Regional Collaboration in ASEAN and APEC: A Thai Perspective

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1. Introduction

The Association of Southeast Asian Nations (ASEAN) made it clear at the meeting of foreign ministers in Manila in July 1998 that they prefer the group only to be a lobby against external political threat. Most ASEAN member states showed that they were not in a position to make any special concessions to members whose economies are melting down.

Thailand's call for more open debate on domestic issues that threaten the region was muted. Burma, Indonesia, Malaysia and Singapore made only a verbose response. Vietnam seemed more restrained despite its clear opposition to the proposal. Brunei showed a feeling of doubt, while Laos kept quiet about its opinion. The Philippines was Thailand's only ally in the bid for a flexible approach to the application of the non-interference principle.

Economically, some ASEAN member countries opposed the idea of setting up an economic surveillance system in order to keep track of capital flows, banking practices and macroeconomic indicators. The opponents argued that the sharing of information regarding banking and financial sectors is intrusive. The objections, however, were not raised at the meeting of senior ASEAN officials in Rangoon that resolved to set up such a mechanism. The objecting countries are also believed to have supported the Manila Framework, which includes such a mechanism, of the Asia-Pacific Economic Cooperation (APEC) forum in Vancouver in November 1997. In addition, the same ASEAN countries attended the Asia-Europe Meeting in London in April 1998 that called for a more transparent global surveillance system under the International Monetary Fund (IMF) that would be complemented in Asia.

Faced with such political problems, Thailand may have to concentrate only on the bilateral approach to problem-solving. The decades of the 2,400-kilometer-long border problem with Burma show the depth of the difficulty. The long-standing problem with some 90,000 refugees along the same border is an

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example, as Rangoon remains averse to the idea of the United Nations High Commissioner for Refugees. Laos has been more willing with border demarcation, although that task is by no means trouble-free. And large numbers of displaced Hmong remain a sticking point as Vientiane is still suspicious of these anti-Communists' activities. The Thai-Malaysian solution for a joint development area, however, is widely and frequently applauded as the best option for maritime border problems between neighboring countries. Cambodia, which shares another part of the Gulf of Thailand, is seeking a similar arrangement.

On the economic front, the recent Manila meeting confirmed commitments on the ASEAN Free Trade Area (AFTA), conceived at the fourth ASEAN summit in Singapore in 1992. But the reluctance of at least two member states to share financial information and the current cash squeeze on most member states raises doubts whether they can meet commitments to reduce tariffs to the minimum 0-5 percent as required by AFTA. The five founding members of ASEAN plus Brunei are due to do so by the year 2003, while Vietnam is to follow by the year 2006, and Burma and Laos two years after that. The dialogue partners' response to ASEAN's call for at least some of them to help lead and coordinate the international effort to stop the Asian crisis from going global was also lukewarm. Japan's answer was vague when ASEAN foreign ministers urged it to work with the G-7 to stop the slide of the yen and to stimulate the Japanese economy. The United States also insisted on Asians undertaking structural reforms required under IMF rescue packages, although the appropriateness of these conditions is being increasingly questioned.

Should Thailand's conduct of regional foreign policy be transformed? Will Thailand pursue independently a more principled, assertive, and proactive foreign policy when the diversity of ASEAN's nine members has become baggage? What are the political and economic implications for Thailand in challenging ASEAN's principle of non-intervention? Should Thailand stand on its own two feet and strengthen its ties with countries further away than its immediate neighborhood, especially member countries of APEC, to enhance political and economic self-reliance? Is it likely that Thailand will not put a high priority on regional free trade to avoid social unrest and political instability? What role should Thailand have when pressures to liberalize the market weaken its development capacity?

This paper seeks to explain analytically regional collaboration in ASEAN and APEC after the financial crisis. Section 2 relates the problem of regional diversity to the Thai proposal for flexible engagement. Section 3 discusses the economic liberalization policies in ASEAN and APEC. Section 4 examines the effects of the financial crisis. Finally, the effects of liberalization policies on the Thai automobile industry are described in Section 5.

2. A Policy of Flexible Engagement

The concept of flexible engagement was initiated by Anwar Ibrahim, the former Malaysian deputy prime minister, who, after the upheavals in Cambodia last year lamented in public the lack of ASEAN involvement in the rebuilding of Cambodia. However, Malaysia has since been silent on the question of constructive intervention despite its initial leadership and enthusiasm. At the recent ASEAN foreign ministers' meeting in Manila, Malaysian representatives returned to supporting the importance of non-intervention as a principle in ASEAN affairs.

The Thai foreign minister has done his job raising the issue. He has emphasized that he is not asking ASEAN to abandon the principle of non-interference, rather a flexible approach towards it that allows for open discussion. The Thai proposal, however, was accused of misdirecting its frustrations with Burma and bending to pressures from the European Union (EU). Moreover, the proposal was seen as an invitation for other countries to intervene in ASEAN affairs and thereby compromise its bid to enhance leverage with other regional groupings.

Thailand was criticized that it was not necessary to take such a strong stance and to challenge ASEAN's principle of non-intervention. In Cambodia, for example, a constructive intervention policy based on genuine partnership and mutual gain is probably more suitable. ASEAN appointed the troika of foreign ministers from Indonesia, the Philippines and Thailand to help restore political stability to Cambodia after violent factional fighting ousted first prime minister Norodom Ranariddh in July 1997. The troika's assessment of the elections is crucial to the timing of Cambodia's admission into ASEAN, which was delayed after bloodshed in 1997. Since September 1998 the association has already endorsed the view that Cambodia's July 26 elections were largely free and fair to an extent that enabled them to reflect the will of the Cambodian people. This implies that the question of Cambodia's ASEAN membership will be discussed within a matter of months. If Thailand was involved more in the social, political and economic rebuilding of Cambodia, it would help stabilize the Kingdom and raise ASEAN's visibility and respectability. Thailand and other members should be invited in and work with the democratically elected officials and institutions through a consultative process.

In the case of Burma, a policy of flexible engagement will also not help. Moreover, Thailand should abandon its failed policy of constructive engagement. The policy has done nothing but given ASEAN a black eye. Burma has not been weaned away from Chinese influence despite ASEAN's hopes, and the authoritarian State Peace and Development Council (SPDC) shows no signs of improving the political and human rights situation within the country . The SPDC that replaced the State Law and Order Restoration Council still resists formal dialogue with the opposition National League for Democracy (NLD) and real peace with ethnic minorities, despite pacts with 15 groups. Moreover, the SPDC has stepped up pressure on the NLD since the opposition party emboldened its bid for recognition of the results of the 1990 elections which it won by a landslide.

ASEAN admitted Burma and Laos in a hurry in 1997 in order to boost its bargaining power with other regional groupings. But ASEAN has not succeeded in achieving the objective of this enlargement exercise. Burma's admission drew fierce opposition from ASEAN's Western trade partners. ASEAN's long-standing cooperation with the EU was jolted in November 1997 when the EU postponed a scheduled meeting in Bangkok after ASEAN insisted on Burma's participation in a regular review of ASEAN-EU cooperation.

Faced with these problems, Thailand should institute a policy of preventive intervention, realizing that without efforts now, Burma could end up with a bloodbath that will erode regional peace and stability. It could also jeopardize ASEAN's international credibility as a competent and mature regional body able to deal with politically sensitive issues. A policy of preventive intervention means that it would allow for open criticism of the military regime in Burma by the Burmese people themselves. If the people of Burma want change, expatriates should return home and initiate a revolution. Thailand should actively support refugees fleeing from Burma and grant political asylum to those in need of protection. It should offer to host or co-host talks between SPDC, NLD and the ethnic minorities in Burma and use a system of economic incentives and disincentives to encourage political change in Burma.

Moreover, to enhance political and economic self-reliance, Thailand should strengthen friendships with countries further away than its immediate neighborhood. As much effort should be spent on countries in the Asia-Pacific region. Thailand already enjoys good relations with China. Its $3 billion contribution to Thailand's rescue in August 1997 and unprecedented military aid a year earlier constitute generosity. In addition, to ensure a balance in the subregion, Thailand needs to build on already positive ties with Japan and South Korea, and to work on uncertain relations with Russia.

Thailand should also step up economic and technical cooperation within the APEC forum to ensure the transfer of technology from developed to developing members and to achieve an equal partnership among the 18 APEC economies as well as with the three new members: Russia, Vietnam and Peru. There should be a mechanism such as a human resource development fund to intensify the transfer process, launched in Manila in 1996. Thailand has already proposed five key areas of cooperation: access to markets, technology, information, and sources of funds, as well as human resource development for small and medium-sized enterprises (SMEs), which account for 90 percent of the production base in APEC economies. The SME Action Plan was launched in January 1998, to enhance cross-border cooperation and coordinate manufacturing bases so that not everything is in the hands of multinational companies. However, in the wake of the Asian crisis, there might be hesitation or even delays in liberalizing trade in the nine sectors agreed on in Vancouver.

In contrast to its policy toward ASEAN, Thailand has been cautious about APEC when it comes to the question of fear of dilution in a wider regional organization and the concern of being dominated and overshadowed by the much larger economies. The country is now working to make sure that the commitments will be implemented. But the tight budget for Thailand's participation in various projects of the group has prompted worries over future cooperation. Various working groups have been set up, but some did not have participation by the relevant agencies.

3. The Economic Liberalization Policies

Theoretically, there are three ways in which economic integration can proceed among economies in a single region, without discrimination in the application of official barriers to trade (Garnaut 1994). The first is through non-discriminatory reduction of protection in economies which have the capacity to expand trade as a result of high complementarity, or of low bilateral trade resistance that does not depend on official barriers. Such non-discriminatory trade liberalization may or may not lead to intensificaton of bilateral trade. The second is through expanded provision by governments of public goods relevant to the efficient operation of the regional international market for goods and services. The third is through the processes of market integration. This can proceed as a result of governments getting out of the way of profit maximizing patterns of trade, or through the dynamics of private discovery of profit maximizing patterns, without any change in the policy stance of governments. Market integration is likely to intensify intra-regional trade. Moreover, regional economic integration remarkably advances in a region of liberalizing economies, and is retarded in a region in which member economies are inward looking and raising barriers to trade.

Asia Pacific was identified as a region of open economies, in which non-discriminatory, mostly unilateral liberalization was generating rising trade shares of output and expenditure, and rapidly expanding intra-regional trade. The concept "open regionalism", that involves regional economic integration without discrimination against economies outside the region, was articulated by the first Pacific Economic Cooperation Conference (PECC) in Canberra in 1980, and by the first APEC Ministerial Meeting in Canberra in 1989, as an ideal for the future development of economic relations in the Asia-Pacific region.

By contrast, economic cooperation amongst the ASEAN countries was supported by a widening range of inter-governmental contacts promoting information flows and confidence in the maintenance of open trade policies, prior to the commitment in 1992 to move toward the establishment of a discriminatory free trade area or AFTA.

There is some recent empirical evidence on the virtues of openness in the Asia-Pacific region. Edwards (1993) and Rodrik (1993) suggest that openness to trade and investment is associated with higher growth rates. Frankel and Romer (1996) and Krugman (1993) estimate much higher magnitudes of trade/income-per capita links, with an increase in income per person. Urata and Yokota (1994), Osada (1994) and Okamoto (1994) conclude that economic liberalization policies played important roles in improving productivity in Thailand, Indonesia and Malaysia. The policies are also important in the transmission of technology from industrial countries to developing countries in Asia.

The example of the ASEAN countries is very interesting, as their experiences seem to have been more typical of economic reform in developing countries. First, they were forced to liberalize because external shocks, combined with internal financial imperatives, forced them to choose either to further insulate the economy from the external sector or liberalize. Eventually, they all chose the latter path, though the Philippines was a bit tardy due to internal political turmoil. Vietnam also jointed the trend around 1988. Malaysia and Thailand were liberalizing rapidly and counted among the most rapidly-growing economies in the world.

Second, liberalization was comprehensive, including both trade and investment. In addition to lowering tariffs substantially, non-tariff barriers fell even faster over the 1984/87 to 1991/93 periods, from 93 percent to 7 percent in Indonesia, 8 percent to 5 percent in Malaysia, and 20 percent to 8 percent in Thailand (Petri and Plummer 1996). The changes in ASEAN policies over this period were also tremendous. In order to lure in more foreign direct investment (FDI), all ASEAN countries established one-stop investment centers and worked to make investment laws as transparent as possible. Legal equity participation was liberalized. Restrictions on repatriation of profits were abolished. Restrictions on personnel were loosened. And performance requirements were made less stringent, generally what is now the WTO-instigated minimum.

The result is that ASEAN countries experienced rapid increases in exports of manufactures, attracted large inflows of FDI in a variety of areas, and underwent dramatic change in economic structure generally considered to be in line with comparative advantage. However, certain aspects of import substitution still remain, for example, the protection of high-profile industries such as automobiles in Indonesia, Malaysia, Thailand and the Philippines and aircraft in Indonesia. Still, these sectors in ASEAN are more open than they were a decade ago. And although economic nationalist elements remain, ASEAN countries are committed to the liberalization agenda. The movement toward AFTA is further evidence of this.

The APEC liberalization process is a consequence of the region's openness. The process has become important at the national level since the Bogor Declaration in 1994. The APEC leaders have adopted a vision of liberalizing trade and investment in the Asia-Pacific region by the year 2020. After the Osaka Meeting in November 1995, each member country was requested to prepare an Action Plan for the Manila Meeting in November 1996. The Action Plan could be grouped into three aspects: trade and investment liberalization, trade and investment facilitation and economic and technical cooperation. The trade and investment liberalization and facilitation process have entered the stage of implementation since January 1997.

Thailand's short-term action plan (1997-2000), for example, is close to its commitment to the WTO resulting from the Uruguay Round. For the medium-term (2001-2010) and long-term (2011-2020), the plan is still not clear. The short-term plan includes tariff reduction, conversion of non-tariff measures unto tariff measures, liberalization of trade in services and liberalization of investment using an initial WTO framework. The government has approved the 15 sectors in which Thailand will liberalize trade ahead of the schedule agreed by APEC at the summit in November in Vancouver. The first nine sectors are gems and jewelry, forest products, fish and fish products, toys, chemicals, medical equipment and instruments, environmental goods and services, energy, energy-related products and services, and telecommunication products. The six additional sectors are natural and synthetic rubber, oil seeds, food, fertilizers, automobiles and commercial aircraft. Under the APEC framework, tariffs will be reduced to between zero and 5 percent by 2005.

Under the commitment to the WTO, tariff reforms were announced in December 1994 with implementation commencing in January 1995, reducing the number of tariff rates from 39 to 6. The new tariff structure is under the value-added escalation principle. Thailand has committed to free up by the year 2020. The tariff reduction will be consistent with the EFTA guidelines.

To conform with WTO regulations, Thailand has been committed to converting non-tariff measures into tariff measures since 1995. The non-tariff measures include import licensing and local content requirements. There are three types of import licensing in Thailand: automatic licensing, non-automatic licensing and special measures. Non-automatic licensing covers the major items, especially agricultural products, under the Export and Import Act 1979. Special measures apply to yellow fin tuna and wood and sawn wood from neighboring countries. The local content requirements are applied to domestic production of passenger cars, light trucks and buses, motorcycles and dairy products. The country is committed to eliminate local content requirements in 1999. For APEC, Thailand has offered to increase the quantity of imported soybean, soybean cake and skimmed milk powder above the quantity specified under the WTO agreement.

Under the General Agreement on Trade in Services, Thailand is committed to liberalizing the services sector, including business services, communication, construction, education, environmental services, finance, tourism, recreation services and transport. For AFTA, the liberalization of trade in services includes tourism, maritime transport and air transport in the Fast Track scheme. For APEC, Thailand has offered to open trade in services, including telecommunication, maritime transport, air transport, road transport, insurance and energy. The plan is similar to the country's commitment to WTO.

Finally, under the APEC agreement, Thailand is to liberalize investment by using an initial WTO framework, the APEC non-binding investment principles, as the first step. In the year 2000, the country will amend the Alien Business Law to facilitate trade and investment liberalization by allowing greater foreign participation in a large number of areas, increasing the quantity of production, allowing the establishment of more branches of a business, revising the types of business in which to allow aliens to hold a hundred percent of equity, and adjusting the types of business to be liberalized.

4. The Financial Crisis

It would be more accurate to confine the expression "financial crisis" to Indonesia, Malaysia, South Korea and Thailand. The contagion followed the Thai abandonment of the dollar peg in July 1997. Other developing economies in the Asia-Pacific region will grow this year and next at rates below the average of recent years, but well within the range of their own experience over the past two decades. Of course the effects of the crisis have not yet been fully revealed in the Philippines, Singapore, Hong Kong, China and Taiwan. Some economies look more vulnerable to further complications than others, Vietnam and Burma in particular.

The 1997 crisis had its origins in mismanagement of short-term macroeconomic policy. The policy challenge was complicated by greatly increased international capital mobility in the 1990s. Rapid expansion of trade and direct foreign investment, at rates well in excess of production, also widened the channels of international capital mobility. Moreover, the large increase in stock market and real estate values helped to expose flaws in the system of macroeconomic management. first of all in exchange rate regimes.

The Thai baht had been fixed against a basket that had an overwhelming US dollar weighting. This fixed exchange rate regime ran into problems when the authorities were unable to manage demand within the limits required to validate the rate. The inflexibility in the economy prevented downward adjustment of costs when validation of the rate required contraction of domestic demand. The consequence was a misaligned real exchange rate. The real exchange rate was fixed at too high a level, a situation that was converted into a crisis by speculative capital flows.

Since the mid-1980s, three main influences had come together to generate misalignment in the Thai, as well as in the Malaysian, Indonesian, and South Korean exchange rates. The first factor was the strengthening of the dollar against the yen and other major currencies, which generated a large nominal effective appreciation of currencies pegged to baskets with a high dollar weighting. The second factor was an increase in domestic demand. Inflation was very high and some of it was in asset prices, compounded by speculative capital inflow and bank lending. The result was large real appreciation in all four economies, by 6-9 percent against major industrial economies and 12-17 percent against Japan from 1995 to 1996. The third factor was a slump in the international market for electronic products which reduced the terms of trade and sales growth of Thailand and Malaysia in particular.

These three factors together precipitated a contraction in export growth. Thai export growth in dollars slumped from 25 percent in 1995 to zero in 1996, Malaysian from 22 percent to 5 percent, and Indonesian from 18 percent to 4 percent. The growth of South Korean exports fell sharply to 4 percent in 1996, from 16 percent in 1994 and 32 percent in 1995. In the case of Thailand, the reduction in export growth to Japan was also dramatic, from almost 20 percent to zero. The loss of competitiveness in the export industries reduced the attractions of these economies to FDI. This was most pronounced in relation to Japan. Japan had been a major source of FDI to Southeast Asia in the first half of the 1990s. with the high yen contributing to the movement offshore of much manufacturing industry.

Moreover, current account deficits in Thailand, Malaysia, Indonesia and South Korea had been the subject of concern since 1995, as a possible sign that demand expansion had been excessive in the light of the exchange rate strategy. The current account deficit in Thailand was 8.1 percent of GDP in 1995 and 8.4 percent of GDP in 1996. In Malaysia, the deficit had peaked at over 8 percent of GDP in 1995, and had eased to 6 percent in 1996. The Indonesian deficits were more modest, 3.3 percent of GDP in 1995 and 3.4 percent in 1996.

The South Korean current account was moving into deficit, from 1.8 percent of GDP in 1995 to 4.7 percent in 1996.

The Thai currency crisis originally began in 1996, interacting with the stock and property market slump, and influenced by the marked slowdown in export growth. Rumors of possible baht devaluation circulated from May 1996. In June and also in October, steps were taken partially to reverse the capital account liberalization. In May 1997, drastic central bank intervention saved the baht from devaluation. Official reserves were reduced to $33.3 billion at the end of May. The success this time was supported by the central banks in ASEAN countries under a series of agreements signed in 1995 and 1996. However, the speculative outflow was threatening the convertibility of the baht, prompting a comprehensive effort to defend the established exchange rate against the dollar. Speculation against the exchange rate quickly overwhelmed the monetary authorities, leading to the floating of the baht and massive depreciation in July. Financial instability then spread rapidly throughout East Asia.

The contagion had probably three sources. One was the realization that presumed government guarantees of currency parities, and in various ways of asset values, were not guarantees at all. The second source was realization by investors that they had poor understanding of the working of the economies in Asia. This caused a sudden and large increase in risk premium on investment throughout developing Asia. The third source was the diminished opportunity for gains from real trade and investment with regional economic partners. The fall in value of regional currencies and assets pointed immediately to slower expansion of trade and investment, lower economic growth, and domestic currency and asset values lower than they otherwise would be.

The Japanese government declined to take any action to save the baht from devaluation because of concerns about Thai authorities large-scale intervention in the futures market. Thailand had to seek $17.2 billion in a loan from the IMF. To be matched by the IMF, Japan agreed to contribute $4 billion through its Export-Import Bank. China agreed to contribute $3 billion. Australia, Hong Kong, Singapore and Malaysia each agreed to lend $1 billion to bail out Thailand. Another $2.2 billion came from Indonesia, South Korea and the Asian Development Bank. Moreover, the Thai government had to seek an additional $3.3 billion loan from the Bank of International Settlements.

Japan has also made a great deal of effort to halt the contagion and quiet the turmoil in the region's economies. In 1994, the country had discussions on exchange rates with Australia, Singapore and Hong Kong. It took the lead in organizing a meeting of East Asian and Pacific central banks. In March 1997, officials from the United States, Japan, China, Hong Kong, Singapore and Australia met in Tokyo at the first reunion. Japan, in particular, wanted this new group to become a forum to discuss exchange rates. The group asked the IMF to prepare a proposal for setting up a region-wide currency stabilization fund. However, the flotation of the baht in July showed that with many nations involved. exchange rate cooperation could be difficult to manage.

Japan then proposed the self-contained Asia fund to stabilize the region's economies, arguing that IMF resources were not enough to deal with Asia's problems. The proposal was first discussed in Manila in November 1997. The United States as well as other western nations resisted any bail-out fund independent of the IMF as they feared that it would allow countries to escape the stringent conditions of an IMF package. One month later, ASEAN finance ministers agreed to the concept of a standby fund to supplement resources of the IMF. The fund would only be available to countries already under an IMF program. Moreover, a new surveillance mechanism within the association would be established to prevent future crises. The ASEAN secretariat would play the lead role in monitoring Southeast Asian economies in combination with the IMF. The Asian Development Bank has been asked by ASEAN to provide the technical support. However, the establishment of such a mechanism is likely to be inhibited by ASEAN barriers against disclosure of sensitive economic data.

The financial crisis has exposed weaknesses in regulatory systems and financial institutions in Thailand, South Korea and Indonesia in particular. The fall in asset value and in currency in these economies placed pressure on financial institutions. The fall gave rise to non-performing loans and deficiencies in the security backing of non-performing loans even in well-managed banks. Moreover, lenders insisted on immediate repayment at the crisis exchange rates.

The crisis demanded policy decisions in these economies as a matter of great urgency: the exchange rate regimes; the setting of macroeconomic policy; and management and rehabilitation of the financial system. The first area for urgent policy decision was the exchange rate regimes. The pressure of capital outflow forced Malaysia, the Philippines, Indonesia and South Korea to follow Thailand in floating their currencies. Real choices on exchange rate regimes for the future must wait until the floating currencies have settled down. In the troubled countries, there is unlikely to be a return to a pegged exchange rate in the old style that has been discredited by the events of 1997. The choice will be between a floating rate and a rigidly fixed rate in the Hong Kong style. The exchange rate regimes which have effectively handled the pressure from competitive devaluation in crisis are being discussed. Among them are currency controls (the Chinese model), a strict monetary regime in the Hong Kong style which ties a currency to central bank reserves and Singapore's managed float. Malaysia, for instance, has turned to currency controls since September 1998. The Malaysian government sets a fixed rate for the ringgit and allows it to be traded only within the country. Thai policymakers, however, insisted that Thailand had no need to impose similar capital restrictions as Malaysia, as both the baht and interest rates were moving in a satisfactory direction. From the Thai viewpoint, a floating rate regime is currently preferable. The Philippines also ruled out following the path set by Malaysia. The country lifted its currency controls in 1992 and has not completely deregulated all currency rules. Moreover, currency controls are traditionally opposed by the IMF. The measure would not help investor confidence.

The second area was the setting of macroeconomic policy. Monetary policy was tightened within IMF packages, or independently, with rising interest rates. This was seen as a means of stemming capital outflow. Moreover, the IMF packages in Thailand, South Korea and Indonesia required highly contractionary budgets that were contested by the authorities. There was widespread realization that the fiscal prescriptions of the IMF and the financial markets were excessively contractionary. The Thai economy, for example, contracted 0.4 percent in 1997. The IMF has estimated that the economy would contract by 8.5 percent in 1998. In addition to this, consumption would shrink by 7 percent and investment by 13.8 percent. Inflation would be 10.4 percent, compared with 5.6 percent in 1997.

The third area of urgent policy decision, the management and rehabilitation of financial systems, was critical to recovery. Necessary requirements included greater transparency, improved regulatory arrangements and the closure of financial institutions that did not meet these stronger requirements. It was necessary to facilitate injection of new equity, including from foreign enterprises. The credit for investment in fixed assets was the main source of non-performing loans for financial institutions in Thailand during the economic crisis, since business units could not generate enough revenue to pay back loans agreed on during an economic boom. Non-performing loans for financial institutions in Thailand reached 35-40 percent of total loans in August 1998. Resolving this difficulty requires cooperation between the public and private sectors. At the same time, creditors and debtors must renegotiate their loans. The cooperation and compromise will be the last and only choice to loosen the Gordian knot.

There is promise in Malaysia, Thailand and South Korea that progress is being made on financial rehabilitation, and that the export-led recovery is likely to be powerful and not long delayed. In Thailand, for example, implementation of strict fiscal and monetary measures to tackle problems in the finance sector and maintain economic stability has improved overall economic stability. This has resulted in relatively stable baht exchange rates, a high current account surplus and reasonable average inflation rate. The Thai government will ease monetary and fiscal controls to stimulate the economy, especially in the real sector, by expediting public expenditures, easing interest rates, expediting debt restructuring in the private sector, and maintaining incentives to attract foreign capital inflows. Positive economic growth is expected in the first half of 1999 as exports increase in response to the improving financial status of Thailand's Asian trading partners, improved liquidity of Thai exporters, and ability to repay foreign loans or pay for imports as the baht strengthens. Eventually, domestic demand will rise accordingly.

It is, however, too early for assessment of the effects of the crisis on regional collaboration. The combination of the export-led recovery due to a huge boost in competitiveness from currency depreciation in the troubled economies, weak domestic demand in East Asia, and continued economic expansion and an extremely strong dollar in the United States is likely bound to generate a large trade and current payments imbalance across the Asia-Pacific region. There is a danger that this will generate powerful political responses in the US, complicating the task of maintaining an open framework for Asian-Pacific trade relations.

It is also likely that the Chinese yuan and the Hong Kong dollar may come under strong downward pressure in the near future. In the last two years, the Chinese authorities had subdued an inflationary boom. The current account was in surplus, and high inflows of FDI were contributing to foreign exchange reserves that were rising strongly from a high base. Short-term capital flows were inhibited by controls. Moreover, Chinese officials have said that the need to provide an anchor of stability at a time of crisis in East Asia and a desire not to inflame US political reaction to a bilateral trade imbalance argued against devaluation. However, contagion and the decline in opportunities for trade and investment will lead to a diminution of the current account surplus. There will be strong pressure on the yuan. Besides, market turmoil, heightened in August and September 1998 with Russia's devaluation and debt moratorium and speculative attacks against Hong Kong markets, have highlighted the challenges facing the Hong Kong dollar peg.

The crisis may also lead to strict controls of the capital account. In Thailand and Malaysia, capital liberalization in the early 1990s is seen as having facilitated the speculative inflows of the boom times and the outflows of the crisis. Both countries reimposed elements of control at the onset of crisis. More importantly, the crisis has increased caution about capital account liberalization in China, Vietnam and Burma. In China, it has led to retreat from earlier announcements on full yuan convertibility. The Vietnamese dong is still a non-convertible currency internationally, and trading is subject to strict restrictions. In Burma, the government has printed foreign-exchange certificates, which are supposed to be a proxy for the dollar. However, it is hard for Burma's citizens to convert them into foreign currency.

Vietnam looks more vulnerable to adverse effects in the medium term. Current account deficits as a proportion of GDP have been larger in Vietnam than in any other major Southeast Asian economy in recent years. Vietnam's currency had depreciated about 14 percent since the outbreak of the regional crisis in 1997. In August 1998, the country had to implement a de facto 7 percent devaluation of its currency. While the devaluation could help narrow Vietnam's trade deficit, which reached $1.44 billion in the first seven months of 1998, it will also place pressure on Vietnamese companies, most of them state-owned, which have overseas dollar debts. The country's external debt is estimated at about $10 billion. Vietnam has also moved a step closer to full convertibility with a new decree on foreign exchange to take effect on September 1, 1998. But the effectiveness of the new decree will depend on how the government plans to stamp out illegal trading in the dollar and other foreign currencies. The country has tried and failed to outlaw trading in the dollar several times, and was unclear from the new decree how this effort will succeed. That means full convertibility in Vietnam is still a long way off.

Burma's economy is also ailing and many of its people are suffering hardships. The country's economic growth has slowed since 1997 due to mismanagement and infrastructure inadequacies. The slowdown has been clearly exacerbated by Asia's financial crisis. The government has to face a host of problems, including soaring inflation and a plummeting currency. It is estimated that foreign reserves are only about $100 million. Inflation is at least 50 percent for domestic goods and more than a 100 percent for imports. The market rate for the kyat has fallen from 100 to the dollar in 1996 to 420 in 1998.

Finally, there is now widespread debate about the effects of the financial crisis and the ASEAN diversity on liberalization. It is likely that Thailand, Malaysia, Indonesia and the Philippines will not put a high priority on regional free trade, despite Singapore's calls to maintain or even advance the deadline of the AFTA. A lot of these governments are already in the position where they have to implement economic restructuring policies which are seen to threaten jobs at least in the short term. The decline in economic activity is probably associated with social unrest and the danger of political instability. The crisis has caused several countries to introduce their own safeguards to protect domestic business. A group of Philippine industrialists, for example, has asked the government to suspend the lowering of import tariffs. The Philippines has already been slowly lowering its tariffs in line with the AFTA targets. Moreover, it is not only because of the economic crisis, but also because it has to deal with countries such as Vietnam, Burma and Laos, who have not traditionally been open. These countries may use the crisis as a reason to delay implementing free trade.

5. The Thai Automobile Industry

Automotive development in Thailand, especially passenger cars and commercial vehicles, has gone through successive stages distinguished by the level of efficiency attained in auto parts manufacturing (Sato 1993). In the 1960s and 1970s, a wide variety of vehicles were assembled from the imported CKD (completely knocked-down) kits. A limited domestic market inhibited adequate scale. Consumers absorbed the cost penalty because local assemblers were protected by high tariffs or a complete ban on imported vehicles. Localization, enforced through local content requirements, was limited to minor mechanical components such as starters, wiring, harness, batteries, and other parts that are bulky to transport, such as body stampings and seats.

In the 1980s, the growth stage of the Thai automotive industry was characterized by a rapidly expanding domestic market and a fairly developed network of domestic auto-part suppliers. Since the beginning of the 1990s, the industry has surpassed a critical mass of 200,000 vehicles a year, and entered the rapid growth stage. The auto-part manufacturers have produced high value-added components locally. Rationalizing the industry has been done by reducing the number of makers and models and standardizing certain components. The country has also restructured and loosened protection of its automotive industry. However, despite an enlarged market, there are still 12 assemblers assembling 42 models in Thailand (Buranathanung 1997). The existence of too many assemblers producing a wide array of brands and models has still prevented the industry from realizing scale economies. These small production volumes hinder investment in research and development, and thus slow down improvements in productivity and quality.

According to figures provided by Toyota Motor (Thailand), Thailand's total vehicle sales were 363,156 units in 1997. Toyota sold 107,121 vehicles and held 29.5 percent market share, Isuzu and Nissan claimed the second and third spot selling 82,519 units and 42,569 units and capturing a market share of 22.7 percent and 11.7 percent, respectively. Toyota also claimed the top spot in the passenger car market, selling 47,577 units with a 36 percent market share. Honda and Nissan ranked second and third, with 34,589 units and 11,376 units sold, and 26.2 percent and 8.6 percent market share, respectively. Isuzu led the one-ton pick-up truck market selling 71,824 units and holding 38.1 percent market share. Toyota and Nissan ranked second and third, selling 51,932 units and 27,224 units and capturing 27.6 percent and 14.5 percent market share, respectively.

The Japanese makers are most dominant not only in Thailand, but also in the other three major ASEAN countries where they control over 90 percent of the market. These countries captured most of the Japanese capital that moved out of Japan following the rapid appreciation of the yen during the 1985-1995 period.

The Japanese makers can enjoy a commanding position, having already established a complementary network among their auto-part assembly plants across ASEAN to take advantage of lower tariff rates among these countries. As a prelude to the formation of an AFTA, a common effective preferential tariff (CEPT) scheme was created in 1993. CEPT provides a timetable for tariff reduction through 2003. It calls for lowering of tariffs between ASEAN countries to below 20 percent by January 1998, and to 0-5 percent by January 2003. Another scheme put in place in 1988, Brand-to-Brand Complementation (BBC), allowed for a 50 percent reduction in the import tariff applied to an auto part exported by an assembler's subsidiary based in one ASEAN country to another subsidiary in ASEAN. In November 1996, BBC was replaced by an expanded version called ASEAN Industrial Cooperation (AICO); a complementation agreement can exist between two companies not necessarily affiliated to a specific transnational interest.

The opportunities presented by regional collaboration are apparent. Economies of scale support technological advance through research and development. Auto-part manufacturers are pressured to achieve the flexibility, timeliness, cost efficiency and quality required of regional suppliers. It will also enhance manufacturers of ASEAN to be able to integrate fully to global competition.

The liberalization, however, can threaten national car programs in Malaysia and Indonesia. Uncompetitive national assemblers cannot stand up against Japanese producers, especially without the tariffs and regulations that protected them in the past. Similarly threatened are the US and European makers without an operating base or suppliers' base in the region. They have little prospect of exporting vehicles to the Asia-Pacific region. The ASEAN schemes, therefore, reflect concerns that they may benefit only the Japanese interests, and will not bring about regional development and economic self-reliance.

The issue, however, has been the subject of much controversy. In recent years, it has been observed that the US and the European makers have conceded the Asian market. The US makers' key strategy is to form alliances with local manufacturers and even with Japanese makers. In Thailand, for example, General Motors is advancing its market position through a joint venture agreement with local manufacturers and \$450-\$500 investments to produce 40,000 vehicles a year, beginning in 1999. It has decided to award auto-part supply contracts for around 900 items to 50 companies in Thailand, 25-30 percent of which are joint-ventures with local partners. It is also counting on its affiliation with Japanese makers Isuzu and Suzuki, to set up an integrated Asian production system. Ford and Mazda have also a manufacturing joint venture in Thailand. By contrast, the European makers, Mercedes-Benz and BMW in particular, focus on the low-volume but high-margin market of luxury automobiles and on heavy commercial vehicles. Moreover, the liberalization, for example in Thailand, has only partially eliminated protection. It still maintains huge tariff differentials between CBUs (completely built up) and CKDs to encourage local assembly, local content requirements to support parts manufacturing, and restrictions on entry and limitations on model changes to prevent market fragmentation. These policies are accompanied by automotive tax policies, including value-added tax and excise tariffs. The domestic price of a passenger car in Thailand is more than twice the CIF (cartage, insurance, freight) price because of domestic taxes. From this point of view, Thailand's automobile industry seems to be a long way from full exposure to industrial competition despite its implementation of liberalization schemes.

Finally, there is now widespread debate about the effects of the financial crisis on the Thai automobile industry. Thailand total vehicle sales fell in 1997 by 38.4 percent to 363,156 units from 589,126 the previous year. All major makers suffered declines in sales, ranging from Honda's 12.4 percent to Kia's staggering 61.7 percent. Sales in each segment shrank with passenger cars falling 23.5 percent, commercial vehicles dropping 44.5 percent and one-ton pick-up trucks plummeting 42.5 percent. During the first seven months of 1998, a total of 79,828 vehicles were sold, a drop of 71.1 percent from the same period of 1997. Japanese brands accounted for 88.5 percent of sales, American and European 8.4 percent and South Korean 1.9 percent. Toyota dominated vehicle sales, which totaled 19,858 units followed by Isuzu 19,422 units and Honda 9,647 units. Honda dominated passenger car sales, which totaled 8,687 units followed by Toyota 7,974 units and Nissan 2,084 units.

The slump in sales because of the financial crisis caused the companies to close local plants. For example, Mazda Motor Corporation and its Thai subsidiary closed one of their assembly plants in July 1998. The company had been operating far below capacity since July 1997 when the baht was floated. The company will still operate only one factory in Thailand in conjunction with Ford Motor Co. of the United States and two Thai partners to make Ford and Mazda pick-up trucks. The closure has put 550 workers out of work.

The slump has forced the companies to develop new strategies. Among them are launching of new products, increasing their exports, and more cooperation among makers through the AICO. For example, Toyota replaced its Mighty X with Tiger. Ford and Mazda launched Ranger and Fighter. Automobiles that are currently exported in completely built-up form include the Mitsubishi Strada, Ford Ranger, Mazda Fighter, Toyota Soluna, Honda City, Honda Accords and Mitsubishi Lancer. Hino allows its factories in Thailand to be used by sister operations in ASEAN in order to brighten export prospects so that it can keep current production going. Thailand's total vehicle exports in the seven months of

1998 reached 30,659 units, up 11,642 units or 61.22 percent. Export value also jumped by 7,311.47 million baht or 117.42 percent, to 13,638.47 million baht. New markets include Australia, New Zealand and South Africa.

Assuming that the automobile industry is one of the most important sectors in which Thailand can excel in Asia, the Thai government will provide loans under the $1.19 billion industrial restructuring program over a five-year period starting in 1998. It is also looking at reducing import duties on automotive products including kits, components and raw materials. In August 1998, the government announced a new hire purchase scheme to solve liquidity problems in the automobile industry. The minimum down payment required is reduced from 25 to 10 percent, and the repayment period is extended from four to seven years. The government claimed that the measure will help the industry, which hires more than 200,000 people, to survive the economic crisis. Dealers and auto-part manufacturers will also benefit. However, it is still doubtful whether the measure will rekindle demand. The automobile industry's problems do not rest only in downpayments or installment duration, but also high lending rates.

The Board of Investment (BoI) also announced in August 1998 that it will allow foreigners to have majority ownership of all diesel-engine manufacturing plants in Thailand. It believes that allowing majority foreign ownership would increase transfer of technology to improve production quality and volume. Toyota Motor Corporation of Japan, for example, will increase its stake in Siam Toyota Manufacturing Co. from 40 percent to 60 percent. The company, makes 270,000 diesel engines per year at its factory in Thailand.

In sum, the future prospects of the Thai automobile industry are difficult to predict, given worldwide overcapacity and the slump in the domestic sector. Locally, the development of the industry is still inhibited by high value-added tax, excise tariffs and institutional factors, including lack of skillful human resources. In the longer term, more cooperation among automakers through the AICO is essential to ensure the region's industry stays competitive worldwide. From the Thai viewpoint, ASEAN member countries should treat the region as one market, which would help manufacturers to improve economies of scale, instead of developing their own supplier network and national car projects. They should also remain fully committed to the liberalization process under the AFTA, APEC and WTO agreements.

6. Concluding Remarks

The objection against the Thai proposal for a policy of flexible engagement at the recent ASEAN Ministerial Meeting in Manila will likely transform Thailand's conduct of regional policy. The mood is also exacerbated by the failure of ASEAN to address the financial crisis and the baggage of ASEAN diversity. Thailand may have to concentrate only on the bilateral approach and more toward economic and political self-reliance by strengthening its relationships with countries further away than its immediate neighborhood. The Thai automobile industry, for example, still maintains domestic taxes. It is also looking at new markets in New Zealand, Australia and South Africa. The country is likely to remain fully committed to the liberalization process under the AFTA, APEC and WTO agreements. Besides, it will focus on other significant issues in the market-opening process, including equitable development, transfer of technology and public understanding and support for further liberalization. Thailand's problem lies not in liberalization itself, but with inadequate preparation for liberalization. The country has aired its views that improvement and implementation of action plans by individual member countries of both ASEAN and APEC had been slow. The groups also have to enhance human resource development and to find a way how to reduce the development gap between members. The group's liberalization goals would also be hard to reach without strong and efficient financial sectors in place.

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