THE DEVELOPING COUNTRIES OF EASTERN ASIA : 2

This is the second article of a series of three which discuss the developing countries of Eastern Asia. In this article the economies of Malaysia, Thailand, Indonesia and the Philippines are considered.

Introduction

The first article in this series, published in the April 1984 *Bulletin*, noted that *Bulletin* articles on developments in the international economy do not usually refer in any detail to the less developed countries. That article attempted to redress this imbalance by discussing the development, current economic situation and prospects for South Korea, Taiwan, Hong Kong and Singapore. This article continues the series and discusses the four other original members of ASEAN[1], namely Malaysia, Thailand, Indonesia and the Philippines. The third and final article in the series will appear in a future *Bulletin* and will cover the People's Republic of China.

The intention of this series is not to discuss opportunities for increased trade between New Zealand and these countries, nor is it to attempt to draw lessons for New Zealand from the experiences of these countries. Rather the aim is simply to provide some reasonably broad ranging background information on economies which are becoming increasingly important to New Zealand and to the world economy.

Table 1 shows how important these countries have become as trading partners for New Zealand. Exports to the nine countries accounted for 12 per cent of New Zealand's total exports in the year ended June 1985, while imports from these countries represented 12.3 per cent of total imports. Table 2 provides information on the populations, Gross National Products (GNP's) and growth rates of the nine countries considered.

TABLE 1
NEW ZEALAND'S TRADE WITH ASIAN DEVELOPING COUNTRIES

	Exports		Imports	
	% of Total	NZ$M	% of Total	NZ$M
China	2.6	298.2	0.7	78.9
Hong Kong	1.5	168.5	1.5	166.0
Indonesia	0.9	98.4	3.4	386.1
Malaysia	1.4	162.3	0.6	69.2
Philippines	0.5	55.0	0.4	49.0
Singapore	1.4	144.0	3.2	359.0
South Korea	1.9	213.6	0.8	91.8
Taiwan	1.5	167.6	1.5	166.6
Thailand	0.4	46.8	0.2	26.2
Above Nine Countries	12.0	1,354.4	12.3	1,392.8

Source: New Zealand Department of Statistics
[1] June year 1985. Export FOB, Imports CIF.

Malaysia

Malaysia is one of the wealthier nations of Eastern Asia, with its per capita GNP placing it third among the six members of ASEAN, behind Singapore and Brunei.

Since the early 1970s the Government has pursued a policy of encouraging industrialisation based on the use of labour and indigenous natural resources. Reflecting this, the manufacturing sector's share of GDP has risen steadily, reaching 19 per cent in 1984 from the 14 per cent recorded in 1971. Two of the more rapidly expanding industries were textiles and electronics where, as with much of the production in the primary sector, output was directed to export markets. The agricultural sector has, however, always been the 'backbone' of the economy of Malaysia and this continues to be the case. Agriculture contributes about 20 per cent of Gross Domestic Product (GDP), compared with 30 per cent in the early 1970s. While rubber and oil palm are the two most important agricultural crops (Malaysia is the world's largest producer of natural rubber), pepper and tropical timber are also major export earners. The country is an oil producer and has other mineral deposits including tin, of which it is the world's largest exporter.

A series of five year indicative plans — the First (1966–70), Second (1971–75) and Third (1976–80) Malaysia Plans — were formulated to raise the rate of economic growth through rapid industrialisation. The second and third of these plans sought to give effect to the New Economic Policy (NEP) of 1971, which arose

1 The Association of South East Asian Nations. The original members were Singapore, Malaysia, Thailand, Indonesia and the Philippines. Brunei joined ASEAN after gaining independence in 1984.

TABLE 2
Asian Developing Countries : Population, GNP and Growth

	Population (millions) Mid 1983	GNP (US$bn) 1983	GNP per capita (US$) 1983	Average Annual Growth Rates Popluation 1973–82	GNP per capita 1973–82
China	1,021.6	301.8	290	1.2	4.5
Hong Kong	5.3	31.9	6,000	2.6	6.8
Indonesia	155.8	87.1	560	2.3	4.6
Malaysia	14.9	27.8	1,870	2.4	4.9
Philippines	52.0	39.4	760	2.8	2.9
Singapore	2.5	16.6	6,620	1.3	6.5
South Korea	40.0	80.3	2,010	1.6	5.6
Taiwan[1]	17.6	38.2	2,160	2.0	7.3
Thailand	49.6	40.4	810	2.4	4.0

Source: World Bank Altas 1981, 1985.
[1] Figures for Taiwan are for 1980 and the period 1970–79.

out of the social unrest that occurred in the late 1960s. The objective of the NEP is to eliminate inequalities in incomes, employment opportunities and educational attainment across racial groups, and in particular, is intended to improve the living standards of the native Malays (Bumiputras), and to ensure they control 30 per cent of Malaysian corporate equity by 1990 (in contrast to the 4 per cent they held in 1971).

During the 1970s, real GDP grew at an average annual rate of 7.8 per cent, assisted by a high rate of investment, particularly in oil exploration and development. However, more recently the more difficult international economic environment and a prolonged downturn in commodity prices was reflected in a much more restrained growth performance during the 1980s.

Initially the fall in foreign demand in 1981/82 was partially offset by increased public expenditure as the Government followed a traditional counter-cyclical fiscal policy. Nevertheless, external trends dominated and eventually the decline in the terms of trade impacted on real incomes. By 1982 the rate of economic growth had fallen to 5.6 per cent.

While the economy was growing strongly, other economic indicators followed in generally favourable trends. Unemployment fell from 8 per cent of the labour force in 1970 to 5.5 per cent in 1982 and inflation averaged 6 per cent per annum during the 1970s. The rising import prices and export boom accompanying the second oil shock helped boost inflation from an annual rate of 3.5 per cent in 1979 to 9.7 per cent in 1981, but inflation slowed as domestic economic growth decelerated.

The external current account remained in surplus throughout the 1970s and during 1980. A positive trade balance (largely due to oil exports) more than offset a deficit on invisibles. However, the factors which caused the slowdown in growth and the increase in inflation in the early 1980s also contributed to a sharp turnaround in the trade balance. As demand for exports fell and payments for imports increased, the trade balance went from a surplus equal to 15.2 per cent of GNP in 1979 to a deficit of 2.5 per cent in 1982. The deficit on invisibles also worsened, mainly as a result of higher payments on freight, insurance and interest. As a consequence the external current account deteriorated sharply, from a surplus of 4.3 per cent of GNP in 1979 to a deficit of 14.4 per cent of GNP in 1982.

The Fourth Malaysia Plan (for the years 1981–85) was introduced during this recessionary period. Like its predecessors, this plan promoted the industrialisation drive, but with several new features. The private sector was to be encouraged to undertake a greater share of investment in the manufacturing sector, industrial development was to be encouraged in less developed rural areas, but emphasis was switched away from labour-intensive light industry to resource-intensive, higher value-added industrial projects, including a sponge iron plant, an oil refinery, a scheme to produce a Malaysian car, a liquified natural gas plant, pulp and paper mills and an ammonium-urea plant. The plan was intended to create the conditions for economic growth at an average annual rate of 7.6 per cent over its five year horizon.

However, doubts were later raised about the economic rationale for many of the large projects set in place by the plan, in particular where it appeared that

Table 3
Malaysia — Recent Economic Performance

Calendar Years		1980	1981	1982	1983	1984
Real GDP growth	(%)	7.8	7.1	5.6	5.9	7.3
Consumer Price Inflation	(%)	6.7	9.7	5.8	3.7	3.9
Unemployment Rate	(%)	. .	5.5	5.5	6.1	6.6
Export Growth [1]	(%)	2.9	0.5	9.1	10.4	13.6
Trade Balance	(US$bn)	2.4	−0.1	−0.8	0.5	2.7
Current Account Balance	(US$bn)	−0.3	−2.4	−3.6	−3.2	−1.8
Current Account/GNP	(%)	−1.2	−10.4	−14.4	−11.7	−5.8
External Debt	(US$bn)	5.7	8.5	12.2	16.6	17.8
External Debt/GNP	(%)	25.5	35.0	48.3	60.5	60.3
Debt Service Ratio [2]	(%)	4.3	8.0	10.2	10.9	13.1

Source: IMF
[1] Change in export volume.
[2] Total debt service payments/current account receipts.

Malaysia had no comparative advantage. Concern was also expressed about the level of foreign borrowing needed to finance the projects — although Malaysia's foreign indebtedness and its debt service ratio were and still are small compared to those of many other developing countries.

The early 1980s saw an increasing degree of Government participation in the economy, despite the expanded role envisaged for the private sector in the Fourth Malaysia Plan. Government expenditure rose to about 40 per cent of GNP in the 1980/81 fiscal year, with the largest increase being in development expenditure. Revenue did not keep pace with the increases in expenditure and there was a widening in the government budget deficit, from 6.8 per cent of GNP in 1978 to 15.8 per cent in 1981.

However, a reduction in the relative size of the fiscal deficit has been a primary objective of fiscal policy since 1982. Policies in the 1982 budget were directed at slowing the rise in government expenditure, but the economic downturn in that year reduced government revenue, and as a consequence the budget deficit expanded to 17 per cent of GNP. Efforts to reduce the budget deficit have continued in successive budgets since 1982. While some tax measures have been introduced to increase revenue the main focus of this fiscal adjustment has been on curtailing development expenditure. Spending on major development projects has been cut back and some projects have been deferred. The effect of these measures has however been partly offset by reduced revenue — in particular as a result of lower oil prices. In 1984 the budget deficit was equal to 7.5 per cent of GNP, and it is estimated to have been marginally lower in 1985.

One other factor restricting the room for manoeuvre in dealing with the budget deficit has been the Government's determination to implement the NEP. To date a proportion of about 20 per cent ownership of the corporate sector by Bumiputras has been achieved but this is largely due to the acquisition of existing assets by government-funded institutions.

The structure of the tax system also poses problems for attempts to reduce the fiscal deficit. The single most important source of government revenue has been petroleum taxes and dividends from Petronas, the national petroleum company.

In recognition of the continued importance of the agricultural sector, and to further its attempts to eradicate rural poverty, the Government announced a National Agricultural Policy at the end of 1983. The objective is to restore growth in agricultural output by concentrating production on crops for which world demand and prices have been stronger, for instance palm oil and cocoa, and by encouraging land reform to overcome the problem of small and fragmented farms.

These policy initiatives all aim to build on the export-led recovery the Malaysian economy experienced in 1983, with real GDP growth of 7.3 per cent. Although growth slowed slightly in 1985 it was still at an annual rate of more than 5 per cent. Inflation has dropped, initially to an annual rate of about 4 per cent, but to under 1 per cent by late 1985.

To allow this recovery to be sustained Malaysia is attempting to deal with the structural problems highlighted by the 1981/82 recession, namely the size of the public sector, a persistent current account deficit and the accompanying growth in external debt. These problems are addressed in the Fifth Malaysia Plan (1986-1990). Over this period the intention is to build on the fiscal adjustment already undertaken, with major emphasis still on the development of export-oriented industries. One major uncertainty is whether the private sector will take up the slack in investment left by the Government. This concern stems from the fact that non-oil private investment in recent years has been mostly in sectors which have little potential to sustain growth, either because they are already near saturation (for instance palm oil processing) or because they have limited links with the rest of the economy (electronics assembly) or because their chances of expansion are limited by protectionist policies in export markets (textiles). A further element adding to uncertainty over the short-term is the fall in both export and Government revenue as a result of the sharp decline in oil prices in late 1985 — early 1986.

Thailand

Thailand ranks as one of the poorer nations of ASEAN, with low incomes a particular problem in its rural areas. Nevertheless, in the last two decades its per capita GNP has grown at a comparable rate to Malaysia's, with real economic growth at an annual average rate of 8.4 per cent in the 1960s and 7.2 per cent in the 1970s. As is the case with Malaysia, the Thai economy continues to be based on the production and export of primary products. Industrialisation has resulted in the share of agriculture in GNP falling from 40 per cent in 1960 to about 20 per cent in 1985, but about two thirds of the labour force is still employed in the agricultural sector. The foundation for Thailand's impressive growth record has been provided by exports of rice, rubber, sugar cane, maize, tapioca and tin.

During the 1960s and 1970s a series of national five year plans were implemented which emphasised the importance of agriculture within the economy and fostered its development. These plans also implied reduced income and employment imbalances between the various sectors and regions of the country and in particular the plans included the intention to improve living standards in the rural districts relative to the capital, Bangkok. The process of industrialisation has been built on the growth achieved in the agricultural sector and, at the outset, encouragement was given to the development of import substituting industries; principally textiles, food processing and petroleum refining.

Prices for Thailand's primary products remained high on world markets following the first oil shock in 1973/74 and this cushioned the effect of the oil price increase on the terms of trade. Nevertheless, the commodity price boom at the time masked underlying structural problems in the economy, problems which were highlighted by the second oil shock of 1979/80 and the world recession in 1981/82.

In particular, the importance of agriculture to the Thai economy means that variations in overall economic growth are closely linked to the performance of the agricultural sector, which has a high degree of dependence on climatic conditions. At the time of the first oil shock, agricultural conditions were favourable and world demand was reasonably buoyant. The opposite conditions existed at the time of the second oil shock (1979/80). In 1981 the international recession and a slump in demand for Thailand's primary exports constrained growth.

Table 4
Thailand — Recent Economic Performance

Calendar Years		1980	1981	1982	1983	1984
Real GDP growth	(%)	5.8	6.3	4.1	6.0	6.3
Consumer Price Inflation	(%)	16.4	12.3	2.6	3.8	-0.8
Export Growth [1]	(%)	8.2	17.3	17.6	-3.2	16.5
Trade Balance	(US$bn)	-2.8	-3.0	-1.6	-3.9	-3.0
Current Account Balance	(US$bn)	-2.1	-2.5	-1.0	-2.9	-2.1
Current Account/GNP	(%)	-6.8	-7.1	-2.7	-7.2	-5.0
External Debt	(US$bn)	8.5	11.1	12.3	13.9	15.5
External Debt/GNP	(%)	25.0	30.6	33.3	34.7	36.6
Debt Service Ratio [2]	(%)	17.4	19.0	20.9	23.2	23.6

Source: IMF
[1] Change in export volume.
[2] Total debt service payments/current account receipts.

Moreover, a trade deficit had persisted throughout the 1970s but this had been largely offset by a surplus on services and transfers (mainly due to tourism and remittances from Thai workers overseas). This surplus, combined with buoyant export prices, allowed in the current account deficit to remain essentially unchanged in 1973/74, when the deficits of many other countries deteriorated rapidly. But in 1979, as a result of increased import payments the current account deteriorated and a deficit of 7.7 per cent of GDP was recorded. The deficit remained high for the next two years as export prices declined, but following the downturn in the domestic economy in 1982 the demand for imports fell substantially, allowing an improvement in the deficit to 2.7 per cent of GDP.

For most of the 1970s the open nature of the Thai economy and a minimum of controls on prices resulted in rates of inflation similar to the trend of world inflation. Following the second increase in oil prices, inflation rose from 7.8 per cent in 1978 to 16.4 per cent in 1980. But in 1982 inflation fell dramatically to only 2.6 per cent, with the effect of a devaluation in the Thai baht and a rise in wages more than offset by a downturn in the domestic economy and lower world inflation.

In the middle of the 1981/82 recession, the Thai Government introduced its Fifth National Economic and Social Development Plan (1981-86). This plan continues the thrust of its predecessors and has as principal objectives the control of overseas borrowing, balanced regional growth to improve the standard of living in rural areas, equity in the provision of social services and a switch in the focus of industry from import substitution to exporting. All this is to be achieved through the use of government incentives for production and investment in the agricultural, manufacturing and energy sectors, with particular emphasis on the development of agriculturally-based manufacturing. These incentives have been financed, in part, by standby arrangements with the IMF and Structural Adjustment Loans from the World Bank. The plan set a target of 6.6 per cent a year for economic growth over the planning horizon.

In 1983 Thailand experienced a relatively strong recovery. Domestic demand picked up as a fall in inflationary expectations, interest rates and import prices (including oil prices) combined with restocking by firms to give a strong upturn in private investment. As a result, the growth rate increased to 6 per cent for the year. Since 1983 economic performance has been influenced to a large degree by a persistent trade deficit and the policy measures which have attempted to deal with that deficit. The trade deficit widened in 1983 as the increased domestic demand resulted in a large increase in import spending while exports expanded less rapidly. This poor export performance is explained by a number of factors including a smaller than expected harvest, protectionist trade policies overseas and the appreciation of the baht against major currencies other than the US dollar.

The preferred response of the Government to these problems was to tighten monetary policy. Growth in broad money in 1983 was at an annual rate of about 25 per cent, reflecting rapid growth in domestic credit. In late 1983 the authorities tightened credit conditions, and increased the interest ceilings on bank loans. Over 1984 this restrictive credit policy slowed the demand for imports, while the strength of the recovery in the industrial countries and a better harvest in 1983 resulted in an improved export performance. The improvement in export demand was sufficient to offset a slowdown in consumption and investment expenditure and overall real GDP growth remained strong.

To facilitate the continuation of this adjustment the Government devalued the baht in November 1984. The devaluation of 14.8 per cent was accompanied by a move to end the effective pegging of the baht to the US dollar. Although, previously, the baht's value was officially determined in relation to a basket of currencies, it retained a close relationship with the US dollar as virtually all Thailand's exports and about two-thirds of its imports are denominated in that currency. Accordingly, the strengthening of the dollar up until mid-1985 led to an appreciation of the baht.

The persistence of the trade deficit is one of the major problems facing the Thai Government. An oversupply of many of Thailand's agricultural exports in world markets has made it difficult to achieve an improvement in the deficit in spite of the devaluation. At the same time the moves to restrict credit have slowed domestic demand and it appears that growth in real GDP over 1985 slowed to less than 6 per cent. Nevertheless, the Government has continued its adjustment efforts, supported by an SDR 585 million standby arranged with the IMF in mid-1985.

An important part of these adjustment efforts has been steps to reduce the Government's budget deficit. During the 1970s a large part of government expenditure was directed towards capital spending for development. But, because of a narrow tax base which had an excessive dependence on taxes on foreign trade, revenue was unable to keep pace with the growth in expenditure. As a result, the budget deficit expanded from 2 per cent of GDP in 1974/75 to 4.6 per cent in 1979/80 and increased further to 5.8 per cent in 1981/82

as the economic downturn resulted in an even smaller tax take than usual.

In recognition of the problems being caused by the budget deficit, particularly the growth in external debt, the Government has since moved to reduce the deficit. Significant cuts in Government expenditure along with moves to increase tax revenue have been made in successive budgets since 1982/83. While these moves have succeeded in reducing the deficit to about 3 per cent of GDP, it is widely recognised that if further progress is to be made in reducing the deficit, the tax base will need to be widened. With the help of the World Bank, steps have been taken to improve the collection of taxes but there has been less progress made in broadening the tax base.

Indonesia

Indonesia is the world's fifth most populous nation, and although it is rich in natural resources it is the poorest member of ASEAN in terms of GDP per capita. The growth in population over the last twenty years has required rapid growth in GDP to improve GDP per capita and to provide jobs for the large numbers joining the workforce. In tackling this problem the Indonesian Government has been aided by Indonesia's oil and natural gas production. It was exports of oil and liquified natural gas which were the foundation for an impressive growth record over the 1970s when real GDP growth averaged 7.6 per cent a year. Oil accounted for about 70 per cent of both export receipts and government revenue by the start of the 1980s. The recent sharp fall in oil prices therefore presents the Government with significant additional difficulties in maintaining economic growth and balance of payments stability.

Although oil and natural gas exports are important, the largest contribution to GDP still comes from agriculture. Rice is the most important crop, but Indonesia is also a large producer and exporter of rubber, palm oil and timber. With progressive industrialisation, the relative size of the agricultural sector has fallen from about 50 per cent of GDP in the mid-1960s to about 25 per cent at present. Agriculture still employs about 55 per cent of the labour force and 75 per cent of the population is estimated to be dependent on the sector in some way.

During the 1970s the Indonesian Government followed a policy, under successive five year plans, of using oil revenues and foreign aid to finance development projects which would utilise the natural resources available. In the first two of these plans — Repelita I (1969–1974) and Repelita II (1974–1979) — the emphasis was on developing import substituting industries which would process domestic materials. During Repelita III (1979–1984) the public sector undertook further major development projects such as the construction of plants to produce petrochemicals, fertiliser, cement and pulp and paper, all of which would utilise domestic natural resources. With these developments, the share of manufacturing to GDP rose from 8 per cent in 1971 to 12 per cent in 1984. At the same time, it was realised that the agricultural sector would remain important, providing both food and jobs to the expanding population. For this reason, one of the goals of Repelita III was self-sufficiency in rice production.

The oil price increases in 1979/80 improved Indonesia's terms of trade considerably but with the subsequent international downturn, the demand for and eventually the price of oil fell substantially, seriously affecting Indonesia's economic stability. The favourable movement in the terms of trade in 1979 and 1980 was one of the main factors that sustained strong real growth in the period 1979–1981. A slight slowdown in 1979 was the result of slower agricultural growth and demand restraint policies after a devaluation of the Indonesian rupiah in 1978. In 1980, an impressive growth rate of 8.3 per cent was recorded as the income from oil exports boosted domestic demand and the Government continued its development spending. An easing of credit policy allowed private investment to pick up while an excellent rice harvest boosted incomes in rural areas giving further stimulus to overall domestic demand. In 1981 strong investment continued, especially on the part of the Government, and there was an even larger rice harvest. However, the world oil market was beginning to deteriorate, and in the following year a slump in oil export revenues cut domestic incomes and forced the Government to cut back its spending. Superimposed on this the prices for non-oil commodity exports fell and a drought affected agricultural output. The combined result was that the real growth rate for 1982 fell to 0.2 per cent, low by recent Indonesian standards.

These developments were also reflected in Indonesia's balance of payments performance. The strong growth in oil revenues had resulted in external current account surpluses of 5.3 per cent of GDP in 1979/80 and 3.6 per cent in 1980/81. But as the world oil market contracted and the price of non-oil commodities fell, the current account swung from a surplus to a deficit of 3 per cent of GDP in 1981/82. The maintenance of imports of capital goods for the public sector's development projects, combined with the full impact of the recession on export demand, led to a widening of the deficit to 7.5 per cent of GDP in 1982/83.

Faced with these problems the Government responded with a series of policy moves designed to reduce the economy's dependence on oil exports. The initial response was to tighten monetary and fiscal policy. Since the 1982/83 fiscal year government budgets have been austere with routine government expenditures cut by such measures as a two year freeze on civil service salaries and reductions in domestic consumption subsidies on oil, food and fertiliser. The removal of the subsidy on oil led to the domestic oil price rising to bring it more into line with international prices. As a result of these moves the fiscal deficit was reduced from 4.8 per cent of GDP in 1982/83 to 2.6 per cent in 1983/84.

The Government also attempted to stimulate exports by means of a counterpurchase policy on government contracts. Under this policy, introduced in 1982, foreign firms bidding to supply goods for certain public sector development projects have to agree to buy non-oil exports of an equal foreign currency value. By 1983 it was clear to the Government that further policy changes were required and in March 1983, the rupiah was devalued by 27.5 per cent against the US dollar.

In a further attempt to improve the balance of payments and save foreign exchange the Government decided to review planned capital intensive development projects. Several of these projects, particularly petrochemical plants, were postponed. The domestic resources saved by not proceeding with these projects were to be redirected to smaller, labour-intensive developments.

Table 5
Indonesia — Recent Economic Performance

Calendar Years		1981	1982	1983	1984	1985
Real GDP growth	(%)	8.3	6.9	0.2	3.3	5.8
Consumer Price Inflation	(%)	17.1	7.3	10.1	12.0	9.1
Export Growth [1,2]	(%)	-3.6	-4.5	-11.6	19.2	5.7
Current Account Balance [1]	(US$bn)	2.8	-2.8	- 7.1	-3.9	-1.8
Current Account/GNP [1]	(%)	3.6	-3.0	- 7.5	-4.9	-2.2
External Debt[1,3,4]	(US$bn)	14.9	17.0	21.2	24.6	24.4
Debt/GNP [1,3,4]	(%)	19.1	18.5	22.3	30.4	29.1
Debt Service Ratio [3,4,5]	(%)	8.1	8.9	12.2	12.4	15.5

Source: IMF
[1] March years.
[2] Change in export volume.
[3] Public sector debt.
[4] End of period.
[5] Total debt service payments/exports of goods and services.

With oil providing about 70 per cent of total tax revenues, another target of policy changes was the revenue side of the government budget. A reform of the tax system was undertaken, the major features of which were a revised income tax structure and the introduction of a value added tax. In addition improvements were made to the administration of the tax system.

Finally, a major reform of the financial system was undertaken. This was designed to increase domestic savings, to reduce capital outflows, to increase competition and efficiency in banking and to increase the authorities' ability to conduct monetary policy. Previously the state-owned banks, which constitute about 80 per cent of the financial system, had been tightly controlled by Bank Indonesia, the central bank. Credit ceilings were in place to limit lending to various sectors of the economy and interest rates were also regulated. A major source of funds for the state banks was cheap, subsidised lending by the central bank (known as liquidity credits). One result of these controls was an interest differential in favour of foreign assets which, during the oil boom years, had resulted in a sizeable capital outflow. The state banks had also tended to hold foreign assets because of the limits on their domestic activities. To free up the market the Government abolished the credit ceilings and allowed state banks to set their own interest rates on deposits. Immediately the state banks raised their deposit rates and holdings of time deposits increased.

Following the abolition of credit ceilings the authorities had no adequate means permitting appropriate monetary control. To rectify this problem, Bank Indonesia began to issue short-term bonds (known as SBIs) with which it could conduct open market operations. Government securities had been virtually non-existent since the mid-1960s when hyper-inflation had destroyed the market. By stopping the payment of interest on excess rupiah reserves held with Bank Indonesia, and thus encouraging the holding of SBIs, it is hoped to establish a secondary market for short-term government securities in which effective open market operations can be conducted.

The success of these measures can only be judged in the longer term. In the meantime, a number of problems still face the Indonesian economy. The moves taken to reduce Indonesia's dependence on oil exports have not yet significantly reduced the economy's vulnerability to world oil prices. Oil and natural gas revenue for instance still comprises over 50 per cent of Government revenue. Although growth and balance of payments performance improved following the international upturn in 1983, the domestic recovery was not economy-wide. The major impetus once again came from renewed oil exports which were limited by the agreed OPEC production quota. Buoyant demand for non-oil exports allowed the recovery to continue in 1984 but over 1985 that demand levelled off and conditions in the world oil market led to further reductions in oil revenue. As a result it appears that the growth in real GDP for 1985 will be less than the 5.8 per cent recorded in 1984, and on the basis of world oil prices, an improved growth performance in 1986 is not anticipated.

Another matter of some concern is the size of Indonesia's external debt. A persistent current account deficit and any move to restart work on the postponed projects would further add to a debt burden which increased significantly following the downturn in 1981/82. In spite of the measures taken by the Government, public sector external debt rose from 18.5 per cent of GDP in 1981/82 to 29.1 per cent in 1984/85, while the debt service ratio on this borrowing rose from 8.9 per cent to 15.5 per cent. While the burden has certainly increased, Indonesia's debts are not as large as those of the Philippines or of many Latin American countries, much of the debt is low interest loans and of long maturity and there is little floating rate debt. Nevertheless, the sharp fall in oil prices in early 1986 implies a further and rapid deterioration in the debt-servicing ratio.

The Philippines

The Philippines trails the other members of ASEAN in terms of economic performance and is also the only country in Asia which has sought to reschedule its external debt. A primary factor in the country's current economic problems can be attributed to the social unrest and uncertainty following the death of the main opposition leader in August 1983, which sparked a massive outflow of short-term capital. In October 1983, in an attempt to conserve foreign exchange reserves the Government placed a moratorium on principal repayments on outstanding external debt while it negotiated with the IMF and private creditors for this debt to be rescheduled. In addition to a rescheduling of existing debt, the Philippines sought an SDR615 million IMF stand-by arrangement and US$3.3 billion in new loans from private banks and multilateral agencies such as the World Bank and Asian Development Bank (a pre-requisite for which was agreement with the IMF).

The IMF negotiations proved to be a drawn out process and with no new funds forthcoming in the interim, the Philippines was forced to cut its imports of components for domestic industry, which in turn meant large numbers of workers were laid off. To ration foreign exchange, and to discourage its use, the Government introduced a number of measures including a series of devaluations of the peso, a requirement that commercial banks sell all foreign exchange to the central bank (which could then use it to buy government determined priority imports, mainly oil and food), a clampdown on government expenditure and attempts to decrease the growth in the money supply.

Although it was the capital outflow in late 1983 which precipitated the crisis, pressure had been building up on the Philippine economy for some time. Over the 1970s a shortage of domestic savings relative to investment plans meant that a rising proportion of development projects were financed by overseas borrowing. Interest rates were controlled at artificially low levels which discouraged saving. In addition, investment funds were allocated by the Government. Investment was directed towards heavily protected, import substituting, capital intensive projects, a number of which were unable to earn an economic return.

Despite these factors, economic growth during the 1970s averaged about 6 per cent a year, with the main impetus coming from exports, particularly of primary products. Agricultural goods continue to make up the bulk of exports. The Philippines is the world's largest producer and exporter of coconut related products and these remain the largest single primary export. Sugar cane, timber, copper, tin, garments and electronic goods are the other major foreign exchange earners. Oil and components for local assembly are the principal imports.

At the time of the first oil shock in 1973 the Philippines was able to maintain its growth momentum by stepping up its overseas borrowing and by being able to, more or less, maintain its exports of primary products. However, this path was not available following the second oil shock. External indebtedness was at a much higher level (44 per cent of GNP in 1979 compared with 26.8 per cent in 1973), and traditional exports suffered because of the subsequent world recession. After increasing 6.7 per cent in 1979, real GNP rose 5 per cent in 1980. As the recession deepened, real incomes (especially in rural areas) and private consumption fell. In addition, private investment was curtailed by a loss in business confidence. In 1982 a real growth rate of only 1.9 per cent was recorded. Even with some upturn in the world economy in 1983 stronger export demand was insufficient to prevent a further reduction in the growth rate to 1.3 per cent, and this situation was aggravated by adverse weather conditions which constrained supply in the agricultural sector.

An apparently overvalued exchange rate was a major factor behind the continuing poor export performance, compounding the problems generated by inefficient resource allocation. From 1979 to 1981 domestic inflation was higher than inflation in the Philippines' major trading partners. During 1981 and 1982, price increases slowed with the downturn in domestic demand and an easing in import prices. The authorities allowed the peso to depreciate against the US dollar but the depreciation was insufficient to offset the appreciation of the dollar against other currencies. With inflation running at 10 per cent a year, the Philippines continued to lose competitiveness with respect to its major trading partners.

The overvaluation of the peso was reflected in a steadily deteriorating external current account balance with the deficit being financed by overseas borrowing. By 1982, the current account deficit was equivalent to about 8 per cent of GNP and external debt was equivalent to 60 per cent of GNP. When it became obvious that the expected improvement in export demand was not going to occur in 1983 two discrete devaluations of the peso against the US dollar, were made; 7.3 per cent in June and 21.4 per cent in October. The most noticeable effect of these devaluations was a sharp increase in inflation. By the end of 1983 the annual inflation rate was 26 per cent.

With the economy seemingly locked in a circle of depreciation and inflation, speculation remained that further devaluations would be forthcoming. A black market in foreign exchange thrived, frustrating government attempts to control the use of foreign exchange. In an attempt to discourage the growth of the black market the Government adopted a system of cash bonuses for those individuals who sold foreign currency through the banking system. This policy was mainly aimed at Filipinos working overseas to encourage them to remit their earnings through the banking system. The expectation of another devaluation meant remittances of export receipts were being delayed, and in June 1984 the peso was devalued by 22 per cent and the 'crawling

Table 6
The Philippines — Recent Economic Performance

Calendar Years		1980	1981	1982	1983	1984
Real GNP growth	(%)	5.0	3.4	1.9	1.3	−5.3
Consumer Price Inflation	(%)	17.8	10.7	8.5	26.1	50.8
Unemployment Rate	(%)	4.8	5.4	5.5	4.9	6.1
Export Growth [1]	(%)	20.7	1.1	5.6	−5.0	−2.3
Current Account Balance	(US$bn)	−1.9	−2.1	−3.2	−2.8	−1.5
Current Account/GNP	(%)	−5.4	−5.4	−8.1	−8.1	−4.5
Overall Balance	(US$bn)	−0.4	−0.6	−1.7	−2.1	−0.2
External Debt [2]	(US$bn)	17.3	20.9	24.7	24.8	25.4
External Debt/GNP [2]	(%)	48.9	54.4	62.8	72.7	79.0
Debt Service Ratio [2,3]	(%)	20.9	25.2	38.1	35.7	42.8

Source: IMF
[1] Change in export volume.
[2] Total external debt including IMF.
[3] Total debt service payments/exports of goods and services.

peg' exchange rate mechanism was reintroduced. Finally, in October 1984, with an agreement with the IMF imminent, the peso was floated and the banks were once again permitted to deal in foreign exchange.

As with the 1983 devaluations, the major impact of the adjustments made to the exchange rate in 1984, in the absence of close control over the money supply, was to fuel inflation, which in the course of the year reached annual rates of about 50 per cent. The external current account deficit remained at more than 8 per cent of GNP in 1983 with an added burden being the interest payments on outstanding external debt. In 1984 the current account deficit did improve to 4.5 per cent of GNP largely because of the significant downturn in domestic economic activity and the resulting decline in import demand.

Early in 1983, before the large scale capital outflow, the Government began to respond to the problems building up in the Philippine economy with policies broadly in line with those advocated by the IMF. As well as devaluing the peso and attempting to control the money supply, the Government took steps to reduce the size of its budget deficit. Traditionally the Government had kept the deficit at a relatively low level, but in 1981/82 the deficit grew to 4 per cent of GNP as revenue fell and the Government attempted to run a countercyclical fiscal policy.

Over the years the Government has played an increasing role in the economy in promoting the development of industry, particularly in capital intensive projects. The broad thrust of the Government's development strategy has been contained in a series of Development Plans. The latest (fifth) plan had as its main objective the achievement of sustainable economic growth through the efficient use of domestic resources. To this end the plan originally included eleven major industrial projects, including a copper smelter, fertiliser plant and petrochemical plants, all of which would have required large investment outlays on the part of the Government. When it became clear, in 1983, that adjustments were needed to reduce both the fiscal and current account deficits and the reliance on overseas borrowing, the Government moved to reduce its expenditure and in doing so it postponed five of the eleven projects. Moves were also made to reduce the fiscal deficit from the revenue side. A new range of taxes was introduced including an import surcharge.

Although some progress was being made early in 1983 towards achieving the necessary adjustment, the economy was not well placed to handle the capital outflow in late 1983. Resources were locked into inefficient uses and many industries were reliant on imported components which they were no longer able to obtain given the shortage of foreign exchange. More recently, renewed official and private capital inflows have allowed further progress to be made in implementing appropriate adjustment policies.

The recent change of government has been followed by new confidence in the economic outlook for the Philippines. Although there are clearly still major economic problems to be dealt with, a firm commitment to orthodox economic policies and prospects for greater social and political stability than has been the case in recent years should allow more effective moves towards a resolution of these difficulties.

Conclusion

Malaysia, Thailand, Indonesia and the Philippines all remain largely dependent on their primary sectors in spite of the degree of industrialisation which has taken place in the last ten to fifteen years. Exports of agricultural products and, in the case of Indonesia, oil, provided the base for a generally impressive growth record in the late 1970s. However, the second oil shock and subsequent world recession in 1981/82 highlighted significant problems in the four countries. All have moved, with varying degrees of success, to tackle rising fiscal and current account deficits and mounting external debt. The general willingness of these countries to undertake the necessary adjustments has been recognised in international financial markets with the result that access to external financing has for the most part been maintained. This in turn has helped them to to continue to implement policies for economic and social development.