Foreign & Commonwealth Office

ASEAN 2030: ECONOMIC OPPORTUNITIES AND CHALLENGES

SUMMARY

In 2030, ASEAN could be the fourth largest single market in the world. But there are a number of challenges that its members, individually and collectively, will need to overcome if they are to realise the stellar growth predictions afforded by their relatively strong fundamentals.

DETAIL

ASEAN's Economic Potential

1. The outlook for SE Asia over the next 6 months is encouraging, despite the heavy global headwinds – the result of resilient domestic demand. But it is the long-term potential of the region that most excites British/global investors and exporters. The 10 ASEAN member states currently have a combined population of around 600 million and a GDP similar to the UK's. But by 2030 the ASEAN economy is predicted to eclipse Japan's, and be the fourth largest single market after the EU, US, and China. The Asia Development Bank (ADB) predicts the size of the middle class in South East Asia will rise from 24% of the population in 2010 to 65% in 2030. Only 1% of the population is likely to be living in extreme poverty (less than $1.25/day).

2. Indonesia, Vietnam, the Philippines, and Malaysia figure (in various permutations) in most of the groupings of second-generation (i.e. after the BRICs) high-growth emerging markets coined by banks and other institutions. Thailand is just outside most of these groupings. The Asia Development Bank (ADB) recently predicted that Burma could grow at rates of 7-8% for the next few decades, if its rapid emergence from isolation continues. Smaller Cambodia and Laos also look set to record equally impressive growth.

3. Part of the high growth story comes from the fact these countries, except Malaysia, are 'catching-up' from a very low base per capita income - in 2011 Indonesia ranked 110th in the world in GDP per capita terms, Philippines 126th, Vietnam 141st (Laos, Cambodia, and Burma rank even lower). But growth projections for SE Asian emerging economies beat those for many other countries with the same income per capita.

4. Demographics work strongly in favour of the Philippines, Malaysia, Indonesia, and Vietnam, which are predicted to experience significant increases in their working age populations (in decreasing order of relative magnitude). Labour costs are low, particularly in Vietnam (around a third of Chinese levels), Laos, Cambodia, and Burma. A child born in Indonesia, Thailand, Malaysia, or the Philippines is likely to receive more years of formal full-time education than his/her peers in China or India (native English language is also a major benefit for Malaysia and the Philippines). Literacy rates are high in relation to income levels. This, combined with relatively low income levels, gives the

'ASEAN-5' emerging markets in the region a strong foundation for rapid growth (see Table 1 below – Singapore is not included as it has a much higher income per capita).

Table 1: Strong Foundations for Long-term Growth in ASEAN-5 Emerging Powers

	Population millions	GDP per capita, 2011 $ nominal (global ranking)	% population 0-15 years old	Average expected years of full time education	Adult literacy rate, % population	Global Competitiveness Index 2012, 7=most competitive (ranking)
Indonesia	238	3,509 (110)	27	13.2	92	4.4 (50)
Thailand	65	5,394 (90)	20	12.3	94	4.5 (38)
Malaysia	29	9,700 (64)	30	12.6	92	5.1 (25)
Philippines	92	2,223 (126)	35	11.9	95	4.2 (65)
Vietnam	88	1,374 (141)	23	10.4	93	4.1 (75)

Sources: UN for population, expected years of full time education for children currently under 7 years old, and literacy rates; IMF for income per capita; World Economic Forum for Global Competitiveness Index 2012 (covers range of indicators including market size, macroeconomic environment, financial sector development. education etc).

5. The painful lessons learnt during the 1997-8 Asian Financial Crisis have also generally resulted in more prudent macroeconomic policy management – laying the foundations for sustainable growth.

The Challenges

6. It's easy to get giddy over the stellar growth predictions churned out by fairly simplistic economic models. The predictions need to be put in perspective though. McKinsey recently predicted Indonesia could overtake the UK by 2030 to become the world's 7th largest economy, up from 16th now (though other forecasts put it just behind Germany and the UK in 2030). But it is likely to still be the only SE Asian country among the world's 20 largest economies in 2030. Economic models also fail to adequately capture many of the obstacles and potential bear traps that lie in countries' development paths.

7. The inadequacy of emerging SE Asia's infrastructure is a major bottleneck – hampering the development of more integrated markets within and between countries, and reducing competitiveness. Governments across the region are now addressing this problem with varying degrees of urgency, including by drawing in private and foreign capital. SE Asia is collectively likely to see around 10 million people a year move from rural areas to cities (a scale not dissimilar to China). This will pile the pressure on emerging SE Asia's already creaking hard infrastructure, but will also require improvements in social infrastructure – especially if demographics are not to become a double-edge sword. Health spending per capita is low, except in Thailand, compared to emerging markets elsewhere in the world. Social welfare is relatively underdeveloped. The quantity of education provided is relatively high in several countries, but there are some concerns over the quality. Investment in education and skills, in particular higher education and vocational training, will be required to ensure growth becomes driven more by 'inspiration' than 'perspiration', and the ASEAN-5 avoid the 'middle income trap'.

8. Financial sector development and reform will be critical, to enhance the efficiency of capital allocation and make growth more sustainable. Significant improvements in governance and the business environment are also needed. Corruption prevents an efficient allocation of resources. It's one of several factors, along with excessive bureaucracy, regulatory uncertainty, and weak rule of law, which are muddying the investment climate in Vietnam, Indonesia, and the Philippines in particular (see Table 2 below – according to the World Bank, Singapore has the best business environment in the world, and would be 'green' for all the indicators. The World Bank ranks the business environment in Laos, Cambodia, and Burma as worse than in the ASEAN-5).

Table 2: Constraints to Growth in ASEAN-5 Emerging Powers

	Economic Freedom Index 2012, high score = freer economy (ranking)	Political Stability Index 2010, low score= stable	Enabling Trade Index 2012, 7=easiest cross-border trading (ranking)	Ease of Doing Business, 2012 ranking	Rule of law 2011, global percentile rank, 100=strongest rule of law	Corruption Perceptions Index 2011, lower score=more corrupt (ranking)
Indonesia	56.4 (115)	6.8	4.19 (58)	129	31	3 (100)
Thailand	64.9 (60)	7.0	4.21 (57)	17	48.4	3.4 (80)
Malaysia	66.4 (53)	6.5	4.90 (24)	18	66.2	4.3 (60)
Philippines	57.1 (107)	6.8	3.96 (72)	136	34.7	2.6 (129)
Vietnam	51.3 (136)	4.3	4.02 (68)	98	38.5	2.9 (112)

Sources: Heritage Foundation and Wall Street Journal for the Economic Freedom Index (covers size of government spending, regulatory freedom for businesses, property rights etc); Economist for Political Stability Index; World Economic Forum for Enabling Trade Index (covers market access, customs efficiency, trade infrastructure etc); World Bank for Ease of Doing Business ranking (covers ease of starting business, enforcing contracts etc) and Rule of Law; Transparency International for Corruption Perceptions Index.

9. Rapidly rising demand for energy will require improvements in energy efficiency and/or energy supply. As SE Asia's thirst for resources increases, the risk of inadvertent conflict in the South China Sea rises. Indonesia has a different problem - avoiding the 'natural resource curse' that often plagues energy producers, resulting in poorly diversified economies and unproductive rent seeking. Food security, currently not a concern, is also likely to rise up the agenda. Growing populations and rising incomes will push up demand, while urbanisation and the impacts of climate change will restrain supply. The region's susceptibility to natural and climate-related disasters is a broader concern, with significant improvements needed in disaster-preparedness and crisis management.

10. Countries in the region will also need to grapple with a range of political challenges. Rising inequality will become more of a political challenge, as in any emerging economy. Economists argue governments in the region need to wean their populations off fuel subsidies which are politically popular but economically distortive – particularly in Indonesia, but also Vietnam, Thailand, and Malaysia. Governments in Thailand, Burma, Indonesia, and the Philippines need to manage difficult domestic conflicts. Brunei needs to handle the side-effects of economic diversification.

11. Singapore is predicted to continue growing relatively rapidly, for one of the richest countries in the world (and it is expected to rise further up the per capita income

rankings). But it faces its own unique set of challenges – squeezed by an ageing population on the one hand, and increasing political sensitivities over immigration into the world's most densely populated country (after Monaco) on the other.

12. Protectionism is an ever present threat to growth, although the major SE Asian emerging economies are more open than many of their peers (and all are WTO members). The region's ability to overcome wide disparities in development levels and achieve political consensus over economic and trade integration will have a major bearing on SE Asia's growth trajectory. The ASEAN Economic Community is scheduled to launch in 2015. But some commentators argue this timescale looks unrealistic. Significant delays in progressing integration between ASEAN's 10 member states will reduce the region's growth potential – though even if behind schedule, incremental steps over time will arguably bring compounded benefits.

Opportunities for the UK

13. The combination of enormous potential and significant challenges make this very fertile ground for boosting our commercial and policy cooperation. The ASEAN region already punches above its weight in terms of the UK's economic interests. But rapidly expanding SE Asian economies will not automatically translate into booming markets for UK goods and services. Our economic interests are largely concentrated in a handful of countries - 85% of our ASEAN exports go to Singapore, Thailand, and Malaysia. Singapore and Malaysia are the only significant investors in the UK - though Thailand is also emerging as an important investor and other countries have potential. In the coming decades, rapid economic growth in ASEAN is predicted to come largely from those countries where our export performance has been weakest to date – both in absolute terms and compared to key competitors. Indonesia accounts for 40% of ASEAN GDP, but was the destination for only 7% of our total ASEAN exports in 2011 (only partly explained by the fact it is a populous but poor country). Most of the nearly 300 million people predicted to enter the middle class by 2030 live in the 'harder' ASEAN markets.

14. This paper does not reflect the views of the UK Government.

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October 2012