



**LOWY
INSTITUTE
DEBATE**

Does Southeast Asia need a new development model?

EDITED BY ROLAND RAJAH AND BEN BLAND
SEPTEMBER 2022

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

The Lowy Institute is an independent policy think tank. Its mandate ranges across all the dimensions of international policy debate in Australia — economic, political and strategic — and it is not limited to a particular geographic region. Its two core tasks are to:

- produce distinctive research and fresh policy options for Australia's international policy and to contribute to the wider international debate
- promote discussion of Australia's role in the world by providing an accessible and high-quality forum for discussion of Australian international relations through debates, seminars, lectures, dialogues and conferences.

This debate feature was coordinated at the Lowy Institute by Roland Rajah and Ben Bland. It was funded by the Australian Department of Foreign Affairs and Trade. Responsibility for the views, information, or advice expressed in these articles is that of the authors. The contents of these articles do not necessarily reflect the views of the Lowy Institute or the Australian government.

INTRODUCTION

Roland Rajah and **Ben Bland**

Southeast Asia is one of the most economically and developmentally successful regions in the world. However, the ability of the region's developing economies to sustain this success is increasingly in question.

The Covid-19 pandemic has had a devastating impact and will likely leave long-lasting economic, social, and political scars. Poverty will be higher, precarious employment more prevalent, basic schooling disrupted, health outcomes worsened, and businesses left financially damaged. Government budgets will also be under pressure for years to come, contending with higher spending pressures, lower revenues, and elevated debt. Moreover, recovery from the pandemic has barely begun but already been made vastly more difficult by the Ukraine crisis, disrupted energy and food markets, high inflation, and rising global interest rates. Meanwhile, globalisation is under threat, climate change continues to accelerate, and geopolitical instability is on a sharply escalating trajectory.

Yet the challenges facing Southeast Asia are not solely about these destabilising external developments. They are equally about developments internal to Southeast Asian nations, going to the heart of matters of domestic reform, governance, and politics and whether these countries can escape the "middle-income trap" to successfully transition to high-income status.

The key question is, then, does Southeast Asia need a new development model? There are no easy answers. In this interactive, we enlist six of Southeast Asia's most interesting economic thinkers to share their perspectives on what is needed.

Some, such as Jomo Kwame Sundaram, a former United Nations Assistant Secretary-General for Economic Development, say that a specific Southeast Asian development model does not exist. At one level, this is undeniably true. Nonetheless, the term has its merits in describing a broadly successful approach to development that shares several basic features, including the mobilisation of a large and growing pool of young workers, economic modernisation through large-scale industrialisation and urbanisation, and a focus on taking advantage of globalisation and regional integration. These features are all underpinned by generally prudent macroeconomic management, investment in basic public services, "good enough" governance, and a relatively benign regional security

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

environment. To varying extents, these are the key factors often credited for Southeast Asia's economic success, notably amongst the region's major economies — Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

The problem today is that many of these previously supportive factors appear to be turning against the region while significant weaknesses in the development model have been exposed.

Southeast Asia's demographic dividend is fading. An ageing population in most countries poses the risk of the region getting old before it gets rich. The easy one-off productivity wins gained by shifting workers off-farm and into more productive jobs in manufacturing and urban services have also already largely been reaped. Sustaining future productivity growth and export competitiveness is thus becoming harder. As former Indonesian finance minister Chatib Basri notes, "industrialisation strategies can no longer afford to rely solely on the low-skilled manufacturing industry and the creation of low-skilled jobs".

Meanwhile, the hyper-globalisation and diffusion of complex global production networks that propelled Southeast Asia forward for decades now seem well and truly over. They have largely been replaced by global powers' state-driven efforts to re-shore jobs and production, regulate supply chains, decouple from geopolitical rivals, and engage in zero-sum competition over technology, markets, and national influence. As leading Asia business analyst Vasuki Shastry astutely notes, "Southeast Asia is hard-wired for global integration at a time when globalisation is stalling."

The end of ever-deepening globalisation, and its potential degradation, has also exposed the shortcomings of Southeast Asia's own half-hearted embrace of trade openness, liberalisation, and domestic reform — often dubbed "selective opening". Several Southeast Asian thinkers featured in the debate zero in on the self-imposed costs this entails for the region's development prospects. Although governments in the region operate low tariffs and actively court foreign investment, many continue to impose other significant trade barriers, restrict foreign investment outside of manufacturing, and protect their domestic services industries. Large state-owned enterprises and politically connected businesses dominate the domestic market — hurting efficiency and encouraging "rentier" economies and crony capitalism.

At the heart of Southeast Asia's selective opening is what public policy analyst Tricia Yeoh identifies as the failure of the region to match economic progress with the commensurate development of the kinds of institutions needed to sustain long-term developmental advancement. Rule of law, functioning courts, and transparent government regulation remain lacking in many countries, limiting the

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

meaningful check on power necessary to prevent “the capture of state resources by those who will use them for their own benefit”.

What, then, should be done? Though each author has their own unique take, Basri, Shastry, and Yeoh essentially argue that Southeast Asian nations need to focus on key next-generation reforms — plugging the gaps, adjusting, and building on what has essentially been a very successful model in order to unlock continued rapid development.

For our other contributors, however, a more drastic rethink is necessary. Political scientist Yuen Yuen Ang argues that in response to globalisation retreating, environmental crises, and technological disruption, Southeast Asia’s development model must shift from “specialisation” to “diversification”. The problem, as Ang says, is that there is no established playbook for doing so. Jomo, for his part, endorses a more heterodox and country-specific approach to policy reform, rejecting the traditional orthodoxies of the benefits of liberalisation. Finally, climate policy analyst Tiza Mafira calls for a deep transformation of Southeast Asia’s current development model, from one that emphasises linear industrialisation and resource extraction to one focused on circular economics and more decentralised and localised solutions.

Clearly, there is no shortage of ideas in terms of how Southeast Asia’s approach to development needs to change. Each perspective also prompts its own additional questions. How can barriers to further liberalisation be overcome? What opportunities for reform does digitalisation offer? What should the role of industrial policy be? We put these and other challenge questions to our contributors. Again, there are no easy answers. The perspectives in this debate series from some of Southeast Asia’s most interesting economic thinkers provide plenty of food for thought and further discussion.

DIVERSIFICATION, NOT SPECIALISATION



Yuen Yuen Ang is Professor of Politics at the University of Michigan. She was named by *Apolitical* as one of the 100 Most Influential Academics in Government.

As a rising global power, China has been eager to share lessons from its development success around the world — and the most obvious of those, it seems, is on export manufacturing. Justin Yifu Lin, former chief economist at the World Bank and an influential policy advisor in China, urges developing countries to “follow the tried and tested path to prosperity”. They should leverage their comparative advantage in labour-intensive, low-wage manufacturing (e.g., garments and toys) and then gradually move up the global value chain. Furthermore, he adds, they should build export zones and industrial parks like those in China.

There is no doubt that export manufacturing will remain a key growth driver among developing countries given its potential to generate mass employment for the rural population who can send wages home, urbanise, and eventually enter the ranks of middle-class consumers. But times have changed since the peak growth period in East Asia. In Southeast Asia today, specialising in export industrialisation alone will not be enough and will render such economies vulnerable to external shocks. *Diversification* is now the zeitgeist.

The current developmental state model grew out of a particular combination of global factors. The “long peace” in the seven decades after the Second World War centred on a US-led global order. (Although in certain parts of Asia, such as Vietnam, the Cold War boiled over into devastating conflict.) To draw and build on alliances during this period, the United States spearheaded a liberalisation of the world economy. Newly industrialised economies could benefit from open

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

market access in developed economies while protecting their own industries. The fall of the Soviet Union in 1991 and the creation of the World Trade Organization (WTO) in 1995 further expanded global trade. China grew explosively after it joined the WTO in 2001.

The twentieth-century global order has today been upended in several ways. First, developed economies have gone from championing globalisation to resisting it. In the United States, the Trump administration promised to bring manufacturing jobs home under the banner of “America First”. Although President Joe Biden has reversed many of his predecessor’s policies, he maintains the same course on trade protectionism. This wave of de-globalisation has been exacerbated by the pandemic and geopolitical tensions between the United States and China. A “decoupling” of the superpowers may transfer some manufacturing from China to Southeast Asia, but it also brings unpredictability for countries that trade extensively with the two giants.

Second, the effects of climate change and ecological crises are becoming more critical by the year. Southeast Asia is especially susceptible to rising sea levels and widespread flooding. There is no point building sprawling industrial parks if parts of Ho Chi Minh City and Bangkok will be under water in the coming decades. Indeed, Indonesia has announced plans to move its capital from the sinking metropolis of Jakarta. Whereas “green” development used to be a goal that countries strove for once they reached a sufficient level of wealth, developing countries today must prioritise sustainability and decarbonisation *now*. As we have learned from China’s ongoing energy crunch, balancing growth with carbon emissions reduction is not easy.

Third, technological disruptions are bringing a mixture of peril and promise to Southeast Asia. On the one hand, automation threatens to eliminate numerous labour-intensive manufacturing jobs. On the other hand, the increased use of the internet and mobile phones — spurred by lockdowns during the pandemic — has spawned new businesses and industries, from e-commerce and ride-hailing apps to fintech and edtech. This provides unprecedented opportunities for Southeast Asian countries to partially leapfrog past manufacturing and into a range of technology-enabled services. Kevin Aluwi, the CEO of Gojek, an Indonesia-based technology company, declared in 2021, “We’re about to enter the golden age of technology companies in Indonesia and the rest of Southeast Asia.”

All of these ongoing disruptions compel a drastic rethinking of national development strategies in Southeast Asia. Economic specialisation is being replaced by diversification. Furthermore, climate change mitigation and technology must be at the heart of any development plan.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Working with the United Nations Development Programme, I saw these shifts in action in Cambodia. In 2018, the government of Cambodia unveiled the “Rectangular Strategy” — a four-pronged development vision for 2050. One of the pillars is economic diversification, which includes developing new sources of growth, promoting banking and finance, preparing for the digital economy and fourth industrial revolution, and improving the logistics system. According to the report, the Cambodian economy needs to diversify in order to be “resilient to shocks”. Policymakers also recognised that as Cambodia graduates from least developed country (LDC) status, it will no longer enjoy the trade benefits that it used to have.

But while there is a well-trodden path in export manufacturing and abundant experience in designing industrial policies for economic specialisation, there is no established playbook for diversification. What should diversification entail? What is the right mix of sectors and services in a diversified economy? What can governments do to support diversification? How can developing countries simultaneously conserve the environment and produce growth while they are not yet rich?

These are new challenges and questions for which there are no easy or clear solutions. The scholarly literature has not yet noticed, let alone responded to, these disruptions. Stephan Haggard’s primer, *Developmental States*, for example, does not once mention “economic diversification” as a national strategy, or the words “digital” or “climate change”.

The first step of adaptation is to recognise that conditions have changed. The modern world is in a new chapter of “development”, with new priorities, dilemmas, dangers, and opportunities. We must change the questions we ask before we can find the right answers.

CHALLENGE QUESTION

What role should industrial policy play in Southeast Asia in meeting these new challenges?

Industrial policy is a term that is often debated but seldom defined. Specifically, it means government policies to support selected industries that are considered strategically important. On industrial policy, there is no one-size-fits-all answer for Southeast Asia, which includes countries with very different socio-economic conditions and economic activities. Diversification and building climate resilience do not amount to an “industrial policy”, as I understand it. These should be considered part of an overarching national paradigm that defines the goals and priorities of development. This may involve selecting industries as a policy tool.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

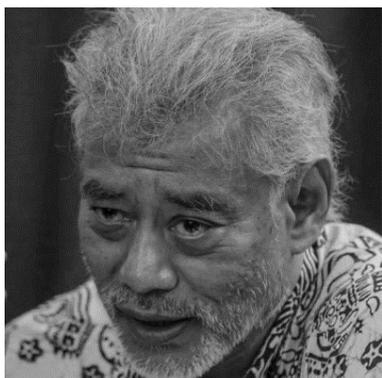
The basic formula for export-led manufacturing does not differ significantly around the world. It includes focusing on areas of competitive advantage (e.g., wage-intensive, low-cost manufacturing) and having governments who promote industrialisation by providing political stability, low-wage labour, and infrastructure.

As Joseph Wong argues in his book, *Betting on Biotech*, this model reaches its limits when governments attempt to promote uncertain industries, such as biotech, because they cannot predict success accurately and plan ahead. Technocracies will always be indispensable for reliable policy implementation, but dealing with uncertainty (climate change) and multifaceted social problems (inequality) are qualitatively different tasks. I would argue that Deng Xiaoping's "directed improvisation" system would be a suitable model for this new environment because it relies on the government to direct rather than plan and dictate, while encouraging local actors to discover indigenous solutions to local problems. I introduce this model in depth in *How China Escaped the Poverty Trap*.

Should Southeast Asia follow China in emphasising higher quality growth and common prosperity?

In principle, of course! One of the United Nations' Sustainable Development Goals (SDG) is "inclusive growth", which President Xi Jinping's leadership calls "common prosperity". The challenge is how to achieve high-quality, inclusive growth at early stages of development, when income is low, capacity is weak, and there are not enough resources to go around. For instance, many low-income countries rely on low-wage manufacturing and ignore environmental and labour regulations in order to gain a competitive edge. If they follow standards of high-quality growth, their model — which countries in East Asia and China have pursued to achieve rapid industrialisation — will be unacceptable. By contrast, Bhutan is a poor country, but it has equality and pristine ecology; normatively, the country is willing to accept low growth for the non-financial benefits that its policies bring. To be clear, I am not saying that Southeast Asia should give up on inclusive growth. I am saying we need to be realistic and recognise the trade-offs and hard choices that governments must make, otherwise "inclusive growth" will just be a slogan.

REGIONAL DIVERSITY NEEDS DIVERSE SOLUTIONS



Jomo Kwame Sundaram was an Assistant Secretary-General for Economic Development in the United Nations system from 2005–15 and received the Wassily Leontief Prize for Advancing the Frontiers of Economic Thought in 2007.

It is tempting to think that there is an off-the-shelf development model from Southeast Asian nations for others to emulate as they plot their future paths in these uncertain economic times. That would be wrong. Not only has our world transformed irreversibly in recent decades, but many governments are still failing to learn the right lessons from Asia’s past development success stories. While trade liberalisation and foreign direct investment (FDI) are routinely held up as the keys to these nations’ remarkable success, and as the key catalysts for others to deploy, many other factors at play are less well understood or even discussed.

Moreover, although Southeast Asia is seen as a “region” by those outside, most countries and people in the region did not see their pasts and futures as interdependent until about half a century ago. The countries have had diverse experiences, especially in recent centuries, due to the impact of not one, but many imperialisms (even Thailand, which has never been ruled by colonial powers).

The Association of Southeast Asian Nations (ASEAN) has often been hailed as an exemplar of regional economic cooperation, with many citing the ASEAN Free Trade Area (AFTA) agreement of 1992 as a prime illustration. But ASEAN’s contributions have, in reality, been limited in scope and consequence.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Rather than ASEAN alone, it is ASEAN plus Japan, South Korea, and China that has become more significant in terms of regional integration, forming the basis for the Regional Comprehensive Economic Partnership (RCEP) agreed last year, which also includes Australia and New Zealand. Most countries in the region are involved with the China-led Belt and Road Initiative. And, in a remarkable *tai chi* move, China has applied to join what is left of the Trans-Pacific Partnership, an initiative championed and later abandoned by the United States to counter Beijing's influence in the region.

Northeast Asia also played a key role in Southeast Asia's industrial development in the decades before the Asian financial crisis of 1997. As Japan, South Korea, and Taiwan faced full employment and rising wages in the 1980s, relocating labour-intensive production to China and Southeast Asia accelerated growth in much of their East Asian regional hinterland. AFTA's establishment during this 1990s boom implied a Southeast Asian "miracle" — and model — despite its actual provenance.

There were important differences between what may be caricatured as Southeast versus Northeast Asian development models. Growth in the latter relied much more on domestic capital accumulation, whereas Malaysia, Indonesia, and Thailand sought FDI — not unlike Singapore, alone from Southeast Asia among the "first tier" newly industrialising economies.

Northeast Asia sustained rapid growth and industrialisation for much longer, with equitable distributional outcomes except in China. Meanwhile, Southeast Asian growth has been more episodic, with less equitable results. But despite all this, it is still tempting to ask if Southeast Asian export-led industrialisation, before the Asian financial crisis, is still a viable basis for development and progress in the region.

Undoubtedly, growth and industrialisation accelerated in Malaysia, Thailand, and Indonesia for a decade from the late 1980s thanks to a specific conjuncture of events. But conventional wisdom is wrong in asserting that this increase in manufacturing FDI was the result of trade and financial liberalisation.

Trade liberalisation in the preceding period was either unilateral or bilateral. The World Trade Organization was established in 1995, with China only joining in the new century. While host governments, including those in East Asia, undoubtedly sought to attract industrial FDI, general policies of globalisation, liberalisation, and financialisation actually delivered little. And Southeast Asia's decade of rapid industrialisation and growth was abruptly disrupted by the financial crises from mid-1997 — especially in Thailand, Indonesia, and Malaysia.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Unlike the success stories of Northeast Asia, including China, most of Southeast Asia has only seen modest improvements in domestic industrial capacities and capabilities. This has been due to the official preference for FDI in the region, often marginalising local entrepreneurs. In contrast, Singapore has taken a path similar to Israel's, with a domestic technology development strategy designed to complement FDI.

In recent years, Southeast Asian policymakers have become bolder in their policymaking. Meanwhile, domestic business elites have been increasingly assertive in creating and seizing new opportunities in these fast-changing economic times.

While Southeast Asian governments were chastised by US and International Monetary Fund officials for their heterodox policies in the wake of the Asian financial crisis, many such policies were implemented a decade later to cope with the 2008 global financial crisis, as most rich countries retreated from the very trade liberalisation they had once preached.

Now, Western governments are explicitly embracing previously eschewed “industrial policy” after a decade of lacklustre growth. Thus, the European Commission espouses Mariana Mazzucato’s “mission economy”, which would have been a heresy at the end of the last century.

While the United States and other Western nations are questioning their old economic assumptions, they are also witnessing a slow but sure shift of power to China, whose meteoric economic rise contrasts with much of the world in recent decades. China is now the most important trading partner for all East Asian countries — each now participating in the nominally ASEAN-led RCEP. Many are also involved in Beijing’s Belt and Road Initiative. The Covid-19 pandemic has further consolidated acceptance for China’s rise in the region, with many countries relying heavily on vaccines and other pandemic needs produced by China.

These shifts in economic thinking and the regional economic balance of power present Southeast Asian governments with good opportunities to sharpen their own approaches to development. Even as they struggle with basic development challenges such as poverty reduction and industrialisation, many Southeast Asian nations are facing a growing list of emerging problems, from climate change and the pandemic to widespread social inequality.

But while these might be common problems, the region’s diverse economies will need to deploy appropriate, often different solutions that fit their own needs rather than look for any over-arching model.

CHALLENGE QUESTIONS

Can new industrial policies be deployed without creating new openings for cronyism and rent-seeking?

The existence of rents in a controlled environment can well mean that rents created are not all wasted by rent-seeking. Economist Anne Krueger presumed that when rents are created by distortive state interventions, it will incentivise corresponding wasteful rent-seeking resulting in equivalent “economic welfare” losses. But, in fact, there is no empirical evidence for this assumption, and the policymaking challenge includes minimising such losses. Most firm investments in any oligopolistic situation inevitably seek to capture rents, in line with the profit maximisation drive. After all, what are “incentives” but state authorised rents to motivate desired economic behaviour, including investments. Of course, there is a great deal of historical, national, and other variation.

“Perfect competition” remains a pedagogical myth of convenience for teaching economics — which was undermined from the mid-nineteenth century in the West, as observed by English liberals such as John Stuart Mill. Alexander Hamilton may well be far more relevant for post-colonial developing countries in Southeast Asia. Faced with building a new nation from a British colony, Washington’s first treasury secretary improvised, developing customs revenue collection to finance the new state. Two-thirds of a century later, after the US Civil War, the triumph of the North drew on his report on manufactures to promote policies to develop American manufacturing capacity. Thus, the United States developed significant industry — unlike, say, Australia or Canada under continued British rule. If the Southern Confederacy of export-oriented plantation interests had prevailed instead, the economic consequences would have been very different, arguably changing the shape of the world in the twentieth century. All this was recognised by Friedrich List — who repudiated his own *Principles of the Natural Economy* a decade later after visiting America and discovering Hamilton’s work — in writing *Principles of the National Economy*.

Hamiltonian pragmatism is still needed today, instead of the usual Washington and now Davos slogans and prescriptions, which Southeast Asian developing country policymakers are urged or even required to emulate.

What are the implications of a slowing Chinese economy for Southeast Asia’s future development?

There are so many possible scenarios that can be seriously envisaged, and it is difficult to fully think through their implications. The so-called new trade war is clearly far more than that. At the heart of it is the new US–China Cold War. And

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

if China manages to grow despite all the new obstacles, we are likely to see further escalation.

Westphalian multilateralism — with all its limitations — is in decline, and the US-led West's interest in trade liberalisation has declined since the turn of the century. International trade grows little these days, exacerbated by supply chain disruptions due to the pandemic and new Cold War tensions. Donald Trump and Shinzo Abe's anti-China trade and investment measures are going to be justified by more sanctions, ostensibly inspired by solidarity with Ukraine, Uyghurs, Hong Kong, etc. It hardly matters if the current and future equivalents of the “weapons of mass destruction” turn out to be bogus or misrepresented. The AUKUS security pact between Australia, the United Kingdom, and the United States, and the deployment of one of two UK aircraft carriers to this part of the world are not helping.

But all this is going to cost both sides, and the world economy may well slow down some more as global warming continues to pick up momentum, especially in the tropics, including Southeast Asia. Besides leaving many developing countries further behind, with little prospect of significant economic support from the global North, this will push the region further into China's embrace if Beijing improves its accommodation of regional and national sensitivities. ASEAN's half-century-old commitment to creating a Zone for Peace, Freedom, and Neutrality (ZOPFAN) — which is non-aligned and nuclear-free — has acquired renewed relevance in these uncertain times.

SOUTHEAST ASIA'S RESILIENCE WILL NOT BE ACHIEVED THROUGH INDUSTRIALISATION



Tiza Mafira is a climate policy expert based in Jakarta. She leads Climate Policy Initiative Indonesia, a think tank, and in 2020 received the Gen.T Award for Future Leaders of Asia.

Industrialisation drove decades of rapid economic growth, innovation, and infrastructure building across Southeast Asia. But the focus on growth-at-all-costs also drove widening inequalities in our region — a problem that has been exacerbated by Covid-19. Death tolls for the poor are higher than for wealthier citizens, and significant numbers of children with no internet access have suffered from lack of remote schooling. Across Southeast Asia, the pandemic has exposed how our existing approaches to economic development fail to deliver sufficient welfare and wellbeing to our citizens. These weaknesses and the lack of resilience in our economies should be cause for alarm, especially given the enormity of the systemic crisis that we face due to climate change.

From Indonesia to Vietnam and Myanmar to the Philippines, the region is experiencing an increase in extreme weather disasters that are compounding Southeast Asia's developmental challenges, including food insecurity, child malnutrition, and access to decent healthcare and sanitation. As our ecosystems come under more pressure and we struggle to emerge from the pandemic and repair the scarring it has caused, Southeast Asian nations need to imagine new ways to rejuvenate our economies that make them fairer and better able to withstand the turbulence we will face.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Whether we like it or not, economic growth is limited by the health of the ecosystems that provide us with clean water, air, and other essentials for human existence. As the climate crisis prompts us to contemplate the limits of growth, we also need to ponder the real purpose of this growth. If, as most politicians and economists agree, growth is meant to support our common welfare, we should ask why our wellbeing has not increased in equal measure despite consistent GDP growth. The member states of the Association of Southeast Asian Nations (ASEAN) enjoyed growth of around five per cent a year over the decade before Covid-19, but Indonesia, Laos, the Philippines, and Vietnam experienced rising or persistent inequality. We must think again about the way we have structured our economies.

The resilient economies of the future will be those that do not rely on the linear industrial model of extraction/production/distribution/consumption/disposal. These models deplete resources, generate pollution and emissions, and do not factor these external costs into their prices.

We need to reshape our economic strategies by mimicking nature. Economies can be more resilient if they are circular instead of linear, decentralised instead of centralised, and diverse instead of monocultural. A circular economy will mean that instead of using new materials, most of the things we produce should use recycled, regenerated, repaired, or reused materials, and be powered by renewable energy.

Very little will be extracted from the ground, and very little will be disposed of during production processes or at the end of a product's lifecycle. Diversity will be favoured over size, mirroring the flourishing of biodiverse areas compared to monocultures. This could mean, for example, a mixture of renewable energy sources is preferred over a single commodity-based energy source; a mixture of endemic crops is preferred over vast food estates dominated by a single crop; and a competitive landscape of businesses is preferred over giant multinational industries that are too big to be allowed to fail. Vietnam is touted as the leader in ASEAN on scaling up renewable energy, with hydropower a prominent part of its energy mix and other renewables making up 25 per cent. Solar power capacity in the country jumped from 86 MW to 4500 MW between 2018 and 2019, with most of the investment coming from medium and small enterprises.

A decentralised economy means that the capital and resources needed to produce goods can be spread out, particularly for essential needs. Communities or even individual households can produce their own food and renewable energy, thereby requiring rural, suburban, and urban areas alike to maintain healthy ecosystems. This type of decentralisation would increase the odds of vulnerable communities maintaining access to essentials, even if supply chains were disrupted.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

In Southeast Asia, conventional economists tend to blame rising inequality on the “middle-income trap”, which proponents say will be corrected with more growth and more downstream industrialisation. Nowhere is this more apparent than in climate policies.

The preferred solutions to climate change have been the ones that are already commercial, able to be scaled up, or able to “strike a balance” between environmental protection and economic growth. For example, deforestation pledges come with carve-outs for large agricultural estates on peat lands in the name of “efficient” food crop production. The pledges are accompanied by assurances that they will not sacrifice large-scale economic development, instead of focusing on how preserving forests and healthy ecosystems can increase food diversity and food security. This is despite success stories that show a focus on healthy ecosystems boosts food production and revenues. One example is the Siak district in Sumatra, Indonesia, which has chosen to forego converting its peat-rich lands into large agricultural estates in favour of cultivating endemic fish and producing fish extract products. In addition to conserving the peat lands, the revenue is reportedly double the potential revenue from planting oil palm trees in the same area.

Renewable energy is now enjoying increased support from policymakers, but only after overwhelming arguments were made about its commercial worth, including reduced energy costs, the ability to harness local content and promote domestic assembly of parts, and opportunities for state-owned utility companies. Carbon taxes are being supported, yet only after the tax rates were watered down, and even then, fossil fuel subsidies are still in place despite being contradictory to the goal of a carbon tax.

Simultaneously, important renewable solutions, such as off-grid energy, fail to attract investment because of small returns. Governments, including in Indonesia, do not tend to see the potential of renewable energy as a small-scale, decentralised, democratic form of energy creation, and thus off-grid solutions often fail to attract public financing. So too, climate adaptation projects, such as mangrove replanting in coastal communities to guard against sea level rise, are severely underfunded, with financing for climate action overwhelmingly dominated by spending on the commercial renewable energy sector.

The unsaid sentiment behind these policies is that environmental measures are considered a setback to the region’s efforts to industrialise. Industrialisation is still touted as a panacea for economic development and job creation. Unfortunately, linear industrialisation models are exactly the problem exacerbating the climate crisis. The good news is that greener alternatives can generate significant numbers of new jobs, while providing an opportunity for improved equality. But to enact such transformational change, we need a clearer

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

idea of which policies to pursue and how to implement them. This work needs to start now. If Southeast Asia chooses to embrace the full transformational potential of circular economies ahead of industrialised countries, it may even have a competitive edge over other regions.

CHALLENGE QUESTIONS

Would a circular economy, with less consumption, lead to even less trickle down and lower living standards?

The failure of trickle down is not due to a lack of growth, it is the consequence of a failure to distribute wealth and distribute the means to create value. A circular economy still creates value. There will be more jobs focusing on regenerating resources, reclaiming materials, repairing, reusing, and repurposing. These jobs will require human skill, craftsmanship, and innovation.

Communities that have passed the poverty line and have all their basic needs fulfilled already have a distorted and comparative view of what living standards should be. The more unequal a society, the more likely the disadvantaged in that society view themselves as having a low living standard, even though they have housing and access to schools, healthcare, food, and electricity. There are multiple examples of high-consumer societies in which citizens report depression and a lack of fulfilment and wellbeing. At the same time, there are low-income countries where citizens report high wellbeing. Consumption is a poor indicator of living standards.

Is there really a growth vs circular economy dichotomy?

If I reuse my tumbler to purchase coffee, I am contributing to the growth of coffee consumption, but I am not contributing to the growth of cup sales. It is the coffee that makes me happy, not the cup. The circular economy finds ways to deliver the product needed, without the usual extraction of natural resources, energy combustion, single-use packaging, and landfilling. That means there will be no growth in those sectors, but there can still be growth in the things that matter to our wellbeing. And of course, a community-led business of cup-washing, cup-mending, or cup-recycling could grow, too.

What role do you see for governments and the private sector in promoting the community-led approach that you favour?

Governments can correct the pricing of products by requiring external costs to be internalised. For example, the longer the supply chain and the more energy and emissions it takes to produce and distribute the product, the more expensive it should be. It is okay for governments to put in place an ambitious carbon tax.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

It is okay for governments to require decent wages for workers and transporters. These changes would provide small businesses with a fair playing field and push the whole economy into more sustainable business practices. Yes, prices might rise overall, but people will have better wages, products will be appropriately valued, and consumers will have less wasteful consumption habits.

Can community-led development really deliver the needed scale of impact?

Community-led businesses can also reach scale — but scale by number of self-sustaining and resilient communities instead of number of factory workers or global sales. We see it all around us: coffeeshops and restaurants, tailors and mechanics, snack producers and market vendors, and textile and furniture makers that have been around for generations without feeling the need to scale. They are a significant part of the economy. Those that have achieved “artisanal” status, such as bespoke distillers, can even export a limited batch of products while remaining a small-sized business. This is very different from a multinational company that is so “efficient” it floods the global market with cheap products despite there being little demand.

MODERNISING SOUTHEAST ASIA'S DEVELOPMENT STRATEGY



Chatib Basri is a Senior Lecturer at the Department of Economics at the University of Indonesia and a former Minister of Finance of Indonesia.

Two words sum up Southeast Asia's economic success: industrialisation and trade. However, the pandemic and recent conflicts have altered the global trade landscape and political economy. Given this context, can the countries of the Association of Southeast Asian Nations (ASEAN), including Indonesia, accelerate their own development by following the same recipe? There is no simple answer to this question, of course. Southeast Asia, in my opinion, must maintain its industrialisation and trade strategy while making significant changes. This is due to several key factors.

First, conflict and the Covid-19 pandemic have exposed various supply chain vulnerabilities and raised concerns about globalisation. Dependence on other countries causes issues when vaccine nationalism, medical supply shortages, and production disruptions occur as a result of supply chain reliance. As we saw in Asia during the global financial crisis (GFC), countries that maintained or even increased their share of GDP from domestic demand were in a better position to withstand the global economic downturn. Indonesia, for example, survived the GFC thanks to appropriate policy responses because it was less integrated into the global economy than export-oriented economies such as Singapore or Taiwan. Thus, to some extent, we require the domestic market.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Second, digital disruption and the global turn towards a greater focus on protecting the environment have resulted in a shift in the pattern of industrialisation. Our industrialisation strategies can no longer afford to rely solely on the low-skilled manufacturing industry and the creation of low-skilled jobs. There is a need for improved human capital quality as well. We must not just create jobs, but good jobs.

Third, Southeast Asia cannot thrive if it looks inward. Due to limited domestic capacity, Southeast Asia cannot afford to take the path of autarky. Even if the region had the capacity, choosing an inward-looking approach may result in higher production costs. Reducing the reliance on foreign inputs increases the reliance on domestic inputs, which is counterproductive because any national pandemic-related lockdown affects domestic sectors; there is generally no resilience benefit from re-nationalising international supply chains. In the case of Indonesia, imports are an important part of encouraging investment, with raw materials making up 90 per cent of imported goods. In tandem, the positive lag effect of exports is driving the country's strong household consumption. This means that trade will continue to play a vital role. Indonesia, which has a very large domestic market, cannot afford to be autarkic or disconnected from global supply chains, let alone other ASEAN countries with smaller domestic markets.

Fourth, it is getting harder to make good economic policy decisions. Political pressure to reduce economic interdependence is rising across the world. The reasons for this include an increased focus on national security, the emergence of identity politics as a result of weakening economic growth, and opportunities for rent-seekers to justify the need for protectionist policies. Consumers, on the other hand, continue to desire access to high-quality, low-cost goods and services. As a result, policies are likely to become more stringent. Southeast Asia's economies have a history of growing regional and global economic integration. Many of the factors driving discontent with globalisation in rich economies do not exist to the same extent in Southeast Asian countries. Nonetheless, there is no room for complacency. Economic growth is slowing in some countries and economic insecurity persists.

So, what should be Southeast Asia's future development strategy? Southeast Asia, I believe, should remain connected to global supply chains with some important modifications.

First, it is critical to maintain domestic demand. However, given the importance of trade to economic growth, improving domestic economic integration can help boost demand while also improving export competitiveness. Domestic transaction costs can be reduced by investing in both physical and soft infrastructure.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Second, all countries, including those in Southeast Asia, must diversify their supply chain bases; diverse exports and destinations are required.

Third, digital technology will play an increasingly critical role. The spread of automation and the rapid adoption of other technologies such as video conferencing and e-commerce have helped reduce the economic disruptions caused by the pandemic. We will also see the manufacturing sector shift from just-in-time production to a focus on safety stock intermediate inventory.

Last, in terms of employment, the continuing expansion of Southeast Asia's middle class will drive growing demand for higher-skilled workers. This requires a jumpstart in the quality of training and education. If governments can improve their skills base, they can precipitate a virtuous circle that will further boost the size of the middle class and accelerate the shift away from low-skill, low-wage jobs.

In the future, Southeast Asia cannot rely solely on natural resources or low-wage labour, as it has too often in the past. But significant economic change will not happen overnight, for the reasons I set out above. The key questions are how quickly and smoothly Southeast Asian governments can manage the adjustment and fund its costs. There is room for industrial policy, so long as it leads to higher research and development spending, and investment in human capital and infrastructure, rather than providing cover for protectionist policies. What Southeast Asia needs is not a change in development strategy, but to refine its development strategy. Trade and industrialisation remain the keys, adapted to meet the challenges of a region and a world under strain.

CHALLENGE QUESTIONS

How can barriers to further liberalisation be overcome?

Several factors make it difficult for various countries to continue liberalising. First, there are changes in global geopolitics and slowing growth in the global economy. In recent years, there has been an increase in economic nationalism, which has been triggered by a variety of factors, most notably rising inequality, particularly in developed countries. The preceding developments demonstrate that the first-generation model of globalisation, which entailed erecting the lowest possible barriers to trade in goods and services, did not garner widespread political support. So far, the assumption that economic reform through market opening will be followed by political reform has not been realised. Globalisation's positive impact on people is not being felt. As a result, political support for globalisation has dwindled, and resistance to globalisation has emerged.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Second, we are beginning to see signs of a shift in the economy's structure, which previously relied on the manufacturing sector but is now moving towards the service sector. This is also a symptom of China's adjustment process. As economist Dani Rodrik of Harvard University stated, unlike manufacturing, the service sector necessitates much higher levels of education and training. As a result, the service sector is not a perfect replacement for manufactured exports. Outside of tourism or simple services, the sector also generally necessitates strong institutions. And this is the main weakness of emerging market countries: human and institutional capital. This has the potential to encourage increased protectionism in developing countries.

What steps can be taken under these conditions to ensure the viability of the global trading system? From a political economy standpoint, I believe that, while ideal, unilateral reform is difficult to implement. Economic nationalism and supply chain disruption are the main hurdles. Continuing multilateral cooperation, on the other hand, is an optimal solution. However, the facts show that progress in multilateral cooperation is extremely slow, and deadlocks are possible. Regional cooperation is another option, while still attempting to combine unilateral reform with a multilateral framework. In this context, open regionalism is the second-best form of regional cooperation available.

Of course, a combination of the three approaches is also an option. Creating several successful stories is critical in terms of the political economy of reform. The dilemma of reform is that the cost is always immediate, but the benefit is long term. As a result, in order to gain political backing, it is necessary to achieve quick victories. Reforms that only address long-term issues without considering the political cycle will face difficulty gaining support from politicians and leaders. It is necessary to have modalities in place that allow for multi-stage regional cooperation, beginning with less ambition and gradually increasing in complexity.

Has governance become a binding constraint for the region?

Former Venezuelan minister of Trade and Industry Moisés Naím divides reform into two categories: the first generation of reforms, which includes macroeconomic stabilisation, tariff reduction, budget cuts, and privatisation; and the second generation of reforms, which are broader in scope and include bureaucratic reform, efforts to improve public services, and the maintenance of human capital quality. According to Naím, while the first generation of reforms discusses the instruments to be used, the second generation focuses on desired outcomes, such as improved public services. Because it is closely related to change or institutional development, the second generation of reforms is likely to be more complex and difficult to implement and come with a lower chance of success.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

With conditions such as the current pandemic, the role of the second generation of reformers is becoming more important because the government is expected to be responsive, make quick decisions, and provide good public services. This process is not always easy in a vibrant democratic system. Decision speed, for example, is difficult to achieve because it necessitates the cooperation of multiple parties. With the limitations of existing bureaucratic capacity, the role of technology and collaboration with the private sector, non-governmental organisations, and the community becomes critical.

Does digital disruption create opportunities for reform?

Digital disruption can create opportunities for reform, such as overcoming bureaucratic barriers. As a result of digital disruption, various licensing processes will be accelerated. However, there is one thing to keep in mind: regulators can no longer think in the same way they used to. Digital disruption makes the product cycle shorter. It is difficult for regulators to keep up with each innovation. Regulation has shifted from a static to a dynamic state, with a greater emphasis placed on fundamental principles, such as consumer protection, a level playing field, and transparency. There is a constant risk that regulation will become obsolete due to the rapid rate of innovation. The main criticism directed at bureaucracy is its rigidity; “agile bureaucracy” is an oxymoron. The issues will be whether the regulators can be dynamic and flexible, and how bureaucracy will deal with products and services that are becoming more personal and discretionary.

ECONOMIC GOVERNANCE: FUTURE-PROOFING SOUTHEAST ASIA POST-PANDEMIC



Tricia Yeoh is CEO of Institute for Democracy and Economic Affairs (IDEAS) and holds a PhD from the School of Politics, History and International Relations at the University of Nottingham, Malaysia.

The Covid-19 pandemic has delivered an unexpected blow to all economies in the region, exposing underlying and pre-existing structural flaws in each country. The multiple waves that have hit Southeast Asia have seen often-times haphazard horizontal coordination as governments struggled to balance public health and economic priorities. This crisis has revealed several fundamental weaknesses in Southeast Asia's economies: inadequately resourced public healthcare systems, poorly managed lockdowns, and politically driven policy decisions. With marked country-to-country variation in pandemic outcomes, the question is what the region's countries can and should be doing as they consider a post-pandemic future.

Despite having vastly different political histories and cultural lineages, almost all the countries of Southeast Asia have one thing in common. Most chose to embark on their own version of largely similar export-oriented economic development. Throughout the 1980s and 1990s, these countries adopted a predominantly East Asian industrialist model, in combination with a big government approach. Prior to the Asian financial crisis of 1997, the economies of Southeast Asia expanded rapidly, with an average GDP growth rate across the region of 6.74 per cent in the 1990s according to the World Bank.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Some countries underwent rapid modernisation, primarily Malaysia, Singapore, Thailand, and Brunei, while others would take a decade or more to catch up, such as Indonesia, the Philippines, and then more recently Vietnam, Cambodia, Laos, and Myanmar. The thrill of experiencing growth, “new money”, and the infrastructure boom alongside it, however, was not necessarily matched by the development of the strong and stable institutions required to govern efficiently.

With the exception of Timor-Leste, most countries in the region are classified as “not free” by Freedom House, and either have been or still are ruled by dominant parties couched within semi-authoritarian regimes. In fact, the freedom scores of most countries in the region declined after Covid-19 hit. Indonesia’s leadership initially championed good governance, but even this has regressed somewhat. Research indicates that democratic countries tend to practice better governing standards, which could explain why institutions are not as robust as they ought to be within the region.

Within such a context of either unstable or weak democracies (Thailand, Malaysia, the Philippines) or excessively strong states (Cambodia and Myanmar), efficient resource allocation towards high-level productivity has been challenging, to say the least. Rentier economics, patronage, and cronyism predominate across the region. Singapore may have escaped the problem of endemic bureaucratic corruption by adopting a highly technocratic model and paying its senior politicians and bureaucrats well, which it can afford to do.

In the 2016 crony-capitalism index constructed by *The Economist*, Malaysia ranked second in the world, with the Philippines third, Singapore fourth, Indonesia seventh, and Thailand twelfth. Strategic industries such as telecoms, natural resources, real estate, construction, and defence were found to be most vulnerable to exploitation. We need strong, stable, and independent institutions to prevent the capture of state resources by those who will use them for their own benefit.

Southeast Asia has experienced tremendous economic growth over the last three decades primarily due to its cheap labour, access to raw materials, and more recently thanks to greater economic integration. Yet such growth has taken place in spite of corrosive trends that have eaten away at the fundamentals required to truly leap up the value chain.

The future is not all bleak, though.

The first reason for this is that investors’ increasing emphasis on environmental, social, and governance issues and the global push towards sustainability have prompted countries to start re-examining their regulatory environments. These are positive trends, but governments and companies cannot hope to ride the

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

sustainability wave without corresponding institutional reforms. For example, moving away from fossil fuels towards hydropower could wreak disastrous environmental and social impacts in poorly governed Southeast Asia. We need to ask how the construction of new dams in Laos will affect indigenous and community land. And what will happen to hydrocarbon-dependent countries such as Brunei, Malaysia, and Indonesia if the global economy decarbonises?

The second reason is that better governance is a realistic ambition for the region. Multilateral trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) contain multiple provisions for domestic reform on issues ranging from labour to procurement and state-owned enterprises (SOEs) that member countries would be obliged to adopt.

Adopting these, alongside the corresponding domestic reforms, provides a strong basis upon which enterprise can begin to flourish through more productive and competitive means. Southeast Asian economies, especially in a post-pandemic world, may well continue on their export-oriented path. As economic integration deepens, it is imperative that countries take seriously the need to overhaul their internal regulatory systems towards strong economic governance, establishing open governments that practice transparency and accountability, and access to information by default. Investments from abroad must also adhere closely to domestic rules within such an open and transparent environment — which is not necessarily the case for some foreign investments, such as from China, as detailed in the recent Belt and Road Initiative Monitor research project from the Institute for Democracy and Economic Affairs.

Moving up the value chain towards growth and development in the next few decades and breaking out of the “middle-income trap” will require not only institutional reforms but decisive, ambitious governments. Many Southeast Asian economies would benefit from reducing the role of the government in the economy, curbing their dependence on SOEs, pushing for greater public procurement transparency, and implementing competition laws to reduce the hold of monopolies and cartels.

Each country will have to finely balance these efforts towards an open economy while still maintaining a sufficient buffer to provide social protection for the poorest communities. Reducing state corruption and patronage would lead to less wastage of public funds, while institutional strengthening would allow funds to reach their intended targets and also reduce inflationary pressure. Fiscal discipline is crucial for the long-term sustainability of such efforts.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

The third reason for cautious optimism is that Southeast Asia has always been a region of countries well placed geographically to trade. Such dynamic regional economic exchanges will continue, despite the disruptions of the pandemic. To fully capitalise on our connections to global markets, we need to embark on profound economic governance reforms that strengthen our domestic institutions, laws, and regulatory frameworks while simultaneously liberalising our economies. This will boost our growth prospects, protect those who are currently falling through the cracks, and better prepare our economies and our people for future challenges and crises.

The author thanks IDEAS researchers Imran Shamsunahar and Low Zhen Ting for their input and assistance.

CHALLENGE QUESTIONS

Can the crisis produced by the pandemic provide a political impetus for reform?

Throughout Southeast Asia, we have seen evidence of how the pandemic showed up pre-existing structural weaknesses and flaws in our political economies. Among these are indeed the vested interests and strong protectionist sentiments that were already deeply embedded within the systems of many Southeast Asian countries.

In such a climate, we need to position reform squarely on post-pandemic recovery. If our political economies were revealed to be not as shock-proof as we thought, then this is the perfect time to galvanise support in cross-partisan sectors with the message that economic resilience lies precisely in the strengthening of institutions. Open and competitive markets will allow struggling micro and small enterprises to compete more fairly.

We need to embrace every opportunity to encourage this, taking advantage of such moments of crisis to do so. Political, business, and bureaucratic elites may have interests to protect, but they too can be incentivised by the prospect of improved growth and distribution outcomes, which ultimately benefit them and their businesses, too.

This is where independent think tanks, civil society groups, and private sector associations need to step in and make a strong case for reforms that they (and we) believe will bring positive change for our respective countries in the long run. A big “sell” would be to ensure our economies do not fall victim to yet another public health (or environmental) crisis in the near future.

What is the role of regional trade agreements in driving domestic reform?

One of the arguments against the ratification of RCEP and CPTPP is that we should not rely on multilateral agreements to drive domestic economic or institutional reforms. According to this line of thinking, national governments should therefore be able to conduct these reforms from within, at their own pace, and without the need for any external instrument. While reforms should certainly be encouraged to emerge domestically, they are highly unlikely to take place due to a slate of factors including those spelled out in my original article, such as weak institutions, rentier economics, patronage, and cronyism.

As to the question of whether multilateral agreements such as RCEP and CPTPP can truly drive these reforms, the answer is that they offer the strongest and most likely framework for reforms to take place. It is untrue that these trade agreements are limited; in fact, the CPTPP exemplifies the deep reforms that would be required of member countries.

This is especially the case for SOEs, public procurement, and labour, for which domestic reforms have lagged so far behind within Southeast Asian economies and are in dire need of structural change if the economies are to truly transform. The desired outcome would be that these reforms incentivise local actors — both political and bureaucratic elites — to address the main systemic challenges facing our political economies, which then have the potential to emerge as stronger economies in a post-pandemic future.

HOSTAGE OF FORTUNE: SOUTHEAST ASIA'S DEVELOPMENT MODEL NEEDS A REBOOT



Vasuki Shastry is an Associate Fellow in the Asia Pacific program of Chatham House. He was formerly with the IMF, Standard Chartered Bank, and the Singapore central bank. He is the author of *Has Asia Lost It? Dynamic Past, Turbulent Future*.

It is no exaggeration to say that Southeast Asia has been the single largest beneficiary of globalisation and its twins: trade and investment flows. The disparate collection of high-, middle-, and low-income nations, grouped under the Association of Southeast Asian Nations (ASEAN), has made a virtue out of openness and integration with the global economy. And it has been handsomely rewarded with consistently high rates of economic growth and impressive strides in inclusion and social mobility. Until now.

Today, ASEAN's combined GDP of US\$3 trillion places it in the exalted company of Japan, China, and India in the league table of Asia's largest economies. Foreign investors, nervous about the outcome of the US–China struggle for supremacy, are increasingly diverting their investment dollars into countries such as Vietnam and Malaysia. The region's many boosters have proclaimed that a potential Asian century will only be possible with ASEAN's centrality in driving growth and prosperity.

What could be wrong with this generally positive picture? The pandemic for a start, which has hit the region's health systems and economies hard. While many

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

countries, Singapore and Vietnam notably, have demonstrated technocratic competence in managing the virus, others have faltered, exposing deep weaknesses in state capacity and governance. Indonesia and the Philippines have stumbled in navigating the lifecycle of virus management, from testing and tracing to therapeutics. Far from ASEAN centrality, the duality in the region today is evident in a group of nations hard-wired for global integration at a time when globalisation is stalling, while simultaneously being poorly coordinated for everything else.

The defiant protests in Myanmar in the face of last year's coup and the continued youth-led unrest in Thailand are ominous signs that post-pandemic ASEAN will have to contend with a more uncertain future. While rising inequality is not a peculiarly Asian or ASEAN phenomenon, strides in social mobility are reversing. In Vietnam, the United Nations Research Institute for Social Development warned before the pandemic that rising inequality was threatening the country's continued socio-economic development.

Young people have fewer opportunities for higher earnings and improved social status than a decade ago. These trends make it harder for Vietnam to meet its commitments to achieve the SDGs [Sustainable Development Goals] and stand in contrast with its past experience of inclusive growth.

As Singapore's Prime Minister Lee Hsien Loong noted in April 2020 during the early days of the pandemic, "This crisis will fundamentally change globalisation." He told ASEAN leaders:

There will be controls on movement of people across borders. Governments will intervene to prevent over-dependency on other countries for food, medical products, and other essential goods. And on all parties, I fear that there will be diminished confidence that international rules will hold and be respected in a crisis.

The remarkable aspect of Lee's intervention is that his speech did not trigger much debate or discussion about ASEAN's defining economic model, which is hostage to the fortune of continued good tidings and the tailwinds of globalisation, trade, and investment. In the 2020 World Bank ranking of countries based on trade as a percentage of GDP, ASEAN nations are a standout. Malaysia (117 per cent), Thailand (98 per cent), Singapore (321 per cent), and Vietnam (209 per cent) shine in the rankings compared with regional peers such as Indonesia (a paltry 33 per cent) and the Philippines (58 per cent). When the times are good for global integration, as they have been for the past few decades, *entrepôt* economies such as Singapore and Vietnam have thrived compared with more inward-looking economies such as Indonesia and the Philippines.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

However, the region's overexposure to the global economy comes with costs. The International Monetary Fund (IMF) estimated in its latest *World Economic Outlook Update* that GDP growth for the ASEAN-5 (Singapore, Indonesia, Malaysia, Thailand, and the Philippines) will have recovered at a modest 3.4 per cent in 2021 and 5.3 per cent in 2022 — compared with a more robust 8.1 per cent and 3.3 per cent for China, and 8.7 per cent and 7.4 per cent for India. In a region intoxicated by high growth rates of the past, the latest IMF data must be sobering news indeed.

The fundamental question is whether ASEAN's historic approach of “selective opening” can be sustained well into the future. Building on the experience of China, Japan, and South Korea — of partially opening their economies to trade and investment, while walling off other sectors — ASEAN's economic model is no longer fit for purpose for the following reasons:

- First, the walled-off portions of the economy are hugely inefficient and a drag on economic efficiency and productivity. These include the many state-owned enterprises in ASEAN countries — concentrated in the energy and financial sectors — which suffer from opaque governance and unlimited state support.
- Second, the domestic private sector is a haven for rent-seekers. ASEAN nations could benefit from more competition in the private sector but favoured business groups have been allowed to thrive with monopolies and quasi-monopolies in sectors such as property development, telecommunications, manufacturing, and distribution. This creates huge distortions in the form of predatory pricing and lack of incentive to innovate.
- Third, as the pandemic has demonstrated, state capacity to deliver public services (Singapore and Vietnam excepted) has seriously diminished. One of the major achievements of Suharto-era Indonesia, for example, was investments in primary education and health, which have been chipped away as local and national leaders become preoccupied with building trophy projects (a new capital for Indonesia) rather than basic investments in primary learning and care.
- Finally, ASEAN leaders appear to be oblivious to the risks from climate change. Both mainland and archipelagic Southeast Asia are vulnerable to rising temperatures and coastal flooding, as is already evident from the periodic forest fires in Borneo and the annual surges in water levels in Vietnam. ASEAN's climate change strategy is notable for its lack of ambition.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

Any serious debate on a new ASEAN development model will require a reconfiguration in the design and structure of the economy. As an insurance against probable external shocks from deglobalisation, the region must rebalance economic growth and incentives towards boosting domestic demand and consumption. In short, the region's *entrepôt* economies should behave more like Indonesia, where consumption has been the bedrock of economic growth since the Asian financial crisis. Indonesia, for its part, could be more open and receptive to trade and foreign investment. There also must be a fundamental rethinking of the role of the state, which has taken a *laissez faire* approach in recent years on important issues such as levelling the economic playing field and delivering social mobility to a population that is skewing younger and more anxious about accessing economic opportunity. In its first 55 years as a regional association, ASEAN has been the exception to the rule that developing country economic groupings generally fail because of a lack of cohesion. In its next 50 years, ASEAN and its member states must reform and adapt to remain an exceptional example of inclusive economic growth.

CHALLENGE QUESTIONS

If countries must refocus on domestic demand, does this make slower growth inevitable?

A reset was underway in global trade patterns and indeed in globalisation long before the pandemic. Countries can no longer rely on the export-oriented growth strategy of the 1960s and 1970s. The pandemic has only sharpened and reshaped policy choices for countries. The focus has shifted from the imperative to exporting your way out, which has been the norm for smaller Southeast Asian nations, to the critical question of how to build domestic self-sufficiency (for key medical supplies, for example) and resilience. It is a fallacy to suggest that countries have an either/or choice in boosting domestic demand and consumption at the expense of trade. The pendulum in China and Southeast Asia swung too far in the direction of the latter and rebalancing in favour of domestic demand is both appropriate and essential.

The transition is going to be painful, but slower growth is not inevitable. The domestic manufacturing base is heavily skewed in the direction of feeding components and sub-components into regional supply chains. This has a positive side in the transfer of innovation and skills. However, companies in the hi-tech sector in Southeast Asia are islands of excellence compared with the rest of industry, which is tied up in monopolies, crony practices, and policy distortions. Establishing a level playing field and allowing new entrepreneurs to flourish will be a driver of growth and economic opportunity.

DOES SOUTHEAST ASIA NEED A NEW DEVELOPMENT MODEL?

How essential is governance reform to Southeast Asia's prospects?

Governance reforms absolutely must form the core of any post-pandemic reform package. In the past, Southeast Asian leaders, like their peers elsewhere, have made anti-corruption campaigns a centrepiece of their reform drives. However, this addresses the symptom while ignoring the cause. Unfashionable issues such as civil service reform, a stronger framework to curb monopolies and rent-seeking, and cleaning up the financial system are much more difficult to achieve. Weak state capacity represents a profound policy failure of governments, and economic rebalancing will not take off unless there is root and branch reform. In the past, governments have sought shelter in high rates of economic growth, which may not be available as an excuse in the future.

Can digital disruption create opportunities for reform and reinvigorating governance?

Significant drivers of domestic growth and economic opportunity include the digitalisation of public services, easier access to e-governance portals, and the establishment of secure digital identities for all citizens. These will create a virtuous ecosystem where the private sector can build a stack of services — in payments, e-commerce, and mobility — that will increase public trust and create new business modes. Some of these shifts are already taking place, but the heavy hand of the state is becoming apparent.

Many governments in Southeast Asia regard digitalisation as a great threat to the political primacy of the state. Democracies and dictatorships alike in the region are pursuing command and control surveillance, mimicking the Great Firewall of China, and sacrificing citizens' privacy and trust as a result.

It is difficult to imagine pure private sector-driven digital disruption in an environment where the state is suspicious of its citizens and there is a general lack of public trust in big tech platforms. The space for pure start up-driven innovation is shrinking as well-entrenched monopolies in Southeast Asia and elsewhere represent a formidable barrier to entry. The outlook for digital disruption creating fresh opportunities for reform, while necessary, does not present an easy path.

ABOUT THE EDITORS



Roland Rajah

Roland Rajah is Lead Economist and Director of the International Economics Program at the Lowy Institute. A development economist by background, his work focuses on international economic policy, particularly in the Asia Pacific, including matters of macroeconomics, economic development, aid and development finance, debt sustainability, globalisation, and geo-economics, among others.

Roland was previously an economist with the Asian Development Bank where he worked on macro-fiscal policy, economic growth, and infrastructure development in the Pacific. Earlier he was based in Indonesia with the Australian Department of Foreign Affairs and Trade managing its flagship economic reform advisory program to the Indonesian government. Roland has also served in the Economics Advisory Group of the Australian Agency for International Development (AusAid) and the International Department of the Reserve Bank of Australia. He also currently serves as an international member on the board of the Cambodia Development Resource Institute.

He holds a master's degree in economics from the Australian National University, where he was awarded the Helen Hughes prize in international and development economics.

Ben Bland is the director of the Asia-Pacific programme at Chatham House. His research focuses on the nexus of politics, economics and international relations in Southeast Asia, as well as China's growing role in the broader region and the contours of US-China strategic competition. He was formerly the director of the Southeast Asia programme at the Lowy Institute.

Ben is the author of two critically-acclaimed books on Asian politics: *Man of Contradictions: Joko Widodo and the Struggle to Remake Indonesia* (Penguin Random House, 2020) and *Generation HK: Seeking Identity in China's Shadow* (Penguin Random House, 2017). He regularly briefs senior officials, parliamentarians and business groups on regional issues, and contributes opinion and analysis to many global media organizations including *Bloomberg*, *CNN*, the *New York Times*, *Reuters*, and *Nikkei Asia*.

In his earlier career, Ben was an award-winning correspondent for the *Financial Times*, with postings in Hanoi, Jakarta and Hong Kong, and experience reporting across Southeast Asia and China for more than a decade.

He has an MA in Southeast Asian studies from the School of Oriental and African Studies at the University of London and an undergraduate degree in history from the University of Cambridge.



Ben Bland

LOWY INSTITUTE

31 Bligh Street
Sydney NSW 2000

Tel. +61 2 8238 9000
Fax +61 2 8238 9005

lowyinstitute.org
[@LowyInstitute](https://www.instagram.com/LowyInstitute)