

Opinion: "ASEAN rebalancing act" by S. Pushpanathan The Jakarta

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When the leaders of the Association of Southeast Asian Nations meet in Jakarta this weekend for their 18th annual summit, the economy will continue to be one of their top agenda.

True to the commitment they made in 2003, the leaders will discuss the progress of building a competitive and highly integrated economic region by 2015. Now, it's time to hold on that commitment, and perhaps show some gains — and more actions.

Perhaps one action that is more needed now than before is how to sustain the current economic recovery in ASEAN. It is tempting to dismiss the economy for now when economic conditions have started to show some strength again. However, as the ASEAN finance ministers have warned in their meeting in Bali last month, there are still risks that can derail the recovery.

Last year the region grew by 7.6 percent, after stalling to 1.5 percent in 2009 because of the crisis. Most countries have now reached or exceeded their pre-crisis growth rates. For the first time in a decade, six countries (Lao PDR, Malaysia, Myanmar, the Philippines, Singapore and Thailand) expanded by 7 percent or higher.

The more advanced ASEAN-5 economies have now posted five consecutive quarters of economic expansion, while the smaller economies also rebounded strongly. The ASEAN Integration Monitoring Office (AIMO) of the ASEAN Secretariat predicted that regional GDP should expand by 6.4 percent this year — slower than last year but still above the region's average growth of 5.7 percent over the last 10 years.

To be sure, it's the strength of domestic demand that helped the region cope with the onslaught of the financial meltdown. Not surprisingly, considering the spending power that the various fiscal stimulus measures have unleashed in a market of US\$1.6 trillion and 600 million consumers. But what's more surprising is the apparent return of private sector in the region.

Private investment — a perennial Achilles heel in the region's quest for growth, has shown signs of growth lately, even in countries like Indonesia and the Philippines where private investment has always been a drag. Last year private inflows (mainly FDI) in the region are estimated to have reached US\$70 billion. Market issuance of bonds, equities and loans by private firms in the region also peaked at \$23.5 billion.

In many ways, ASEAN has managed to keep its fundamentals in better shape to support private demand. Courtesy of good economic management since the Asian financial crisis, both macroeconomic and financial stability is well entrenched. The region's banks are more stable, its exchange rates more flexible, and its foreign exchange reserves bigger.

Countries in the region have also become more integrated — with trade and investment regimes less rigid and more open than seen in earlier years. Despite the pockets of poverty that still exist, social tensions have been eased somewhat — thanks to some trickle-down effects. No one can deny that these changes have helped firm up regional domestic demand.

Yet the reality is that these changes are not enough. Somehow there is still this missing ingredient of rebalancing in favor of domestic demand. ASEAN economies

are still dependent on exports as engine of growth — with the share of external trade amounting to more than 100 percent of regional GDP on average.

Most obviously, fixed investment in ASEAN has been sluggish. Its average contribution to growth in the region over the last ten years has been very low (0.2 percent) — and although it increased strongly last year — perhaps due to low base effects, private investment has been stagnant on real terms. Most vital signs, from productivity to real income growth, have also slowed a bit.

While rebalancing is not easy to do, it's about time that ASEAN countries act on it if the current recovery is to be sustained. With the continuing global uncertainty, ASEAN economies would be better off to focus on the domestic foundations for growth which would shield the region from further volatility in global demand. Such rebalancing requires two important actions.

First macroeconomic policies must be recalibrated. Critical here are those policies that increase the return on investment, improve access to financing, and bolster business climate to reduce uncertainty. Recent initiatives that address financing constraints to investment in the region such as the ASEAN Infrastructure Fund are steps in right direction, but more comprehensive actions are needed.

Diversifying the sources of growth would also help. This can be done by pursuing productivity-augmenting measures in agriculture and the services sector, improving wages and income through greater labor market flexibility and supporting skills upgrading. Policies that would support the growth of domestic income including the provision of public transfers and safety nets are also noteworthy.

Second, and just as important, is for ASEAN to remain committed to market reforms, particularly reforms that enhance the efficiency and transparency of domestic financial systems. So far ASEAN is heeding the call — with its various roadmaps to financial integration, as well as initiatives that develop the capital markets such as the Asian Bond Markets Initiative and Implementation Plan for Integrated Capital Markets under the ASEAN Capital Markets Forum.

But given the financial sector fragility, more credible and appropriate reforms must continue to be implemented to sustain investor confidence, re-establish market and financial stability, and support growth. The region should also continue to implement measures that boost medium-growth prospects, including more human capital development and capital accumulation to support innovation and technical progress.

None of these actions is easy. Policy interventions will not yield instant rewards to be sure. Current uncertainties such as rising food and commodity prices, overheating pressures in Asia, and continued global financial stresses may also complicate policies. But these should not prevent ASEAN countries from putting their rebalancing act together. In fact, the more countries cooperate and coordinate policies the more they can sustain the recovery against all these external uncertainties

This weekend's summit, I believe, should get them off to a good start.

The writer is the Deputy Secretary-General of ASEAN for ASEAN Economic Community. His views are personal.