account controls,<sup>27</sup> lost 0.6 per cent in the same period. While much blame for the crisis must be apportioned to the stampede of portfolio investors into the region between 1994 and 1997, the crisis damaged the international reputation of Malaysia and the region as a whole.

## **5 Employment, inequality, and social development**

In chapter 9 of AD, Myrdal highlighted the deep economic and ethnic divides in business and political participation specific to each country and their roles in national politics and social stability. What role did economic growth and structural transformation play in bridging the social divides inherited from the colonial era in the Six? How did economic growth and structural change affect poverty, inequality, and social development?

One early view, from the World Bank (1993), is that Malaysia and Thailand<sup>28</sup> married strong growth with equity. The competing view is that growth was not accompanied by improved equity—in terms of income distribution, access to social services, and political participation. The record of successful economies among the Six is a mix of spectacular reductions in poverty incidence during periods of rapid employment growth and little progress, if not a worsening, in equity.

This mix can be attributed to three trends: (1) income gains by the richest strata outstripping income gains obtained by workers moving from rural sectors to industrial activities; (2) state investment in social development, including in education, being inadequate to increase the access of the general population to skills premia introduced by structural change and international integration; and (3) the indifference, if not hostility, of the development model to more widespread political participation and the strengthening of citizens' rights and labour protections.

These three trends are incorporated in the discussion, grouped into the following three topics: (1) employment absorption and poverty reduction; (2) social and political inequity; and (3) state investments in social development.

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<sup>27</sup> See Khor (2005) for a description of these capital controls and their impacts.

<sup>28</sup> Indonesia was also characterized this way. The World Bank study did not consider the other four.

## 5.1 Poverty reduction as redeployment of the rural labour force to industry

Southeast Asia has an exceptional record in employment absorption and employment redeployment<sup>29</sup> out of agriculture.<sup>30</sup> As elsewhere, informality and precarious conditions of work accompanied the farm-to-city movement, but during periods of high-growth employment absorption rates mitigated social pressures. Much of the redeployed labour was absorbed in enterprises whose markets were overseas.

At the national level the poverty impact of the labour redeployment has been spectacular in specific periods among the Six. In Malaysia, the incidence of rural poverty fell from 27.3 per cent in 1985 to 18.6 per cent by 1993 (Government of Malaysia 1996). The performance of Cambodia, Lao PDR, and Myanmar as they moved rural labour into labour-intensive manufacturing for export follow the Malaysian pattern, as reflected in Table 6.

In terms of poverty reduction, Thailand's performance—reflecting the greater progress achieved in the rural sector—outshines that of the Philippines, with poverty incidence that is little over half that of the Philippines' 21 per cent, a level in the same vicinity as that of Cambodia, Lao PDR, and Myanmar (Table 6). Malaysia's poverty incidence was around 5 per cent in 2005 and has shrunk to practically zero by 2015.

Table 6: Poverty incidence (percentage of population, national estimates)

	1975	1980	1985	1990	1995	2000	2005	2010	2015
Cambodia							46.7	22.1	
Lao PDR					42.6	35.7	30.2	26.0	
Myanmar							48.2	42.4	32.1
Malaysia		34.1	20.3	15.1	8.7	6.7	5.0	3.1	0.5
Philippines			44.2	40.0	34.3	33.7	26.0	25.9	21.6
Thailand	48.6	37.7	43.0	27.2	13.9	14.2	9.4	7.8	9.6

Source: author, based on data from the World Bank's World Development Indicators, the Asian Development Bank, Warr (2004), and country sources.

As it absorbed foreign investment after the yen revaluation, Malaysia's proportion of employment<sup>31</sup> in agriculture fell from 30.4 per cent in 1985 to 20.0 per cent by 1995, matching an increase in the proportion of employment in industry from 23.8 to 32.3 per cent in the same period. The proportion of Thai employment in agriculture fell from 66.6 per cent in 1980 to 52.0 per cent in 1995, in step with an increase in industry's proportion from 12.1 to 20.0 per cent by 1995.

The Malaysia and Thai precedent became a model for mobilizing unskilled workers, particularly young female workers, from rural areas into industry. Cambodia built its export garment sector more than a decade later using this model. At present, garment workers, recruited principally through personal networks, constitute 80 per cent of the industrial labour force. Remittances to

<sup>29</sup> Warr (2015) sounds a discordant note in finding poverty reduction to be strongly related to the growth of agriculture and services, but *not* to the growth of industry. If due to increased productivity, agricultural output growth is not necessarily inconsistent with a strong movement of labour out of rural areas.

<sup>30</sup> Except for the Philippines, where the direction of structural redeployment from both urban and rural areas was overseas.

<sup>31</sup> All data cited in this paragraph are from the World Bank database.

rural areas amplified the poverty impact of the new labour opportunities. ‘Based on examples from small sample surveys of garment workers, more than 90 per cent send remittances home, with the average annual amount ranging from US\$246 in 2007, amounting to 29 per cent of salaries earned, to US\$508 in 2009, amounting to 40 per cent of salaries earned’ (Chhair and Ung 2016: 228).

The most prominent and dynamic element in the redeployment process involved women’s work in light manufacturing (formal and informal, including contract work performed at home). Table 7 indicates the pattern, mirroring the FDI-driven export trends in the previous section. For Malaysia,<sup>32</sup> the Philippines, and Thailand, female labour force participation rates peaked around 1990 with the influx of foreign investment. Studies in the garment and textiles sectors have pointed out that as firms expanded their operations and increased mechanization, female workers were being let go in favour of male operators.

Table 7: Ratio of female to male labour force participation rate (percentage, national estimates)

	1970	1975	1980	1985	1990	1995	2000	2005	2010	2015
Cambodia						98.7	94.3	89.4	93.5	
Lao PDR						97.2	99.0	99.3	96.0	
Myanmar				49.5	41.5	46.1	50.6	55.2	59.8	64.3
Malaysia			49.4	53.6	56.0	53.0	58.2	57.4	60.5	67.1
Philippines	43.6	51.9	30.2	59.7	58.1	59.7	60.2	62.3	64.0	64.8
Thailand	83.6	62.8	87.2	87.1	87.0	79.4	80.5	81.3	79.6	78.4

Source: author, based on the World Bank’s World Development Indicators.

Into the 1990s, the mobilization of women’s labour into export industries gave foreign companies access to Lewis’ (1954) fabled unlimited supply of unskilled labour, initially in Malaysia and Thailand, then in the other four. Women gained employment in subcontracting companies producing for multinational corporations and in related informal work. Women’s employment was ‘characterized by long hours, job insecurity and unhealthy working conditions, as well as low pay. However, women’s wages and working conditions in export-oriented production, particularly in multinationals or their subcontractors can be better than the alternatives ... and these jobs may even be coveted by women ... indicating just how harsh conditions are for them in alternative forms of work in general’ (Çağatay and Ertürk 2004: 20).

Feminist research from the late 1990s indicated that—instead of competitive pressures driving a decline of discrimination against women and minorities as predicted in mainstream economics—the low cost of non-unionized, and therefore docile, women’s labour often played the same role as an undervalued exchange rate in preserving international competitiveness in East Asia.<sup>33</sup>

## 5.2 Social and political (in)equity

The lagging progress in social and political equity in the Six can be traced to the economic model and the efforts of post-colonial elites in these countries in keeping their political dominance. This section will begin by presenting the basic data on economic inequality, then discuss the role of the economic model followed by a discussion of the mechanisms of elite dominance.

<sup>32</sup> Though in the case of Malaysia, the female participation rate appears to begin to recover starting in 2010.

<sup>33</sup> See, for example, Berik et al. (2004).

The performance of the three market-oriented economies of Malaysia, the Philippines, and Thailand is quite weak in terms of improving social and political equity. You (1999) found that at most, Thailand and Malaysia were near the median of performance among high-growth countries. Based on World Bank estimates, Thailand's Gini index was 37.8, not much different from the Philippines' 40.1 in 2014–15. Malaysia's Gini in 2009 was 46.3.

Chongvilaivan (2014) suggests that rising inequality in Southeast Asia has been driven primarily by the extent to which incomes of the rich have outstripped income growth of the poor despite significant reductions in the poverty headcount ratio. These are reflected in the relatively stagnant trends at high levels of inequality in the Gini coefficient. While Malaysia's Gini did exhibit a slight decline in 1997–2004 (after the Asian financial crisis), it had been increasing from the late 1980s and began rising again after 2004. For the Philippines, inequality increased from 1985 to 1997, and has been declining gently since then with the rise of overseas workers' incomes. Thailand's inequality measured by the Gini declined in the 1990s but has increased slightly since the Asian crisis. In Lao PDR, after a modest decline in inequality between 1997 and 2002, it has been increasing since 2002. Cambodia's Gini increased in 1994–97, and declined slightly after 1997.

These patterns are consistent with an economic model in which the key driver is the movement of rural labour to low-skill, export-oriented jobs. Low labour costs were the original source of attraction for the relocation of production facilities to the subregion, 'militating against rapid wage growth in these countries' (Jomo 2003b: 203). Jomo reports that 1970–80 period real wages in Malaysia grew by 2 per cent per year and by 2.3 per cent in the 1980–92 period; in Thailand real wages grew by 2 per cent per year in 1973–81 and by 2.8 per cent per year in 1981–89. Governments were not sympathetic to labour unions and labour militancy, and particularly suppressed these, sometimes brutally, in Malaysia and Thailand.

In the 1970s and early 1980s, the Philippine martial law regime under Ferdinand Marcos also found it agreeable to repress labour unions which, in the context of the loss of legal protections, were increasingly associated with the communist party-led underground resistance. In the economic crisis that began in 1984, these organizations provided the main forces of the uprising against the regime in urban areas, requiring the country's elite to make a temporary accommodation until they could wrest back political control from the Marcos faction.

Myrdal (1968) presented the notion that social conflict and governance failings have an enormous influence on development policy and prospects. He noted, for example, that the royal family and aristocracy in Lao could be found both in the communist-inspired and in the Western-oriented political movements. In Myanmar, the ruling elite, many in the ranks of the army, shared a socialist ideology opposed by the more conservative 'hill peoples' of ethnic minorities; the recent capture of parliamentary power by the movement associated with Aung Sang Suu Kyi brings into the open these conflicts over state advantages.

In Malaysia, intra-elite conflicts have not expanded popular political participation within the state and across the society (Juego 2015; Weiss 2006); conflicts over corruption and government inefficiency have been debated among the elite. In May 2018, elections ended a 60-year control of the government by the Barisan National party, a coalition that included a party representing ethnic Chinese. The arenas of elite competition differ among the Six. Single-party control in Cambodia, Lao PDR, Malaysia, and Myanmar over long periods have kept intra-elite competition out of the public eye. The Philippines is distinguished in relying on periodic elections, enabling sweeping shifts in power over economic policy within the elite. In Thailand, periods of military control restrained intra-elite conflict; in the 2000s, a rural-based movement led by Prime Minister Thaksin Shinawatra threatened to broaden political participation.

While there are specific features of political competition among the Six, intra-elite competition restrained the space for genuinely equity-oriented government programmes. Popular demands for greater equity have become overpowering during periods of economic stress or slow economic growth, and could do so again in the future.

### 5.3 Shortfalls in state investments in the social sectors

Among the Six, a profile of exceptional growth and structural change is not matched by a strong record of investments in the social sector and social protection. The mobilization of rural workers, especially women, into the industrial labour force had a strong impact on poverty reduction in its heyday; but this was not accompanied by a ratcheting up in capabilities<sup>34</sup> in the labour force because of shortfalls in the expansion of education, health, and other social programmes. In this section, we shall review the extent of these programmes and illustrate how these now represent a binding constraint for development, even for successful countries among the Six.

Social programmes and protections in the Six cannot be considered generous. Many of the customary programmes are still to be introduced<sup>35</sup> or with coverage only for urban populations or the employed, and their long-term sustainability is weak (Chongvilaivan 2014). While there are variations among the Six on the coverage and scale of the different social programmes, these are not distinctly more encompassing than in other developing countries. These have also not been essential elements of their developmental strategies, even as the introduction of the United Nations' Millennium Development Goals in 2000 have compelled national authorities to compile statistics on progress towards these 'development' goals in response to donor funding.

Table 8: Existence of national statutory programmes and health financing

	Cambodia	Lao PDR	Myanmar	Malaysia	Philippines	Thailand
Medical care	∞	✓	✓	Ω	✓	✓
Sickness	None	✓	✓	Σ	✓	✓
Maternity	Σ	✓	✓	Σ	✓	✓
Old age	∞	✓	∞	✓	✓	✓
Work injury	✓	✓	✓	✓	✓	✓
Invalidity	∞	✓	∞	✓	✓	✓
Survivors	∞	✓	∞	✓	✓	✓
Family allowances	None	None	∞	None	None	✓
Unemployment	Σ	∞	∞	Σ	Σ	✓
Total health expenditures						
Total (percentage of GDP)	5.4	2.9	1.8	4.0	4.6	3.9
Out-of-pocket (percentage of total health expenditures)	61.8	38.2	71.3	34.9	52.0	13.1

None: no statutory programme anchored in national legislation; ✓ at least one programme anchored in national legislation; Ω medical benefit in kind without statutory programme anchored in national legislation; Σ limited liability via employers' liability under the national labour code (includes company sick leave and severance payments); ∞ programme has yet to be implemented

<sup>34</sup> Sen (2000) posed a rather comprehensive formulation of human capabilities. Here the discussion will be confined to the utilitarian dimensions of capabilities, which Sen considered inadequate.

<sup>35</sup> For example, during the Asian crisis one reason why the Indonesian structural adjustment program in 1998 was unduly tight in macroeconomic terms was the lack of unemployment programs in place that could serve as automatic macroeconomic stabilizers (Montes 2017).

Source: author, based on table A and table 1 in ILO (2015).

The top part of Table 8 provides a survey of the existence of social supports in the Six in statutory form at the national level. Thailand, followed by the Philippines, appears to have made the most progress in terms of the existence of national statutory social provisions. Lao PDR leads the three LDCs in introducing statutory protections. As in other developing countries, the existence of statutory national protections among the Six can fall far short of the extent of actual funding or its transfer component, the quality of provision, and equality of access by gender, social class, and urban/rural location (ILO 2015; Mundle 2018). For development purposes, the most critical investments are in health and education.

### *Health*

There is progress in health provision among the Six, but increasing coverage and keeping out-of-pocket costs low is difficult among the three LDCs because of the undeveloped health infrastructure. Malaysia and Thailand have achieved universal coverage for essential health problems, while the Philippines had just crossed 80 per cent coverage in 2015 (ILO 2015). Health coverage in Cambodia and Lao PDR are in the range of 25 per cent of the population. Various strategies have been tried to increase coverage. The most notable and successful is that of Thailand, in the 2000s, which introduced subsidies for the self-employed to obtain health coverage, but service utilization by the poor remains low.

Out-of-pocket expenditures as a proportion of total health expenditures tend to be high among the LDCs (Table 8), with 71.3 for Myanmar, 61.8 per cent for Cambodia, and 38.2 per cent for Lao PDR. However, in the Philippines, with a relatively well-developed health system and a large component of private provision, out-of-pocket costs constitute 52 per cent of total expenditures.

### *Education*

Inadequate investment in education has implications for the long-term sustainability of the export-oriented model. The Philippines had the strongest post-colonial inheritance in education but insufficient public investment has seen the other five catch up to it in terms of years-of-schooling indicators.

At present, Malaysia and Thailand are investing only a little less than Viet Nam in education as a percentage of GDP, but they are playing catch-up, and are facing labour skill shortages critical to extending their export and manufacturing advantages. In 1996, Thailand's secondary enrolment ratio was low for its level of income; both Malaysia and Thailand had lower secondary enrolment rates than South Korea in 1980, though per capita GDP was higher (Booth 2003b: 175). In the earlier period, Malaysia probably overinvested in educating its nationals abroad (Jomo 2003a); moreover, these investments have been unrelated to its need to sustain its industrial achievements, which would be skills in engineering and technology.

The quality of education in the region is low and expansion of access is often at the cost of quality (Phan and Coxhead 2015). Inequality in access to education among the Six does not show a decreasing trend, staying at stagnant levels in most countries experiencing rapid economic growth.

In Thailand, school completion rates are not distinguished. Skill shortages have become quite noticeable. Buoyed by investment by leading global automobile producers, Thailand's automobile sector became a major engine of growth of Thai industrial development since the Asian crisis. The sector is now hampered by the fact that '[T]echnological universities in Thailand do not educate and train enough engineers to help Thailand cover needs to expand its higher quality automobile

production and other high-tech industries' (Orihashi 2010: 228). Leading companies have to contend with 'job-hopping' among technical workers even as the average wage for a labour force, consisting mainly of shop floor workers of which a surplus still exists in the labour market, especially in northern Thailand, remains lower than that in China. Thailand must also contend with a shortage of supporting industries, inadequate organizational capacity, and poor capabilities of small- and medium-scale enterprises.

As mentioned in Section 2, the extractive industries represent a high proportion of GDP in Cambodia, Lao PDR, and Myanmar. With low levels of education and social services, extractive industry earnings could be the source of investment for human development among these three countries, but very few developing countries, including the other three members of the Six, which in earlier decades had important mining sectors, have managed this potential well.

## **6 Southeast Asian development narratives**

Why is the development record in the Six stronger than most other developing countries? What did Myrdal miss in 1968? One could group the errors in Myrdal's (1968) otherwise deeply grounded and wide-ranging social analysis into three types: (1) unexpected events that would have been difficult to predict; (2) mistaken inferences drawn from observations at the time; and (3) blind spots arising from the underlying analytical framework.

The most important unexpected event would be Japan's seizure of the United States' private sector's global dominance in key manufacturing areas such as automobiles, which triggered a drastic fall in the value of the dollar. The resulting yen revaluation required many industries in Japan to seek to relocate their labour-intensive activities to Thailand and Malaysia and initiated a trend that facilitated the shift to export-orientation among the Six.

Another unforeseen event would be the experimentation and institutional reforms by Southeast Asian states in the agricultural sector, including a retreat from the socialist experiment of collectivized farming, and the significant allocation of state investments in agriculture. The dissemination of HYV rice also played a strong role in boosting national agricultural productivity, though the technology favoured large landholders. State successes through institutional reforms and investment which mitigated existing inequalities in rural areas affected agricultural performance via their impact on unleashing private incentives.

In the case of the mistaken inferences from observation, an important example could be made about the undervaluing of a possible positive role of the elite in development processes, perhaps from an undue emphasis on obstacles from corruption and poor governance. Against social democratic benchmarks, Myrdal (1968) pinpointed cultural impediments and the dominance of an unprogressive elite as villains in the Asian drama. Among the Six, it is true the exertions of post-colonial elites to protect their supremacy have shaped economic policies and reforms. This has meant that except for Malaysia, with its explicit programme to raise the social position of Malays, and the Philippines with its efforts at radical economic liberalization, changes have been gradual, in order not to jeopardize elite economic interests.

Gradual reform could have fallen afoul of Myrdal's warning that such a pace of change could be self-defeating. In Malaysia, ethnic conflict set the stage for the rise of a Malaysian state strong enough to embark on a coherent and self-driven industrial policy. Myrdal (1968) identified the Philippines as having the singular advantage over other Asian countries of an indigenous entrepreneurial class and civil service. These advantages were rendered moot in intense domestic



political contests and the radical economic reform from the mid-1980s, itself an occasion for political instability, which took a quarter of a century to elicit positive results.

In terms of blind spots arising from Myrdal's (1968) underlying social democratic framework, it cannot be denied that the rent-driven industrial policies were occasions for corruption and extended inefficiency. However, there were sufficient opportunities for socially productive private wealth creation in the interface between state intervention and the external economy during and after import-substitution. In Thailand, a privileged domestic capitalist class kept private investment rates high, dominated the design of state interventionist policies, and managed the engagement with international sources of capital and technology. With single-party systems and working within the handicap of a small indigenous private sector, the elite classes in Cambodia, Myanmar, and Lao PDR steered state efforts to build domestic enterprises and engage international businesses to support these efforts.

Contrary to Myrdal's expectations, elites in the region, even those without a socialist mindset, have been relatively successful in nation-building efforts, including through evolving, though socially costly, industrial development interventions.

Especially within ethnic networks, capitalist motivations appear to have been sufficiently strong to mobilize adequate reinvestments of the state-provided rent surpluses without the need for heavy state supervision to substitute for market discipline. In the Six, the pursuit of development and export success relied heavily on existing technology and foreign investment, thus making the government burden lighter; the difference is that most governments dared to sustain sectoral industrial policy.

The ability of the societies in the Six to productively and profitably participate in international production networks was facilitated by the practices of relational contracting, reminiscent of the mercantilist period, which Myrdal considered unsuitable. This kind of contracting has facilitated commercial engagement with informal global business networks,<sup>36</sup> such as those introduced during the WTO's ATC regime. This structure proved advantageous to Cambodia and Myanmar in recent decades.

Shortfalls in social development and technological upgrading are the consequences of the chosen, elite-protecting, development path. These shortfalls, in line with Myrdal's earlier insights, could impose a ceiling on an otherwise relatively successful development record.

A second blind spot from an underlying social democratic framework could be undervaluing in the Six of the commercial and innovative drives of the small farmers, who responded well to economic incentives and to access to higher-yielding farm technologies. Myrdal in 1968 was aware of the initial successes in seed research, the first of which, IR-8, had been introduced in 1966. In rural Cambodia, Lao PDR, and Myanmar, the soft state could not fully implement collectivization; this led to a retreat from collectivization and other measures to boost food production. In these countries, the spread of modern farming techniques, with state assistance, was rapid, even though the process could have worsened the existing economic and political imbalances against small farmers.

Myrdal's analytical framework did not imagine the resilience and adaptability of the rentier economy in poor countries operating within a global capitalist economy. A lot of international

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<sup>36</sup> The argument is that the effectiveness of these networks was independent of liberalized trade regimes.

trade and investment does not take place in an ‘arm’s length’ manner, but relies heavily on international business networks and their engagement with local businessmen.

Myrdal also did not foresee how workers’ overseas remittances and business process outsourcing could extend the life of a rentier economy in the Philippines, even though he predicted in 1968 either a thoroughgoing democratization based on agrarian reform or a communist regime in the Philippines (Myrdal 1968: 390). Myrdal expressed scepticism of the diffuse form of socialism in Myanmar (then Burma); in actual operation this regime, which relied heavily on state-owned enterprises, survived economic isolation with an extended operation of a command-and-control system but lagged in growth and industrial development.

In the other four, the record suggests that domestic rentiers can engage in capital accumulation while interacting with global capitalist processes. This raises larger issues. The Six’s experience suggests that a globally friendly post-colonial elite could play a positive role in coherently taking advantage of opportunities in the global economy to raise economic growth rates. But it is not a guarantee of long-term development, especially because sustaining growth will require upgraded domestic technological capabilities, which in turn requires building internationally capable indigenous enterprises and workers.

To an extent not foreseen by Myrdal, the development achievements of the Six have been predicated on a benign influence of the external economy—both in short-term events and long-term evolution.

In the short term, the three LDCs’ dependence on commodity exports signals continuing vulnerability to global economic cycles; with state facilitation, these economies have been increasing their participation in global production networks whose economic cycles have smaller amplitude. In the case of the three middle-income countries, the short-term external vulnerability derives from their open capital accounts in a world of highly volatile private capital flows. The abortive attempt by the Thai Central Bank beginning in 2006 to impose a levy on capital inflows and the short, but sharp, payments crisis occasioned by the ‘taper tantrum’ episode in April–May 2013 sparked by the announcement of the reduction of liquidity provision by the US Federal Reserve illustrates these vulnerabilities. The economically costly maintenance of high levels of international reserves might not prove to be adequate in the event of a systemic global crisis. The Six have to manage these vulnerabilities themselves because the prospects are poor regarding concerted private capital re-regulation or global institutional reforms to constrain global economic cycles, commodity price cycles, and private capital flow volatility.

In the long term, the first binding constraint comes from climate change. With large cities and farmland situated near coasts and river basins, weather inundation is an economically costly threat. Infrastructure development would be an appropriate response, and this would require upfront financing on a scale that is not in place.

As discussed in Section 5, the inadequate level of social development and provisioning constitutes the most binding internal constraint in the context of the Six’s reliance on international trade. Capturing greater value-added from participation in international value chains requires an increasingly capable labour force and private sector. Moreover, signs that the high growth in fragmented international production is receding or of reshoring of production facilitated by automation are threats to the Six’s goods-exports model. China’s increasing domestic costs and wages and its pivot towards domestic demand-led growth could facilitate new investments and provide new markets, and this could extend the Six’s goods-exports model but this would have a limited import as long as the domestic social development is inadequate.

Extending the model of exporting goods does not augur well for further development. While there is still some room for climbing up the value chain among the three LDCs, for the middle-income countries the threat is stagnation in the middle-income category. Growth among the Six is not distinguished by significant upgrading of human or technological capabilities. Southeast Asia does not have large international companies that participate actively in international technological advances. The social structure—including a narrow private sector base—and internal politics among the Six also do not portend an ample change in attention to investment in social development or a ratcheting up of technological capabilities.

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