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The Investment Climate in Southeast Asia

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<u>The Investment Climate in Southeast Asia*</u>

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One normally does not find sudden and dramatic changes in the investment climate, barring the unexpected outbreak of wars or revolutions. Asia has seen a fair amount of military action and revolt during the past year, not all of it unexpected. There was the fighting in Laos, which resulted in the as yet unconcluded negotiations which will probably lead to the establishment of a neutralist regime. In April of 1961, another revolution occurred in South Korea, and the elected government was replaced by a military dictatorship. Communist guerrilla activity in South Vietnam was stepped up, and uncertainty about the future of that area increased. Relations between Pakistan and Afghanistan became more strained, and while no fighting has broken out, diplomatic relations between the two countries were broken off. India was both the victim of further incursions of her territory by communist China and the perpetrator of the forcible seizure of territory from Portugal. Indonesia has been making preparations for an armed attack on the Dutch in New Guinea.

These developments, singly or combined, may influence investment decisions in that they call attention in a dramatic way to areas of possible instability or danger. The impact of the newspaper headlines on potential investors whose familiarity with the Asian area is slight might be far greater than on one who knows enough about the area to put the headlines in proper perspective. An important part of that perspective is the realization that in an area with as many diverse countries as Asia, it is very misleading to try to talk about the area as a whole or even about smaller divisions such as South Asia and Southeast Asia. The importance of geographical proximity can easily be exaggerated by such an approach.

For example, though no one would deny that the developments of the past year in Laos and Vietnam have been discouraging to investment, to say the least, it would be wrong to go on from this to conclude that all Southeast Asia was one large dark spot. The stability and economic progress that is being made in some of the other countries of the area are impressive, and we should not allow the gloomy headlines to overshadow this fact.

Philippine outlook bright

It is, for example, tremendously encouraging to see the Philippines making another orderly, democratic transfer of the reigns of government to the opposition party. This was the first time for the Nacionalista party to surrender the presidential office which it captured under Ramon Magsaysay in 1953, and in accepting their defeat at the polls the Nacionalistas have now demonstrated that both the major political parties in the Philippines have the maturity to make a democratic constitution work.

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The outlook in the Philippines is certainly for continued political stability. Economically the country has great potential. Its agricultural and mineral resources are substantial, and industrial development is proceeding at a fairly rapid pace, the index of manufacturing production having nearly doubled from 1953 to 1960. The rate of investment in the Philippines, foreign and domestic, has probably not been as high as the potentialities would justify. This, I am sure, has been due in large part to the fact that for the past decade the Philippines has been burdened with an unrealistic exchange rate structure accompanied by controls on imports and foreign exchange that have unquestionably deterred foreign investors. The official policy of discriminating against non-Filipinos in certain areas has probably also added to the fears of investors and may have driven capital out of the country.

The new Philippine Government on January 22nd of this year instituted a bold program of exchange reform which for the first time in a decade has given both Filipinos and foreigners complete freedom to buy and sell the Philippine peso without restriction. The Government has permitted supply and demand to determine the exchange rate for the peso, and it seems to be settling down at a rate of around 29 cents. This compares with the prewar value of 50 cents, which the Government mistakenly tried to maintain for so long during the postwar period in spite of the obvious wartime depreciation of the currency. Freeing the peso has been coupled with tighter credit policies and promises of firm fiscal policy. If the new administration can succeed in warding off inflation, we will see the emergency of a stable currency in the Philippines, which will go far to create an attractive investment climate. The Philippines has considerable potential for development in the mineral, agricultural and industrial fields. With English the dominant language, a heritage of American type institutions, a literate labor force and a growing class of native entrepreneurs, the country offers many attractions to the investor.

Hong Kong vindicates "planners"

Other bright spots in the Southeast Asian area are Hong Kong, Malaya and Thailand. All of these are countries that have eschewed the idea that economic freedom is incompatible with economic growth. Hong Kong, in spite of its proximity to communist China, has been for several years a haven for the capital of Chinese residents of other Asian countries who have frequently been the object of racial discrimination. Today, Hong Kong is increasingly attracting capital from other sources -- Japan, Europe and the U.S. Of course, Hong Kong's mineral resources are extremely limited, its total land area being but 398 square miles, but it has become an important industrial city -- and a very prosperous one. Despite the tremendous influx of refugees from the mainland, which has brought the population to over 3 million, Hong Kong is actually short of labor, and wages there are now reported to be up to the Southern European level. The achievements of Hong Kong stand out as a tribute to her economic "planners" -- the British civil servants who thought the economic wisdom of Adam Smith superior to that of Mao Tse Tung. Today when a thriving and prosperous Hong Kong is sending 9 million food parcels a year to help alleviate the starvation in the centrally planned economy of communist China, their judgment would seem to be vindicated.

Thailand's prospects good

Thailand is a country with considerable potential. The Government is not democratic, but its economic policies are reasonably liberal. The major fly in the ointment is the fact that private business very often finds that it is up against competition from government enterprise or a business run by someone very influential in the Government, and this sometimes means unfair competition. However, the Thai proclivity for government enterprise appears to stem more from the entrepreneurial drive of some government officials than from ideology. There is no tendency in Thailand to draw sharp lines between public and private enterprise and exclude private competition from sectors in which the Government has an interest. Private investment is warmly welcomed, and while some potential investors may be repelled by the prospect of having to compete with government firms which may have unfair advantages, others are demonstrating that private enterprise can thrive under these conditions.

Capital is in heavy demand and hence expensive in Thailand, with interest rates on good bank loans beginning at 9 per cent a year. This is a measure of the profitable opportunities that exist there. The country is politically stable and has shown considerable skill in managing its financial affairs. Its ability to maintain a stable exchange rate with minimal exchange controls demonstrates this.

It is true that Thailand has some neighbors that suffer from political instability. The Thais themselves have been deeply concerned with developments in Laos, and they are not pleased about the increase in communist influence there. However, this poses no immediate danger to Thailand, though the Thais would feel much happier if a way of halting the creep of communism decisively could be found.

The high cost of electric power has probably been something of an obstacle to economic development in Thailand. In Bangkok the charge for power to large industrial users is 2.85 cents per kilowatts hours, one of the highest rates in the world. By way of comparison, the comparable TVA rate is 1.01 cents, the Tokyo Electric Power Co. rate is 1.36 cents, and the Potomac Electric Power Co. in Washington, D.C. charges 1.44 cents. Bangkok, which is a city of nearly 2 million people, has only 180,000 kilowatts of generating capacity, and only half of that is used to generate power for sale to the public. However, a large hydroelectric project is now under construction, and another 75,000 kw thermal plant is now being planned. It is now anticipated that 140,000 kw's of the hydroelectric power will be available in 1964, which means that Bangkok's electric power supply will be more than doubled in the next two years, with additional rapid expansion planned in the years to follow. This should bring rates down to more attractive levels and greatly stimulate industrial development.

Malaya thrives on specialization

Malaya is another well-managed country whose performance shines all the brighter against the background of economic travail found in her large neighbor to the south--Indonesia. Malaya is a highly specialized producer of rubber and tin, with lesser amounts of income derived from iron ore and a few other agricultural products. Many countries blessed with even greater natural resources have bewailed the fact that they are at the mercy of the world commodity markets and their fluctuating prices, and have sought to blame all their troubles on this fact. Malaya, on the other hand, has demonstrated that with proper policies a country can ride out the waves in even such widely fluctuating markets as rubber and tin and utilize the advantages that come from specialization to achieve high levels of income. For example, the price of rubber last year went down sharply, with the result that Malaya's earnings from rubber exports fell about 30 per cent. Increased earnings from iron and tin helped offset this decline, but they did not fully compensate for it. Nevertheless, Malaya did not fall into difficulties. The size of her trade surplus was reduced, but no deficit was incurred even though imports have risen. This reflects the Government's prudent policies, which have resulted in a very impressive increase in foreign exchange reserves since 1957 in spite of export price fluctuations. Domestic demand has been held within reasonable bounds, but the country has enjoyed the benefit of a flourishing and expanding international trade and rising levels of living.

Malaya welcomes foreign investment and offers a number of special inducements, notably tax advantages to attract industrial enterprise. Since it is one of Asia's most prosperous countries, wage rates are high by Asian standards, which may be one obstacle to a more rapid trend toward industrial development.

Economic rationality scanted in Indonesia

The climate for investment in Indonesia is gloomy, as it has been for a number of years. The policy of substituting government for private enterprise has clearly resulted in a tangle of inefficiency and mismanagement, and it is increasingly recognized as a failure even by Indonesian officials. The country has been brought to the verge of bankruptcy and the value of the currency in free markets depreciated about one-third last year. Food shortages in the urban areas became acute, and even sugar, which was once a major Indonesian export, became so scarce that it was reported that it was being sold by the spoonful. In spite of this very discouraging record, the Government has not as yet given any indication that it will abandon the policies that have led the country into its present plight. Indeed, the dificulties that have been created in recent months with respect to renewal of the concessions for some long-established and well-managed rubber estates operated by foreign concerns seems to indicate that economic rationality doesn't get much of a hearing in Indonesia.

Burma's handicap

Burma suffers to a lesser degree from the attitudes that have prevailed in Indonesia at such heavy cost to the country's economic progress. Burmese policies have not always been motivated by the desire to maximize the economic advantage to the country, but the Government has been fairly responsible, and the country has not been afflicted by fiscal chaos and rampant inflation. Nevertheless the investment climate is adversely affected by a deeply entrenched suspicion or dislike of private enterprise. The Burmese foreign investment law, which had formerly pledged that no new enterprise would be nationalized for ten years, was modified last year. The period during which the pledge not to nationalize was to be operative was left to the determination of an administrative body. This action was well-intentioned, since the provision had been criticized as appearing to threaten nationalization after the expiry of ten years, and it was thought that the elimination of any mention of a specific time would reduce fears in the minds of potential investors about nationalization. However, this doesn't help much, if at all, since the government is avowedly socialist in its philosophy, and as long as nationalization has not been forsworn as a policy, investors cannot be blamed if they continue to harbor fears.

These fears will not have been at all moderated by the action taken by the government at the beginning of February to almost completely nationalize the country's import trade. The issue of individual import licenses was halted, and it was announced that the imports previously covered by such licenses would be handled by new trading companies to be set up by the government in partnership with private capital. This means that over 90 per cent of Burma's import trade will now be handled by the Government or firms controlled by the government. Needless to say, this does not improve the climate for private investment.

Although some top Burmese officials have come to believe that it is desirable to encourage foreign investment, the old suspicions are still deeply imbedded in the minds of the lesser bureaucrats, who often have enough power to block projects or harrass the businessman. They scrutinize applications for approval of investment plans with footdragging care.

Even if a project is approved, the investor's troubles are by no means over. He may have considerable difficulty, for example, in getting needed supplies and equipment from abroad. One firm after putting a substantial amount of money into its enterprise in Burma, found itself denied a permit to bring in a badly needed piece of equipment even though it was not seeking any Burmese foreign exchange to pay for the import. The transaction had to be approved by several different ministries, and even though all but one gave their approval, one veto was enough to block it.

In general it is said that if you have enough capital, both inside and outside the country, you can make money in Burma, but manipulation is likely to be more profitable than production.

It may be legitimate to squeeze in a few remarks about Pakistan under the heading of the climate in Southeast Asia, taking advantage of the fact that Pakistan, or at least its eastern wing, borders on Burma.

Pakistan has good intentions

Pakistan's president, Ayub Khan, and his top officials have a sincere strong interest in attracting foreign private capital to assist in the economic development of their country. They are advocates of the private enterprise system and are good friends and allies of the United States. They are realistic enough to appreciate that the achievement of their hopes for economic development will be greatly facilitated by the introduction of foreign capital and know-how. This attitude has been backed up by the legal provision of tax holidays for periods of as high as eight years for new industries and free remittance of profits and repatriation of capital. A recent U.S. Investment Development Mission to Pakistan found that there were many attractive opportunities for American investment there. The Mission also noted a very high degree of interest on the part of Pakistani businessmen in participating in joint ventures with U.S. firms.

While Pakistan is not well endowed with mineral resources, it has considerable potential for economic development. At present, Pakistan is making very poor use of its available manpower, and if a way can be found of breaking down the barriers that stand in the way of the efficient utilization of a larger proportion of the population in productive activities the country could surge ahead economically at a much more rapid pace. This would require the greater utilization of female labor, breaking down the high degree of specialization that exists in unskilled labor which reduces labor mobility and often requires the employment of several men to do work that might be performed by one, and the introduction of longer working days.

Unfortunately there is, in Pakistan's present approach, too little appreciation of the importance of this problem. The emphasis tends to be largely on capital. It may be easier to get capital than to make fundamental improvements in productivity through institutional changes, but the latter are likely to yield greater dividends in the long run and may be indispensable to any significant progress in raising living standards. As things now stand, wage rates are low in Pakistan, but labor is not cheap in terms of productivity. This and the fact that the country is still enmeshed in a net of exchange controls which provide lesser officials with opportunities for tying businessmen up in red tape, are probably the main unfavorable factors in the investment picture. The two are not unrelated, since it is the protection provided through the controls on imports that make it possible for businesses to survive and even thrive in Pakistan in spite of inefficient and, by outside standards, high cost operations. Whether or not the Government will recognize this fact and adopt policies that will not only cut away the red tape but will introduce more competitive pressure remains to be seen.

Experience may improve practice

The picture for investment in Southeast Asia remains mixed, as it has been for a number of years. The changes in the Philippines represent the most notable improvement, and the increase of communist activity in Vietnam the most serious adverse turn. But even in the areas where the picture is not particularly rosy, especially Indonesia and Burma, there are indications that intelligent men are beginning to draw lessons from experience. They are beginning to appreciate that in countries with limited human resources more reliance must be placed upon incentives to work and invest if men are to make their maximum contribution to the developmental process. It is becoming increasingly evident in these countries that government controls are not working as well as market forces as allocators of resources. If the Philippine experiment with freer markets is a success, it should encourage others to follow suit.