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In this Issue

Strategist Jan Lee

INTERNATIONAL

ASIA2004

ASIA 2020

New wealth in a world of its own?

20th anniversary issue

ASIA2004

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asia today INTERNATIONAL

ASIA2004

The ASIA TODAY INTERNATIONAL Yearbook

WILL REALITY MATCH ASIA'S VISION? By 2020, Asia is at centre–stage in the world economy, China at the heart of regional economic activity. East Asia is a wealthy metropolis of more than two billion people, intra-regional trade fed by steadily-increasing domestic consumption. The so-called ASEAN–Plus–Three Free Trade Agreement brings together 10 ASEAN nations plus Korea, China and Japan. ASEAN itself has created a Common Market of some 550 million consumers — sufficient to provide a credible alternative to China's dominance of foreign investment flow. But can the dream match the reality?

Singapore-based economist and strategist Jan Lee speaks of an era of diminishing expectations *(page 18)*. He argues that the 'curve' of global economic cycles has changed, and that deflation will become more entrenched. The middle class will be squeezed. This will impact on consumption.

In this 20th anniversary issue of *ASIA TODAY INTERNATIONAL*, we look back at the signposts of history since our first issue in 1983 — and project the aspirations of Asia forward two decades. We include an assessment of new moves to build a canal through Thailand's Kra Isthmus *(page 25)* — China is keen because it will have workers (and equipment) available when its Three Gorges project is complete, and, for strategic reasons, the US would like faster ocean access to South Asia. But Singapore's role as a shipping hub would be in jeopardy.

We also assess market prospects in the nearer term, into 2004 and beyond. The regional offices of PricewaterhouseCoopers write on emerging tax issues in Asia *(pages 66-75)*, we report on the outlook for regional currencies, include an index to our issues of the past 12 months and update our Contact Directory for those involved in regional trade and investment. This issue contains, in effect, two volumes — the traditional elements of our Yearbook, plus a snapshot of Asia, past and future, over a 40-year span. Come 2020, the world will be able to match the reality with Asia's vision *(index page 8)*.

20th anniversary issue

Signposts to history over 20 years

By **BARRY PEARTON**
Publisher, ASIA TODAY INTERNATIONAL

HISTORIANS OFTEN seize the most significant evidence of major signposts in the march of time from the minutiae of daily life. We found our signposts amongst the travel notes of our first issue in October 1983.

Korean Airlines, we reported, had just introduced a new direct Seoul-Singapore service, initially on a weekly basis. A little further down, we noted that Thai International was to add Phuket, 'the tropical island resort 900 km south of Bangkok', to its network from December — and that there was a four-day/three-night package on offer for US$58 per person, twin-share. Fast becoming the 'in' place for weary 'Manilans' was Borocay Island, where you could bunk in a beachside cottage for US$2 a night, or live it up, 'super deluxe class' at Lotty's for US$12.

Just 20 years ago, Asia was a geographical grouping of vastly disparate nations, poorly served by transport, communications and other infrastructure. China was a closed shop. Governments and people generally had little inter-action with each other, and were little understood by the West. Tourism was in its infancy, and foreign managers pioneering trade and investment ventures were pre-briefed on the oddities of 'Asian' culture without being made aware of the enormous differences in local ways they might encounter between East and West, North and South, often within the same country. There was no CNN or Internet to carry live a new insight into the Asian enigma. Phone connections were, at best, doubtful. Here at *ASIA TODAY INTERNATIONAL*, we depended on correspondents armed with manual typewriters who mailed their reports and hoped the system worked.

In Australia, *ASIA TODAY INTERNATIONAL* pioneered serious reporting of business opportunity in Asia. Our learning curve began early. An advertisement in our first issue referring to 'TAIWAN R.O.C.' brought the wrath of bureaucrats in Canberra, who immediately threatened to withdraw the visa of the then-Sydney-based Taiwan tourism representative if the advertisement re-appeared (it did!).

TODAY, ASIA IS an increasingly–integrated economic powerhouse, more dependent on intra-regional trade. And it is moving towards a phalanx of new infrastructure which will bring its various nations ever closer. APEC, ASEAN, AFTA, AFTA Plus 3, renewed talk of a regional energy grid, the Kra Canal concept (which could alter the dynamics of regional trade), an Asian National Highway, an Asia-Europe rail network — are all signposts to the future.

Despite its myriad challenges and problems, Asia continues to be the world's biggest potential and prospective market. The biggest lesson for business is to understand that this is a dynamic market, and that complex and unplanned events can bring market change that is instant and lasting. Those who drop even two or three months behind in their market intelligence can find a previously assured customer base is suddenly gone — forever.

In this special issue of ***ASIA TODAY INTERNATIONAL***, we look back at some key business developments in Asia over the past 20 years, assess where the market is today and where it might be next year, and project the market forward to 2020.

The signposts are there.

They are there, too, in the snapshots we've offered in five-year grabs from our issues of October 1983, October 1988, October 1993 and October 1998.

In 1988, for example, we reported that changing consumer tastes born of simple social advancement among Asian countries were accelerating rapid integration of manufacturing and marketing arrangements within the region.

"The push towards intra-regional manufacture and trade was initiated in a small way by entrepreneurial garment-makers from Hong Kong and Taiwan," we wrote. "Facing rising labour costs and quota problems in the United States, they relocated some production to less-developed countries such as Bangladesh, which is now happy to refer to itself as the 'workshop' of Asia.

Hong Kong, we said then, had turned to China as its factory. "The factory in Hong Kong by the turn of the century may be as relevant as the rickshaw," we wrote. "Hong Kong will be a giant services centre".

Another era: *advertising from our first issue — Qantas, HSBC, Philippines Airlines — and part of that offending placement from Taiwan.*

About half right. Hong Kong's hinterland, the Pearl River Delta, has become the world's factory. But today, China is increasingly looking to service itself. Foreigners offering civil engineering and construction services for major projects in China are beginning to find themselves locked out in favour of locally-grown skills and technology.

FOR ASIA2004, Australian Trade Commissioners throughout Asia have again provided valuable insight into individual market conditions and prospects. Whlle their approach obviously tilts towards the Australian experience, they offer valuable lessons and ideas for any trader or investor seeking new opportunity.

Likerwise, contributions from the regional offices of PricewaterhouseCoopers highlight regulatory trends in tax compliance which will impact on foreign business in Asia in the years ahead. Once again, they point to a tightening of transfer pricing rules — an emerging issue identified in earlier years.

Australia's Foreign Minister, Alexander Downer, writes on the Australian approach to regional security, and Trade Minister Mark Vaile again spells out the Australian agenda on both regional and global trade issues.

OUR FIRST ISSUE was published in newsletter format as *"A personal guide to business opportunity in Asia"*. Twenty years on, *ASIA TODAY INTERNATIONAL* has earned a degree of respect in Asia — a respect which opens the doors to the people who matter in regional business.

We've earned that respect because we've never pretended to be other than what we are — a no-nonsense business journal linking business to potential in regional markets.

It is a respect that is in no small way due to the personal knowledge and reputation of our Editor, Florence Chong, and a team of vastly experienced Asia correspondents, including Abby Tan, who has filed from Manila from our earliest days, veteran China-watcher Jimmy Yapp and K K Chadha in Hong Kong, Russ McCulloch in Tokyo and Andrew Symon, who has reported extensively for *ASIA TODAY INTERNATIONAL*, first from Jakarta and in recent years from Singapore.

We remain independent, a feat in itself in today's multi-media world. It's not been easy, and, sadly, a number of worthy titles reporting on Asia have disappeared since the 1997 economic crisis — and its impact on both revenue and readership.

Three years ago, we established *ASIA TODAY ONLINE* and have added significantly to these services during 2003. *ASIA TODAY ONLINE* will be further expanded as a subscriber resource in 2004.

To our subscribers, advertisers and others who have believed in us, and supported us in so many ways over 20 years — thank you. We affirm our commitment to excellence in reporting of regional business.

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CAB AUDIT

TOWARDS 2020

COMMENT

ASIA2004

SERVICES

Will reality match Asia's 2020 vision?

1. THE PIPE–DREAM

THE YEAR IS 2020, and Asia has moved into the third decade of the 21st millennium at centre-stage in the world economy.

China provides the main heartbeat of economic activity, with the arteries of regional (and world) trade emanating from this economic juggernaut. China is second only to the United States as the world's largest trading nation.

Thailand, Malaysia and India have achieved the status of developed nations.

East Asia is a wealthy, throbbing metropolis of more than two billion people, with intra-regional trade — fed by steadily-increasing domestic consumption — the mainstay of economic health. Geopolitical tensions inherited from the 20th century have not, however, been eradicated.

The efforts of two decades have brought about a labyrinth of trade pacts seeking to enmesh the economies of the region much more closely, but their effectiveness has been seen to wax and wane, depending on the economic imperatives of the day.

> "In 2020, the yen is no longer the dominant currency of Asia. That mantle has passed to the renminbi"

The key development is the so-called ASEAN-Plus-Three Free Trade Agreement, which brought together the 10 nations of Southeast Asia, Korea, China and Japan less than a decade ago. Taking its cue from China, which began separate negotiations with ASEAN in 2001 to form an ASEAN-China FTA, India (which began talks with ASEAN to form an FTA in 2003) is now part of the jigsaw of regional trade pacts. In its own right, India has had much to offer since becoming the world's preferred IT back-office.

India is part of an economic grouping of South Asian economies, including Pakistan, Sri Lanka, Bangladesh and Nepal. The South Asian continent, home to more than a billion people, remains in the shadow of a more dynamic East Asia, but India's trade pact with ASEAN provides a pivotal link to wider markets in Asia and beyond.

Over-arching Asia's own regional arrangements is the Asia Pacific Economic Co-operation (APEC) forum, born out of an Australian diplomatic initiative in 1989. In 1994, in the Indonesian city of Bogor, leaders of APEC economies set out a vision that promised to lower barriers to freer trade among all APEC members by 2020. APEC membership includes Australia, New Zealand, the United States, Canada, Russia, and 16 other Asia Pacific nations, providing a trade bridge between the West — especially the US — and the East.

APEC continues to provides a crucial annual dialogue for the leaders of Pacific Rim nations in a world otherwise carved into four major trading blocs — the enlarged European Union, the Free Trade Agreement of the Americas (FTAA), Africa and the Middle East and East Asia. FTAA has grouped North and South America, providing a unified market of the Western Hemisphere. Some 34 North and Latin American nations are part of this trading bloc, which came into being in the first decade of this millennium.

COMMENT

FLORENCE CHONG

MUCH HAS CHANGED in East Asia since 1983 (when *ASIA TODAY INTERNATIONAL* first began publication). Then, Japan was Asia's key economic power — and the major source of capital and debt financing for the region.

According to Hong Kong-based economic strategist Chi Lo, author of *When Asia Meets China in the New Millenium*, published in April, Japan in the 1990s provided 53 per cent of all Asian foreign borrowing, and Japanese investment in the early 1990s represented 26 per cent of all foreign direct investment (FDI).

In 2020, the yen is no longer the dominant currency of Asia. That mantle has been passed to the Chinese renminbi.

The bursting of Japan's bubble economy in the early 1990s ended an era for the Land of Rising Sun and heralded the onset of a lost decade, which turned out to be more protracted than expected because of national inertia. Successive Japanese governments struggled against an entrenched bureaucracy and vested interests to reform the economy.

As Japan struggled with anaemic growth, it began to stagnate and its economic influence waned. Chi notes that Japanese lending to its Asian neighbours dropped from 53 per cent in the 1990s to 25 per cent in 2001. Its share of FDI that same year shrank to 11 per cent.

Leading Japanese policy-thinker Yukio Okamoto, who was Chairman of the Prime Minister's Task Force on Foreign Relations in the reformist Koizumi Government in the early 2000s, expected the coastal regions of China to overtake Japan in terms of living standards by 2010. Okamoto said there were two Chinas — the rich, urban coastal China and the poor

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interior China. "Mind-boggling" developments were taking place in the cities of the 'first' China — the rich coastal region.

Okamoto told *ASIA TODAY INTERNATIONAL* in October 2002: "China has an infinite amount of labour now that its huge agrarian population has been amalgamated into the national economy. It also has an infinite amount of land, which it can use when needed. Cumulatively, China has received US$500 billion in foreign direct investment. Imagine what that amount of investment has done to enrich the Chinese economy."

On top of that investment, Okamoto said that whether in central or provincial government, China's key asset was the quality of its government officials. He described them as "brilliant" and completely driven by a single goal — China's economic development. Together, they articulated the strategy of the country and brought about dramatic changes. China was like Japan in the Meiji era, where young, competent and ambitious people worked for the government, he said.

The difference was, said Okamoto, that there were five or six Japans in China. "Until a few years ago, the thinking was: How can we stay ahead of China? How can China not beat us in the world market? That is outdated now." The prevailing preoccupation in Japan was not to fall too far behind China, he said.

Okomato was part of a groundswell of opinion predicting China's ascendancy in the early 2000s. In 2020, China is a significant exporter of capital as its companies seek to invest offshore, partly to secure much-needed resources. It has been investing offshore now in oil and gas projects for some 20 years ago (note its stake in Australia's North West Shelf gas field, negotiated in 2003).

asia today **CHINA STUMBLED OUT** of more than 40 years of self-imposed isolation under communism 41 in 1979, under the direction of then-President Deng Xiao-ping —but the sleeping giant did not really begin to stir until the mid-1990s. The East Asian economic crisis of 1997/98 changed the course of economic development for the entire region, and China established itself as the destination of choice for foreign investors, eclipsing Southeast Asia which, for the previous 15 years, had won the lion's share of international capital inflow.

China's star began to shine brightly as it maintained strong growth, while its ASEAN neighbours, together with its Hong Kong Special Administrative Region (HKSAR), wallowed in economic misfortune. In hindsight, China's era began at the turn of the century, its status then enhanced with entry to the World Trade Organisation (in 2002) and an international focus on the country which continued through to 2008, when Beijing hosted the Olympics.

In 1997, a World Bank report predicted that the Middle Kingdom would, by 2020, become a global economic power with a 10 per cent share of world trade - ahead of Japan but still behind North America. (Regional economists now believe that China's share of trade could exceed this number)

It would be the world's second largest trading nation, with per-capita income surging to more than US$10,000. "If China's trade was to expand as projected in this report, its incremental share of world trade in the 21st century would be no different from what (the US and Japan) achieved," the report said. "The emergence of the US and Japan as trading powers was not merely good for their own economies, it was good for the world. The same should hold true for China."

At its most positive, the World Bank projected China as a nation engaging the rest of the world as "an equal and responsible partner in trade and finance, built on modern institutions and the rule of law" by 2020. "There is potential for China to emerge as a middle-income country with a strong private sector driving rapid sustainable growth, particularly in grain and energy markets," the Bank said. It expected China's comparative advantage to shift towards intermediate technology manufactures.

By 2020, the World Bank said, China would boast a 10 per cent world market share in light manufactures (leather, fabricated metal products and miscellaneous manufactures) and eight per cent in transport equipment and other machinery. But in the clothing industry, China and Hong Kong could lose as much as 16 per cent of the world market by 2020. China could also lose share in some agricultural products, such as rice, livestock and processed food, with Australia being one of the trading nations to pick up the slack.

2. THE REALITY

"China's trading partners will be the final arbiters of whether China indeed becomes a global giant. Open trade access might prove difficult in the 21st century."

asia today **CHINA'S TRADING PARTNERS** will be the final arbiters of whether China indeed becomes a global giant. Japan and South Korea would not be where they were in the late 1990s if markets had not been open to them in the 1950s and 1960s — and open access might prove difficult for China in the 21st century because trade issues have become more sensitive and complex.

Washington shifted its focus from Japan to China in the early 2000s as its trade deficit with China grew. In 2003, Washington threatened punitive action if China did not revalue its currency, in the face of a weakening US dollar. The US now claims unfair competition from Chinese producers.

The last two decades of the 20th century have seen sustained, rapid modernisation, unlike any other period in China's long history. The next two decades promise more of the same, says the World Bank. The pace of GDP growth is expected to slow over time, from between nine and 10 per cent to five per cent in 2020. But growth could still average 6.6 per cent until 2020.

China's leadership faces continuous challenges before 2020. It must curb corruption, fully reform its economy, and enforce the law to ensure that China's legal system is credible and effective. Past success, however, will not guarantee China's future performance, and China's promise may well fade into what the World Bank termed "sinosclerosis", troubled by internal disharmony and social issues.

In the shadow of China, other East Asian countries prosper where their economy is complementary to China's. Survival, let alone prosperity, depends on their ability to adjust to the new economic paradigms of the region.

The proactive countries have had to reinvent themselves in the preceding two decades. In 2020, Thailand will probably have constructed the Kra Canal, ensuring a new trading role for itself. The Canal (see page 25) has almost certainly shifted the centre of gravity for trade and shipping away from the pirate-infested Straits of Malacca and away from Singapore, which has been Southeast Asia's shipping hub since Singapore was founded in 1819.

To survive in the new competitive environment, smaller nations, including Singapore, Laos, Cambodia and Sri Lanka, will find it necessary to forge closer economic linkages with their immediate neighbours to establish a hinterland. Back in 1997, Hong Kong returned to China and China's Pearl River Delta became its hinterland, allowing Hong Kong to re-focus its economy.

In its heyday before 1997, Hong Kong thrived as the financial centre to China and the hub for shipping — and particularly air travel — to the Mainland. In subsequent years, the emergence of major facilities such as Guangzhou's Baiyun International Airport threaten to supplant Hong Kong's role. In financial services, the growing sophistication of Shanghai poses another challenge.

As of 2003, Baiyun International Airport is China's largest and most-advanced international airport. By 2010, says economist Chi Lo, the airport is expected to process 25 million passengers and one million tonnes of cargo annually. Hong Kong has much to lose if and when cargo firms start operating directly through Mainland airports. The air transport industry contributes about HK$30 billion to Hong Kong's economy, 2.5 per cent of GDP. Of the 1.6 million tonnes of cargo that passed through Hong Kong Air Cargo Terminals in 2001, more than 90 per cent originated from or was destined for Chinese sources. On the trade side, says Chi, about 85 per cent of all goods leaving Hong Kong were re-exports and about 40 per cent originated from Southern China.

Unless Hong Kong reads the competition

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from China correctly, it would lose out in the longer run in its desire to become the services centre for the Mainland. Beijing has equipped and provided the backing necessary to turn Shanghai into a financial centre. Hong Kong always believed there would room for two financial centres in Greater China. However, Hong Kong may become the Manhattan of China — a role that many Hong Kong people believe to be possible. There would be a premium to live in Hong Kong, and it would be a tourist magnet, attracting many millions of Chinese tourists.

IN SOUTHEAST ASIA, Singapore could well be forced to negotiate for closer economic integration with Malaysia. Not quite a re-merger politically, but a closer economic partnership. Jan Lee, Singapore-based Chief Strategist for the Swiss investment banking group EFG, firmly believes Singapore will need to integrate with Malaysia's economy — much as Hong Kong has with China's.

Lee looks beyond Free Trade Agreements, which do not solve issues such as labour costs. As an example, he believes that if the Port of Singapore Authority was to shut down, its workers could cross the border to Malaysia and find jobs in Tanjong Pelapas in Johore, the southernmost State of Malaysia. He goes further, arguing that not only will a City-State like Singapore need to find economies of scale and more efficient use of resources by integrating with its northern neighbours — other, smaller, countries in ASEAN will have to do likewise. Regionalisation is necessary to get the best benefits of labour costs and resources to hone competitiveness in an increasingly–competitive world, he says.

One argument is that ASEAN lost out to China from the late 1990s, because it did not have the appeal of China to multinationals. China offers a huge single market. Most investors do not invest just to make cheaper products for their home markets —they seek growth and access to domestic markets.

In contrast, despite the ASEAN Free Trade Agreement, ASEAN remains a fragmented grouping of competitive neighbours. But ASEAN could transform itself into an ASEAN Economic Community by 2020. The object is clearly to involve a higher degree of economic integration within ASEAN. ASEAN leaders, especially Singapore, have always hoped that AFTA will progress to become a Common Market. AFTA in 2003 boasted a huge population mass — of 550 million. An ASEAN Economic Community of 550 million could offer a more realistic challenge to China's 1.2 billion market in appealing to foreign investors.

But will the next generation of ASEAN leaders be prepared to put aside their differences and national pride to push for the greater good of the region? ASEAN had never been short on dreams. As far back as 1988, *ASIA TODAY INTERNATIONAL* reported the desire of ASEAN to become a single market. The sentiment has remained — only the action is missing.

BIGGER COUNTRIES like Malaysia, Indonesia and Thailand have managed to retain industries and continue to supply some components and parts to China. In some instances, multinationals who want an alternative source of supply so as not to place all their eggs in one (China's) basket continue to invest in the larger ASEAN countries. These also offer the promise of a domestic market. Thailand remains attractive as a hub for car manufacturing — and, in fact, continues to receive investment from Japan even as Japan's general outbound investment dries up. With rich natural resources and a large pool of young labour, Indonesia remains a country of promise. But its Achilles Heel is political stability and Moslem fundamentalism.

In 2020, Taiwan's political status quo may well remain as it is in 2003, but its economy has become totally intertwined with the Mainland's. Already, at the turn of the century, Taiwan's industry had relocated the bulk of its manufacturing to China. In parallel, Taiwan increased research and development work as it sought to move into new areas, such as life sciences, to keep ahead of China. But, if Japan has found it a struggle, questions have to be raised about Taiwan's ability to maintain its economic edge. Once, Taiwan's sizeable foreign reserves were considered an economic superiority in balancing poor political relations with China. No longer. China is quickly building its own reserves.

Since the early 2000s, South Korea has hoped to form an FTA with Japan and China, but with determination and astute business sense has simultaneously continued to push ahead with its own technological excellence. It has built on leading-edge performance in such areas as "intelligent" consumer goods. In the early 2000s. Korea already had the highest broadband penetration rate in the world, with 60 per cent of all households connected to the high-speed Internet network. By 2020, most Koreans will be able to speak English fluently — overcoming what has been a handicap in global commerce, where English is the working language.

Individual countries, however, still need to resolve a number of domestic issues which must be addressed to enable a restructuring of their economies to fit with a different world. If they choose to sweep core problems, such as bad loans in their banking systems and systemic corruption, into the 'too-hard' basket, Asia's promise will not be fulfilled.

And a vibrant Asia in 2020 will remain — just a pipe dream!

3. AN ECONOMIST'S VIEW

Asia to outgrow the world

By **ROGER DONNELLY**
Chief Economist, Export Finance and Insurance Corporation (EFIC)

SYDNEY: In one respect, the future of Asia is clear. Barring an unforeseen apocalypse, it will continue to outgrow the rest of the world —and its weight in the world economy will correspondingly rise.

Assuming China grows at eight per cent annually and the US at four per cent over the next few decades, China will overtake the US to become the world's largest economy in either less than 20 years or just after mid-century, depending upon how you measure GDP (at so-called purchasing power parity exchange rates sooner and at market exchange rates later).

Roger Donnelly: China will overtake the US.

Meanwhile, the share of world GDP produced by Asia as a whole, which has doubled to 30 per cent since World War 2, should continue to climb.

What are the grounds for thinking this will happen?

- The enormous potential for technological catch-up for one.
- Favourable demographics — apart from sheer size of population — China has 2.35 workers for every dependant.
- Vast untapped supplies of rural labour — perhaps 600 million people in China alone.
- Continuing integration of regional economies into global supply chains.

All these factors should turbo-charge growth for at least another 20-30 years.

Trade — within Asia and between Asia and the rest of the world — is likely to undergo even greater expansion and transformation than production. Over 1975-2001, East Asia's share of world exports more than tripled to 19 per cent, and over 1985-2001 it doubled. Meanwhile, intra-regional exports (expressed as a share of world trade) went up even more sharply, rising six-fold over 1975-2001.**

The emergence of China in trade statistics is particularly striking. Its share of world exports has risen from 1.6 per cent in 1985 to 6.5 per cent in 2001. A lot of these exports have been generated from the assembly of parts and components made in other Asian countries. So, as Chinese exports have soared, so have regional exports to China. Over 1985-2001, East Asia's exports to China grew at 11.5 per cent annually, far above the 3.8 per cent annual rate for world trade.

According to most industrialists and expert observers, the internationalisation of production processes that has spurred this increasing Asian inter-dependence and outsized trade growth still has a good way to run. So unless protectionist trade barriers get in the way, we should continue to see buoyant trade growth in the region.

But though the region's growth will probably be rapid, it is unlikely to be smooth. Profound economic transformations are always accompanied by 'gales of creative destruction' in which the structure as well as scale of economies changes out of all recognition.

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I have noted just now the increasing tendency of countries to specialise in just one part of a global supply chain, and to import from and export to those lower and higher in the chain. Another important structural shift now under way is the 'emergence of the Asian consumer' and a corresponding decline in the traditional export bias of economies.

At least 140 million affluent consumers have emerged in East Asia, according to the Japan External Trade Organisation (JETRO). Their willingness to spend more than their thrifty parents on everything from mobile phones to PCs to home renovation is fuelling enormous growth in consumer outlays -- and prompting JETRO to warn Japanese companies to adapt or lose out to overseas competition.

A third structural shift is the relative economic decline of Japan. Japan will remain a major, if not pre-eminent, export market for other Asian economies for decades to come. But the slippage in the share of East Asia's exports going to Japan — almost seven percentage points over 1985-2001 — is likely to continue, as Japan's growth rate lags other more youthful, less-developed economies. Japan will be an important existing market to nurture, but it won't, in most cases, be the place to go for growth.

Setbacks and crises are also quite likely along the path to further development. As the saying goes, 'Those who don't study the past will repeat its error. Those who do study it will find other ways to err'.

Policymakers and businesspeople in the region have studied the immediate past and won't commit its errors again soon. They know that large current account deficits, high short-term foreign debt, low FX reserves, pegged currencies and excessive bank lending to companies brought several countries undone in the crisis of 1997. So they now run current account surpluses, hold FX reserves at several times their short term debt, have flexible exchange rates and are de-leveraging.

Even so, there are many balance sheet problems within the region, and instances of breakneck lending that could sow the seeds of future problems.

Back in 1997 just before the financial crisis broke, an American economist named Christopher Lingle wrote a book called The Rise and Decline of the Asian Century, in which he argued that predictions of an impending Asian Century were a 'seductive myth'. A few months afterwards his observations looked remarkably prescient. But with the region now getting back on to its feet and the crisis beginning to resemble nothing more than a hiccup, the idea of an Asian Century may need dusting off.

** These and other trade statistics gleaned from Francis Ng and Alexander Yeats, 'Major Trade Trends in East Asia', World Bank, June 2003.

How times change — or do they?

Reviewing 20 years of economic growth in Asia

1983 - Toying with privatisation

IN OCTOBER 1983, Malaysia was already toying with privatisation of some major public utilities in exchange for foreign capital, expertise, technology and management skills. We led our first issue with a report that a major new market was opening for Australian coal to Malaysia (for electricity generation), with China lobbying hard to clinch the deal for itself.

Indonesia was deferring several major industrial projects in refining and alumina in a bid to improve balance of payments problems, shutting the door to billions of dollars in contract opportunities for foreign firms.

In South Korea, concern over a three-to-one trade imbalance saw Chun Doo Whan planning the first visit to Australia of a South Korean President since 1968 – to protest Australian tariffs. "Why lose a beef market worth $80 million to prevent tyre imports worth $10 million?" asked senior trade official Un Suh Park, angered by an Australian decision to remove Korea from the list of developing countries exporting power transformers. But South Korea was looking to Australia for technology to enable a quadrupling of its grazing lands.

October 1983

In trade, the newly-formed Singapore Trade Development Board (recently renamed International Enterprise (IE) Singapore) was planning a full-time agency in Australia, and the Philippines had just established a new Center for International Trade Expositions and Missions (CITEM) to promote non-traditional exports.

1988 - An ASEAN Common Market?

IN OUR OCTOBER 1988 issue, sub-titled *ASIA'89 AND BEYOND*, we said Asian economies were becoming mutually inter-dependent and self-reliant, and that the regional trade concept was not only logical, but was already occurring naturally. "To some extent, it is already a matter of fact," we wrote.

In this issue, we reported that ASEAN member countries had reached agreement to promote ASEAN Industrial Joint Ventures (AIJVs), and that three of Asia's four newly-industrialising countries — Taiwan, Korea and Singapore — were building export-oriented manufacturing bases in Malaysia.

The late Rajiv Gandhi was 'building a fire' under Indian industry, with unfamiliar words such as efficiency of production, economy of scale and technological upgradation becoming an integral part of the Indian businessman's vocabulary.

In an overview, Australia's then-Minister for Foreign Affairs and Trade, Gareth Evans, described Japan as Asia's engine of growth, and our Tokyo correspondent, Russell McCulloch, said consumers were leading Japan to economic recovery. Singapore, our correspondent Ronnie Tan reported, was hoping to become a regional centre for procurement and distribution, counter-trade, conventions and exhibitions, resources processing, operational headquarters, R&D and training.

October 1988

Brunei unveiled a five-year plan to diversify from oil and gas into export-oriented high-tech industries, where the focus was on capital rather than labour.

We reported that investors in China were becoming more cautious as initial euphoria faded. "There are still areas (such as Wuhan, Hubei and Yangtse) where the left-wing leadership is hostile to foreign joint ventures," our report said. Meanwhile, in Hong Kong, the manufacturing economy had already cooled, and the services sector was gathering strength. In Taiwan, local investors were beginning to look offshore — to Thailand, Indonesia, the Philippines and China — to cut production costs.

Indonesia was beginning to move away from dependence on oil, replacing import substitution in favour of promoting export-oriented manufacturing — at the same time dropping protective barriers and allowing the private sector to play a more important role.

Thailand's then-new Industry Minister, Banharn Silpa-archa, said he was placing more emphasis on investment in rural areas and on trade with Indo-China, while in Korea, the Government moved to liberalise its import regime as its trade surplus ballooned, opening a new market for consumer goods.

1993 - Asia's best decade gone?

IN OCTOBER 1993, four years before the 1997 economic crash, we commented that, ironically, Australia had let the best decade of Asia go — a decade during which new markets were more easily accessible — and that growth in Asia was slowing.

In China, problems with letters-of-credit were emerging, and we warned that some new investments in China may have been made too hastily. "China requires a steep learning curve, where one learns from a small investment," we said. Many investors in those early days were subsequently badly burnt.

"Pockets of high growth will continue in Asia, but the overall tone is for slower growth — reflective of maturing economies," we wrote. "The decade ahead in many ways poses more challenges in Asia than in the past — the growth of democracy, higher competition for investment funds, and restructuring of industries will, for some, mean a redefining of roles.

"Singapore is looking to an 'external' economy, Taiwan and South Korea seek to upgrade their manufacturing to high-value-added, technology-intensive production. Even Thailand and Indonesia face competition from lower-cost countries — China and Vietnam.

October 1993

"The coming years present relatively more risks in Asian than did the 1980s because Asian economies then were able to commit to development unencumbered by political constraint." A reference to environment and labour laws and devolvement of taxing and other powers to local governments.

In an exclusive interview with *ASIA TODAY INTERNATIONAL*, Taiwan's then-President Lee Teng-hui predicted that trade friction with the United States could lead Japan to increase its investment in other Asian nations.

In other reports, we said appreciation of the yen had put pressure on Indonesia's external accounts, with more than 40 per cent of national debt denominated in yen; that Malaysia, having learned from Thailand's experience, had moved decisively to proceed with a host of new infrastructure projects; and that India was beginning to address the opening of protected market areas to the private sector.

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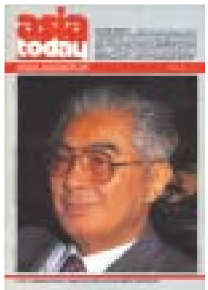
Taking our cue from Asia's leaders

ASIA TODAY INTERNATIONAL moved to a pictorial cover in October 1989, in an issue which profiled Hong Kong's then-Home Secretary Peter Tsao. On this page, we have included a sampling of key interviews with past and present business and government leaders . . .





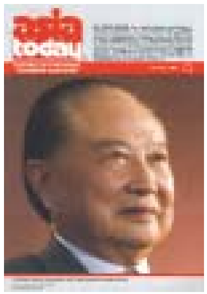
Taiwan's then-Minister for Economic Affairs, Vincent Siew (1990); Singapore's then-Minister of Trade and Industry and current Prime Minister in waiting, Lee Hsien Loong (1990); China's then-CITIC Chairman Rong Yiren (1991).



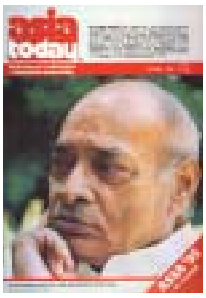
Indonesia's then-Minister for Mines and Energy, Ginandjar Kartasasmita (1991); Thailand's then-interim Prime Minister, Anand Panyarachun (1992); Indonesia's then-Chairman of the Investment Co-ordinating Board, Sanyoto Sastrowardoyo (1992).





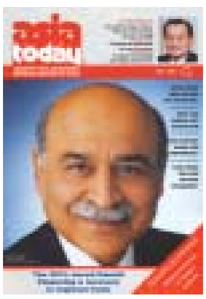


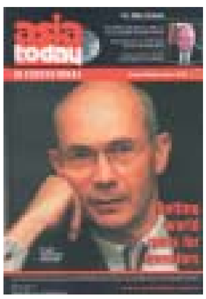
Hong Kong's then-Chairman of the Trade Development Council and current Chairman of the Hong Kong Airport Authority, Victor Fung (1992); Malaysia's Prime Minister, Mahathir Mohamad, who will step down end-October (1992); then-Managing Director of Sanyo Electric Trading Company, Nobuhiro Arimoto (1992); Taiwan's then-President, Lee Teng-hui (1993); China's Wang Daohan, Chairman of the Association for Relations Across the Taiwan Straits (1994).





India's then-Prime Minister Narasimha Rao (1994); then-US Deputy Trade Representative Charlene Barshefsky (1995); then-Managing Director of the International Monetary Fund, Michel Camdessus (1997); Thailand's then-Prime Minister, Chuan Leekpai (1998); former Philippines President and then-Presidential advisor Fidel Ramos (1999).






Then-Director for East Asia and the Pacific of the World Bank's International Finance Corporation, Javed Hamid (1999); Japan's Katsuhiro Fujiwara, then-Managing Director of Keidanren (2000); Malaysia's Minister for International Trade, Dato Rafidah Aziz (2001); EU Trade Commissioner Pascal Lamy (2002); Philippines President Gloria Macapagal-Arroyo (2002).

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1998 - 'A lot of fixing to do'

IN OCTOBER 1998, we reported that a number of Asian economies were still contracting, and that they may not bottom out until mid-1999 — or even later. "There's a lot of fixing to do, especially in the financial/banking sector, and in political cronyism," we wrote. Thailand's then-Prime Minister, Chuan Leekpai, told *ASIA TODAY INTERNATIONAL*: The only way out is to face up to reality — to be prepared to remedy the mistakes, the wrongs of the past." That, he said, meant more jobs losses in Thailand — perhaps another one million unemployed.

Renato Ruggiero, then-Director-General of the World Trade Organisation, saw trade not as the cause, but as part of the solution to Asia's economic problems. Ruggiero was about to leave for Washington to press for better co-ordination between the WTO, the IMF and the World Bank as Asia flooded the world with cheap goods.

"Trade," we wrote, will make or break the strategies of a number of Asian governments struggling to get their economies moving again. One dilemma is the uneven impact of currency devaluation on input costs — already showing up in allegations of dumping against countries like South Korea."

October 1998

In business circles, we said, there was growing consensus that measurable signs of economic recovery would begin to appear in Asia from the third quarter of 1999.

We supported the decision of Malaysia's Prime Minister, Dr Mahathir, to introduce limited currency controls, pointing to his plea for some form of control on international currency speculators who, he said, could undermine national currencies or even governments. Why did they remain anonymous? Why did they not pay taxes on their profits? Mahathir asked.

We wrote: "A free market certainly has a right to determine a market price — for commodities or currencies. But in a world increasingly at the whim of computer jockeys and limited corporate discipline, when does speculation become manipulation — or even intimidation — under the cloak of anonymity? Whatever happened to transparency?"

It was a fair question at a time when Asia's economic crisis had broadened into a range of political and social problems — and it remains relevant today.

An era of diminishing expectations

THE SPURT OF RECOVERY evident in regional economies in recent months is expected to be sustained in 2004 — and possibly beyond — as the global economy strengthens. International financial institutions forecast sustainable recovery in the medium term, with East Asia again achieving the fastest growth rates. But global economic cycles since the late 1990s have defied conventional expectation. Other than China, East Asian economies have gone on a roller-coaster of recovery and growth, only to be plunged into recession yet again.

Jan Lee is not optimistic that the global economy is likely to see the sustained growth that the region enjoyed pre-1997 because the dynamics of global economic cycles have changed fundamentally.

Lee, Singapore-based Chief Strategist for the Swiss investment bank EFG, believes the current period of volatility could well run for some 15 years, until excesses and over-capacity in world trade are finally dissipated.

He argues that the "curve" has changed. Global economic cycles no longer run as expected. The reasons are:

- Diminished expectations by most people about everything;
- Ageing of population in the industrialised countries;
- The rise of China and India;
- Technology — the domestication of the post-industrial revolution; and
- Terrorism — an additional tax on all civil societies.

Lee believes deflation will become more entrenched, and income growth will be weak. Unemployment will continue to rise, and wage-earners will be forced to retire early. The middle class will be squeezed, and this will impact on consumption demand.

> "The global economy is exactly where it was in the 1900s or 1930s (when) boom and bust were brought on by rapid technological change"

TOWARDS 2020

Corporate shake-outs will continue. Lee also says the present low interest rate environment will continue. Equity markets will remain weak and currency movements volatile. Uncertainties will prevail as a result of war — and rumours of war. Lee describes all this as a "quantum leap into the brave new world".

The watershed was the bursting of the Nasdaq bubble and the sharp retrenchment of demand that followed. Since the early 1990s, Asia's success has been built on a technology bubble, with Asian factories churning out products for the US industrial market. The US is still digesting the over-investment that took place in the later 1990s and early 2000 during the tech-boom.

Technology is being harnessed to automate many areas of industrial activity, ranging from conventional manufacturing to extraction of oil and even cement-mixing. Lee refers to this automation process as the domestication of technology which, in turn, depresses the domestic selling price and adds to overall deflationary pressure.

"The global economy is exactly where it was in the 1900s or 1930s," he says. On these two previous occasions, boom and bust were brought on by rapid technological change. In the 1900s, it was the advent of railroads — which paved the way for massive development in agriculture, and production of commodities. In the 1930s the arrival of T-model Ford cars made the horse-and-carriage redundant and destroyed many cottage industries.

On both occasions, it took up to 15 years to work through the impact of two stock-market bubbles. And it took war to snap the global system back into shape and to generate consumption and employment. Lee says the missing link today is interest rates. In the 1900s and 1920s, interest rates were fixed.

Also, he says, today's central banks are more pre-emptive. They ease interest rates to help alleviate global strains. For the first time since the 1970s, he says, real interest rates in the United States are negative. The US dollar will continue to be weak indefinitely — but its weakness is, in itself, an escape valve. The dollar, he says, will weaken further, and this will, in turn, increase China's competitiveness. Trade friction will emerge. Instead of the US dollar, international investors will look to gold as a safe haven, keeping gold prices high.

"The situation could go on for another five years — beyond the next (2004) US election," he says. And if Washington fails to persuade East Asian countries to revalue their currencies, Lee will not be surprised if the US adopts some kind of currency fixability, based on the old gold standards. This would not be good for Asia.

However, Lee believes the in-built obsolescence that helped drive ongoing consumption is slowing down. One example he gives is the Pentium 3 chip, for which software configuration is such that the need to upgrade to the Pentium 4 chip is reduced. When product obsolescence slows, he says it triggers a chain reaction that affects orders and output from factories in Asia.

The emergence of China and India — countries with huge reservoirs of cheap labour — has set in train a deflationary cycle. In fact, he says, it is the problem in dealing with structural deflation that is pushing the Bush Administration (see page 31). to pressure China to revalue its under-valued currency, the renminbi. Lee believes China will do a trade off with Washington to ease the pressure to revalue. China is likely to

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TOWARDS 2020

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open up agriculture and its insurance sector to US companies.

Lee talks of the shrinking of the middle class, squeezed by government taxes and diminished job prospects and employment opportunities. Each time governments increase taxes, as for security measures against terrorism, the tax is on the middle class. The impact is a drop-off in consumption, which is already being impacted by an ageing population in industrialised countries. The doctrine of the balanced budget needs to be reviewed. Instead of increasing taxes and dipping into household spending, governments must accept the need for deficits to help boost private sector demand. But they need to be selective in how public money is spent, and, where possible, must reduce government charges to ease the burden.

The way forward, according to Lee, a strong proponent of economic integration, is for East Asian economies to deepen integration with continental Asia (India and China). Integration means a greater market, efficient allocation of resources (especially labour) and savings from duplicity in various economic agencies. The European Union has shown the way, and enlargement of the EU will mean that labour from the poorer, newer member countries will be able to move freely across borders, he says, adding that “the EU will be a force to reckon with (in future)”.

Whence China? A diversity of views

From **JONATHAN STORY** *

A CENTRAL FEATURE of mainland China is the extraordinary diversity of views about where it is heading.

To the dustbin of history, says one camp. Signs of collapse lie all around: urban unemployment, a floating population of up to 200 million unemployed, weak public finances, sick State enterprises and banks laden with non-performing loans, extensive corruption, the proliferation of sects to fill the vacuum left by the death of Communist ideals, major policy rifts within the Communist "emperor's household," centre-province tensions, widening income disparities, rising pollution, and mounting lawlessness.

Not so, says another camp. China's Communist regime is a second-rank middle power, and has a long march ahead of it to regain the position held in a very different world nearly two centuries ago. The 50 years of the Communist dynasty has been a failure: in 1950, the Chinese economy weighed just over six per cent of world GNP. For all the high growth rates recorded since 1978, China is at most 3.7 per cent of the world economy now. The most that the party-State can do now is ditch arguments about how "China is different".

Nonsense, says a third group. Communist China has no intention of adapting to Western preferences. Mao's egalitarianism is being ditched in favour of unashamed elitism, crass materialism and great power aspirations. China is like Germany a century ago, seeking its own "place in the sun". Once the huge internal market is fully-developed, and Chinese military spending can be readily financed on the back of a huge economy, China will be an empire to dwarf the US.

Jonathan Story: China is morphing into something else.

Not so fast, say a fourth view. The regime has no option in the longer run but to introduce "market democracy". This means becoming a full participant in this dull, rich global village. China has to sign up to the UN-centred network of global governance, agreement on collective and individual rights and duties, the elaboration of common rules and regulations to govern trade, investment or the environment, and the guarantee of equal access for all to world markets.

My argument is that Communist China is not dying but is morphing into something else; it gives priority to domestic affairs in order to emerge in the longer term as a pillar of global society. The factor of time is thus crucial to an understanding of China, and of how to operate there.

Consider the present clamour, recently endorsed by the IMF, for China to adopt a flexible exchange rate. The last thing the Chinese leadership will do is to be seen to concede to foreign pressure. So the State media has published a series of articles defending the peg of 8.28 to the dollar, adopted in 1998 at the time of the East Asian financial crash. Then, the yuan was under pressure to devalue, and the fear was of China grabbing market share at others' expense.

Even so, China has piled up trade surpluses as economic reform bites. WTO entry in 2002 charts a huge domestic programme of opening up the domestic market, re-centralising administrative powers in Beijing, and separating Ministries at all levels from enterprises. Foreign investment has flooded in, and China is a prime export platform for global, as well as local corporations to the rich western world.

But Beijing is not going to unpeg the yuan in a hurry. With a revalued yuan, the trade surplus would swell, given relative savings rates in China and the US. US household savings are negative, while Chinese households save more than 40 per cent of revenue. This relationship whereby China saves and works and the US works and consumes will not change in the foreseeable future.

> “China is morphing into something else. It gives priority to domestic affairs in order to emerge in the longer term as a pillar of global society”

The leadership is also in the early stages of separating business, administration and politics. For the moment, the party–State runs and owns the budget, the capital market, the banks and most corporations. This makes the whole of China one extensive political market for favours.

Yet to keep the faith of Chinese households in the financial system, the regime has had to accelerate structural change. In particular, the party state has no option but to ensure that China's retail investors earn a real return. This all takes time.

Not least, unpegging the yuan is a major step to freeing capital movements. For the moment, that is a step too far. The experience of financial meltdowns around the world is there to remind the Chinese Government that getting open access to global capital markets is a major political risk. Foreign portfolio investors tend to head for the exits at the slightest piece of bad news, leaving the locals to clear up the mess..

The bottom line is that China's leadership is determined to become a pillar of global society. Making the economy maximally efficient is the only way available for the party-state to create jobs, promote growth and ensure higher living standards. Sustaining the international trade system is a crucial Chinese interest, just as maintaining political stability is a priority.

The remimbi will be revalued in due course, but capital controls will remain because the Communist leadership prefers evolution to revolution.

** Jonathan Story is The Shell Fellow in Economic Transformation, INSEAD, Fontainebleau and Singapore. He is author of China: The Race to Market, Financial Times/Prentice-Hall, 2003.*

Hong Kong's glory days have gone

From **K K CHADHA**
ASIA TODAY INTERNATIONAL Correspondent

HONG KONG: It can be safely said about Hong Kong that its glory days as the Gateway to China are behind it, never to return.

China opened its doors to all and sundry 24 years ago, and they are still pouring in. By 2020, Hong Kong will be just another city in China because China’s cities are developing very fast while Hong Kong is at a standstill. Until 10 years ago, Hong Kong was a shoppers’ paradise for people around the world. That crown has passed to Shenzhen, across the border, favoured even by Hong Kong residents.

Although the cost of doing business in Hong Kong is still high, the city is thriving as a financial and logistics centre by servicing companies from all over the world with manufacturing operations in China, particularly in the southern Guangdong Province. That’s because they want to keep their money in Hong Kong and ship some of their goods through its highly-efficient container port as they can charge higher prices by labelling them “Made in Hong Kong”. That could continue for a while, but not for too long.

Shenzhen may not be a big threat to Hong Kong but Shanghai — the Pearl of the Orient

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