



# **BALANCED GROWTH FOR AN INCLUSIVE & EQUITABLE ASEAN COMMUNITY**

**Edited by  
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SCHOOL OF  
INTERNATIONAL  
STUDIES



**ASEAN-Canada  
Research  
Partnership**

# Balanced Growth for an Inclusive and Equitable ASEAN Community

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## PREFACE

Economic integration in Southeast Asia is a high priority within ASEAN, as seen by efforts to establish the ASEAN Economic Community (AEC) by 2015. By fostering greater connectivity within the region — via physical connectivity (namely, infrastructure), institutional connectivity (via organisational arrangements) and people-to-people connectivity — economic gaps among the ASEAN member states will progressively narrow and the people of ASEAN will attain higher standards of economic development. Several initiatives have been proposed in recent decades to encourage closer regional economic relations, such as freer trade of goods and services within the ASEAN Free Trade Area (AFTA), improved infrastructure (including regional communication and transportation), coordination of domestic policies, and improved international flows of capital trade, foreign investment and labour (both skilled and unskilled).

Establishing the AEC, however, poses several challenges. Firstly, while there has been more rapid economic growth in the Southeast Asian region, there is also an increase in economic disparities — both across and within countries. Secondly, the increased connectivity also highlights the need for effective multi-level governance and management of domestic politics and needs, which could have regional implications. These conditions bring about two important questions for policymakers. First, are there development options and strategies that can generate similar levels of economic growth without such large increases in inequity? Second, what are the required policy mechanisms or responses to this observed inequity that will reduce its impact or costs for certain groups?

In today's globalised world, the ASEAN countries realise that overcoming these economic challenges, as they work toward building an AEC, cannot be done by the region alone and that they require the support of ASEAN's external partners. Thus, ASEAN's Dialogue partners — such as Canada since 1977 — play an important role in helping ASEAN achieve its goal of creating an economically prosperous and equitable ASEAN community.

In light of this, the ASEAN-Canada Research Partnership was launched to build on the objectives of the ASEAN-Canada Enhanced Partnership Plan of Action (2010–2015), which states that ASEAN and Canada are to:

...work and consult closely in responding to regional and international challenges, and in building an ASEAN-centred regional architecture which is open and inclusive, promotes the development of enhanced ASEAN connectivity which will help foster the building of an ASEAN Community by 2015...<sup>1</sup>

With the support of the International Development Research Centre (IDRC) in Canada, the Research Partnership was launched in 2012 by the Centre for Non-Traditional Security (NTS) Studies at the S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University (NTU), Singapore; and, the Institute of Asian Research (IAR), University of British Columbia, Vancouver, Canada, as a means to facilitate an exchange of ideas among senior and young, budding scholars in ASEAN and Canada on how best to address pertinent challenges faced by Southeast Asia.

This edited volume is a compilation of research output from selected senior and junior fellows under the first phase (2012–2013) of the ASEAN-Canada Research Partnership. Based on the theme of ‘Towards balanced growth — Alternative development models and redistribution mechanisms’, these chapters provide different yet complementary perspectives on economic activity in the East Asian region.

Tu-Anh Vu-Thanh’s chapter, ‘A tale of two regions: Northeast Asia versus Southeast Asia’, provides a comprehensive and historical account of the different growth trajectories between Northeast Asia and Southeast Asia, thus contributing to research on why Southeast Asia currently lags behind Northeast Asia in terms of development and living standards.

Chia Siow Yue in 'Narrowing the development gap in the ASEAN Economic Community' goes one level deeper by highlighting the economic disparities within Southeast Asia and the current ASEAN-led efforts to narrow the development gaps among ASEAN countries.

Mochammad Faisal Karim's chapter on micro-regionalism, 'Local-central dynamics and limitations of micro-regionalism: Understanding West Kalimantan and Sarawak cross-border cooperation', examines another level of cooperation, where sub-national entities have the potential to facilitate economic development along common borders and yet are faced with several local challenges.

Celia M. Reyes, in 'Chronic poverty, transient poverty and inequality in the ASEAN region', and Danielle Labbé, in 'Once the land is gone: Land redevelopment and livelihood adaptations on the outskirts of Hanoi, Vietnam', further highlight economic challenges at the national and local levels that may undermine national and regional efforts of economic development and integration.

There are two themes that run through all five chapters. The first theme is the need to have realistic indicators that measure economic growth and assess the benefits of regional integration. These indicators should also be examined at the national and sub-national levels. Tu-Anh's chapter highlights how Northeast Asian countries have been able to develop faster than Southeast Asia due to better factor accumulation, macroeconomic management and openness. The latter points are also mentioned in Chia's chapter, which shows that CLMV countries (i.e., Cambodia, Laos, Myanmar and Vietnam) lag behind other ASEAN member states in terms of competitiveness, as seen from their rankings in the Global Competitiveness Index and Ease of Doing Business Index. Karim's chapter sheds light on the lack of development in provincial areas outside major cities where most of the economic activity takes place.

Issues of economic inequality are also important indicators of equitable economic development and, if not addressed, these can work against overall economic development strategies. Reyes' chapter examines the

phenomenon of chronic and transient poverty amid economic growth. While it is commendable that great progress has been made in lifting peoples of Southeast Asia out of extreme poverty, as a whole, disparities among ASEAN nations themselves vary significantly. Higher income inequality has been observed even as economic growth has accelerated. Reyes' chapter also highlights the challenges in determining the extent of chronic and transient poverty due to the fluidity of transient poverty (particularly in times of shocks) and the lack of available data.

Labbé's paper highlights another major factor that compounds economic inequality — urbanisation trends in Southeast Asia that have led to the development of new towns and gated communities targeted at the middle and upper classes. These wealthy gated communities create not only distinct demarcations between the haves and have-nots but also increased demand for relatively low-paid, informal-sector jobs (such as domestic helpers, chauffeurs and security guards), which are commonly filled by the urban poor. While this creates jobs, many of those providing such services are likely to remain trapped in a vicious cycle of poverty, especially if they are not also given sufficient access to basic services, such as healthcare and education. These inequalities are likely to persist, as Asian governments prefer to promote the development of new towns given that such projects bring in substantial foreign direct investment.

Another common theme found in these chapters is that inclusivity and good governance are two sides of the same coin. Tu-Anh's chapter notes that the tendency to symbolically highlight the sociocultural and political diversity of the people of ASEAN may, in fact, work against economic integration, as societies remain disparate and operate exclusively. As such, it is necessary to find avenues to enhance cohesion and inclusivity within diversity. Chia addresses this, in part, by noting ASEAN efforts to narrow the economic gap between CLMV countries and the other ASEAN member countries while also noting the need for CLMV countries to improve their own governance capabilities and institutional quality to enhance their economic competitiveness.



Karim, Reyes and Labbé's chapters highlight the challenges in ensuring inclusivity due to ineffective governance. Karim's chapter on sub-regional economic cooperation, in fact, provides a potential solution whereby common cross-border language and cultural links form a basis for cooperation and, ultimately, development for corridors that may not have initially received much attention from central governments. However, despite keen interest from the private sector, the West Kalimantan-Sarawak socioeconomic forum (Sosek Malindo) project has seen limited progress due to lack of transparent and clear governance procedures, and political disagreements between the central and local governments of Indonesia and Malaysia. As a result, local communities are ultimately disadvantaged and continue to be excluded from the benefits of prospective development plans.

Reyes and Labbé's chapters highlight the importance of taking into account the needs of the poor as a way of ensuring equitable economic growth. More effort must be put into providing basic social services for low-income informal workers serving wealthier gated communities in the cities. The poor are especially vulnerable as poverty can be potentially exacerbated in times of shocks — be it natural disasters or financial shocks — as the loss of lives, assets and disrupted supply chains can affect the poor more than the wealthier sections of the society, which have some level of redundancy to withstand shocks. Those categorised under transient poverty may run the risk of falling back into chronic poverty due to such shocks, thus neutralising national efforts of pursuing economic growth and development.

These are certainly challenges that ASEAN countries need to factor in more effectively in their economic and development policies. Evident in these chapters is the need for greater people-centred development as is the mantra for building an ASEAN community. There is a need to shift from an emphasis simply on developing natural resources and infrastructure as the bread and butter of development to a focus on human resources. From the young booming populations of CLMV countries to the progressively ageing populations of Thailand and Singapore, important considerations must be put in place to ensure long-term sustainability and prosperity in Southeast Asia.

Mely Caballero-Anthony and  
Richard Barichello  
Project leaders for 2012–2015  
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<sup>1</sup> Foreign Affairs, Trade and Development Canada, Government of Canada, 'Plan of action to implement the joint declaration on ASEAN-Canada Enhanced Partnership' (Ottawa: Foreign Affairs, Trade and Development Canada, 2012), last modified 21 December 2012, [http://www.international.gc.ca/asean/action\\_plan\\_action.aspx?lang=eng](http://www.international.gc.ca/asean/action_plan_action.aspx?lang=eng).

# Chapter One

## A Tale of Two Regions: Northeast Asia versus Southeast Asia<sup>1</sup>

*Tu-Anh Vu-Thanh<sup>2</sup>*

*Despite the fact that Southeast Asia (SEA) and Northeast Asia (NEA) entered the post-World War II period with comparably low levels of income and economic development, the two regions have followed very different growth paths and reached very different endpoints. The NEA countries have grown at historically unprecedented rates, becoming some of the most developed economies in the world. In contrast, the SEA countries have remained in the middle-income trap and are yet to achieve the political, economic and social transformations that set NEA apart from the rest of the developing world. The objectives of this study are to review and explain major differences between the two regions in terms of growth paths and, thereby, suggest policy recommendations for the SEA countries to promote economic growth.*

*At the fundamental level, conventional wisdom suggests that it is essential to improve factor accumulation, macroeconomic management and openness. However, these fundamentals themselves are products of a country's governance and institutions. Therefore, firstly, this chapter highlights that the SEA countries should implement sufficiently strong institutional reform — to transform extractive institutions into inclusive ones — so as to overcome the 'poor governance trap', which is the underlying cause of their middle-income trap.*

*Secondly, instead of passively accepting their high degree of ethnic, linguistic and religious heterogeneities as given or, even worse, reinforcing it, the SEA countries should actively find ways that make their societies less fractionalised or, even better, more cohesive. Ultimately, political and economic institutions as well as public policies are choices made by the society. By making the right choices — that is, by choosing to be more inclusive rather than extractive — a society can transform negative aspects of social fractionalisation and, in so doing, create a positive feedback loop that facilitates the emergence of good institutions.*

*Keywords: Economic growth, governance, institution, Northeast Asia, Southeast Asia*

## **1. Introduction: Historical Background and the Policy Question**

The spectacular growth achievement of the East Asian countries during 1960s–1990s inspired a wave of research on the economics of growth in the region.<sup>3</sup> The general consensus emerging from this literature was that much of the East Asian ‘miracle’ was attributable to a small set of factors that included greater openness and export orientation, higher savings and investment, better education, and stronger macroeconomic management.

Within Asia, the contrasting growth performances of East Asia and South Asia have been emphasised by a number of studies.<sup>4</sup> However, the heterogeneous growth performance within East Asia is much less heralded. In retrospect, it is obvious that the growth trajectory of the Southeast Asian countries (except Singapore) has generally lagged behind that of their Northeast Asian counterparts.<sup>5</sup> The objective of this study is to understand why Northeast Asia (NEA) and Southeast Asia (SEA) have followed divergent paths in their economic growth. This chapter is not, however, intended to be either comprehensive or exhaustive, but instead aims to broadly review the fundamental differences in terms of the growth paths of the two groups, and analyses the factors that engender NEA’s success and SEA’s relative failure.<sup>6</sup>

Countries in NEA and SEA share many common experiences within each group, even as there are major differences between the two groups. To reflect within-group commonalities and between-group differences, this chapter gives special attention to the contrasting experiences of SEA and NEA with respect to industrialisation strategy, which is arguably the most important economic issue that has preoccupied the minds of politicians and policymakers in these countries since the 1950s. More specifically, we have attempted to identify how current theories could help us understand a broader picture of industrial policy, as adopted by the SEA and NEA countries in the last half century.

SEA and NEA (except for Japan) entered the post-World War II period with comparably low levels of income and economic development.<sup>7,8</sup>

However, the two regions have followed very different growth paths ever since and thereby reached very different destinations. The East Asian countries, particularly during the period 1960–1990, have grown at historically unprecedented rates. In the period 1960–2010, the average gross domestic product (GDP) growth rate of the NEA group was 4.8 per cent while that of the SEA countries was only 3.5 per cent (Figure 2.1).<sup>9</sup> Today, the NEA countries are among the most developed economies in the world, with effective states, internationally competitive firms, and world-class education and healthcare systems. In contrast, despite periods of relatively rapid growth, the SEA countries have remained in the middle-income trap and are yet to achieve the political, economic and social transformation that sets NEA apart from the rest of the developing world (Figure 2.1).

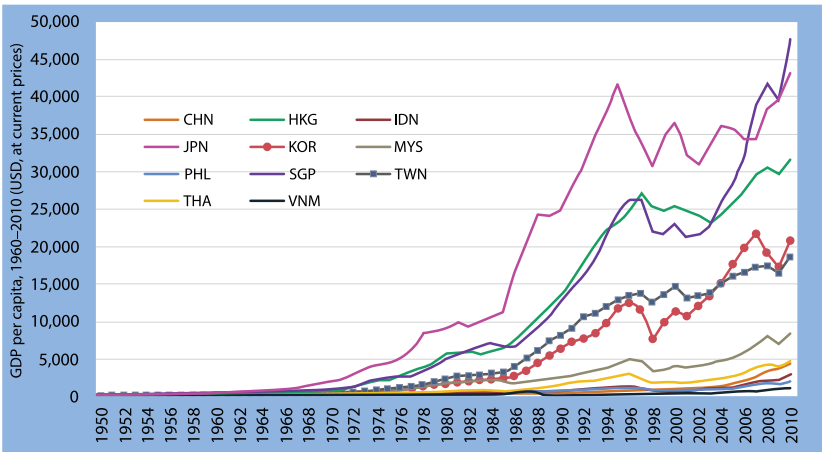


Figure 2.1: Growth paths, 1960–2010: Northeast Asia versus Southeast Asia. CHN = China; GDP = gross domestic product; HKG = Hong Kong; IDN = Indonesia; JPN = Japan; KOR = South Korea; MYS = Malaysia; PHL = the Philippines; SGP = Singapore; THA = Thailand; TWN = Taiwan; VNM = Vietnam

Source: Alan Heston, Robert Summers and Bettina Aten, *Penn World Table version 7.1* (Philadelphia: Center for International Comparisons of Production, Income and Prices, University of Pennsylvania, 2012).

By the late 1970s, four groups of countries with distinct growth trajectories had been identified. Japan was the leader and itself formed the highest group. The second group included the two city-states, namely Singapore and Hong Kong. The third group consisted of South Korea, Taiwan and Malaysia. And, finally, the Philippines, which initially lagged behind, joined the remaining SEA countries and China in the last group.

A decade later, the growth trajectories of the East Asian region witnessed two interesting changes. On the one hand, the Malaysian economy under Prime Minister Mahathir had run out of steam and was increasingly lagging further behind South Korea and Taiwan. At about the same time, another SEA country — Thailand — began taking off and distancing itself from the lowest-income group.

However, Thailand's growth was not sustainable due to its heavy reliance on short-term speculative private capital flows, little improvement in the intrinsic competitiveness of its economy and imprudent macroeconomic management. The Asian financial crisis, which started in Thailand, drove the country back to the low-income group among the SEA countries, and the ensuing political crisis pushed the economy even further out of the high growth trajectory. A similar situation occurred in Malaysia as well.

Although all countries in the region, and not only Thailand and Malaysia, were severely affected by the Asian financial crisis, there were significant differences in the long-term consequences of the crisis for the various countries affected. While it took South Korea and Taiwan only about three years to return to their pre-crisis per capita GDP levels, it took Indonesia, Malaysia and Thailand 7–8 years to do the same (Figure 2.1).<sup>10</sup> What is more, while the former group regained its previous growth momentum, the latter group dropped to a lower growth trajectory.

The 1990s also witnessed the crisis and stagnation of the Japanese economy. For almost 20 years, the Japanese economy has experienced virtually no growth at all and, as a result, Japan was recently surpassed by Singapore in terms of per capita GDP and by China in terms of total GDP (Figure 2.1).

Different growth trajectories have led to differences in the pace of improvement of the standard of living in these countries. For instance, to reach a GDP per capita level of USD 10,000 (purchasing power parity [PPP]-adjusted, at 2005 constant prices) from similar starting points of USD 1,500, it took Taiwan and South Korea 32 years and 36 years, respectively, while Malaysia took 43 years to reach comparable levels (Figure 2.1). The rest of the SEA countries, meanwhile, are yet to get there. In the early 1990s, Thailand was on course to catch up with the rapid growth group, but failed to do so in the aftermath of the crisis in 1997. The performance of Indonesia, and especially the Philippines, was even more disappointing. Starting from PPP-adjusted GDP per capita levels of USD 1,500 — after more than 30 years in the case of Indonesia and over 50 years for the Philippines — neither country has achieved a PPP-adjusted GDP per capita level of USD 5,000 (Figure 2.1). Despite having similar starting points as Malaysia and the Philippines, Taiwan and South Korea have now outstripped both these countries due to high and sustained growth (Figure 2.1). Thus, a key lesson to be learnt from the growth experience of these countries is that the quest for growth is not a sprint but a marathon in which players must constantly maintain performance and be able to correct their mistakes and bounce back from adversities. In other words, sustained improvement in GDP terms requires maintaining and strengthening the foundation of growth. This topic will be discussed in detail in the next section.

## **2. Conventional Wisdom: Factor Accumulation, Macroeconomic Management and Openness**

What has caused NEA's relative success and SEA's relative failure? From policy perspectives, three factors — namely, factor accumulation,

macroeconomic management and openness — have played fundamental roles.<sup>11</sup> In all three areas, the NEA countries have outperformed the SEA countries (Table 2.1).

*Table 2.1: Comparison of Northeast Asia versus Southeast Asia.*

Variable	Southeast Asia (ASEAN-5)	Northeast Asia (Hong Kong, South Korea and Japan)	Northeast Asia without Japan	Japan	China	Singapore
Initial GDP per capita (USD, PPP-adjusted, at 2005 constant prices)						
1960	1,136.8	3,518.0	2,479.8	5,594.3	329.3	4,398.1
2010	5,993.0	32,251.7	32,651.0	31,453.1	7,129.7	55,838.6
GDP growth (% , PPP-adjusted, at 2005 constant prices)						
1960–1990	3.9	6.2	6.6	5.5	4.3	5.8
1960–2010	3.5	4.8	5.4	3.5	6.3	5.2
Factor accumulation						
Average years of secondary schooling						
1960	0.48	1.64	1.21	2.49	0.33	2.49
2010	2.49	4.72	4.83	4.50	2.88	4.50
Gross domestic savings rate						
1960–1990	23.0	31.1	30.5	32.28	36.24	40.53
1960–2010	25.5	33.3	34.0	31.93	38.20	46.28
Gross capital formation						
1960–1990	22.3	26.3	26.3	NA	29.38	33.44
1960–2010	23.6	27.4	27.4	NA	33.85	31.35
Macroeconomic management						
Inflation rate (GDP deflator), 1961–2009	12.50	7.00	11.10	3.00	3.56	2.58
Fiscal balance, 1960–1990*	-2.88	-2.09	-1.00	-3.17	-1.20	1.27
Fiscal balance variance, 1960–1990*	5.62	4.01	1.58	6.45	1.88	8.21



Openness (% , at current prices)						
1960–1990	51.7	84.4	115.8	21.6	14.0	307.2
1960–2010	74.6	105.2	146.8	22.1	27.1	330.1
Resources and geography						
Primary export (% GDP)						
1962	12.2	2.3	3.0	1.0	NA	-5.9
2010	16.5	14.9	22.0	0.8	1.7	-13.5
Tropics (% land area)	0.37	0.00	0.00	0.00	0.00	1.00
Area/coastline (m/sq. km)	36.7	267.2	360.0	81.6	1.5	281.0

ASEAN-5 = Malaysia, Indonesia, Thailand, Singapore and the Philippines; GDP = gross domestic product; NA = not available; PPP = purchasing power parity  
 \* For available years.

Source: Alan Heston, Robert Summers and Bettina Aten, *Penn World Table version 7.1* (Philadelphia: Center for International Comparisons of Production, Income and Prices, University of Pennsylvania, 2012); 'World development indicators', World Bank, accessed 31 October 2014, <http://data.worldbank.org/data-catalog/world-development-indicators>; Steven Radelet, Jeffrey Sachs and Jong-Wha Lee, 'Economic growth in Asia', Background paper for the Asian Development Bank's study *Emerging Asia: Changes and challenges* (Development Discussion Paper No. 609, Cambridge, US: Harvard Institute for International Development, 1997).

## 2.1 Factor accumulation

Many studies have shown that there was nothing really magical about the spectacular growth of Japan and the Asian Tigers during 1960–1990. According to contemporary theories of growth, the performance that these economies achieved were mainly the result of their ability to accumulate a very high level of human and physical capital.<sup>12</sup> As seen from Table 2.1, the domestic savings rate — and, consequently, the rate of gross capital formation — of the NEA countries has always exceeded that of the SEA countries, especially during the period 1960–1990 when the Asian Tigers started to take off. Similarly, compared to the SEA countries, the average years of secondary schooling in the NEA countries have been much higher, creating a foundation for world-class universities, the importance of which cannot be overemphasised in the present global knowledge economy. While every NEA country has several universities ranked in the

top 200 universities worldwide, no universities from the SEA countries (except Singapore) make it into this list.<sup>13</sup>

If the formula for economic prosperity were so simple — that is, accumulating as much physical and human capital as possible — why, in reality, do we see so many poor countries and so few rich ones? As we will see in the forthcoming sections, this disparity is because productive economic activities transpire not in a vacuum but in very complex nexuses of institutional and policy variables, both domestic and international in ambit. For example, in a pervasively speculative environment (such as that seen in Thailand and Indonesia in the early 1990s, and Vietnam in the early 2000s), speculative activities in asset markets would promise quick and easy profits and thus crowd out investments in productivity enhancing activities. Or, for a person born as Bumiputera in Malaysia or Muslim in Indonesia who, being guaranteed a relatively favoured position in the society and public sector vis-à-vis members of other ethnicities or religions, would have limited motivation to invest in human capital. Similarly, internationally, countries that industrialised late, such as Thailand or Indonesia, have not enjoyed the same level of tolerance for trade restrictions aimed at promoting industrialisation as was granted to South Korea or Taiwan in the 1960s and 1970s by the world trading system.

The government has always played a critical role in factor accumulation (or the lack thereof). Indeed, an important feature of the NEA development model has been extensive intervention by the ‘developmental state’ in the economy. The World Bank, albeit reluctantly, had to admit that a significant part of the NEA miracle was attributable to governments’ careful policy interventions.<sup>14</sup> However, a government’s interventions always involve costs and benefits, both of which depend on the government’s capability as well as the interests it serves. If the purpose of a policy, regardless of how sophisticated it may be, is only to serve the interests of a minority elite group at the cost of the remaining majority, then such policy can never lead to sustainable and long-term growth, a situation experienced by most oligarchic governments in SEA. Conversely, if a policy is well intentioned but not designed and implemented effectively by a competent

government, then too it cannot bring about prosperity. As we will see in the next section, the capability of the government and the interests it serves depend very much on the political and economic institutional environment of that country.

## *2.2 Macroeconomic management*

The NEA countries have adopted a much more responsible macroeconomic policy when compared to the SEA countries (Table 2.1). Budget deficits in the NEA group have been generally under control and are significantly lower than that of the SEA group. Moreover, the fluctuations in budget deficit (measured by time-series variance) of the NEA group were lower. Lower budget deficits have helped the NEA countries keep inflation in check and maintain adequate fiscal space to respond more effectively to negative external shocks as well as internal fiscal pressures. For example, during the 1961–2009 period, the average inflation rate of the NEA group was only 7.00 per cent while that of the SEA group was up to 12.50 per cent. Low and stable inflation rates have helped the NEA group maintain a low and predictable interest rate. Positive real interest rates, in turn, helped increase savings and private investment in these NEA countries. In short, prudent macroeconomic policies have played an important role in encouraging capital accumulation and promoting entrepreneurship in the NEA countries.

## *2.3 Openness and export orientation*

In the developing world, the NEA countries were pioneers of trade liberalisation. As suggested by Radelet, Sachs and Lee,

Most importantly, the high-performing East Asian countries recognized the imperative of joining the world economy through the promotion of labor-intensive manufactured exports. These economies promoted exports through a combination of policies — relatively free trade, convertible currencies, macroeconomic stability — and through a

set of innovative institutions — such as export processing zones, duty exemption schemes, and incentive packages for foreign direct investment.<sup>15</sup>

Many studies have demonstrated that this policy is a key factor behind the success of the NEA economies. Note, however, that the openness matrix — the degree of openness along various international trade dimensions — of each country is heterogeneous. In general, the SEA group has been less open to international trade than the NEA group, especially in the decades immediately following World War II. For instance, for the period 1960–1990, the SEA openness index<sup>16</sup>, which was 51.7, was far below that for NEA, which was at 84.4 (Table 2.1).<sup>17</sup>

The lower degree of openness of the SEA countries was partly the result of their late trade liberalisation and partly due to their heavier aversion to foreign powers owing to negative colonial legacies.<sup>18</sup> During the 1950s and 1960s, while Japan and then Hong Kong, Taiwan and South Korea turned to export-oriented industrialisation, the SEA countries were still pursuing import substitution policies many years later. This industrial strategy turned out to have profound consequences not only for industrial development but also for the overall competitiveness of the import substitution countries.

The policy of heavy industry development and import substitution in Malaysia and Indonesia required a large and sustained amount of foreign currency, which was met by exporting natural resources. The immediate consequence of this policy was that exchange rates were overvalued, and this not only hurt manufactured exports but also kept domestic manufacturing concentrated on low productivity and low technology products.<sup>19</sup> In contrast, from the mid-1960s, because of the sharp reduction in US aid, which was the main source of foreign exchange for both South Korea and Taiwan, these countries had to devalue their currencies to maximise the inflow of aid and to strengthen the competitiveness of their manufactured exports. In addition, the relatively free trade environment of the 1960s and 1970s led by the US, the Bretton

Woods Institutions and the General Agreement on Tariffs and Trade (GATT) system gave a boost to both the Taiwanese and South Korean economies, which by that time had already developed export-oriented industrialisation strategies.

The degree of openness of most SEA countries today is already very high, implying that there is not much scope left for further trade liberalisation. Moreover, the World Trade Organization (WTO), along with other bilateral and multilateral treaties, prevents the latecomers from implementing policies that were previously used by successful exporting countries.<sup>20</sup> However, in the current global trade environment, SEA, as a group, can still deepen their regional and global integration, continue to take advantage of access to international markets, and, equally importantly, use globalisation to promote industrial learning and upgrading, thereby improving their productivity and competitiveness.

### **3. Somewhat Less Conventional Wisdom: Natural Conditions and Geopolitics**

#### *3.1 Natural conditions: Resources and geography*

In terms of natural resources, the SEA countries (with the exception of Singapore) are much richer than the NEA countries (Table 2.1). However, having a lot of natural resources is not necessarily a blessing for growth. The large literature on the ‘resource curse’ has shown that natural resource-rich countries tend to grow more slowly than natural resource-poor countries.<sup>21</sup> There are several reasons for this. When resource prices are high, large foreign exchange income generated from natural resource exports tends to lead to currency overvaluation, which in turn negatively affects the competitiveness of other sectors — a phenomenon called the Dutch disease. The large foreign exchange income also makes the import substitution industrial strategy more attractive, as we have seen in Latin America and elsewhere, but at the cost of export-oriented industries. Moreover, large budget revenue from natural resources tends to encourage the development of bad gigantic projects and create many

opportunities for corruption. The difficulty is that, while resource price hikes may stop, corruption and bad projects do not. This implies that cyclic fluctuation in resource prices inevitably leads to macroeconomic instability and also makes it very difficult to build a governance system conducive to growth in resource-rich countries.

As for the role of geography, a vast empirical literature has documented high correlation between geographic factors (such as latitude and climate) and the current level of economic development (such as income per capita). However, the interpretation of this correlation, that is, whether the impact of geography is direct or indirect, remains a hot subject of debate. Some scholars claim that the impact of geography is direct because the extent of endemic and infectious diseases in the tropics — which tends to be much higher compared to temperate climates — can negatively influence long-term labour productivity and thereby lower the rate of economic growth at any given income level.<sup>22</sup> In addition, warmer temperatures and torrential rains, which tend to leech soils of important nutrients, have hindered tropical agriculture. According to Radelet, Sachs and Lee, ‘as a result of these influences, tropical climates tend to support much lower population densities and thereby a less extensive division of labor than more temperate climates’.<sup>23</sup>

In contrast, other scholars argue that the impact of geography is indirect — mainly through historical channels, such as institutions, human capital, social capital and cultural traits, all of which can potentially affect the level of productivity and hence income and prosperity in the long run. Along the lines of earlier authors<sup>24</sup>, this chapter will focus on the indirect causal effect of geography via institutions on the level of development in East Asia.

Is it indeed the case that the SEA countries are poor because they are located in the tropics? The answer, according to the geography school of thought, is ‘yes’. For instance, Radelet, Sachs and Lee affirm that very few countries located in the tropics have achieved sustained economic success.<sup>25</sup> They go even further to assert that there exists the possibility

of a 'tropical poverty trap'. These authors, of course, claim that Singapore and Hong Kong are the two exceptions to the case in point since, as city states with small share of agriculture in GDP, they are not significantly affected by their location in the tropics.

Looking back at the history of the tropical SEA region, we can see that its relative poverty cannot simply be attributed to its geography. In the 16th century, the records of international explorers reveal that the level of development of the SEA countries were not by any means inferior, even when compared with western European countries. For instance, a study by Reid pointed out that, in the 16th century, in terms of population and prosperity, the SEA cities seemed to be comparable to the most bustling cities of Europe.<sup>26</sup> This wealth and prosperity arose directly or indirectly from trade. In this respect, the cities and city-states of SEA in the 16th and early 17th centuries looked more like Venice, Genoa and Antwerp than even Delhi or Golconda. However, by the late 17th century, all great trading nations in the SEA region ceased to exist and, by the 19th century, the West had far exceeded SEA in almost every sphere and the West, to some degree, dominated almost all SEA countries.

### *3.2 Geopolitics: The fate of smaller countries induced by great power politics*

Unlike geography, geopolitics has played a pivotal role in the development path (particularly for industrial and trade policies) of the NEA and SEA countries since World War II. As mentioned above, after World War II and in the following decade, South Korea, Taiwan and even Japan did not enjoy a favourable position vis-à-vis Malaysia or the Philippines in terms of growth potential. For instance, the defeat in World War II pushed Japan into a state of physical exhaustion, mental depression and international isolation. At about the same time, upon losing the civil war in 1949, the Kuomintang (KMT) was forced to flee to the island of Taiwan in expectation of opportunities to retake the mainland. Similarly, the outbreak of bloody internal struggle in 1950 in the Korean peninsula was quickly internationalised, pushing the peninsula to become a fierce ideological frontline.

It is worth noting that, had the Korean War broken several years later, the fortunes of both Taiwan and Japan could have been very different. According to US official history, in early 1950, President Truman proclaimed that he would not defend the Nationalists from a communist attack.<sup>27</sup> However, after the outbreak of war in Korea, Truman swiftly changed his mind and sent the US Seventh Fleet into the Taiwan Strait to stop the communists from spreading in the region. Also, according to US official history, ‘... efforts to save South Korea from Communist invasion accelerated Department of State attempts to restore Japan to a respected international position, and make that country a prosperous ally of the United States’.<sup>28</sup>

These US interventions in the Far East were parts of its ‘containment’ strategy, with the goal of preventing the spread and manipulation of Communism, especially by China. As a result, most of the non-communist countries in the region received sizable economic and military aids from the US for an extended period of time. In addition, the US and the West also opened their markets for exports from these countries.

However, the impact of the US strategy in the region was uneven — partly because of the discriminatory nature of the strategy itself and partly due to the intrinsic capacity of each country to take advantage of the opportunities induced by the international context. From the US perspective, Japan — highly endowed with technological and organisational capabilities developed prior to World War II — was considered as the only country capable of developing a modern industrial economy that could become an economic shield against and a key counterweight to Chinese expansion in the region. The US reconstruction programme in Japan — especially the stabilisation programme (i.e., the Dodge Line) and industrial development — had put the country beyond the orbit of the region and created a remarkable growth path for Japan post the 1950s.<sup>29</sup>

It has been argued that the rapid rise of Japan was at the expense of the ‘low growth trap’ of a number of SEA countries in the region. For



example, Salvador Araneta, Secretary of Economic Coordination under President Elpidio Quirino, asserted that:

[T]he indifferent economic development of the country — at least during the first two decades that followed the grant of formal independence — was due to America's policy toward Japan and the Philippines. This policy was the result of the Dodds Report, which Truman accepted, and which had, as its objective, to make Japan the industrial workshop of Asia and the Philippines a mere supplier of raw materials ... certainly we can argue against a policy that would make Japan the exclusive industrialized country in the Far East, for such a policy was most detrimental to the Philippines ... As a result of this policy, industrialization in the Philippines suffered severe setbacks and delay.<sup>30</sup>

A similar line of argument was offered by Callahan, according to whom, 'The Japanese economy gained momentum in East and Southeast Asia after World War II, largely because it figured into the American Cold War plan to contain communism, and later because it benefited from both the Korean and Vietnam wars.'<sup>31</sup>

In Korea and Taiwan — under the constant threat of being taken over by next-door communist regimes — the US was forced to intervene strongly to ensure their political stability as well as military and economic strength. This high priority was reflected in the US aid programme in Asia between 1946 and 1965.<sup>32</sup>

According to a report of the Bureau for the Far East Agency for International Development, during the period 1951–1965, the total US aid to Taiwan (or 'Free China') was nearly USD 1.5 billion (or USD 10.0 billion in 2005 prices).<sup>33</sup> In other words, during this period, the average annual US aid to Taiwan was equivalent to 6.4 per cent of the country's gross national product, contributing 34 per cent to its gross investment and accounting for 91 per cent of aggregate net import of goods and services. The volume of this aid accounted for 15 per cent to 25 per cent of total US obligations to the Far East region.

US aid to South Korea was even larger. Again, the US strategy toward South Korea was revised for the reason that it considered the attack of the North as vivid evidence that communism would actively challenge the free world.<sup>34</sup> The US-South Korea relationship, which was ‘forged in blood’, manifested in material terms as aid of USD 2.5 billion between 1954 and 1962 (or USD 16.8 billion in 2005 prices).<sup>35</sup>

In summary, the American grand strategy in the Far East region after World War II transformed Japan in two ways: (i) from a former US enemy, Japan became its most important ally in the region; and, (ii) from being a humiliated and devastated country, Japan was transfigured to a respected international position and became the regional industrial powerhouse. This grand strategy also helped to build strong industrial foundations in South Korea and Taiwan beginning in the 1960s, even as — as argued by Araneta and others — the Philippines was placed in a disadvantageous position with respect to industrial development.

## **4. Newer Approaches to the Old Question**

### *4.1 Governance matters*

Since the mid-1990s, growing, empirical literature has documented the correlation between governance quality and economic outcomes.<sup>36</sup> The body of literature expanded even faster in the early 2000s after the governance matters database, constructed by Kaufmann, Kraay and Zoido-Lobatón, was first published in 1999.<sup>37</sup> The database has been updated regularly ever since.

Using this dataset, Kaufmann, Kraay and Zoido-Lobatón found a large causal effect running from improved governance to better development outcomes. For instance, they found that an improvement in the rule of law from a low level, as seen in Russia, to a middle level in a country such as the Czech Republic or a reduction in corruption from a very high level in Indonesia to a lower level in South Korea lead to 2–4 fold

increase in per capita incomes, 2–4 fold decline in infant mortality and 15–25 percentage point improvement in literacy levels.<sup>38</sup>

In contrast, other scholars argue that the correlation between governance quality and economic outcomes can also be conversely interpreted, that is, the correlation may simply mean that richer countries are able to afford ‘the luxury of good governance’.<sup>39</sup>

Needless to say, the NEA group has outperformed the SEA group in every governance indicator. This is even true after adjusting for the level of income. Table 2.2 presents International Country Risk Guide (ICRG) data on several governance-related variables for Thailand and Malaysia in 2012 (the most recently available data) vis-à-vis South Korea and Taiwan in 1985 (the first year when data was available for all four countries). The Economist Intelligence Unit (EIU) database shows that the per capita incomes (PPP, USD at current prices) of Thailand and Malaysia in 2012 were much higher than that of South Korea and Taiwan in 1985.<sup>40</sup> However, Table 2.2 suggests that the quality of governance in 2012 for the former two countries was much lower than that of South Korea and Taiwan in 1985.

*Table 2.2: Governance: Thailand and Malaysia in 2012 versus South Korea and Taiwan in 1985.*

Governance indicator	2012		1985		Maximum points
	Thailand	Malaysia	South Korea	Taiwan	
Government stability	7.38	5.25	5.64	8.83	12.00
Internal conflict	7.75	9.50	12.00	11.00	12.00

Corruption	2.00	2.50	5.00	4.00	6.00
Military in politics	2.00	5.00	2.00	4.00	6.00
Religion in politics	2.00	4.00	6.00	6.00	6.00
Law and order	2.50	4.00	3.00	5.00	6.00
Ethnic tensions	2.00	1.25	5.00	3.00	6.00
Democratic accountability	4.50	4.00	5.00	3.00	6.00
Bureaucracy quality	2.00	3.00	2.00	3.00	4.00
Total	32.13	38.50	45.64	47.83	64.00

Source: 'International Country Risk Guide (ICRG)', PRS Group, available at: <https://www.prsgroup.com/about-us/our-two-methodologies/icrg>.

For a policymaker believing in the causal relationship between governance quality and economic performance, the sharp difference in terms of governance quality between the two groups would imply that governance reform was needed to improve the livelihood of his countrymen. However, the experience of the SEA and NEA countries is not entirely consistent with this conclusion. During the period 1996–2010, even though the composite index of the quality of governance in Malaysia, the Philippines, Thailand and Vietnam declined, the GDP per capita (PPP-adjusted, at constant prices) of these countries increased significantly (Figure 2.2). For the same period, the quality of governance and GDP per capita of the NEA group have generally correlated with each other.

Balanced Growth for an Inclusive and Equitable ASEAN Community

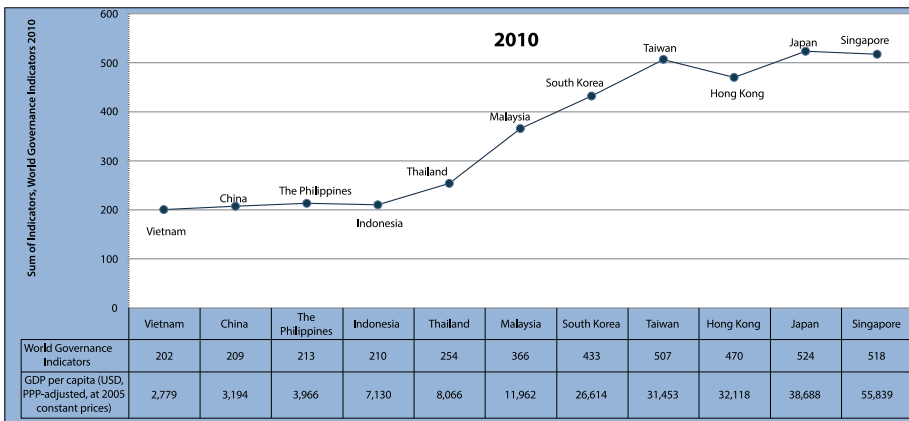
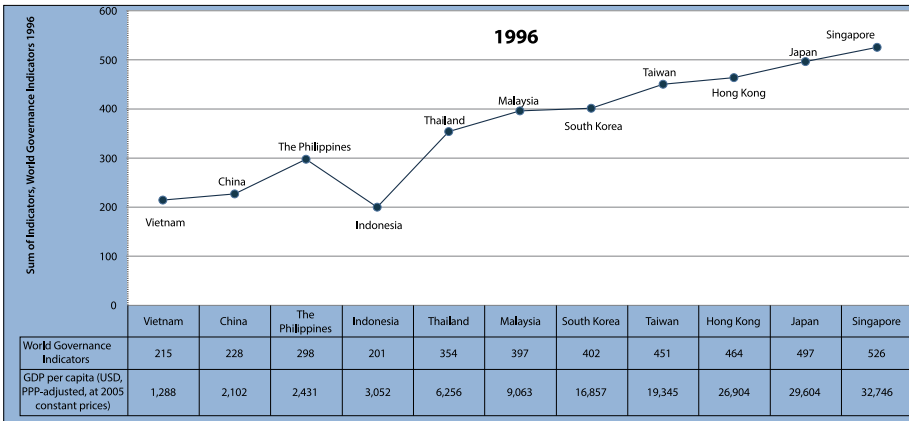


Figure 2.2: Governance quality and gross domestic product per capita of East and Southeast Asian countries for (a) 1996 and (b) 2010.

GDP = gross domestic product; PPP = purchasing power parity

Source: Alan Heston, Robert Summers and Bettina Aten, *Penn World Table version 7.1* (Philadelphia: Center for International Comparisons of Production, Income and Prices, University of Pennsylvania, 2012); ‘The Worldwide Governance Indicators (WGI) project’, World Bank, accessed 31 October 2014, <http://info.worldbank.org/governance/wgi/index.aspx#home>.

It is worth noting that these empirical results do not necessarily reject the causal relationship between governance quality and per capita income, but rather imply that the relationship between the two factors is non-linear. Figure 2.2 may instead suggest that, without a strong push for governance quality, the growth rate of middle-income countries will inevitably decline,

in turn leading to the middle-income trap. In these countries, crony groups may have already captured the government, bending policy in their favour and simultaneously avoiding difficult, but necessary reforms.<sup>41</sup> In other words, escaping the middle-income trap requires sufficiently strong institutional reform to overcome the governance inflection point, beyond which the country will be placed into an institutional orbit that is conducive to maintaining and renewing the engine of growth. Since governance quality is a multidimensional concept, the reform effort must be made simultaneously on multiple fronts. Even so, the weakest links deserve special attention since they significantly constrain progress on other fronts and therefore retard development.

#### *4.2 Institutions matter*

All fundamental factors for growth as well as the quality of governance are endogenous and, according to new institutional economics (NIE)<sup>42</sup>, largely determined by the country's political and economic institutions. In the last two decades, a vast amount of literature has attempted to establish the causal relationship between institutions and economic performance. Since the literature on institutions is so rich, this section, for practical purposes, will only focus on several core institutional aspects that are most relevant to the explanation of growth divergence between SEA and NEA. In doing so, we will employ the institutional paradigm described by Acemoglu and Robinson.<sup>43</sup>

Essentially, Acemoglu and Robinson's central thesis is that most rich countries are rich because they have inclusive political institutions, with a strong accountable state and political power broadly distributed, which then create inclusive economic institutions. In contrast, most poor countries are poor because they have extractive economic institutions whose roots are extractive political institutions (refer to Table 2.3 for a definition of inclusive and extractive institutions). To escape poverty, a poor country has to transform its institutions from extractive to inclusive. It is exactly such a process, in the economic sphere, that has created economic growth in Cambodia, China, Laos and Vietnam in recent decades.

Table 2.3: Extractive versus inclusive institutions.

Institution	Characteristic
Extractive political institution	The political institutions concentrate power in the hands of a few individuals or groups without restriction, checks and balances, there is no rule of law.
Extractive economic institution	There is no law and order, property rights are not guaranteed, and market entry barriers and regulations hinder the operation of the market and create an unfair playing field.
Inclusive political institution	The political institutions allow for broad participation; impose restrictions and control on politicians, the rule of law (closely related to broad participation). But, there is also a sufficient concentration of political power to be able to effectively enforce laws and maintain order.
Inclusive economic institution	Property rights are guaranteed, law and order, relying on the market, the state supports the market (via public services and regulations); market entry relatively free, respect for contracts, access to education and opportunities for a majority of citizens.

Source: Author’s summary from Daron Acemoglu and James A. Robinson, *Why nations fail: The origins of power, prosperity, and poverty* (New York: Crown Publishing Group, 2012).

### Acemoglu and Robinson assert that

There is strong synergy between economic and political institutions. Extractive political institutions concentrate power in the hands of a narrow elite and place few constraints on the exercise of this power. Economic institutions are then often structured by this elite to extract resources from the rest of the society. Extractive economic institutions thus naturally accompany extractive political institutions. In fact, they must inherently depend on extractive political institutions for their survival. Inclusive political institutions, vesting power broadly, would tend to uproot economic institutions that expropriate the resources of the many, erect entry barriers, and suppress the functioning of markets so that only a few benefit.<sup>44</sup>

This synergistic relationship between inclusive economic and political institutions creates a strong positive feedback loop, or a virtuous circle. On the other hand, extractive economic and political institutions create a strong negative feedback loop, or a vicious circle (Figure 2.3).

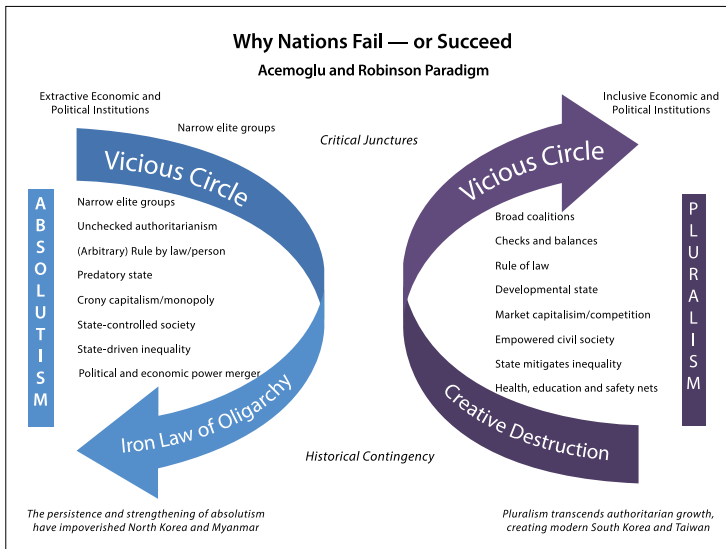


Figure 2.3: Summary of the Acemoglu and Robinson Paradigm.

Source: Adapted from a presentation, 'The imperative of reform: Opportunities and challenges for the Vietnamese economy in 2013', made by David O. Dapice during the Vietnam Executive Leadership Program at Harvard Kennedy School in 2013.

Applying the above paradigm to the East Asian region reveals interesting differences between the NEA and SEA countries. Broadly speaking, economic and political institutions today in the NEA countries (excluding China) are more inclusive while those of the SEA countries are more extractive. However, it is important to remember that political institutions under Park Chung-hee's regime in South Korea were highly extractive. Nevertheless, in spite of being an authoritarian regime, Park tried very hard to promote economic growth by means of relatively more inclusive economic institutions. Then, unlike most other instances of growth under extractive institutions, South Korea was successful in transforming itself from extractive political institutions toward inclusive ones in the 1980s. This successful transformation then activated a virtuous circle by which both political and economic institutions became increasingly more inclusive, which in turn helped encourage continued economic growth.<sup>45</sup>

The type of growth in the SEA countries today features a mix between elements of extractive and inclusive institutions, be it political or economic.



Indonesia and the Philippines today are reasonably functioning electoral democracies. But, at the same time, these countries still feature various forms of authoritarianism based on one-party rule or money politics. Ruling oligarchs in both countries thoroughly dominate the political processes and do not submit to the rule of law.<sup>46</sup> In the SEA region, it is interesting (and puzzling) to find that different forms of interventionist state and predatory systems of governance have survived and flourished alongside market capitalism.<sup>47</sup>

Singapore — the only SEA country that has successfully caught up to and even surpassed Japan in terms of per capita income — has taken a different direction. Singapore today is, to a large extent, still an authoritarian country. However, its institutions, especially the economic ones, are highly inclusive.<sup>48</sup>

#### *4.3 Social cohesion and government fragmentation*

*Social cohesion.* We have seen so far that institutions play a central role in determining economic performance. We have also seen that institutions are, to a large extent, endogenous. The logical question that arises from this discussion is how to create the kind of institutions that are conducive to sustainable economic growth. Unfortunately, we still don't know much about how institutions emerge and evolve; let alone how to transform extractive institutions into inclusive ones. With that caveat in mind, in this section, we will first examine a recent theory that suggests social cohesion (or, conversely, social fractionalisation) as a determinant of institutional quality and subsequently add a closely related factor, namely government fragmentation, as reinforcement (or, negative feedback loop) to institutional quality.

Easterly, Ritzen and Woolcock define social cohesion as the nature and extent of social and economic divisions — whether by income, ethnicity, political party, caste or language — within the society.<sup>49</sup> As such, these authors stress

... socially cohesive societies ... are not necessarily demographically homogenous, but rather ones that have fewer potential and/or actual leverage points for individuals, groups, or events to expose and exacerbate social fault lines, and ones that find ways to harness the potential residing in their societal diversity (in terms of diversity of ideas, opinions, skills, etc.).<sup>50</sup>

Essentially, their main finding, supported by econometric evidence, is that bad policies and institutions, which are so pervasive in the developing world, are a consequence of insufficient social cohesion that impedes the construction of effective institutions.<sup>51</sup> Easterly, Ritzen and Woolcock show that social cohesion determines the quality of institutions, which in turn determines whether and how pro-growth policies are devised and implemented.

Why is social cohesion so important for institutional quality and thereby for economic performance? The implementation of difficult, but necessary, reforms requires the confidence of the public. The government must be able to make the people believe that short-term losses would be adequately offset by long-term benefits, and that the government will try to ensure a fair distribution of both costs and benefits. This public confidence was expressed through images of South Korean citizens who stood in line to sell their modest family treasures with the belief that their financial contributions, regardless of how small they are, could help their country overcome the challenges of the Asian financial crisis. In contrast, in the other crisis countries, such as Indonesia, Malaysia, the Philippines or Thailand, not only was there little confidence in the government during the crisis but also the economic crisis, in various degrees, led to political tensions or even political crisis.

Public confidence in the government, in turn, highly depends on the level of social cohesion. As Easterly, Ritzen and Woolcock put it,

The inclusiveness of a country's communities and institutions (e.g., laws and norms against discrimination) can greatly help to build cohesion.

On the other hand, countries strongly divided along class and ethnic lines will place severe constraints on the attempts of even the boldest, civic-minded, and well-informed politician (or interest group) seeking to bring about policy reform.<sup>52</sup>

Data in Table 2.4, which presents the indicators of social cohesion for the East Asian region, are generally consistent with the conclusions of the current literature on the impact of social cohesion (or fractionalisation) on economic outcomes. Specifically, when compared with the neighbouring SEA countries, the NEA countries have a much lower level of ethnic fractionalisation and, at the same time, a significantly higher middle class share. Singularly, if not uniquely, the NEA countries (excluding China) have achieved a very high growth rate in the long term while being able to maintain a relatively fair distribution of income — all of which has helped strengthen their social cohesion.

Table 2.4: Indicators of social cohesion in East Asia.

Variable	Southeast Asia	Northeast Asia (Hong Kong, South Korea and Japan)	Northeast Asia without Japan	Japan	China	Singapore
Ethnic fractionalisation	0.47	0.03	0.03	0.01	0.15	0.39
Middle class share	46.3	50.8	49.3	53.8	50.3	46.0
Gini coefficient	41.9	36.0	39.4	31.5	35.0	41.0
GDP per capita, 2010 (USD, PPP-adjusted)	5,993	32,252	32,651	31,453	7,130	55,839
GDP per capita growth, 1960–2010 (%)	3.5	4.8	5.4	3.5	6.3	5.2

GDP = gross domestic product; PPP = purchasing power parity

Source: Alan Heston, Robert Summers and Bettina Aten, *Penn World Table version 7.1* (Philadelphia: Center for International Comparisons of Production, Income and Prices, University of Pennsylvania, 2012); Alberto Alesina et al., 'Fractionalization', *Journal of Economic Growth* 8 (2003): 155–94.

Strong national identity and autonomy built upon common culture and language, well-established borders, and a self-governing society have played a significant role in the NEA industrial strategy. Under these conditions, the concept of the 'national' industrial strategy becomes meaningful (in the sense that the strategy is designed to be inclusive) and sustainable (since there are not significant threats to break away or change the political-social status quo).

In contrast, a high level of ethnic fractionalisation, in general, has negatively affected the industrialisation process in the SEA countries. A vivid example is Malaysia, where effort has focused on finding leadership for industrial programmes from within the Malay or Bumiputera population even though, up to that point, there were hardly any Bumiputera industrialists and not even many Bumiputera engineers.<sup>53</sup> While there were Chinese-Malaysian industrialists and numerous foreign direct investment industries (mostly owned by Japanese or American companies), these were for the most part excluded from this programme. Furthermore, Malaysia's universities were not producing many highly trained Bumiputera engineers and scientists although there were an increasing number of Bumiputera trained in Malaysia and abroad in business management skills.

The heavy industry programme in Malaysia started as a programme made up mainly of state-owned enterprises because state ownership made it possible for the Bumiputera-dominated government to ensure that it could control who actually ran and staffed these enterprises. State ownership in Malaysia, however, ran into many of the same problems that have plagued state ownership around the world and the programme required enormous subsidies of various kinds to keep going. These enterprises (and certain other state monopolies) were then privatised although the privatisation exercise was largely confined to sales to Bumiputera. Since there were few Bumiputera businessmen with the financial resources needed to purchase these large enterprises, the government used its influence over the banking system to make highly leveraged loans available to key individuals who the government felt

were capable of running these enterprises. This approach contributed much to the financial crisis that hit Malaysia in 1997–1998.

The problem with Malaysia's heavy industry effort was not that it was run by corrupt politicians. Nor, as in the case of the Indonesian effort to produce commercial jet aircrafts, was Malaysia trying to produce something far beyond the capacity of the country. Instead, Malaysia chose to pursue this effort as much for political reasons, with the desire to create Bumiputera industrialists, as opposed to Malaysian ones, despite the fact that the Bumiputera segment of its population was simply not ready to take on the task. Malaysia could keep the effort going with subsidies in the form of high tariff barriers to imports and by providing financing from government-controlled banks. However, the country had imposed too many political conditions on the effort for it to be ever internationally competitive. Then, as the manner in which industry was organised around the world changed, a national automobile became an anachronism, particularly for a relatively small economy, such as Malaysia.<sup>54</sup>

*Government fragmentation.* In general, the SEA governments are vertically fragmented in the sense that there is an excessive number of tiers of sub-national governments. In a cross-country sample of 197 countries constructed by Gómez-Reino and Martínez-Vázquez, 10 countries — most of which were in South and East Asia — were found to have four tiers of government at the sub-national level.<sup>55</sup>

Despite their similarity in terms of vertical fragmentation, the NEA and SEA governments are very different in terms of horizontal fragmentation, as demonstrated by the number and scale of decentralised units.<sup>56</sup> As can be seen from Table 2.5, a large number of small, decentralised units is a common feature of the SEA countries. As a result, the average size of the decentralised units — in terms of area, population and average GDP — is generally much smaller in SEA than NEA (Table 2.5).

**Table 2.5: Average size of decentralised territories, 2010: Northeast Asia versus Southeast Asia.**

Country	No. of decentralised units	Average area sq. km	Average population Million	Average GDP USD billion
Northeast Asia				
China	34	282,264	38.6	175.0
South Korea	9	10,010	5.5	112.8
Japan	47	8,041	2.7	116.8
Southeast Asia				
Malaysia	16	20,615	2.0	14.9
Indonesia	405	4,739	0.6	5.5
Thailand	75	6,842	0.9	4.3
The Philippines	80	3,750	1.2	2.5
Vietnam	63	5,257	1.4	1.6

**GDP = gross domestic product**

*Source:* Alan Heston, Robert Summers and Bettina Aten, *Penn World Table version 7.1* (Philadelphia: Center for International Comparisons of Production, Income and Prices, University of Pennsylvania, 2012); 'World development indicators', World Bank, accessed 31 October 2014, <http://data.worldbank.org/data-catalog/world-development-indicators>.

Why are governments in the SEA countries more fragmented? Unfortunately, relevant literature has yet to adequately address this important question. Recently, in a cross-country study, Padovano, Petrarca and Rocaboy found that countries with a history of foreign invasions tend to have a higher number of government tiers<sup>57</sup>, and that linguistic fragmentation increases horizontal fragmentation. It would seem that both phenomena, namely history of foreign invasions and linguistic fragmentation, fit well into the SEA versus NEA narrative.

In some respects, such as building a better business environment or providing local services, competition among sub-national governments may be healthy, leading to better performance. However, in other respects, especially in relation to competing for resources or getting

favours from the central government, the outcome may be very negative. There is particularly a possibility that administrative boundaries may become economic boundaries along which the national economy can fragment, and public resources get dispersed and often become redundant. This has happened, for instance, in Vietnam in the last decade and it has received sustained criticism.<sup>58</sup>

In Indonesia, on the other hand, the form of decentralisation implemented in 1999 bypassed the provinces and allowed district governments to use registration and licensing as a means of revenue collection. As a result, the number of licenses proliferated, as each business activity was likely to require multiple licenses. New districts (*pemekaran*) in Indonesia were also created to draw resources from the centre that could be spent on local administration.<sup>59</sup> However, as it is generally with relatively small size, local governments were unable to take advantage of the economies of scale and efficiently solve problems of externalities. Small size and a large number of authorised areas may also give rise to unhealthy competition or even a race to the bottom between localities.

In fiscal terms, the decentralisation put forward in 1999 in Indonesia and in 2002 in Vietnam shifted about 60 per cent of government revenues to sub-national levels. In both countries, sub-national governments also enjoyed greater control over natural resources, resulting in an accelerated rate of natural resource exploitation. For instance, during the period 2001–2008, 2,513 coal mining licenses were issued by local authorities in Indonesia.<sup>60</sup> Similarly, between 2000 and 2010, hundreds of small- and medium-sized hydropower plants were licensed by provincial governments in Vietnam.

In other words, the relatively high degree of social fractionalisation in the SEA countries has, in fact, resulted in institutions of low quality and the fragmented nature of government in these countries reinforces the social fragmentation. Echoing Acemoglu and Robinson, government fragmentation thus creates a strong negative feedback loop — a vicious circle — making institutional change in the SEA countries even more daunting.

## **5. Conclusion and Policy Recommendations**

Despite formidable efforts over the last half-century, the quest to explain growth (or the lack of it) remains elusive. The issues being rather complex, scholastic work seems to have led to further questions than answers. For instance, the Commission on Growth and Development — led by two economics Nobel laureates, Robert Solow and Michael Spence — has admitted that:

We do not know the sufficient conditions for growth. We can characterize the successful economies of the postwar period, but we cannot name with certainty the factors that sealed their success, or the factors they could have succeeded without.<sup>61</sup>

The nature of the growth challenge varies across space and time. During their journey, countries pick up many idiosyncratic economic, political, cultural and social legacies that underlie their institutional and structural differences. In addition, as Acemoglu and Robinson have shown, the evolution of institutions, especially at critical junctures, are so unpredictable that it is nearly impossible to anticipate whether a country's institutions will be transformed into more inclusive or extractive ones. All of these factors imply that policy recommendations should not be general, but country-specific, if they are to be useful.<sup>62</sup>

At the same time, as our analysis in this chapter suggests, the SEA countries do share some common characteristics that render them less successful in terms of growth vis-à-vis the NEA countries. To account for these idiosyncrasies as well as the commonalities of the SEA countries, our policy recommendations will be general enough to be useful for the SEA group as a whole. However, it is up to the policymakers of individual countries to draw appropriate and concrete lessons from these recommendations based on their deep knowledge of the particular country's circumstances.



So what do the SEA countries need to do to achieve economic growth and catch up with their more developed neighbours in the North? Our comparative analysis of the NEA and SEA regions suggests three levels of policy recommendations.

First, based on conventional wisdom, the SEA countries should strive to get the fundamentals right. Public policy should be geared toward encouraging efficient accumulation and allocation of factors of production, such as capital, labour and technology. In addition, since most SEA countries still enjoy a low dependency rate, it is critical that they invest sufficiently and efficiently in education and technical training to meet the needs of the labour market and, at the same time, create enough job opportunities for young people.

Second, the SEA countries should continue to deepen their regional and global integration. Even though the degree of openness of most SEA countries today is already quite high — implying that the remaining space for further trade liberalisation is not that wide — these countries can still take advantage of access to international markets and, equally importantly, use globalisation to promote industrial learning and upgrading, thereby improving productivity and competitiveness.

Third, prudent macroeconomic policies to ensure a predictable environment are a prerequisite for sustainable long-term growth. An expensive lesson learned from the Asian financial crisis is that the cost of such crises is not only painful economic downturn in the short term but also economic backwardness in the long run, as economies fall into lower growth trajectories, with accompanying social and political crises.

Our second recommendation stems from the understanding that factor accumulation, openness and macroeconomic management themselves are only proximate causes of growth. Furthermore, these factors are endogenous in the sense that they are products of the country's governance and institutions.

A key message of this chapter is that the SEA countries may have fallen into the so-called 'poor governance trap', which prevents them from escaping the middle-income trap. To escape this middle-income trap, the SEA countries should implement sufficiently strong institutional reforms to go beyond the governance inflection point, thereby putting the country into an institutional orbit that would be conducive to maintaining and renewing their engines of growth.

But, how should a country reform its institutions? Theoretically, the first task for reformers would be to identify extractive economic and political institutions in their country. Reformers then need to find ways to transform these institutions into more inclusive ones, understanding that they, together with other existing inclusive institutions, will create a virtuous circle that will lead to even more inclusive institutions and therefore better growth performance. During the entire process, it is advisable that reformers take full advantage of unfolding critical junctures, as these provide golden opportunities for institutional change.

This is, of course, always easier said than done. Institutional reform is very difficult, and only very few developing countries have managed to achieve success. Institutional reform is difficult because, as discussed earlier, extractive institutions tend to create strong negative feedback loops or vicious circles. Additionally, institutional reform is difficult because institutions themselves are complex and long-term products of a country's history, society, culture and politics. This is the reason why institutions always feature 'path dependence', rendering them highly resistant to change. Take Indonesia, for example. Institutional legacies of the Guided Democracy and New Order periods in Indonesia, such as economic oligarchy and collusive democracy continue to weigh heavily on the country's economy, society and politics.<sup>63</sup> Similarly, the legacy of weak central rule still prevails in Vietnam today, defying even the central planning efforts of the Communist Party. It is this legacy that has given rise to the extreme fragmentation and lack of coordination evident in the country's core institutions.<sup>64</sup> In comparison, recent institutional reforms

in Myanmar are very positive. However, given the long and complex history of the junta regime, together with cronyism, the vastness of its raw material resources and the country's past isolation, the road to institutional reform in Myanmar may well be long and bumpy.

Our third recommendation deals with social fractionalisation, which, as discussed earlier, partly determines the quality of a country's institutions. One can argue that we should take the high degree of ethnic, linguistic and religious heterogeneity in most SEA countries as given and live with it. However, the existence of these aspects of social fractionalisation should not prevent us from making societies less fractionalised, or even more cohesive. Political and economic institutions as well as public policies are ultimately the choice of society. By making the right choice, that is making institutions more inclusive rather than extractive, a society can transform negative aspects of social fractionalisation. Once transformed, these aspects will contribute to the creation of a positive feedback loop that further reduces the level of fractionalisation. On the contrary, should a wrong choice be made, social fractionalisation would be reinforced, leading to even higher degrees of fractionalisation.

Again, let us take Malaysia as an example. At the beginning of its independence from the British in 1957, the issue of ethnicity was highly politicised, which then led to a bloody racial violence in 1969, in which nearly 200 people were killed. In 1972, the Malaysian government implemented the New Economic Policy, which was an affirmative action programme whose objective was to eliminate the identification of race with economic function.<sup>65</sup> Under this policy, disadvantaged Malays (Bumiputeras) were given preferences for government jobs, higher education and property ownership. This and other similar policies have reinforced the existing fractionalisation in the Malaysian society. They have also had profound impacts on the country's institutions and governance. For instance, the preference given to Bumiputeras have created the 'silo mentality system' in Malaysia's civil service since 'most Malays who enter the civil service have gone through mostly Malay only schools, have majored in subjects in the university where the classes

are made up mostly of Malays and then enter the Malay dominated civil service'.<sup>66</sup> The consequence is that non-Malays and non-civil servants in this system are considered strangers and typically not trusted. Thus, the attitude of the civil service is one of regulation and control to prevent bad behaviour by these strangers.

Finally, despite the fact that SEA and NEA entered the post-World War II period with comparably low levels of income and economic development, the two regions have achieved very different growth performances. This fact, however, should not discourage the SEA countries from striving even harder for growth, simply because, as discussed earlier, the quest for growth is a marathon race in which countries must constantly maintain their performance and be able to correct their mistakes and bounce back from adversities.

## Endnotes

- 1 I would like to thank the Senior Fellowships programme under the ASEAN-Canada Research Partnership, which is funded by the International Development Research Centre (IDRC), for financial support. The views expressed in this chapter are those of the author alone and do not necessarily reflect those of the Fulbright Economics Teaching Program or the Harvard Kennedy School's Vietnam Program.
- 2 Director of Research, Fulbright Economics Teaching Program, Ho Chi Minh City, Vietnam and Senior Research Fellow, Vietnam Program, Ash Center for Democratic Governance and Innovation, Harvard Kennedy School, Cambridge, USA.
- 3 See, World Bank, *The East Asian miracle: Economic growth and public policy* (New York: Oxford University Press, 1993); Alwyn Young, 'The tyranny of numbers: Confronting the statistical realities of the East Asian growth experience', *The Quarterly Journal of Economics* 110, no. 3 (1995): 641–80; Asian Development Bank (ADB), *Emerging Asia: Changes and challenges* (Manila: ADB, 1997); Dani Rodrik, 'TFPG controversies, institutions, and economic performance in East Asia' (NBER Working Paper No. 5914, Cambridge, US: National Bureau of Economic Research [NBER], 1997); Steven Radelet, Jeffrey Sachs and Jong-Wha Lee, 'Economic growth in Asia', Background paper for the Asian Development Bank's study *Emerging Asia: Changes and challenges* (Development Discussion Paper No. 609, Cambridge, US: Harvard Institute for International Development, 1997).

- 4 For instance, World Bank, *The East Asian miracle*, op. cit.; Asian Development Bank, *Emerging Asia*, op. cit.
- 5 For the purpose of this study and for the sake of comparability, 'Northeast Asia' refers to Japan, South Korea and Taiwan while 'Southeast Asia' refers to Indonesia, Malaysia, the Philippines, Thailand and Vietnam.
- 6 This chapter is a continuation of an earlier work done at the Harvard Kennedy School Vietnam Program. See, Harvard Kennedy School Vietnam Program, 'Choosing success: The lessons of East and Southeast Asia and Vietnam's future — A policy framework for Vietnam's socioeconomic development, 2011–2020' (Cambridge, US: Harvard Kennedy School Vietnam Program, 2008).
- 7 By 1960, South Korea was among the poorest 25 countries in the world and described by US policymakers as a 'hopeless case'. See, Iain Pirie, *The Korean developmental state: From dirigisme to neo-liberalism* (Routledge Studies in the Growth Economies of Asia, London and New York: Routledge, 2008).
- 8 Even for Japan, by 1950, Japan's per capita gross domestic product (GDP) at current prices was USD 138 whereas that of the Philippines was USD 175. By 1955, the per capita GDP at current prices of Malaysia and the Philippines was USD 233.7 and USD 211.1, respectively, while that of Taiwan and South Korea was USD 208 and USD 109, respectively. See, Alan Heston, Robert Summers and Bettina Aten, *Penn World Table version 7.1* (Philadelphia: Center for International Comparisons of Production, Income and Prices, University of Pennsylvania, 2012).
- 9 As Figure 2.1 shows, the difference was most pronounced during the 1960–1990 period, during which the Northeast Asia (NEA) group grew at 6.2 per cent while the Southeast Asia (SEA) group grew at only 3.9 per cent.
- 10 In the case of Taiwan, the country survived the East Asian financial crisis relatively unscathed, thanks to its large foreign exchange reserves and low external debt, which were both the result of prudent macroeconomic management. As for South Korea, Haggard argues that the country's rapid recovery was owing to the self-correcting mechanism inherent in its political system that allowed swift and wide-ranging institutional and policy reforms. In contrast, the authoritarian regimes in both Indonesia and Malaysia suffered from serious weaknesses, namely arbitrary

action, lack of transparency in business-government relations and uncertainty of political succession, all of which were not only root causes of the financial crisis but also obstacles to subsequent structural adjustments. See, Stephan Haggard, *The political economy of the Asian financial crisis* (Washington, D.C.: Institute for International Economics, 2000).

- 11 The role of natural resources and geography in the relative developments of the NEA and SEA countries will be discussed in a separate section.
- 12 One may argue that total factor productivity (TFP) should play a critical role in the Asian Tigers' growth performance. But, as Young has shown, once the dramatic rise in factor inputs had been taken into account, the Asian Tigers' TFP growth rates were similar to those of many of the Organisation for Economic Co-operation and Development (OECD) and Latin American economies. Similarly, one may argue that demographic transition is important since it accounts for about a third of the observed economic growth of the NEA countries between 1965 and 1990. However, the population growth effect on economic growth is purely transitional. Moreover, although with some lag, the SEA countries have also enjoyed similar demographic 'gift' as the NEA countries. See, Young, 'The tyranny of numbers', op. cit.; David E. Bloom and Jeffrey G. Williamson, 'Demographic transitions and economic miracles in emerging Asia' (NBER Working Paper No. 6268, Cambridge, US: National Bureau of Economic Research [NBER], 1997).
- 13 'World university rankings 2011–2012', *Thomson Reuters*, accessed 15 August 2014, <http://www.timeshighereducation.co.uk/world-university-rankings/2011-12/world-ranking/range/001-200>.
- 14 World Bank, *The East Asian miracle*, op. cit.
- 15 Radelet, Sachs and Lee, 'Economic growth in Asia', op. cit, 59.
- 16 Openness index is defined here as the total trade (exports plus imports) divided by GDP as a percentage of GDP.
- 17 Heston, Summers and Aten, *Penn World Table version 7.1*, op. cit.
- 18 With the short-term exceptions of Taiwan and South Korea, the NEA countries have always been self-governing. In contrast, all SEA countries (with the exception of Thailand) were colonised for extended periods of time.

- 19 For a similar analysis of the impact of exchange rate overvaluation on industrial development in the Philippines, see Josef Y. Lim, 'Identifying critical constraints on trade and investment', Background report to *Philippines: Critical development constraints* (Manila: Asian Development Bank, 2007).
- 20 Both Japan and South Korea's export promotion, at least in the earlier years, were accompanied by heavy export protection, most of which would not be permitted under the World Trade Organization (WTO) rules today.
- 21 For example, Richard M. Auty, *Sustaining development in mineral economies: The resource curse thesis* (London: Routledge, 1993); Jeffrey D. Sachs and Andrew M. Warner, 'The curse of natural resources', *European Economic Review* 45, nos. 4–6 (2001): 827–38.
- 22 Gunnar Myrdal, *Asian drama: An inquiry into the poverty of nations* (New York: Pantheon, 1968); Andrew M. Kamarck, *The tropics and economic development: A provocative inquiry into the poverty of nations* (Baltimore: John Hopkins University Press, 1976); Sachs and Warner, 'The curse of natural resources', op. cit.
- 23 Radelet, Sachs and Lee, 'Economic growth in Asia', op. cit., 9–10.
- 24 Stanley L. Engerman and Kenneth L. Sokoloff, 'History lessons: Institutions, factor endowments, and paths of development in the New World', *Journal of Economic Perspectives* 14, no. 3 (2000): 217–32; Daron Acemoglu, Simon Johnson and James A. Robinson, 'The colonial origins of comparative development: An empirical investigation', *American Economic Review* 91, no. 5 (2001): 1,369–401; William Easterly and Ross Levine, 'Tropics, germs and crops: How endowments influence economic development', *Journal of Monetary Economics* 50, no. 1 (2003): 3–39; Daron Acemoglu and James A. Robinson, *Why nations fail: The origins of power, prosperity, and poverty* (New York: Crown Publishing Group, 2012).
- 25 Radelet, Sachs and Lee, 'Economic growth in Asia', op. cit., 9–10.
- 26 Anthony Reid, *Charting the shape of early modern Southeast Asia* (Chiang Mai: Silkworm Books, 1999).

- 27 'Milestones: 1945–1952, The Korean War, 1950–1953', Office of the Historian, Bureau of Public Affairs, U.S. Department of State, accessed 15 August 2014, <http://history.state.gov/milestones/1945-1952/KoreanWar2>.
- 28 'Milestones: 1945–1952, Korean War and Japan's recovery', Office of the Historian, Bureau of Public Affairs, U.S. Department of State, accessed 15 August 2014, <http://history.state.gov/milestones/1945-1952/KoreanWar>.
- 29 The original Nine Point Economic Stabilization Plan, approved by the National Security Council in December 1948, was then revised by Joseph Morrell Dodge, Financial Adviser to the Supreme Commander for the Allied Powers, who came to Japan in 1949 to implement the programme. This revised programme then became known as the 'Dodge Line'. See, T. Morris-Suzuki et al., *Japanese capitalism since 1945: Critical perspectives*, eds T. Morris-Suzuki and T. Seiyama (New York and London: M. E. Sharpe, Inc., 1989), 45.
- 30 Araneta probably mistook the 'Dodds Report' for the 'Dodge Line'. I would like to thank a member of the Advisory Committee of the ASEAN-Canada Research Partnership for introducing me to this quote by Araneta. See, Salvador Araneta, *America's double-cross of the Philippines: A democratic ally in 1899 and 1946* (Quezon City: Sahara Heritage Foundation, 1999), 55.
- 31 William A. Callahan, Review of the book by Yoneyuki Sugita and Marie Thorsten, *Beyond the line: Joseph Dodge and the geometry of power in US-Japan relations, 1949–1952* (Okayama: University Education Press, 1999), *H-Net Reviews* (1999), accessed 15 August 2014, <http://www.h-net.org/reviews/showrev.php?id=3563>.
- 32 Unlike later foreign aids to African and other low-income countries, the US aids to Japan, South Korea and Taiwan were more efficiently used for development and reconstruction purposes by these effective developmental states that were under formidable pressure to survive in hostile regional environments.
- 33 Neil H. Jacoby, *An evaluation of U.S. economic aid to Free China, 1951–1965* (Washington, D.C.: Bureau for the Far East Agency for International Development, 1966).



- 34 'Milestones: 1945–1952, The Korean War, 1950–1953', op. cit.
- 35 U.S. Operations Mission to Korea, 'Summary of U.S. economic aid to Korea: FY 1954 thru FY 1962 as of June 30 1972', accessed 31 October 2014, [http://pdf.usaid.gov/pdf\\_docs/PNABK613.pdf](http://pdf.usaid.gov/pdf_docs/PNABK613.pdf).
- 36 For instance, Paolo Mauro, 'Corruption and growth', *Quarterly Journal of Economics* 110, no. 3 (1995): 681–712; Alberto Ades and Rafael Di Tella, 'The causes and consequences of corruption: A review of recent empirical contributions', *IDS Bulletin* 27, no. 2 (1996): 6–10; Philip Keefer and Stephen Knack, 'Why don't poor countries catch up? A cross-national test of an institutional explanation', *Economic Inquiry* 35, no. 3 (1997): 590–602; Rodrik, 'TFPG controversies, institutions, and economic performance in East Asia', op. cit.; Robert Hall and Charles Jones, 'Why do some countries produce so much more output per worker than others?', *Quarterly Journal of Economics* 114, no. 1 (1999): 83–116; Alberto Chong and Cesar Calderón, 'Causality and feedback between institutional measures and economic growth', *Economics & Politics* 12, no. 1 (2000): 69–81.
- 37 This database covers more than 150 countries and contains more than 300 governance indicators compiled from various sources. 'Governance' in this database is defined by the authors 'as the traditions and institutions that determine how authority is exercised in a particular country' and includes: (i) the process by which governments are selected, held accountable, monitored and replaced; (ii) the capacity of governments to manage resources efficiently and formulate, implement, and enforce sound policies and regulations; and, (iii) the respect of citizens and the state for the institutions that govern economic and social interactions among them. See, Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobato, 'Governance matters' (World Bank, Development Research Group, 1999).
- 38 Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobato, 'Governance matters: From measurement to action', *Finance & Development* 37, no. 2 (2000), accessed 31 October 2014, <http://www.imf.org/external/pubs/ft/fandd/2000/06/kauf.htm>.
- 39 For instance, Arthur A. Goldsmith, 'Is governance reform a catalyst for development?', *Governance* 20, no. 2 (2007): 165–86.
- 40 According to the Economist Intelligence Unit (EIU) database, per capita income (purchasing power parity [PPP], USD at current prices) of Thailand and Malaysia in 2012 was USD 9,480 and USD 17,050, respectively; per capita income for South Korea and Taiwan in 1985 was USD 4,682 and USD 6,378, respectively. For more information, see <http://www.eiu.com/>.

- 41 It should be added that once the privileged group captures the government, it is difficult to escape from this low equilibrium and even a transition to democracy does not guarantee that the situation will be reversed.
- 42 New institutional economics (NIE) is a school of economic thought whose main tenet is that institutions are the key for economic development.
- 43 See, Acemoglu and Robinson, *Why nations fail*, op. cit.
- 44 Ibid., 81.
- 45 For more discussion on the transformation of South Korea, see Ibid., 93–4.
- 46 Jeffrey A. Winters, 'Oligarchs and oligarchy in Southeast Asia', in *Routledge handbook of Southeast Asian politics*, ed. Richard Robison (London and New York: Routledge, 2012).
- 47 Richard Robison, ed., *Routledge handbook of Southeast Asian politics* (London and New York: Routledge, 2012).
- 48 Winters, 'Oligarchs and oligarchy in Southeast Asia', op. cit.
- 49 Easterly, Ritzen and Woolcock carefully avoid any misunderstanding by emphasizing that social cohesion, by their definition, is neither equal to cultural homogeneity and intolerance of diversity nor being harmonious, devoid of any political conflict or dissent. Rather, they want to assert that, '... the extent to which people work together when crisis strikes or opportunity knocks is a key factor shaping economic performance'. See, William Easterly, Jozef Ritzen and Michael Woolcock, 'Social cohesion, institutions, and growth', *Economics & Politics* 18, no. 2 (2006): 103–20.
- 50 Ibid., 105.
- 51 Ibid.
- 52 Ibid., 103–4.
- 53 This discussion is drawn from the comparative perspectives arrived at as part of a work co-authored with Dwight H. Perkins on Vietnam industrial policy. See, Dwight H. Perkins and Tu-Anh Vu-Thanh, 'Industrial policy in Vietnam — From industrial policy to industrial development', Background paper for Vietnam's ten-year socio-economic development strategy (Hanoi: Development Strategy Institute, Ministry of Planning and Investment, 2011).
- 54 Ibid.
- 55 Juan L. Gómez-Reino and Jorge Martínez-Vazquez, 'An international perspective on the determinants of local government fragmentation' (International Center for Public Policy Working Paper 12-19, Atlanta: International Center for Public Policy, 2012).

- 56 Here, we deviate somewhat from the conventional measure of horizontal fragmentation, which is the number of sub-national jurisdictions at any level of government.
- 57 These authors also found the same effect for internal risks, such as natural calamities. See, Fabio Padovano, Ilaria Petrarca and Yvon Rocaboy, 'Historical determinants of government fragmentation: A cross country analysis' (paper presented at the International Seminar of the Centre Condorcet for Political Economy, Rennes, and at the PEARLE meetings, 2013), accessed 31 October 2014, [http://crem.univ-rennes1.fr/Documents/Docs\\_workshops\\_2013/2013-05-31\\_10\\_PadoRocPetra.pdf](http://crem.univ-rennes1.fr/Documents/Docs_workshops_2013/2013-05-31_10_PadoRocPetra.pdf).
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- 59 Harvard Kennedy School Indonesia Program, 'From reformasi to institutional transformation: A strategic assessment of Indonesia's prospects for growth, equity and democratic governance' (Cambridge, US: Harvard Kennedy School Indonesia Program, 2011).
- 60 Ibid.
- 61 Commission on Growth and Development, 'The policy ingredients of growth strategies', in *The growth report: Strategies for sustained growth and inclusive development* (Washington, D.C.: International Bank for Reconstruction and Development/World Bank, 2008), 33.
- 62 Given substantial differences among the SEA countries, this study — as any comparative study of the region — confronts the problem of making meaningful comparisons while dealing with quite fundamental differences.
- 63 Harvard Kennedy School Indonesia Program, 'From reformasi to institutional transformation', op. cit.
- 64 Vu Thanh, 'Decentralization in Vietnam from institutional perspectives', op. cit.
- 65 Lee Kam Swee, 'Reconciling competition policy with development policies: The case of Malaysia', in *The future development of competition framework*, eds Tzong-Leh Hwang and Chiyuan Chen (The Hague: Kluwer Law International, 2004), 261–8.
- 66 Quoted from a lecture given by Dwight H. Perkins during the Vietnam Executive Leadership Program at Harvard Kennedy School in 2008.

## Chapter Two

# Narrowing the Development Gap in the ASEAN Economic Community

*Chia Siow Yue<sup>1</sup>*

*Equitable economic development, an objective of the ASEAN Economic Community (AEC), recognises the widely disparate development levels of the various ASEAN countries, particularly the gap between its older members (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand, or ASEAN-6) and the latecomers (Cambodia, Laos, Myanmar and Vietnam, or CLMV). This wide gap will impact on the pace of regional economic integration and social cohesion. ASEAN mechanisms aimed at narrowing this disparity include special and differential treatments as well as development and technical cooperation and assistance.*

*CLMV have achieved remarkable results in transforming their economies. Economic success in these countries has depended crucially on their undertaking necessary unilateral domestic reforms, even as the membership of ASEAN and World Trade Organization (WTO) accession has helped to ensure that CLMV continue to reform and restructure their economies, and improve capacity building to remain globally and regionally competitive. Where per capita income and the Human Development Index (HDI) are concerned, CLMV, and particularly Vietnam, are converging toward ASEAN-6. However, in terms of the Global Competitiveness Index (GCI) and Ease of Doing Business Index, CLMV still have a long way to go.*

*Action is necessary on two fronts. On the one hand, CLMV have abundant natural resources, a young and growing population and labour force, and a strategic location between China, India and ASEAN-6. CLMV need to therefore persist with their regulatory, policy and institutional reforms and capacity building measures to take advantage of the opportunities offered by globalisation, regional production networks and regional economic integration via the AEC, the ASEAN+1 Free Trade Areas (FTAs) and the emergent Regional Comprehensive Economic Partnership (RCEP). On the other, CLMV's efforts will need to be buttressed by increased investment flows, and effective financial and technical assistance from ASEAN and the world, particularly from*

*ASEAN's Dialogue and Development Partners. A two-pronged approach will enable CLMV to continue with their dynamic development and catch up with the middle-income ASEAN countries in good time.*

*Keywords: AEC, CLMV, development divided, economic integration, production networks*

## **1. Introduction**

ASEAN was established in 1967<sup>2</sup> although economic integration was not on the agenda at the time due to the prevalence of import substitution policies and concerns over wide differences in the development levels and industrial competitiveness of member countries, which could disadvantage the weaker economies if they were to open up to regional trade and investment liberalisation. First steps toward ASEAN economic integration began in 1977 with the ASEAN Preferential Trading Arrangement (PTA)<sup>3</sup>, and advanced to the 1992 ASEAN Free Trade Area (AFTA)<sup>4</sup>, the 1995 ASEAN Framework Agreement on Services (AFAS)<sup>5</sup>, the 1998 ASEAN Investment Area (AIA)<sup>6</sup> and the 2003 agreement to establish the ASEAN Economic Community (AEC)<sup>7</sup> by 2020 (which was later brought forward to 2015). The AEC Blueprint<sup>8</sup> has four pillars, including Pillar III on Equitable Economic Development in explicit recognition of the diversity in the development levels of its member countries and the need to narrow the development gap for economic and social coherence and to ensure the success of the AEC.

The ASEAN concern with the development divide between its older and newer members is the focus of this study. It examines the causes and trends in the development gap, the current measures to overcome the gap and further options to narrow the gap. It is recognised that the opening of the CLMV economies to trade and investment liberalisation could exacerbate intra-country income inequalities in the short run, but reduce absolute poverty and increase economic opportunities for most in the longer run by way of increased resources, opportunities and efficiencies, and consequently economic growth and employment. Wherever possible, the inequalities generated by market forces and

economic integration would need to be ameliorated by measures aimed at ‘compensating losers’ from national governments.

## **2. The Development Gap in ASEAN<sup>9</sup>**

Explanations of the differential economic performance of the older members of ASEAN (namely Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand [or, ASEAN-6 for short]) and its newer members (or, Cambodia, Laos, Myanmar and Vietnam [CLMV for short]) can be found in the dissimilarities between the political developments, economic policies, and governance and institutional quality of these countries, which have led to lower levels of economic competitiveness among the latter. For instance,

- Unlike the relative peace and stability that followed the creation of ASEAN in 1967, which enabled its founding members to focus on their economic development, economic development in CLMV was held back by the Vietnam War, the Cambodia-Vietnam conflict and the military regime in Myanmar.
- From the late 1970s, the market-oriented ASEAN-6 have adopted an export-oriented development strategy, improved investment climate to attract foreign direct investment (FDI), and made efforts to become integrated into the global and regional production networks and supply chains. In contrast, after the end of the Indochina War in 1975, the CLMV countries pursued central planning and inward-looking development strategies. However, even after reforms were initiated in the mid-1980s, CLMV remained less integrated into the global economy and global supply chains than ASEAN-6, with Myanmar embarking on major economic reforms only in 2011.

### *2.1 Indicators of the development gap in ASEAN*

The ASEAN development gap is multidimensional. Here, the gap is discussed in terms of parameters such as income, Human Development Index (HDI) and competitiveness.

*Income gap and its narrowing over time.* Table 3.1 highlights the sharp differences in the per capita incomes of ASEAN-6 and CLMV. It should be noted that purchasing power parity (PPP)-adjusted differences were not as large as nominal differences and there was wide disparity not only between ASEAN-6 and CLMV but also among the various ASEAN-6 countries. In fact, the absolute gap among the ASEAN-6 countries was larger than that with CLMV.

*Table 3.1: ASEAN land area, population, GDP and GDP per capita, 2011.*

Country	Land area sq. km	Population Thousands	GDP size USD billion (at current prices)	GDP per capita USD (at current prices)	GDP per capita USD (PPP- adjusted)
Brunei Darussalam	5,765	423	16.36	38,703	52,059
Indonesia	1,860,360	237,671	846.82	3,563	4,736
Malaysia	330,252	28,964	267.92	9,941	15,955
The Philippines	300,000	95,834	224.34	2,341	4,289
Singapore	714	5,184	259.86	50,130	60,744
Thailand	513,120	67,597	345.81	5,116	8,907
Cambodia	181,036	14,521	12.77	879	2,287
Laos	236,800	6,385	8.16	1,279	2,825
Myanmar	676,577	30,384	52.84	875	1,393
Vietnam	331,051	87,840	123.27	1,403	3,440
ASEAN-10	4,435,674	604,803	2,178.15	3,601	5,581

ASEAN-10 = ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) + CLMV (Cambodia, Laos, Myanmar and Vietnam); GDP = gross domestic product; PPP = purchasing power parity

Source: 'ASEAN statistics', ASEAN Secretariat, accessed 31 May 2013, [www.asean.org/resources/category/asean-statistics](http://www.asean.org/resources/category/asean-statistics).

Table 3.2, which shows how gross domestic product (GDP) of CLMV has fared relative to the ASEAN-6 countries, indicates that the average per capita growth rate for CLMV exceeded that for ASEAN-6 during 1990–2010, suggesting economic convergence among these countries. The faster growth performance of CLMV reflected their unilateral market reforms in the mid-1980s and subsequent opening up to trade and investment flows, which were required following their ASEAN and World Trade Organization (WTO; for Cambodia, Laos and Vietnam [CLV]) accessions.

*Table 3.2: Trends in nominal per capita gross domestic product in ASEAN, 1990–2010.*

Country	Market prices USD			2010/1990 ratio
	1990	2000	2010	
Brunei Darussalam	13,913	18,465	30,173	2.17
Indonesia	699	807	3,023	4.32
Malaysia	2,432	4,030	8,260	3.40
The Philippines	718	987	2,014	2.81
Singapore	12,388	22,791	43,898	3.54
Thailand	1,521	1,983	4,735	3.11
Cambodia	106	288	733	6.92
Laos	217	304	1,035	4.77
Myanmar	68	178	715	10.51
Vietnam	98	402	1,239	12.64
ASEAN-10	805	1,166	3,105	3.86
ASEAN-6	1,064	1,537	3,973	3.73
CLMV	94	318	990	10.53

ASEAN-10 = ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) + CLMV (Cambodia, Laos, Myanmar and Vietnam)

Source: Asian Development Bank Institute (ADBI), *ASEAN 2030: Toward a borderless economic community, Draft highlights* (Tokyo: ADBI, 2012), 25.



Table 3.3 shows the ASEAN 2030 study<sup>10</sup> projections for per capita GDP of the ASEAN countries by 2030, indicating further convergence. Where, in 1990, the average per capita GDP of ASEAN-6 was about 11 times above CLMV, the corresponding figures for 2010 were about four times and projections for 2030 are only three times that of CLMV.

Table 3.3: ASEAN aspirations, 2010–2030.

Country	GDP per capita, 2010 USD (at 2010 market prices)	GDP per capita, 2030 USD (at 2010 market prices)	Average yearly growth in GDP per capita, 2010–2030 %	Ratio of GDP per capita/ASEAN, 2010	Ratio of GDP per capita/ASEAN, 2030
Brunei Darussalam	30,173	75,433	4.69	9.72	8.09
Indonesia	3,023	10,582	6.46	0.97	1.13
Malaysia	8,260	24,780	5.65	2.66	2.66
The Philippines	2,014	5,034	4.69	0.65	0.54
Singapore	43,898	79,300	3.00	14.14	8.50
Thailand	4,735	14,204	5.65	1.52	1.52
Cambodia	734	2,934	7.18	0.24	0.31
Laos	1,035	3,623	6.46	0.33	0.39
Myanmar	715	3,216	7.81	0.23	0.34
Vietnam	1,239	4,336	6.46	0.40	0.46
ASEAN-10	3,105	9,325	5.60	1.00	1.00

ASEAN-10 = ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) + CLMV (Cambodia, Laos, Myanmar and Vietnam); GDP = gross domestic product

Source: Asian Development Bank Institute (ADBI), ASEAN 2030: *Toward a borderless economic community, Draft highlights* (Tokyo: ADBI, 2012), 35.

*Human Development Index gap.* Table 3.4 shows the rankings for HDI and its components of ASEAN countries in 2011. Differences in the HDI rankings of ASEAN-6 and CLMV were much smaller than the gross national income (GNI) per capita, PPP-adjusted rankings. Improvements in HDI during 2000–2011 were greater for CLMV than for ASEAN-6.

Table 3.4: Human Development Index for ASEAN countries, 2011.

Country	HDI		Life expectancy at birth Years	Schooling Years		GNI per capita (at constant 2005 PPP USD)	2011/2000 ratio
	Ranking	Value		Mean schooling	Expected schooling		
Singapore	26	0.866	81.1	8.8	14.4	52,569	1.08
Brunei Darussalam	33	0.838	78.0	8.6	14.1	45,753	1.02
Malaysia	61	0.761	74.2	9.5	12.6	13,865	1.08
Thailand	103	0.682	74.1	6.6	12.3	7,694	1.09
The Philippines	112	0.644	68.7	8.9	11.9	3,478	1.07
Indonesia	124	0.612	69.4	5.8	13.2	3,716	1.14
Vietnam	128	0.593	75.2	5.5	10.4	2,805	1.12
Laos	138	0.524	67.5	4.6	9.2	2,242	1.17
Cambodia	139	0.523	63.1	5.8	9.8	1,848	1.19
Myanmar	149	0.483	65.2	4.0	9.2	1,535	1.27

GNI = gross national income; HDI = Human Development Index; PPP = purchasing power parity

Source: United Nations Development Programme (UNDP), *Human Development Report 2011, Sustainability and equity: A better future for all* (New York: UNDP, 2011), 127–30.

**Competitiveness gap.** While indicators such as per capita income and human development reflect living standards and welfare, competitiveness indicators reflect supply side capabilities. The components of the competitiveness index highlight the areas that need regulatory and policy reforms in order to enable CLMV to further catch up to ASEAN-6.

Table 3.5 shows the World Economic Forum’s (WEF) Global Competitiveness Index (GCI) rankings of ASEAN countries for 2011–2012. Singapore ranked second in global competitiveness out of 144 economies while Vietnam and Cambodia had rankings of 75 and 85, respectively. Laos and Myanmar were not included in the survey.

*Table 3.5: Global Competitiveness Index for ASEAN countries, 2011–2012.*

Variable	Ranking among 144 economies							
	Singapore	Malaysia	Brunei Darussalam	Thailand	Indonesia	The Philippines	Vietnam	Cambodia
Global Competitiveness Index	2	25	28	38	50	65	75	85
Subindices								
Basic requirements	1	27	21	45	58	80	91	97
Efficiency enhancers	1	23	68	47	58	61	71	85
Innovation and sophistication factors	11	23	62	55	40	64	90	72
Pillars								
Basic requirements								
1. Institutions	1	29	31	77	72	94	89	73
2. Infrastructure	2	32	57	46	78	98	95	104
3. Macroeconomic environment	7	35	1	27	25	36	6	91
4. Health and primary education	3	33	31	78	70	98	64	102

Efficiency enhancers								
5. Higher education and training	2	39	57	60	73	64	96	111
6. Goods market efficiency	1	11	73	37	63	86	91	50
7. Labour market efficiency	2	24	13	76	0	3	51	28
8. Financial market development	2	6	56	43	70	58	88	64
9. Technological readiness	5	51	64	84	85	79	98	100
10. Market size	7	28	124	22	16	35	32	89
Innovation and sophistication factors								
11. Business sophistication	4	20	65	46	42	49	0	74
12. Innovation	8	25	59	68	39	94	81	67

Source: Compiled by the author from World Economic Forum (WEF), *The Global Competitiveness Report 2011–2012*, ed. Klaus Schwab (Geneva: WEF, 2011), 16–22.

Table 3.6 shows the World Bank's Ease of Doing Business indicators for ASEAN countries in 2011. Among 183 economies covered, Singapore was ranked first while Vietnam ranked 98 (ahead of Indonesia and the Philippines), Cambodia was 138 and Laos 165. Myanmar was not included in the survey.

Table 3.6: Ease of Doing Business rankings for ASEAN countries, 2011.

Variable	Ranking among 183 economies								
	Singapore	Thailand	Malaysia	Brunei Darussalam	Vietnam	Indonesia	The Philippines	Cambodia	Laos
Ease of doing business	1	17	18	83	98	129	136	138	165
Starting a business	4	78	50	136	103	155	158	171	89
Dealing with construction permits	3	14	113	83	67	71	102	149	80
Getting electricity	5	9	59	28	135	161	54	130	138
Registering property	14	28	59	107	47	99	117	110	72
Getting credit	8	67	1	126	24	126	126	98	166
Protecting investors	2	13	4	122	166	46	133	79	182
Paying taxes	4	100	41	20	151	131	136	54	123
Trading across borders	1	17	29	35	68	39	51	120	168
Enforcing contracts	12	24	31	151	30	156	112	142	110
Resolving insolvency	2	51	47	44	142	146	163	149	183

Source: Compiled by the author from World Bank and International Finance Corporation, *Doing business 2012: Doing business in a more transparent world* (Washington, D.C.: International Bank for Reconstruction and Development/World Bank, 2012), 77–138.

In sum, CLMV, particularly Vietnam, have narrowed the gaps in income and HDI. However, the gaps remain extremely wide, particularly between countries at the high end of the spectrum, such as Brunei Darussalam and Singapore, and those at the other end, such as Laos and Myanmar. The causes for the gaps are, in part, reflected in the differences in the competitiveness of these economies, as measured by GCI and Ease of Doing Business Index.

### **3. Benefits and Costs of CLMV Accession to ASEAN**

#### *3.1 Benefits and costs for ASEAN and ASEAN-6*

CLMV accessions to ASEAN achieved the political objective of overcoming the historical Cold War divide in Southeast Asia and the realisation of the founding fathers' vision of 'one Southeast Asia'.<sup>11</sup> However, the accessions also meant that ASEAN had to face new challenges vis-à-vis dealing with an even more diverse regional grouping as also difficult external relations with the US and European Union (EU) over Myanmar.

On the economic front, CLMV membership did not considerably expand the AFTA-AEC market. For instance, in 2011, CLMV accounted for 28 per cent of ASEAN's total population, but only 10 per cent of ASEAN's total GDP (Table 3.1). Also, CLMV membership slowed the pace of ASEAN economic integration, as the new members had to be given more time and greater flexibility to fulfil their trade and investment liberalisation and facilitation commitments.

Narrowing the development gap would strengthen regional solidarity and help ASEAN realise the AEC. Conversely, failure to do so would undermine the stability and coherence of the regional grouping.

### *3.2 Benefits and costs for CLMV*

Venables showed that initial large disparity in the level of development would likely lead to an even greater disparity following the formation of FTAs,<sup>12</sup> as integration schemes, such as those of the AEC, may result in diverting manufacturing production from less developed members to those more developed. Langhammer also noted disparities in economic growth and incomes between core and peripheral regions, with the attractive core regions drawing mobile resources from agglomeration effects.<sup>13</sup> For these reasons, convergence funds were introduced in the EU, taxing core regions to benefit the disadvantaged peripheral regions. Cuyvers argued that, when countries of various development levels agree to integrate their economies, institutional mechanisms need to be designed to cope with income disparities.<sup>14</sup> For weaker integration, such as the AEC, there are weaker possibilities for influencing income disparities, and regional policies have to be covered by additional agreements and financed by national budgets. In contrast, Pomfret argues that membership that involves a large country and small country will result in the small country reaping the gains from freer trade, as its prices converge to those of the large country.<sup>15</sup> Thus, in the AEC, the smaller CLMV economies would reap gains from trade with the larger ASEAN-6 countries. Further, joining an export-oriented grouping, whose members have good economic institutions, would be both a catalyst and an anchor for economic reforms in the new members.

What the above economists did not elaborate were the effects of production networks, which enable less advanced economies to industrialise and link up with the global value chains without requiring capabilities across-the-board but only in specific segments of the value chain. This enables CLMV to develop export-oriented manufacturing activities and links them with global supply chains, thereby, helping to narrow the development gap.

*Political benefits.* Politically, ASEAN membership enabled CLMV to 'come out of the cold' and for Myanmar to withstand isolation by the US and EU. CLMV also have a stronger voice regionally and globally through ASEAN membership.

*Economic benefits.* CLMV need ASEAN membership to meet the challenges of economic globalisation, the technological revolution and economic rise of China, as well as to access additional regional and international financial and development assistance. Specific economic benefits include:

- First, preferential access to the ASEAN regional market, which enables CLMV to enjoy greater market access and security, the static gains of improved resource allocation according to comparative advantage as well as the dynamic gains from scale economies, knowledge spillovers and increased FDI inflows. Cambodia (until October 2004), Vietnam (until January 2007) and Laos (until February 2013) were not WTO members and did not enjoy the most favoured nation (MFN) treatment for their exports while Myanmar, although a WTO member, was subject to sanctions from the US and EU. However, with WTO membership and the normalisation of relations with the US and EU, trade and investment dependence on ASEAN have declined in recent years.
- Second, opportunities to leverage economic complementarities with the more advanced ASEAN countries. The CLMV economies have abundant natural resources and low wage labour, and thus enjoy a comparative advantage in relation to primary resource-based activities and labour-intensive manufacturing. On resource-based activities, CLMV could cooperate with the more advanced ASEAN countries to raise productivity and the quality of products, particularly to comply with sanitary and phytosanitary (SPS) standards for exports. In manufacturing, CLMV could benefit from the relocation of labour-intensive manufacturing from the ASEAN economies facing labour shortages and rising costs, and thus integrate into regional production networks and industry clusters in electronics, automobiles, and textiles and garments.



- Third, CLMV possesses significant historical and cultural attractions for tourism and benefit from joint ASEAN tourism promotion and cooperation on the development of tourism infrastructure (by way of aviation, cruises, hotel development, visa-free travel, etc.).
- Fourth, ASEAN membership could pressure CLMV to pursue further domestic economic, regulatory and institutional reforms to improve economic competitiveness. In particular, CLMV could learn from the best practices in economic development and economic management and access technical assistance from ASEAN-6, including customs harmonisation procedures, technical and SPS standards, and capacity-building measures, such as training of government officials. Some of these programmes are available from ASEAN-6 and ASEAN Dialogue and Development Partners under the Initiative for ASEAN Integration (IAI)<sup>16</sup> and various bilateral schemes.
- Fifth, CLMV countries can leverage on ASEAN when negotiating FTAs with large trading partners. ASEAN+1 agreements have been concluded with China, Japan, South Korea, Australia-New Zealand and India. In contrast, individual CLMV countries would appear less attractive as bilateral FTA partners, as evidenced by the lack of such agreements.

*Possible and perceived costs and concerns.* CLMV are concerned over the possible and perceived costs of trade and investment liberalisation under the AEC:

- First, as low income and least developed economies, CLMV may be unable to exploit economic integration opportunities. They need the capacity to develop a competitive business environment and workforce to participate effectively. At the same time, governments are under pressure to protect less competitive producers in agriculture, manufacturing and services, including state-owned enterprises and small and medium-sized enterprises (SMEs). Economic integration and trade liberalisation would result in their decline, creating structural unemployment and hardships and possibly worsening national income

distributions. While these are important concerns, they tend to be short-term results, as greater efficiency and structural adjustments would lead to higher economic growth and employment.

- Second, concerns over the loss of customs revenue from import tariff eliminations on intra-ASEAN trade and trade with ASEAN+1 FTA partners.
- Third, as ASEAN seeks to establish FTAs with an increasing group of countries (including China, South Korea, Japan, India and Australia-New Zealand), CLMV are under stress owing to inadequate negotiating and implementation resources. They will need to expand the training of government officials.

*Computable general equilibrium modelling results.* Table 3.7 presents the computable general equilibrium (CGE) modelling results of ASEAN economic integration under three different scenarios: (i) scenario 1 (AFTA) removes all remaining tariffs in ASEAN; (ii) scenario 2 (AFTA+) also removes non-tariff barriers, with 5 per cent reduction in trade costs; and, (iii) scenario 3 (AEC) includes FDI effects. As the data indicate, the wider and deeper the integration, the larger the benefits. All ASEAN members gain from the AEC though some countries gain more than the others. The range of gains runs from a 2.8 per cent increase in real income for Vietnam to a 9.7 per cent gain for Singapore. Cambodia gains the most among the CLMV countries, with real income rising by 6.3 per cent. Where effects on trade are concerned, CLMV do particularly well — exports for Laos are expected to more than double and those of Cambodia are expected to rise by more than three-fourths due to the AEC.

*Table 3.7: Computable general equilibrium (CGE) modelling of welfare gains in 2015.*

Country	Welfare gain USD billion (at 2004 prices)			Percentage baseline GDP		
	Scenario 1 (AFTA)	Scenario 2 (AFTA+)	Scenario 3 (AEC)	Scenario 1 (AFTA)	Scenario 2 (AFTA+)	Scenario 3 (AEC)
Brunei Darussalam	0.2	0.4	0.5	2.6	5.4	7.0

Indonesia	1.0	6.2	27.6	0.2	1.4	6.2
Malaysia	2.7	2.9	5.7	1.4	1.5	3.0
The Philippines	0.9	2.2	4.5	0.6	1.6	3.2
Singapore	2.6	14.0	15.1	1.6	9.0	9.7
Thailand	1.6	9.8	12.2	0.6	3.9	4.9
Cambodia	0.3	0.5	0.6	2.7	5.4	6.3
Laos	0.0	0.1	0.2	0.6	2.5	3.6
Myanmar	0.0	0.2	0.6	0.3	1.2	4.4
Vietnam	0.9	1.6	2.4	1.1	1.8	2.8
ASEAN-10	10.1	38.0	69.4	0.8	2.9	5.3

AEC = ASEAN Economic Community; AFTA = ASEAN Free Trade Area; ASEAN-10 = ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) + CLMV (Cambodia, Laos, Myanmar and Vietnam); GDP = gross domestic product

Source: Michael G. Plummer and Chia Siow Yue, eds, *Realizing the ASEAN Economic Community: A comprehensive assessment* (Singapore: ISEAS Publishing, 2009), 35.

**Growth in trade.** Table 3.8 shows trade/GDP ratios of ASEAN countries for 2011, with ratios of 161.9 per cent for Vietnam and even Myanmar achieving 28.2 per cent. By 2011, intra-ASEAN trade accounted for 25 per cent of total ASEAN trade although wide country variations were seen. CLMV accounted for only 7.9 per cent of intra-ASEAN trade, mainly from Vietnam. Among CLMV, dependence on intra-ASEAN trade was highest for Laos (64.0 per cent) and Myanmar (48.3 per cent). Laos is landlocked and conducts a large volume of its trade with and through Thailand whereas Myanmar, which has been politically isolated by the western powers, is heavily dependent on trade with ASEAN. In contrast, intra-ASEAN trade accounted for only 23.4 per cent of Cambodia's trade

in 2011 — expansion of its textiles and clothing exports since 2000 were largely due to favourable quota allocations and MFN tariffs from the US following the US-Cambodia bilateral trade agreement 1999. For Vietnam, the export share of the US expanded rapidly following the US-Vietnam Bilateral Trade Agreement 2001.

Table 3.8: ASEAN trade integration.

Country	Trade, 2011 USD billion	Trade/GDP, 2011 %	Intra-ASEAN trade USD million		Percentage share of intra- ASEAN trade		ASEAN's percentage share of country trade, 2011
			1993	2011	1993	2011	
Brunei Darussalam	14.8	90.6	1,374	2,912	1.7	0.5	19.6
Indonesia	380.9	45.0	7,656	99,353	9.3	16.6	26.1
Malaysia	415.7	144.4	21,891	108,137	26.6	18.1	26.0
The Philippines	111.7	49.8	2,678	23,676	3.2	4.0	21.2
Singapore	775.2	298.3	37,167	205,671	45.1	34.4	26.5
Thailand	458.9	132.7	11,680	111,451	14.2	18.6	24.3
Cambodia	12.8	100.6	NA	3,004	NA	0.5	23.4
Laos	4.0	48.5	NA	2,530	NA	0.4	64.0
Myanmar	14.9	28.2	NA	7,208	NA	1.2	48.3
Vietnam	199.6	161.9	NA	34,298	NA	5.7	17.2
ASEAN-10	2,388.6	109.7	82,444	598,242	100.0	100.0	25.0
ASEAN-6	2,157.2						
CLMV	231.4						

ASEAN-10 = ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) + CLMV (Cambodia, Laos, Myanmar and Vietnam); GDP = gross domestic product; NA = not available

Source: 'ASEAN statistics', ASEAN Secretariat, accessed 31 May 2013, [www.asean.org/resources/category/asean-statistics](http://www.asean.org/resources/category/asean-statistics).

*Growth in foreign direct investment.* The CLMV countries are keen to attract FDI into sectors such as resource development, infrastructure development and manufacturing. However, CLV (no data were available for Myanmar) accounted for only 7.5 per cent of net FDI inflows into ASEAN in 2011.<sup>17</sup> For Myanmar, apart from a less favourable investment climate, FDI inflows were also affected by US and EU sanctions. Until recently, FDI from ASEAN sources remained small although growing investments are seen from Thailand, Malaysia and Singapore in resource processing, economic zones and industrial parks, and labour-intensive industries. CLMV are beginning to be plugged into the regional production networks for electronic products and in garments and footwear. However, product fragmentation is extremely time sensitive and concerned over supply disruptions.

#### **4. ASEAN Economic Community Measures to Narrow the Development Gap**

ASEAN summits and ministerial meetings regularly make references to the ASEAN development divide. Specific references for action are contained in the following:

- The Ha Noi Declaration on Narrowing Development Gap for Closer ASEAN Integration of 2001 noted that the development gap would be further widened without effective measures.
- The Declaration of ASEAN Concord II (Bali Concord II) in October 2003 reaffirmed the commitment, stating: 'The ASEAN Economic Community shall ensure that deepening and broadening integration of ASEAN shall be accompanied by technical and development cooperation in order to address the development divide and accelerate the economic integration of [CLMV countries] ...'.<sup>18</sup>
- The Vientiane Action Plan (VAP) of 2004 is a 6-year plan to realise the end goal of ASEAN Vision 2020 and Declaration of ASEAN Concord II, and focuses on deepening regional integration as well as reducing the large disparities in per capita GDP (and other human development dimensions).

Current mechanisms to narrow the ASEAN development gap have two components, namely special and differential treatment (SDT) in ASEAN agreements, and development and technical cooperation and assistance (by way of IAI, the ASEAN Development Fund [ADF], etc.) aimed at addressing supply constraints and improving CLMV competitiveness. However, it needs to be stressed here that the main effort to narrow the development gap must come from the CLMV countries themselves, as domestic regulatory and policy reforms are needed to enhance their competitiveness, so that they can benefit from trade and investment liberalisation.

#### *4.1 Special and differential treatment*

SDT is accorded to the CLMV countries for implementing obligations under the various ASEAN agreements (such as AFTA, AFAS, AIA and the AEC) in recognition of their late entry into ASEAN and their weaker capacities for adjusting to the trade and investment liberalisation process.

*Longer end-date and flexibility.* CLMV have been given a longer end-date to complete their tariff reduction/elimination obligations under AFTA.<sup>19</sup> End-dates for reducing tariffs to the target range of 0–5 per cent levels were 2002 for ASEAN-6, 2006 for Vietnam, 2008 for Laos and Myanmar, and 2010 for Cambodia. End-dates for reducing tariffs to the 0 per cent level were 2010 for ASEAN-6 and 2015 for CLMV. As tariffs came tumbling down in AFTA, more emphasis is being placed on trade facilitation, especially customs barriers, electronic processing of trade documents, harmonisation of product standards and technical regulations, and mutual recognition agreements, including for test reports and certification. Under the AEC, 12 priority sectors have been identified for accelerated integration.<sup>20</sup> As compared to AFTA deadlines of 2010 for ASEAN-6 and 2015 for CLMV, tariffs were to be eliminated on 85 per cent of products in the priority sectors by 2007 for ASEAN-6 and 2012 for CLMV. Some of these sectors, such as fisheries, textiles and apparel, wood-based products, and tourism, are those in which CLMV have a comparative advantage.

CLMV have also acceded to AFAS and AIA, with delayed or flexible schedules. On AFAS<sup>21</sup>, two flexibilities were introduced in 2003. First was the faster liberalisation for Mode 1 (cross-border supply) and Mode 2 (consumption abroad), and slower liberalisation for Mode 3 (commercial presence) and Mode 4 (presence of natural persons). Second, an 'ASEAN minus X' formula allows two or more ASEAN countries to go ahead with sectoral services liberalisation, with other members joining at a later date when they are ready.

Under the AIA<sup>22</sup>, ASEAN members are committed to gradually eliminate investment barriers, liberalise investment rules and policies, and grant national treatment and open industries to ASEAN investors by 2010 and to non-ASEAN investors by 2020. However, extensive sensitive lists and temporary exclusion lists (TELS) limit the scope of national treatment and industries and sectors that are open to FDI. End-dates for phasing out TEL in manufacturing were January 2003 for ASEAN-6 and Myanmar, and January 2010 for CLV. End-dates for phasing out TEL in the other designated sectors were January 2010 for ASEAN-6 and Cambodia, 2013 for Vietnam, and 2016 for Laos and Myanmar. The ASEAN Comprehensive Investment Agreement (ACIA) came into operation in March 2012, incorporating investment liberalisation, facilitation, protection and promotion.<sup>23</sup> A weak feature of the ACIA was the very extensive exclusion lists prescribed.

*ASEAN Integration System of Preferences.* Since January 2002 ASEAN has adopted the ASEAN Integration System of Preferences (AISP) scheme, whereby ASEAN-6 members offer preferential tariffs to CLMV on a voluntary and bilateral basis, without quid pro. CLMV have been unable to benefit fully from AFTA trade liberalisation because of their own delayed schedule of trade liberalisation. The AFTA Council in September 2005 noted with concern the low utilisation rate of AISP and called for ASEAN-6 to further improve the preferences given to CLMV, both in terms of product coverage and AISP rates, and for CLMV to take advantage of the opportunities provided under the scheme.<sup>24</sup>

#### *4.2 Development and technical cooperation*

Development and technical cooperation at the ASEAN and bilateral levels are intended to help CLMV build capabilities and skills to overcome supply constraints as well as facilitate and accelerate the process of economic integration and narrow the development gap.

Provision of technical know-how could aim to facilitate the adoption and implementation of specific policies and include training, workshops, seminars and secondment of experts. Possible areas include help for governments to improve fiscal management to offset revenue loss from elimination of import tariffs; improving the efficiency of trade documentation and customs procedures; assistance with mutual recognition of test reports and certifications; and, assistance with intellectual property rights legislation and enforcement. Targeted financial assistance could include building hardware and software capacity in infrastructure, information and communications technology (ICT) and human resource development. Development cooperation could include sharing experiences on how the more advanced ASEAN countries have planned and implemented their development policies, strategies and programmes, so that CLMV can draw lessons and best practices to apply to their own situations.

#### *4.3 Improving CLMV negotiating leverage*

The CLMV countries are small- and medium-sized developing and least developed economies without much economic clout regionally or globally. However, as members of ASEAN, CLMV are better able to attract FDI and technology transfer, negotiate market access and seek official development assistance (ODA). ASEAN has also sponsored CLMV membership of the WTO and Asia-Pacific Economic Cooperation (APEC).



CLMV have participated in several ASEAN+1 economic partnership agreements and been accorded SDT and flexibility. However, they have not entered into any bilateral FTAs with major Dialogue Partners, except for Japan-Vietnam, unlike several of the ASEAN-6 members.

*ASEAN-China agreement.* SDT is conferred under the ASEAN-China Free Trade Agreement on the basis of two categories — China and ASEAN-6, and CLMV. The agreement recognises different stages of development and aims to ‘... facilitate the more effective economic integration of the newer ASEAN member states and bridge the development gap among the Parties’.<sup>25</sup>

*Japan-ASEAN agreement.* In addition to the ASEAN-wide agreement, Japan also has bilateral agreements with ASEAN-6 and Vietnam. The Japan-ASEAN agreement recognises the different stages of economic development among the ASEAN members and the gap between Japan and ASEAN as well as the need to facilitate the increasing participation of new members into the Japan-ASEAN Partnership.

*Regional Comprehensive Economic Partnership.* The Regional Comprehensive Economic Partnership (RCEP) is currently under negotiation among 16 countries, including those in ASEAN. Among the RCEP negotiating principles are:

Taking into consideration the different levels of development of the participating countries, the RCEP will include appropriate forms of flexibility including provision for special and differential treatment, plus additional flexibility to the least-developed ASEAN Member States, consistent with the existing ASEAN+1 FTAs, as applicable.<sup>26</sup>

In this regard, the ASEAN-centric RCEP is different from the ongoing Trans-Pacific Partnership negotiations between 12 Pacific countries (including Singapore, Brunei Darussalam, Malaysia and Vietnam), which have no provisions for SDT.

#### *4.4 Initiative for ASEAN Integration*

The IAI, launched in 2000, is one of the two initiatives in the AEC Blueprint aimed at implementing Pillar III on Equitable Economic Development.

The first IAI Work Plan (2002–2007) had priorities addressing infrastructure (transport and energy), human resource development (public sector capacity building, labour and employment, and higher education), ICT and capacity building for regional economic integration. Contributions from ASEAN-6 take various forms, including training, provision of technical experts and supply of equipment. These funds are limited when compared to the needs of CLMV and their total receipts of ODA. ASEAN-6 have also sought to leverage their IAI activities through cooperation with Dialogue and Development Partners and with the Greater Mekong Subregion (GMS) scheme.

The second IAI Work Plan (2009–2015) is based on key programme areas in the ASEAN Community Blueprints. The AEC Blueprint notes that the IAI ‘... gives the direction and sharpens the focus of collective efforts to narrow the development gap not only within ASEAN but between ASEAN and other parts of the world as well.’<sup>27</sup> The coverage of the IAI has been extended to include infrastructure, human resource development, ICT, capacity building for regional economic integration, energy, investment climate, tourism, poverty reduction and improvements in the quality of life.

#### *4.5 Small and medium-sized enterprise development programme*

Actions on SME development include: (i) timely implementation of the ASEAN Policy Blueprint for SME Development (APBSD) 2004–2014; (ii) promoting networking of SMEs and their participation in the building of regional production and distribution networks; and, (iii) promoting best practices in SME development, including SME financing. According to the AEC Blueprint, the APBSD 2004–2014 comprises strategic work programmes, policy measures and indicative outputs.

#### *4.6 ASEAN Development Fund*

The ADF was established in July 2004 to serve as ASEAN's common pool of financial resources to support the implementation of the VAP. The ADF is funded by initial equal contributions of USD 1 million each by ASEAN member countries. Further, ASEAN countries are encouraged to make additional voluntary contributions of any amount, and the ADF is also open to contributions from other public and private sources.

The ADF is to be used for the following purposes, and is not particularly targeted at narrowing the development gap:

- To leverage funding of regional cooperation programmes and projects from Dialogue Partners and other external donors. When used for counterpart funding, the amount should not exceed 20 per cent of the total funding raised regardless of whether the co-funding source is an ASEAN country or external donor.
- To provide seed funding for initial activities of large-scale projects requiring major financial support from a Dialogue Partner or donor institution.
- To provide full funding support for small and short-term projects of a confidential or strategic nature.

#### *4.7 Improving ASEAN connectivity*

ASEAN countries show wide variations in the development of physical infrastructure. CLMV have poor infrastructure in areas such as transportation, ICT, electricity and water resources, which affect their economic competitiveness and living standards, and therefore contribute to the ASEAN development gap.

The AEC Blueprint lists infrastructure development under Pillar II on Competitive Economic Region although infrastructure development is also important for narrowing the ASEAN development gap. The Blueprint notes that regional efforts have been made to enhance transport facilitation and logistics services, promote multimodal transport

infrastructure linkages and connectivity, facilitate transport and tourism integration, and further liberalise the air and maritime transport sectors.

Key initiatives include:

- The ASEAN Transport Action Plan (ATAP) 2005–2010, which covers maritime, land and air transport, and transport facilitation.
- On land transport, priority is given to the completion of the Singapore-Kunming Rail Link and the ASEAN Highway Network.
- On maritime and air transport, the adoption of general principles and framework for an ASEAN Single Shipping Market and the development and implementation of the ASEAN Single Aviation Market are advocated.
- On ICT, efforts have been made to facilitate interconnectivity and technical interoperability among ICT systems, leveraging on existing national networks and evolving these into a regional information infrastructure.
- On energy cooperation, the secure and reliable supply of energy, including biofuel, is envisaged. Regional collaboration in the Trans-ASEAN Gas Pipeline and the ASEAN Power Grid projects allows the optimisation of ASEAN's energy resources for greater security and provides opportunities for the private sector in investment.

*Master Plan on ASEAN Connectivity.*<sup>28</sup> The Master Plan on ASEAN Connectivity (MPAC) was adopted by ASEAN in October 2010 to improve interconnectivity in order to reduce the development gap as well as facilitate production and distribution networks to improve regional competitiveness. Seven key strategies establish seamless regional connectivity through a multimodal transport system, enhanced ICT infrastructure and a regional energy security framework. Huge investments will be required, with estimates of USD 60 billion over the next decade. Other challenges facing MPAC implementation include integrating national, subregional and regional programmes, and conducting environmental and social impact studies.

The huge infrastructure financing needs led to the establishment of the ASEAN Infrastructure Fund (AIF), with an initial equity contribution of about USD 485 million, of which USD 335 million would be provided by nine ASEAN members (excluding Myanmar) and USD 150 million would come from the Asian Development Bank (ADB).<sup>29</sup> With projected 70 per cent co-financing by the ADB, the AIF plans to leverage more than USD 13 billion in infrastructure financing by 2020. The AIF had readied USD 1 billion to begin operations for lending projects by the latter part of 2013 in support of priority projects outlined by the MPAC.

*Improved physical connectivity under the Greater Mekong Subregion programme*<sup>30</sup>. The GMS programme was initiated by the ADB in 1992 to promote integrated development among the riparian states of the Mekong River (namely CLMV, Thailand and Yunnan province in China; later, the Guangxi province joined in 2004). The main thrust is to improve transport infrastructure to promote sub-regional trade and production networking. Four key transport corridors have been identified, but progress has been uneven. The North-South corridor from Kunming to Bangkok is the most dynamic. Progress on the East-West corridor, Southern corridor, and Northern corridor has been slower. More recently, with the upgrading of roads, these corridors have started to become a force for sub-regional development. More substantial benefits lie in improving trade facilitation, such as improving customs procedures, enhancing technical skills and improving the regulatory environment.

## **5. Way Forward to Further Narrow the Development Gap**

In this chapter, the analysis on the way forward to further narrow the ASEAN development gap is divided into two prongs: (i) transfers of development experiences and resources to CLMV; and (ii) regulatory and policy efforts by CLMV themselves to improve their economic competitiveness and performance. The two prongs overlap, as the latter requires assistance from the former to achieve the competitiveness objective.

### *5.1 Further, accelerated CLMV regulatory and policy reforms to improve competitiveness and integration into production networks and supply chains*

This is the crux of our recommendations: any sustainable narrowing of the ASEAN development gap will have to come from catch-up growth in CLMV themselves rather than being primarily dependent on intra-ASEAN resource transfers, although such intra-ASEAN transfers, in partnership with extra-ASEAN sources, are essential to buttress regulatory and policy reforms and capacity building at the national level.

The growth potential of CLMV is huge, given their abundant natural resources, young and growing population, strategic positioning between China and India, and the advantages they enjoy as latecomers to development (which enables them to learn from the early comers and leapfrog technology). However, the GCI and Ease of Doing Business Index outlined earlier point to CLMV weaknesses. Some of the areas requiring further and accelerated regulatory and policy reforms are highlighted below:

*Improving governance and institutional quality.* Governance includes political, economic and financial stability, bureaucratic efficiency and probity, and rule of law (in sectors such as intellectual property rights protection, contract enforcement and control of corruption). Governance and institutional quality interact with other factors to impact on overall economic performance and therefore the development gap.

*Improving trade performance and investment climate.* International trade enables a country's specialisation according to comparative advantage, exploits scale economies, allows transfer of technology and know-how, and engenders the competitive spirit in local businesses. To improve their trade performance, CLMV should lower their WTO tariffs as much as possible and reduce the non-tariff barriers that contribute to high

trade costs. These would include customs procedures, transportation connectivity and logistics. ASEAN and its Development Partners as well as the WTO's Aid-for-Trade programme could provide aid resources to help achieve these objectives.

The benefits from trade liberalisation would be considerably larger if accompanied by investment liberalisation reforms. ASEAN already receives substantial inflows of FDI, but most of these are directed at ASEAN-6. While FDI is attracted to CLMV's abundant natural resources and infrastructure development potential, there is limited market-seeking FDI, as these countries have limited domestic markets and production for the sizeable ASEAN market would tend to gravitate toward ASEAN countries with better investment climates.

FDI in natural resources may not have deep linkages and employment effects and could contribute to the Dutch disease of overvalued currencies. For sustainable growth, CLMV need to pursue industrial policies targeted at global markets. For this, CLMV should improve their investment climate to be part of regional production networks and global supply chains, and take advantage of the ongoing relocation of labour-intensive industries out of China and the more advanced ASEAN countries. CLMV should also take advantage of the special market access provided under WTO's preferential access for least developed countries and the generalised system of preferences provided by advanced industrial countries. To benefit from these preferences, CLMV would need to address their supply constraints.

*Improving supply capabilities and competitiveness through human resource development, physical infrastructure and spatial connectivity.* Abundance of low wage labour does not ensure sustainable competitiveness. CLMV have low labour productivity due to poor education and training of their workforce and limited physical capital per worker. Expansion and upgrading of educational and vocational institutions and qualifications can be facilitated by development cooperation programmes in ASEAN and the ASEAN+1 partnership agreements as well as through aid from other external sources.

Physical infrastructure covers not only transport and ICT for connectivity but also energy availability and economic corridors, special economic zones and industrial parks. Special economic zones and industrial parks to exploit the economies of agglomeration and industry clusters in ASEAN-6 and elsewhere in China, South Korea and Taiwan have facilitated and accelerated industrialisation. Under the GMS scheme, the transportation and border facilitation landscape in CLMV has been transformed. However, much more remains to be done. On financing of these infrastructure projects, the MPAC should work closely with the GMS programme to maximise financial resources, avoid duplications and plug gaps, and exploit synergies. Hopefully, the AIF will lead to an acceleration of infrastructure development in the region. Initiated in 2010, the AIF targets an initial capital of USD 800 million, with contributions from ASEAN members and China, Japan and South Korea. ASEAN could also tap external sources for infrastructure financing. Bilateral assistance could facilitate the development of special economic zones and industrial parks, such as that between Singapore and Vietnam.

### *5.2 Resource transfers to CLMV (including on development experiences)*

*Learning from ASEAN-6 experiences.* The ASEAN region encompasses some of the most successful economies in recent decades. As latecomers, CLMV could usefully learn from the experiences of ASEAN-6 countries on economic development and economic management — lessons of success as well as those of failure in policy formulation and implementation. For example:

- In trade liberalisation, liberalisation policies should be accompanied by capacity building of import-competing sectors and facilitating structural adjustments by SMEs and farmers.
- In investment liberalisation, promotion of inward FDI and accompanying inward movement of intra-corporate personnel should have parallel measures in place to develop local SMEs and local skilled labour.



- Several ASEAN-6 countries have successfully provided the labour force for industrialisation with education and training, focusing on vocational and technical education and tertiary science, engineering and management education.
- Several ASEAN-6 countries have also successfully integrated into regional production networks and global supply chains and the CLMV countries could usefully learn what the requirements for such entries are, including developing local suppliers to complement foreign multinationals.
- CLMV could also learn lessons on governance institutions and on how to avoid widespread corruption in the public services as well as rent-seeking activities by the private sector.

*Improving access to external financial-technical resources.* The issue of resource transfers from the more developed members of ASEAN to those less developed has been widely debated and comparisons have been made with the EU provision of structural and cohesion funds as a redistributive mechanism. Chia noted the huge differences between the EU and AEC integration models, particularly in terms of the depth of integration and supra-nationality provisions.<sup>31</sup> Langhammer also noted the limited transferability of EU institutions, such as the structural and convergence funds, to economic integration groupings that are less deeply integrated than the EU.<sup>32</sup> Nonetheless, the Asian Development Bank Institute's ASEAN 2030 study proposes an ASEAN Convergence Fund through voluntary contributions to bridge the development divide.<sup>33</sup> It argues that the convergence fund could be structured on the existing ADF, with administration left to professionals and the ASEAN Secretariat helping to coordinate the diverse development projects and programmes. Menon though argues to the contrary, suggesting that the proposed ASEAN Convergence Fund may help, but is unlikely to make a significant or lasting difference.<sup>34</sup> One reason is that, unlike in Europe, the higher-income members of ASEAN, from whom most of the funds would presumably have to come, are either very small (Singapore and Brunei Darussalam) or relatively small (Malaysia). However, it bears noting that Singapore accounted for 73 per cent of the ODA from ASEAN-6 to CLMV as of September 2012.<sup>35</sup>

In sum, in view of the different depths of economic integration required for the EU and AEC models, and the fact that the ASEAN high-income countries are very small (Singapore and Brunei Darussalam) while the low-income countries are very large (CLMV, Indonesia and the Philippines), an EU-style structural or cohesion fund for ASEAN would not be feasible politically and financially. For this reason, CLMV will have to continue to depend substantially on financial and technical assistance from extra-ASEAN sources, or on co-funding activities between ASEAN and multilateral organisations and ASEAN's Dialogue and Development Partners.

That said, the higher-income ASEAN countries could increase their provisions of financial and technical assistance to CLMV — either individually or collectively — without a binding agreement (as with the EU structural and cohesion funds), for instance, by higher voluntary contributions to the ADF. Furthermore, while access to public sector funds may be constrained for the ASEAN-6 countries, they should encourage their private sectors to invest in business projects in CLMV. The governments of ASEAN-6 could provide investment facilitation measures, such as information on the investment climates in CLMV and specific investment opportunities, tax incentives for such investments, and even public-private sector partnerships in infrastructure projects. These investments would be more efficient and sustainable in a market-oriented economy than aid projects, with the latter being reserved solely for 'public good' projects.

## **6. Conclusion**

CLMV have achieved remarkable results in transforming and restructuring their economies, policies and institutions since the 1980s. They have become increasingly integrated with ASEAN and the world, as witnessed by rising trade and investment flows and increased participation in production networks and supply chains. Economic success, for CLMV, has depended crucially on undertaking the necessary unilateral domestic reforms, even as membership of ASEAN and WTO accession has helped

to ensure that they continue to reform and restructure their economies and improve capacity building to remain globally and regionally competitive.

CLMV have abundant natural resources, a young and growing population and labour force, and a strategic location, with China to the north, India to the west and the ASEAN-6 countries to the south. If they persist with their regulatory and policy reforms and get their policies and institutions right as well as receive adequate financial and technical external assistance, CLMV will grow faster than ASEAN-6 and catch up with the middle-income ASEAN countries in good time.

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- 3 After the decision at the 1976 Bali Summit.
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## Chapter Three

# Local-Central Dynamics and Limitations of Micro-Regionalism: Understanding West Kalimantan and Sarawak Cross-Border Cooperation

*Mochammad Faisal Karim<sup>1</sup>*

*Despite increased study of Southeast Asian regionalism, micro-regionalism in Southeast Asia remains comparatively less researched. With the emergence of decentralised states in the region, opportunities have opened up for sub-national authorities to play significant roles in the regional integration process, thereby affecting these processes in ways that cannot be underestimated. Taking cross-border cooperation between Indonesia's West Kalimantan and Malaysia's Sarawak as case study, this chapter seeks to examine how the dynamics of relations between local and central governments affect the deepening of cross-border cooperation between sub-national authorities, which is the foundation for emergent micro-regionalism.*

*Based largely on interviews from field research in West Kalimantan and Sarawak, this study finds that despite the increased involvement of business actors, existence of cross-border cooperation mechanisms and decentralisation, the emergence of micro-regionalism remains limited between West Kalimantan and Sarawak. Two inter-related inhibiting factors arising from local-central dynamics that hinder further cross-border cooperation between West Kalimantan and Sarawak were identified: (i) defective decentralisation caused by the absence of legal framework, lack of coordination between sub-national and central government institutions, and the limited authority given by the central government to the sub-national government, limiting the scope for West Kalimantan to conduct cross-border cooperation with Sarawak; and, (ii) the citing of the sovereignty issue by local elites to attract the attention of the central government to development issues in the border areas, which has caused unintentional deterioration of the relations between West Kalimantan and Sarawak.*

*Keywords: Cross-border cooperation, decentralization, local-central dynamics, micro-regionalism, subnational authorities*

## **1. Introduction**

The deepening and widening of the regional integration currently taking place in Southeast Asia has drawn many international relations scholars to the study of the processes of Southeast Asian regionalism. However, despite a growing body of literature on the subject<sup>2</sup>, there remains a scarcity of studies on micro-regionalism in Southeast Asia. The mainstream literature largely focuses on macro-regionalism processes<sup>3</sup>, wherein the accent is firmly on the central state as the sole significant actor in the regional integration process while neglecting the role of sub-national governments.

The emergence of decentralised states in Southeast Asia has opened up opportunities for sub-national actors to play significant roles in the regional integration process<sup>4</sup>, so that these actors and their effects on regional integration can no longer be underestimated. Study of Southeast Asian regionalism has mainly focused on economic factors, institutional capacity and connectivity as determinants for the success of regional integration.<sup>5</sup> Most of the literature, however, has failed to capture the domestic political basis for the sustainability of such arrangements.

This chapter seeks to make a contribution toward closing this gap by examining how the dynamic interaction between the local and central governments affects the progress of regional integration between two adjacent sub-national governments in the border areas. In order to further examine the matter, cross-border cooperation between Indonesia's West Kalimantan and Malaysia's Sarawak was adopted as case study.

A study of West Kalimantan and Sarawak cross-border cooperation was warranted for two reasons. First, cross-border cooperation between West Kalimantan and Sarawak is comparatively less studied in the literature on Southeast Asian regionalism despite its potential for providing insightful understanding of the manner in which the dynamic interaction between local and central governments affects the outcome of micro-regional integration processes. Second, understanding the pattern of micro-regional integration in the border areas may shed light on how to



address the pervasive and increased inequality that has become evident in Southeast Asia during the last two decades. The border regions in Southeast Asian countries are likely to have unequal levels of economic development due to disparities in the states' economic development as well as the tendency of central governments to neglect development in the peripheral regions. Given this, cross-border cooperation between West Kalimantan and Sarawak was likely to provide a broader understanding of how micro-regionalism could prove to be an alternative development model capable of addressing the inequality problem in the border areas of Southeast Asia.

Theoretically speaking, increased involvement of business actors in cross-border economic activity between two adjacent regions is the primary mover for the emergence of micro-regional cooperation in the border areas. Equally importantly, the existence of cross-border cooperation mechanisms between sub-national actors, coupled with the presence of sub-regional institutional mechanisms as a top-down initiative from central governments, can foster deeper cross-border cooperation through the creation of more coordinated policies among sub-national authorities across countries. Additionally, the decentralisation process experienced at the sub-national level may deepen micro-regionalism in the border areas by increasing the role of local governments in managing cross-border cooperation with their counterparts.

In the case of West Kalimantan and Sarawak, cross-border cooperation between the two contiguous regions has developed further through the increased involvement of business actors and with flourishing cross-border cooperation mechanisms. The deepening of cross-border cooperation is evident in terms of increased activity in the areas of cross-border trade, mobility and connectivity between the two regions.<sup>6</sup> However, notwithstanding these developments in cross-border cooperation, the emergence of micro-regionalism between West Kalimantan and Sarawak remains limited.

Two inter-related inhibiting factors, arising from local-central dynamics, that hinder the emergence of micro-regionalism between

West Kalimantan and Sarawak were identified, namely: (i) defective decentralisation, which hinders more coordinated development in the border areas; and, (ii) the invoking of sovereignty by local elites in their interactions with the central government.

Defective decentralisation is caused by the absence of a legal framework, the lack of coordination between local and central government institutions, and the limited authority given by the central government to provincial ones. In other words, defective decentralisation limits the extent of cross-border cooperation between West Kalimantan and Sarawak. Similarly, local governments use the sovereignty issue strategically to draw the central government's attention to development issues in the border areas. However, as an unintended consequence of such actions, relations between West Kalimantan and Sarawak have deteriorated. This chapter puts forth that the intertwining of the above two factors has limited the emergence of micro-regionalism in the border areas of West Kalimantan and Sarawak.

This chapter is divided into four main sections. The first section defines the concept of micro-regionalism and surveys existing explanations. The second and third sections analyse the evolution of cross-border cooperation between West Kalimantan and Sarawak and its limitations. Finally, the last section provides recommendations on the future course of micro-regionalism between West Kalimantan and Sarawak.

## **2. Cross-Border Cooperation and Micro-Regionalism**

### *2.1 Defining micro-regionalism*

In the broader sense, regionalism can be understood as 'structures, processes, and arrangements that are working toward greater coherence within a specific international region in terms of economic, political, security, socio-cultural and other kinds of linkages'<sup>7</sup>. As there is no definition of what a region is, the study of regionalism ranges in focus from broader phenomena, such as Asia-Pacific Economic Cooperation (APEC), to very specific phenomenon, such as cross-border cooperation

between cities with contiguous borders. It also includes the study of interactions between societies and local firms as well as that between states and regional institutions.

When discussing regionalism, there are three concepts that need to be defined carefully, namely regionalism, sub-regionalism and micro-regionalism (Table 4.1). Despite attempts to differentiate between the three concepts<sup>8</sup>, however, in practical use as well as academic discussion, there is no clear distinction between sub-regionalism and micro-regionalism. For instance, the ASEAN growth polygon may be termed as sub-regional cooperation in some studies<sup>9</sup> but cited as micro-regional cooperation in others.<sup>10</sup>

*Table 4.1: Types of regional integration.*

Type of regional integration	Scope of cooperation	State actors involved
Regionalism	State level	Central government driven
Sub-regionalism	Sub-national level	Central government driven
Micro-regionalism	Sub-national level	Sub-national authority driven

For the purpose of the present study, the scope of cooperation as well as the actors involved in the process were combined and the term ‘micro-regional’ was defined as a combination of two or more territorial elements that are adjacent but ‘below the national level’ and ‘across national borders’. Or, in other words, micro-regionalism is basically an integration process that occurs through cross-border cooperation in the border areas while sub-regionalism refers to broader regional integration covering more than three countries without having to directly share a border. Another distinction between sub-regionalism and micro-regionalism is with regard to the primary actors that are involved in the process of regionalism. While state actors in sub-regionalism are primarily central governments, the state actors in micro-regionalism are sub-national authorities. Or, micro-regionalism is, in essence, an integration process occurring through cross-border cooperation in the border areas that is driven by sub-national authorities.

## *2.2 Factors driving the emergence of micro-regionalism*

What are the factors that foster the emergence of micro-regionalism in border areas? Two sets of explanations have been suggested as a basis for micro-regionalism — socioeconomic and institutional. The socioeconomic explanation focuses on aspects of micro-regionalisation where non-state actors are the primary actors of cross-border cooperation while the institutional explanation emphasises micro-regionalism where cross-border cooperation is characterised by inter-state governmental cooperation.

The socioeconomic explanation argues that micro-regionalism emerges due to geographical proximity, as it provides economies of scale in the border regions<sup>11</sup> — geographical proximity reduces transportation costs, transaction costs and information costs. Furthermore, micro-regionalism in border areas grows where there are advantages on account of economic complementarity among the countries involved — especially where there exist differences in the availability of factors of production among the participating countries — and it helps to close gaps in their levels of development.

Economic complementarity is important for micro-regional cooperation, as local regions frequently cannot rely on the national economy to develop their own economies on account of factorial constraints, such as those associated with capital, technology, human resource and geographical location. Under these circumstances, micro-regional cooperation serves to bridge the gaps on factors of production between the contiguous local regions.<sup>12</sup>

In his study on micro-regionalism in East Asia, Sasuga suggested that micro-regionalism emerges from the pressures exerted by non-state actors to fulfil their need for international division of labour, international commodity chains and cross-border production networks, which arise due to differences in the development trajectories of two contiguous regions.<sup>13</sup> This disparity in the development trajectory leads to differences

in the modes of economic production in these regions, creating a condition where economic complementarity is born between them. Or, the increased involvement of business actors, by deepening economic activity between two contiguous regions, becomes an important factor that fosters micro-regionalism.

While the socioeconomic explanation revolves around the private sector as a primary mover of micro-regionalism, the institutional explanation spotlights the role of institutions in the emergence of micro-regionalism. Most of the literature on institutional drivers focuses on the role of political institutions and the political process in shaping micro-regional activity in the border regions.<sup>14</sup> There are several factors that are of particular concern for students of regionalism, namely the effect of decentralisation on encouraging the greater involvement of sub-national governments in cross-border cooperation and the existence of an institutional mechanism for cross-border cooperation at sub-national levels.

The literature on European regionalism suggests that the increasing role of sub-national authorities in managing cross-border cooperation cannot be separated from the decentralisation process happening in most European Union (EU) member countries.<sup>15</sup> In the early 1990s, most EU member countries made serious efforts to decentralise power from the central government to local and regional authorities.<sup>16</sup> This process provided local and regional authorities a greater range of options when dealing with cross-border cooperation with neighbouring countries under the framework of the European Community. Eventually, the process of regional integration in Europe was not only a central government issue but one that also involved local governments.<sup>17</sup>

In the case of China, decentralisation that provides more authority to the provincial government is arguably one of the factors boosting micro-regional cooperation. Decentralisation in the country, where provincial governments are allowed to define new economic strategies, has been a major determinant of China's process of re-engagement with the global economy.<sup>18</sup> For instance, the Chinese province of Yunnan boosted economic relations with five of its neighbouring ASEAN countries,

eventually offering a favourable environment for the expansion of trade and investment.<sup>19</sup> Due to decentralisation, the province also plays a direct role as a representative of China in the Greater Mekong Subregion (GMS) mechanism. In fact, the Yunnan province has become the main implementer of several GMS regional projects.<sup>20</sup>

In Japan, due to overconcentration in Tokyo and other metropolises (such as Osaka), the central government in Tokyo has sought to revitalise peripheral regions (such as the Fukuoka and Okinawa prefectures) in order to stimulate economic growth. In Fukuoka, the central government gave the local government greater freedom to pursue micro-regional activities in the Pan-Yellow Sea Economic Zone area.<sup>21</sup> In Okinawa, the local political and economic elites have tried to revitalise the local economy by developing cross-border economic links with Taiwan and Shanghai.<sup>22</sup> These initiatives have resulted in greater investment and inter-trade activity in the region.<sup>23</sup>

The experiences of Europe, China and Japan show that a greater role for sub-national actors in managing cross-border cooperation with neighbouring countries stimulates cross-border cooperation in the border areas.

Aside from decentralisation, institutional mechanisms of cross-border cooperation are also important for fostering micro-regionalism. These mechanisms can be divided into two levels. The first level includes institutional mechanisms that are promoted by the central government to foster cross-border cooperation (or, central government-driven mechanisms). The second level consists of institutional mechanisms that allow sub-national actors to engage with their sub-national counterparts and thus foster cross-border cooperation (sub-national government-driven mechanisms). The former is much more prevalent in the regionalism of East Asia while the latter is seen more in the regionalism of Europe and Latin America.

Instances of central government-driven institutional mechanisms for micro-regionalism (commonly referred to as sub-regionalism) can be

found in the so-called growth polygon that has become a defining feature of Southeast Asia's regionalism, such as the Indonesia-Malaysia-Singapore Growth Triangle (IMS-GT), the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT), the Brunei Darussalam-Indonesia-Malaysia-the Philippines East ASEAN Growth Area (BIMP-EAGA), and the GMS. Motivation for the central governments to create such institutional mechanisms stems from their eagerness to achieve synergetic development outcomes in cross-border cooperation at the sub-national levels by coordinating development policies among the various central governments involved.<sup>24</sup>

In the case of European regionalism, examples of sub-national government-driven institutional mechanisms include the Association of European Border Regions (AEBR) and the Committee of the Regions (CoR).<sup>25</sup> While the AEBR is an institutional arrangement for local and regional authorities in Europe to promote common interests across borders and cooperate for the common good of the border populations, the CoR is an assembly of local and regional representatives that provides sub-national authorities with a direct voice within the EU institutional framework. Both are institutional mechanisms for the local authorities to play a greater role in the European regional integration process.<sup>26</sup>

Given the above, many scholars of regionalism argue that the emergence of sub-national institutional mechanisms for cross-border cooperation can be viewed as a trend in regional integration, where sub-national governments play an important role. In Southeast Asia, sub-national institutional mechanisms for cross-border cooperation may not be as clearly developed as in Europe. However, in the case of cross-border cooperation between West Kalimantan and Sarawak, sub-national governments in both border regions have an existing mechanism for dialogue between local elites, namely the Malindo Socio-Economic Cooperation between West Kalimantan and Sarawak, known as KK/ JK Sosek Malindo West Kalimantan and Sarawak (*Kelompok Kerja/ Jawatan Kerja Sosial Ekonomi Malaysia-Indonesia Kalimantan Barat dan Sarawak*; or, Sosek Malindo Forum hereafter). Through this mechanism,

local elites at sub-national levels enjoy the space in which negotiation and dialogue can take place.

### **3. West Kalimantan-Sarawak Cross-Border Cooperation**

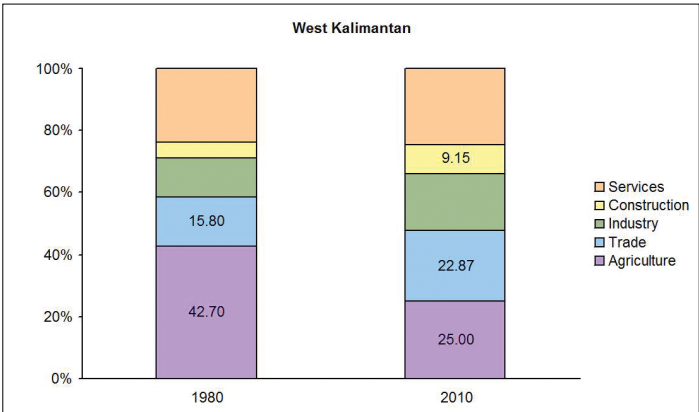
West Kalimantan and East Kalimantan are two provinces that are directly adjacent to East Malaysia along a border around 1,782-km long.<sup>28</sup> While the border of East Kalimantan and Sabah is separated by mountains that create a natural barrier, the border area between West Kalimantan and Sarawak is only separated by latitude coordinates of the earth since it is geographically lowland.<sup>29</sup> As a result, traditionally, the border region of West Kalimantan and Sarawak has long been occupied by natives who have kinship that span both sides of the border.<sup>30</sup> Along the 966-km borderline between West Kalimantan and Sarawak, 50 paths connect 55 villages in West Kalimantan with 32 villages in Sarawak.<sup>31</sup> Currently, 16 villages in West Kalimantan and 10 villages in Sarawak have been agreed upon as inter-state border crossing points (Pos Lintas Batas; PLB) and, in these villages, 16 cross-border posts (PLB) are being used as points of entry and exit between the border regions of West Kalimantan and Sarawak.<sup>32</sup> In 1991, PLB Entikong in West Kalimantan and Tebedu in Sarawak were upgraded into the cross-border check point (Pos Pemeriksaan Lintas Batas; PPLB) Entikong-Tebedu, which is equipped with Custom, Immigration, Quarantine, and Security (CIQS) facilities, to mark the formal cross-border movement of people and goods in the border region of West Kalimantan and Sarawak.<sup>33</sup>

#### *3.1 The development gap between West Kalimantan and Sarawak and attendant economic complementarity*

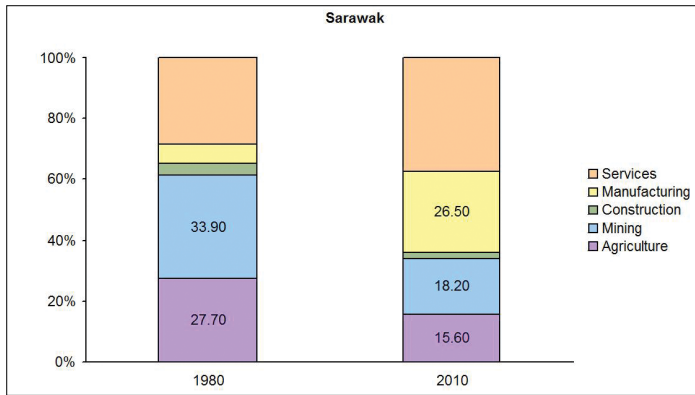
Despite being geographically and culturally connected, cross-border cooperation between West Kalimantan and Sarawak was not significantly fostered until the early 1990s.<sup>34</sup> It was the increasing development gap between the two regions that significantly boosted cross-border cooperation in the region, with the private sectors exploiting each other's markets and infrastructure.<sup>35</sup>



For over four decades, Sarawak has grown from a very poor state within the Federation of Malaysia to become one of its main industrialised states.<sup>36</sup> With its increasing economic wealth, Sarawak is one of the strongest economies relying on manufacturing and services, and the only state in Malaysia to receive an A-rating from Standard & Poors Ratings Services (S&P).<sup>37</sup> Unlike West Kalimantan, Sarawak is able to heavily exploit its rich natural resources to create a robust manufacturing industry that is based on extractive commodities, such as logging, oil and gas, mining, rubber, palm oil and pepper production.<sup>38</sup> While in 1980, Sarawak’s economy was heavily dominated by the agricultural sector (27.7 per cent share of real gross domestic product [GDP]) and mining (33.9 per cent share of real GDP), in 2010, the manufacturing and services sectors dominated Sarawak’s economy, with a 26.5 per cent and 37.4 per cent share of real GDP, respectively (Figure 4.1). During the same period, the West Kalimantan province was heavily dominated by agriculture and trade in 1980, with 42.70 per cent and 15.80 per cent share of real GDP, respectively. In 2010, agriculture and trade continued to dominate West Kalimantan’s economy, with 25.00 per cent and 22.87 per cent share of real GDP, respectively.



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**Figure 4.1: Percentage share of real gross domestic product of (a) West Kalimantan and (b) Sarawak, 1980 versus 2010.**

Source: Kalimantan Barat Dalam Angka 2012', Badan Pusat Statistik Provinsi Kalimantan Barat, accessed 15 June 2013, <http://kalbar.bps.go.id/flippingbook/kalbar%20da%202012%20y/>; State Planning Unit, Chief Minister's Department, 'Sarawak's development plans' (presented at the Workshop on Malaysia's REDD+ Readiness Project: Component 1 Institutional Framework for Sarawak on 2 August 2012), accessed 15 July 2013, [http://inet01.undp.org.my/files/editor\\_files/files/REDD+special%20page/Development%20Briefing%20to%20REDD%20Workshop.pdf](http://inet01.undp.org.my/files/editor_files/files/REDD+special%20page/Development%20Briefing%20to%20REDD%20Workshop.pdf), 4.

This difference in their development trajectories has made the development gap between the two adjacent regions more apparent. In 2012, Sarawak was becoming increasingly wealthy, with GDP per capita around RM 39,874 (USD 12,019)<sup>39</sup>, while West Kalimantan remained poor, with a GDP per capita of around IDR 16,400,000 (USD 1,349).<sup>40</sup> In terms of infrastructure too, Sarawak surpassed West Kalimantan in the construction of road infrastructure (Figure 4.2). Where, in 1963, there were only 1,800 km of sub-standard roads, Sarawak's road network has expanded by nearly 50 times to over 30,000 km today.<sup>41</sup> This road network has connected not only cities and coastal villages but also the remote interiors of Sarawak that border with West Kalimantan. In

contrast, the West Kalimantan government has only maintained around 15,289 km of road networks, with around 3,227 km (or, 21.1 per cent) of road connecting the interiors of West Kalimantan with major cities.<sup>42</sup>



*Figure 4.2: Infrastructure gap between (a) West Kalimantan and (b) Sarawak in the border areas.*

The development gap between West Kalimantan and Sarawak is increasingly evident with the Sarawak Corridor of Renewable Energy (known as SCORE) plan, which was launched by the government of Sarawak in 2008 (Figure 4.3). SCORE, a most ambitious regional development strategy, aims to develop the central part of Sarawak — with five areas, namely Mukah, Tanjung Manis, Samalaju, Baram and

Tunoh, earmarked for development — into an industrial area. Mukah will be developed as a ‘smart city’ that will serve as the main hub of the Sarawak Corridor. Tanjung Manis is to be developed into a port city with industrial areas.<sup>43</sup> Meanwhile, Samalaju will become a heavy industry centre, and Baram and Tunoh will focus on tourism and resource-based industries.<sup>44</sup> These five new growth centres are expected to trigger the development of the entire Sarawak state.

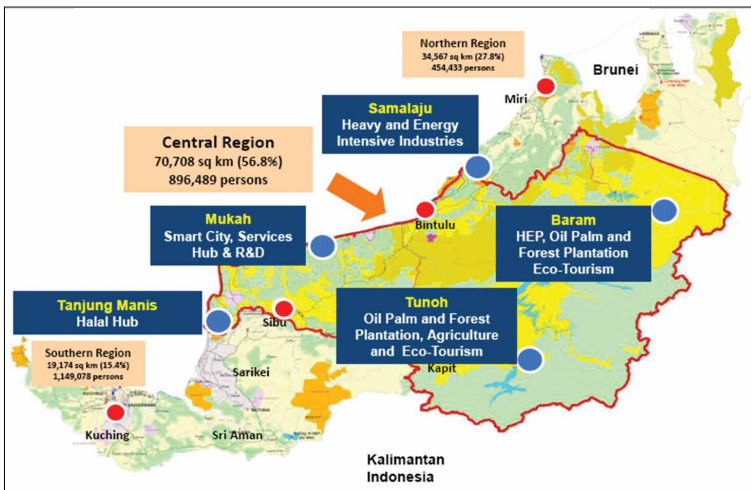


Figure 4.3: Sarawak Corridor of Renewable Energy (SCORE).

Source: Sarawak Corridor of Renewable Energy, ‘SCORE Areas’, accessed 3 August 2015, <http://www.recoda.com.my/invest-in-score/score-areas/>

The development gap between West Kalimantan and Sarawak is caused by the difference in approaches being adopted to deal with the border areas of West Kalimantan and Sarawak. In West Kalimantan, for decades, the development of border areas did not receive adequate attention from the central government on account of the security approach adopted by it for managing cross-border cooperation between West Kalimantan and Sarawak.<sup>45</sup> The security approach of the central government was reflected in its development policy as well, with Kalimantan being kept underdeveloped as a buffer zone between Indonesia and Malaysia. In contrast, in Sarawak, the Malaysian government was more focused on the welfare of people in the border areas and therefore developed

infrastructure actively in the region.<sup>46</sup> It is not surprising therefore that the development of infrastructure and facilities in the border areas of Indonesia were not undertaken with as much alacrity as in the border areas of Malaysia.

The ramifications of this development gap have created deeper cross-border cooperation between the two regions. Due to the lack of proper infrastructure, West Kalimantan was able to accelerate its regional economic growth, particularly in the border regions directly adjacent to Sarawak by using Sarawak's infrastructure. For instance, West Kalimantan, which does not have landline connectivity with any other Indonesian province on the island of Borneo, has a land connection to Sarawak.<sup>47</sup> In other words, West Kalimantan enjoys closer associations with Sarawak when compared to the other Indonesian provinces. In the short and medium terms, cross-border cooperation with Sarawak has offered West Kalimantan accessibility by opening up access to infrastructure, energy and the international seaport owned by Sarawak, so that the border areas in West Kalimantan, in particular, and West Kalimantan, in general, are able to connect to global markets.<sup>48</sup>

Sarawak's infrastructure is vital for the development of palm oil plantations that mainly operate in West Kalimantan's border areas. These plantations — 60 per cent of which are owned by Malaysian companies<sup>49</sup> — are spread over nearly 1 million hectares (ha), with annual production of around 1.3 million tonnes. Despite the increased production, direct exports of palm oil from West Kalimantan are only around 200,000 tonnes, with the rest being exported through ports in other provinces, such as North Sumatra, Jakarta and Riau.<sup>50</sup> This situation is detrimental to West Kalimantan, as it not only loses out on export duty revenue but also creates inefficiencies associated with the export-import process for business actors heavily invested in West Kalimantan. Given this scenario, making use of Sarawak's world-class infrastructure and its international seaport for land cross-border exports makes transportation more efficient and reduces costs for West Kalimantan.

In order to cope with the lack of electricity infrastructure in West Kalimantan, PLN (Perusahaan Listrik Negara), an Indonesian power company, has agreed to purchase electricity from Sarawak Energy Berhad (SEB), a Sarawak-owned investment holding company.<sup>51</sup> SEB will provide electricity to some border areas in West Kalimantan. Currently, a number of areas in West Kalimantan, such as the Sambas and Kapuas Hulu regencies, receive electricity from Malaysia albeit in limited quantities.<sup>52</sup>

In 2013, PLN's West Kalimantan office planned to import more electricity from Syarikat SESCO Berhad (formerly known as Sarawak Electricity Supply Corporation [SESCO]), an SEB-owned electrical company. PLN initiated the electricity import policy to boost the economy in the border region. For West Kalimantan, this arrangement also made economic sense, as electricity imported from Malaysia (at USD 0.10 per kWh) was cheaper than that being produced by diesel power plants operated by PLN (at a cost of USD 0.80 to generate 3 kWh electricity) in the border region.<sup>53</sup>

Even as West Kalimantan exploits Sarawak's infrastructure to boost its economic activity, Sarawak gains access to the former's huge potential as a market for its products. Currently, West Kalimantan accounts for 70 per cent of Sarawak's exports to Indonesia, with annual exports (mostly of consumer goods) to West Kalimantan being valued at around USD 29 million.<sup>54</sup> In addition, due to the dearth of adequate healthcare infrastructure, West Kalimantan is a potential market for healthcare services from Sarawak. It is estimated that roughly 109 rich patients fly to Sarawak daily for treatment.<sup>55</sup> Similarly, due to the lack of tourism infrastructure in West Kalimantan, Sarawak benefits in the tourism sector as well, with the number of tourists from West Kalimantan to Sarawak continuing to grow. In 2011, for instance, of around 415,000 tourists from Indonesia (accounting for nearly 18 per cent of total foreign tourists to Sarawak), 90 per cent entered Sarawak via PPLB Entikong.<sup>56</sup>

As the above discussion shows, the economic complementarity between West Kalimantan and Sarawak, arising mainly due to the development gap between the two regions, is exploited by the greater private sector actors and this interaction has contributed to the deepening of cross-border cooperation between the two regions in the border areas.

### *3.2 Cross-border institutional arrangements between West Kalimantan and Sarawak*

Besides increased involvement from business actors, cross-border cooperation between West Kalimantan and Sarawak is also fostered by the greater cooperation between the local governments of the two regions for developing areas on both sides of the border. Efforts toward greater cooperation between the local governments of West Kalimantan and Sarawak that can be achieved through institutional arrangements began in the mid-1980s.

Given the nature of the region's post-colonial past, informal cross-border cooperation has always existed in the West Kalimantan-Sarawak border regions. For instance, managing the cross-border movement of people living in the border areas was one of the priorities of both governments shortly after the end of the *Konfrontasi*<sup>57</sup> era to reduce tensions between the countries. On 26 May 1967, cross-border cooperation between West Kalimantan and Sarawak was established with the inception of the Basic Arrangement on Border Crossing between Indonesia and Malaysia<sup>58</sup> to formalise cooperation on security arrangements between the two countries in the border region. In 1972, the above agreement was revised to establish the Malaysia-Indonesia General Border Committee (Malindo GBC),<sup>59</sup> which would be responsible for managing all matters regarding the border between Indonesia and Malaysia, be it in the Malacca Straits or in the Borneo islands.

At its inception, cross-border cooperation between West Kalimantan and Sarawak was always motivated by a search for security for both governments, as evidenced by the greater involvement of the military



from both countries, as primary implementers of the Malindo GBC, in the Staff Planning Committee (SPC). However, this motivation was more prevalent in Indonesia than Malaysia, as the Malindo GBC was always led by the TNI (*Tentara Nasional Indonesia*) commander for Indonesia but had a civilian head in control of the committee in Malaysia.<sup>60</sup>

A second revision of the Basic Arrangement on Border Crossing in 1984 gradually widened the scope of cooperation from security issues to include social, cultural and economic matters. The initiative for widening the scope of cooperation was first introduced by the Malaysian Deputy Prime Minister, Dato' Musa Hitam, while calling for greater cooperation in socioeconomic matters in the border areas.<sup>61</sup> As a consequence, in 1985, the Malaysia-Indonesia Social Economic Working Group Meeting (*Kelompok Kerja/Jawatan Kuasa Kerja Sosek Malindo*) between West Kalimantan and Sarawak was established as an organisation within the Malindo GBC. While the Malindo GBC was actually a forum for the central governments on both sides, the West Kalimantan-Sarawak Sosek Malindo meetings served as a forum for sub-national authorities to coordinate on socioeconomic issues in the border regions.<sup>62</sup> The first Sosek Malindo Forum between West Kalimantan and Sarawak was held from 22–23 July 1986 in Pontianak.<sup>63</sup>

Regardless of the fact that the West Kalimantan-Sarawak Sosek Malindo Forum was established by the central governments on both sides, the Sosek Malindo Forum can be considered as a micro-regional institutional mechanism that exists between West Kalimantan and Sarawak. The establishment of the Sosek Malindo Forum at the provincial level was intended to: (i) identify problems associated with the socioeconomic development of the border regions; and, (ii) determine the socioeconomic development projects that could boost economic relations between West Kalimantan and Sarawak. Eight sectors of cooperation are managed by the Sosek Malindo Forum, including economic, interconnection, construction of border crossing posts, health, smuggling issues, forestry and environment, and social and community sectors.<sup>64</sup>



Through the Sosek Malindo initiatives, several cross-border cooperation projects were initiated in West Kalimantan and Sarawak. For instance, in 1991, the upgrading of the Entikong and Tebedu traditional border posts to an international border checkpoint was initiated in order to make the cross-border movement of people and goods between the two regions easier and more controlled.<sup>65</sup> West Kalimantan and Sarawak agreed to build a network of roads connecting Pontianak and Kuching via the international border checkpoints in Entikong and Tebedu. Similarly, in mid-1996, West Kalimantan and Sarawak agreed to establish a border growth centre at the Entikong-Tebedu border checkpoints to earmark areas for development into a new zone of economic growth along the border. Towards this end, some markets and shopping facilities were built by the Ministry of Commerce, Republic of Indonesia, to support economic activities and transactions on the border.<sup>66</sup>

In the transportation sector, the Sosek Malindo Forum agreed to boost cross-border cooperation by facilitating people's movement. For instance, vehicles with Sarawak license plates were allowed easy entry into West Kalimantan and vice versa. People who lived in the border regions were also free to use vehicle number plates from Malaysia while operating along the border in order to promote socioeconomic activities in the region.

Recently, in order to make possible easy cooperation among the private sectors of the two countries as well as to capture investment and trade opportunities between the two regions, the Sosek Malindo Forum has facilitated the establishment of the Sosek Malindo Business Council (SMBC). The SMBC is intended to serve as a venue where the private sector can coordinate with the local government as well as their counterparts in other countries. The council aims to boost private sector involvement in enhancing regional integration through cross-border economic activities, especially in the border areas. Currently, the West Kalimantan Chamber of Commerce and Sarawak Chamber of Commerce are heavily involved in the SMBC.

Besides the Sosek Malindo Forum, West Kalimantan is also among 38 sub-national regions participating in BIMP-EAGA. In 1994, given the success of sub-regional cooperation in the Singapore-Johor-Riau (SIJORI) Growth Triangle (currently known as IMS-GT) partnership arrangement, the Philippine President Fidel Ramos initiated the establishment of the BIMP-EAGA. The ultimate goal of BIMP-EAGA was to narrow the development gap across and within the EAGA sub-national member countries through: (i) promoting intra- and extra-EAGA trade, investments and tourism in selected priority sectors; (ii) coordinating the management of natural resources for sustainable development of the sub-region; and, (iii) improving infrastructural capacities and connectivity as well as CIQS issues.<sup>67</sup>

Although aimed at developing the economy at the sub-national level, sub-national authorities had fewer roles to play in BIMP-EAGA and central governments remained the primary actors determining the future of the sub-regional cooperation framework.<sup>68</sup> The agenda — in three important BIMP-EAGA institutional mechanisms, namely the BIMP-EAGA Summit; the Senior Officials Meeting and Ministers Meeting (SOMM); and, the Clusters and Working Groups — were mainly driven by the central governments.<sup>69</sup>

Through BIMP-EAGA, the Indonesian and Malaysian governments agreed to build the West Kalimantan-Sarawak Power Grid interconnection<sup>70</sup> — consisting of 120 km high voltage 275 kV AC (alternating current) interconnection — which would be operational by 2014 (Figure 4.4).<sup>71</sup> The grid will connect the Bengkayang Substation in West Kalimantan to Mambong Substation in Sarawak. The state-owned power company, PLN, would construct around 82 km of line on the West Kalimantan side while the SESCO would build around 38 km of line on the Sarawak side. In addition to making it possible for power to reach the load centre in West Kalimantan, PLN would further build 60 km of 150 kV AC line from Bengkayang Substation to Singkawang Substation.<sup>72</sup>

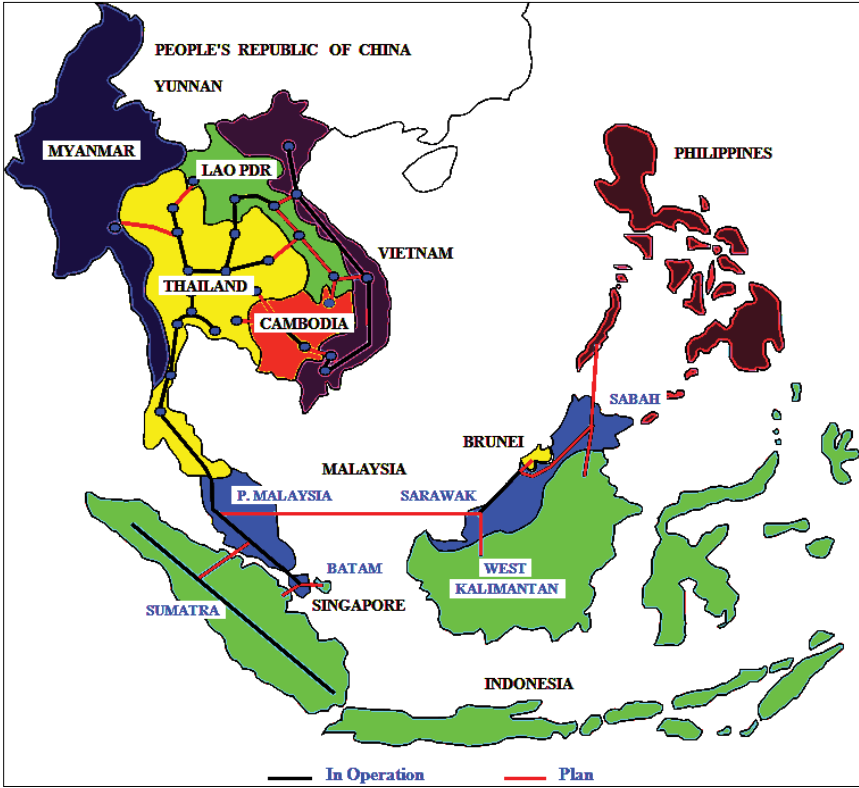


Figure 4.4: The ASEAN Power Grid connectivity plan.

Source: 'ASEAN Power Grid and Sarawak', The Sarawak Energy Newsroom, accessed 21 October 2014, [http://www.sarawakenergynewsroom.com/wp-content/uploads/2014/10/APG\\_MAP-220x126.png](http://www.sarawakenergynewsroom.com/wp-content/uploads/2014/10/APG_MAP-220x126.png)

Another cross-border cooperation initiative fostered by the BIMP-EAGA framework was the creation of a bus lane between West Kalimantan and Sarawak (Figure 4.5) that would serve to mobilise the population between the two contiguous regions on a regular basis from the departure terminal in Pontianak toward Kuching and vice versa.<sup>73</sup> Several companies have operated buses along the Pontianak-Kuching-Brunei-Kota Kinabalu route, including Adau Transportation, Damri (Indonesia owned) SJS and Shaphire (Sarawak owned).

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*Figure 4.5: West Kalimantan-Sarawak-Brunei Darussalam-Sabah bus lane connectivity.*

While Sosek Malindo can be regarded as the institution for micro-regionalism, as the role of the local government in fostering cross-border cooperation at the sub-national level is greater than the central government, the BIMP-EAGA can be considered the institution for sub-regionalism, where the central government dominates the initiative for cross-border cooperation at the sub-national level. These two institutional mechanisms exist to coordinate cross-border cooperation between West Kalimantan and Sarawak. Through their development agenda, Sosek Malindo and BIMP-EAGA have boosted regional cooperation between the two regions. However, despite serving the same development agenda of fostering cross-border cooperation, there is no clear mechanism for

linking the cross-border cooperation and development plans initiated in the Sosek Malindo Forum with BIMP-EAGA development projects. For this reason, BIMP-EAGA development projects sometimes do not integrate well with the substantial local economic development plans and policies initiated in the Sosek Malindo Forum for cross-border cooperation by the sub-national authorities.

#### **4. Limitations of Micro-Regionalism between West Kalimantan and Sarawak**

As argued in the previous section, two factors foster cross-border cooperation in the border areas of West Kalimantan and Sarawak: (i) increased involvement of business actors; and, (ii) the existence of institutional mechanisms for cross-border cooperation. Indeed, these factors have fostered several initiatives that have helped to deepen cross-border cooperation between the two regions. However, further deepening of cross-border cooperation between West Kalimantan and Sarawak remains limited, and there are many cross-border projects that, though initiated, have not been properly implemented. What is more, the provincial government of West Kalimantan has shown a tendency to not fully support cross-border cooperation between West Kalimantan and Sarawak, especially with regard to power grid interconnectivity.

This chapter identifies two inter-related factors that hinder further cross-border cooperation between West Kalimantan and Sarawak in the border areas: (i) defective decentralisation; and, (ii) the widespread invoking of the sovereignty issue in the political discourse of local elites. Both these factors, which have emerged from the dynamics between local and central governments, arguably limit the emergence of micro-regionalism in the border areas of West Kalimantan and Sarawak.

##### *4.1 Defective decentralisation*

The literature suggests that the process of decentralisation has made it more possible for sub-national governments to engage in cross-border cooperation, thus enhancing micro-regionalism.<sup>74</sup> In the case

of West Kalimantan, indeed, one of the measures taken by the central government for implementing decentralisation was to give more flexibility to the local government for initiating collaboration with Sarawak.<sup>75</sup> According to Law no. 32 year 2004 on local government, the provincial government has a greater role in undertaking initiatives for development in order to foster cross-border cooperation. The West Kalimantan provincial government thus has discretionary powers on formulating and implementing development programmes as well as coordinating the development of the border regions with Sarawak in order to create synergies. For instance, through the Sosek Malindo Forum, the West Kalimantan government can also share information with the Sarawak government on programmes and activities in each area without having to wait for approval from the central government.<sup>76</sup>

In spite of the greater role afforded to local governments, however, the decentralisation framework has provided very limited development in the border areas. In fact, decentralisation acts as a hindrance to enhanced micro-regional cooperation when it comes to the relationship between local and central governments. There are three reasons why decentralisation has not fostered greater micro-regionalism in the border areas of West Kalimantan and Sarawak. First is the absence of a comprehensive legal foundation for sub-national governments to conduct further and more technical cross-border cooperation. Decentralisation occurring in the *Reformasi* era is not equipped with legal frameworks that operationalise the authority of sub-national governments at both the provincial and regency government levels.<sup>77</sup> Successful cooperation between sub-national governments from neighbouring countries requires a firm and comprehensive legal foundation that is capable of enabling the conduct of cross-border cooperation. For instance, although one of the most fundamental legal basis for such cross-border cooperation deals with clarity of authority and lines of coordination in the management of border areas,<sup>78</sup> there is no clarity about who has the authority to manage the border region when it comes to West Kalimantan and Sarawak. In this context, it is common to see institutions jockey for influence when there is potential for revenue but shy away from taking responsibilities when problems arise.

The lack of a comprehensive legal foundation is compounded by the absence of political will from the central government to acknowledge the importance of the sub-national government in managing the development of border areas through cross-border cooperation with neighbouring regions. Many in the central government argue that sub-national governments have no institutional and human resource capacity for managing cross-border cooperation with neighbouring countries.<sup>79</sup> The authority of sub-national governments to carry out cooperation in the border areas is, in this manner, undermined because it has not been clarified and reinforced by further technical regulations from the central government. In the case of West Kalimantan, there is even an impression that the central government does not want to grant more authority to the sub-national government to develop the border areas and cooperate further with Sarawak on the grounds that the border issue falls within the authority of the central government.<sup>80</sup>

Second, decentralisation has given rise to incoordination among the various institutions responsible for managing the border region, thereby reducing the effectiveness of cross-border cooperation. According to former Indonesian Minister of Interior, Mr Gamawan Fauzi, 29 ministries or institutions, both at the national and sub-national levels, have 60 development programmes in the border areas at present.<sup>81</sup> Although the goal is to develop the border region and foster cross-border cooperation, these 60 development programmes are being implemented without integrating all the relevant sectors. The lack of programme and policy coordination among the various institutions has hindered provincial governments from cooperating in the border areas.<sup>82</sup> For instance, the markets built by the local government to revive economic activity in the border areas are not functioning optimally due to a lack of coordination when it came to building supporting infrastructure, such as roads and electricity, which are the responsibility of the central government.<sup>83</sup> For reasons such as the above, several infrastructure development projects initiated by the sub-national government have failed to add value in terms of greater cross-border cooperation.<sup>84</sup>

Third, even though decentralisation affords the West Kalimantan provincial government a greater role in initiating cross-border cooperation with their counterpart in Sarawak, the strategic decision on cross-border cooperation is still vested with the authority of the central government, as the management of border areas remains the latter's responsibility. For this reason, the implementation of cross-border cooperation initiated between West Kalimantan and Sarawak faces delays for want of the central government's approval.

The delayed development of the Entikong dry port is a case in point for how defective decentralisation has given rise to the three problems discussed above and consequently hampered cross-border cooperation between West Kalimantan and Sarawak. As part of Sosek Malindo Forum 2004<sup>85</sup>, West Kalimantan and Sarawak agreed to establish dry ports in Entikong, West Kalimantan, and Tebedu, Sarawak.<sup>86</sup> The idea behind the establishment of an inland port was to increase the capacity of trade between the two regions by regulating and monitoring cross-border trade in order to face the challenges that would be posed by the ASEAN Economic Community (AEC) by 2015.<sup>87</sup> The inland ports were expected to serve as catalysts for accelerated growth in the border regions by establishing connectivity for products from these region to the global markets. Through the inland port, West Kalimantan would directly export its products to foreign buyers without having to send them to the seaports in Java that are authorised for overseas export. It was also hoped that the inland port in Entikong would reduce illegal trade that often occurs in the border regions. West Kalimantan and Sarawak agreed to create an industrial estate for light industries to enhance economic growth in the border areas as well.

While Sarawak began opening the Tebedu inland port right away in 2004<sup>88</sup>, West Kalimantan is yet to set up the Entikong dry port<sup>89</sup>. A key reason behind the delay in the development of the Entikong dry port is because policymakers in the central government have not prioritised the project.<sup>90</sup> To circumvent this problem and avoid waiting for the central



government to build the inland port, the West Kalimantan government opted to cooperate with private sector actors to undertake the Entikong dry port's construction, so that it would start operations in 2013.<sup>91</sup> However, the Entikong dry port is not yet developed.

Currently, there is no clear legal framework for the development of an inland port in Entikong. According to existing rules, dry ports are a part of the nearest seaport and should be treated as a branch of the same<sup>92</sup>, and consequently dry ports cannot be used for direct exports. In conflict with the above guidelines, however, the Entikong dry port, though not a branch of the Pontianak seaport, will export or import goods directly to and from Malaysia. As the central government is yet to issue a legal framework responsive enough to solve the legal wrangle associated with the development of the Entikong dry port, the dry port has not been built. According to a West Kalimantan official, with the establishment of the Tebedu inland port, Sarawak has benefited from cross-border cooperation while West Kalimantan remains unable to generate income from associated initiatives due to delays in the development of Entikong.<sup>93</sup>

Besides the development of a dry port in Entikong, in 2008, the West Kalimantan provincial government proposed PPLB Entikong as the entry point for imported goods from Sarawak.<sup>94</sup> However, the central government is yet to respond to this proposal as well. The delay has meant that certain retail products, such as sugar, have to be supplied from Java and not Sarawak, although the former is more expensive, and that illegal goods are increasingly circulating in West Kalimantan.<sup>95</sup>

The delays in the development of the Entikong dry port shows how the absence of a comprehensive legal foundation, incoordination and the lack of authority for strategic decision-making have hampered the provincial government's ability to initiate projects that aim to deepen cross-border cooperation between West Kalimantan and Sarawak. While the provincial government has acknowledged the problem, response from the central government has been rather slow. Under the circumstances, there is a perception among local elites that the central government is shrugging off development in West Kalimantan and only prioritising the development

of Java.<sup>96</sup> This has created some antagonism between the elites in West Kalimantan and the central government and because of this the issue of sovereignty has assumed importance in the political discourse among West Kalimantan's local elites.

#### *4.2 The issue of sovereignty*

While there is no significant discussion on sovereignty issues in the Sarawak government, the issue of sovereignty retains its appeal in the sub-national politics of West Kalimantan, especially with regard to development in the border areas and cross-border cooperation with Sarawak. As mentioned above, the sovereignty issue has gained significance in the political discourse among sub-national elites given the general notion that the central government may be overlooking development in West Kalimantan.

Defective decentralisation has served to intensify this feeling, causing grievance among sub-national elites. However, local elites do not intend to harm relations between West Kalimantan and Sarawak, and officials in West Kalimantan have rarely raised the sovereignty issue during their interactions with Sarawak. Having said that, the sovereignty issue is often invoked by officials in West Kalimantan to draw the attention of central government officials, so that Jakarta remains aware of the problems in the border areas. Local governments make use of the sovereignty issue, as they are accorded greater political autonomy under decentralisation laws.

Many local elites believe that, while the issue of poverty seldom attracts the attention of central governments to the development of border areas, the sovereignty issue can be strategically used to elicit a quicker response from the central government when it comes to developing these areas.<sup>97</sup> For instance, in 2010, the Governor of West Kalimantan, Dr Cornelis M. H., sent a letter to the President of the Republic of Indonesia regarding indications of theft of coal by Malaysian companies from the West Kalimantan border areas (precisely from the Ketungau subdistrict of Sintang Hulu district),<sup>98</sup> seeking a quick response from the central government on the situation. In 2011, the governor again accused

Malaysia of annexing Camar Bulan, an area of 1.499 ha in the Temajuk village in Sambas regency.<sup>99</sup> Cornelis was convinced that the Malaysian government was actively engaged in silent occupation, damaging boundary markers and even making new border markers, and its actions were highly detrimental to the sovereignty of Indonesia. Although these disputed areas were still being negotiated between the Indonesian and Malaysian governments, Cornelis suggested that Indonesian negotiators were giving in to Malaysia's claims of the disputed area.

The aggressive reactions of the Governor of West Kalimantan are partly explained by the ideologies of his political party, which emphasises nationalism and patriotism.<sup>100</sup> Political actors may be required to respond in ways that cater to their own constituencies and political ideologies but may not necessarily be consistent with cross-border objectives. In the case of Kalimantan, although the governor's allegations were not proven, issues such as coal theft in the border region as well as the annexation of Camar Bulan were likely to prod elites in the central government into probing first-hand the conditions in the field. Indeed, some central government officials and politicians did pay the border region a visit almost immediately.<sup>101</sup> Here, the two issues related to the sovereignty discourse were possibly raised by the provincial government to create a sense of urgency in the central government with regard to undertaking the construction of infrastructure facilities in the border region.

Another instance, where the sovereignty issue was strategically used to attract the central government's attention to the development of West Kalimantan, was the West Kalimantan and Sarawak electricity interconnection project. This cross-border cooperation project has been thought to reflect the lack of political willingness on the part of the central government to develop energy infrastructure in West Kalimantan. Many local elites, both in the executive and the parliament, have opposed cooperation between PLN and SEB to buy electricity from Sarawak.<sup>102</sup> For instance, according to a member of the provincial parliament, the notion of buying electricity from Malaysia was embarrassing given the huge potential for providing electricity through hydropower in West

Kalimantan.<sup>103</sup> Many are of the opinion that, instead of buying electricity from other countries, the central government should take advantage of the natural resources of West Kalimantan to the maximum extent possible. For this reason, the electricity interconnection project is heavily scrutinised by local elites, both in the executive as well as the legislature, and this has slowed down its construction substantially. As one provincial government official put it, this project was indicative of how West Kalimantan had lost its energy sovereignty over Sarawak.<sup>104</sup>

While it is primarily intended to attract the central government's attention to the issue of development in the border areas, the sovereignty issue, when used by local elites, has had unintended consequences on the cross-border cooperation between West Kalimantan and Sarawak. For instance, in 2011, in response to claims that the Malaysian government had annexed Camar Bulan, the Governor of West Kalimantan threatened to nationalise Malaysian companies existing in the province if the Malaysian government refused to finalise negotiations on the disputed borderline.<sup>105</sup> Although these developments had no significant impact on West Kalimantan-Sarawak cooperation, the incident created tensions that deterred investments into West Kalimantan from Sarawak. As a spin-off of the West Kalimantan governor invoking the sovereignty issue, Sarawak finds it hard to officially invite high-ranking officials, such as the governor and deputy governor, to the state.<sup>106</sup>

## **5. Conclusion: Toward Micro-Regionalism?**

Cross-border cooperation between West Kalimantan and Sarawak shows that increased involvement of business actors, coupled with a greater role for the local government, through the cross-border cooperation mechanism could play an important role in deepening the micro-regional integration process at the sub-national level. The micro-regional integration process may even help to mitigate unequal development between the two contiguous regions through closer cooperation in socioeconomic activities. Micro-regionalism may serve as an alternative development model within the ASEAN framework for greater regional integration that

can, at the same time, sidestep inequality among participating countries, which often exists vividly in the border areas.

West Kalimantan is an example of how the dynamics of central-local relations may hinder the process of micro-regionalism from advancing. Defective decentralisation hampers greater cross-border cooperation between sub-national entities. In response to defective decentralisation, West Kalimantan's provincial government has invoked the issue of sovereignty to attract the central government's attention to matters of development in the region. However, this approach has had unintended consequences and served to harm relations between West Kalimantan and Sarawak as well.

The Indonesian government should attempt to solve the hitherto unresolved border problems with its Malaysian counterpart. In addition to obviating the strategic use of the sovereignty issue by local governments in their relations with the central government, it will also ensure that the issue of sovereignty does not hamper cross-border cooperation between West Kalimantan and Sarawak in unintended ways.

In order for micro-regionalism to emerge, there is a need to solve problems so that deeper cross-border cooperation between the two regions becomes possible. First, the central government needs to immediately cede some authority to the sub-national government in West Kalimantan, as this would augment the capacity of the local government to provide services easily and quickly and thereby accelerate economic growth in the border region and strengthen cross-border cooperation with Sarawak. Second, effective communication systems need to be put in place in order to strengthen the coordination, integration, synergy and synchronisation between the central and local governments on issues such as the development of the border regions. Third, a closer link should be established between Sosek Malindo, BIMP-EAGA and the ASEAN Secretariat in order to better manage the mutual relationship between integration and cooperation processes at the micro-regional, sub-regional and regional levels.

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## Chapter Four

# Chronic Poverty, Transient Poverty and Inequality in the ASEAN Region

*Celia M. Reyes<sup>1</sup>*

*Strong economic growth in Asia has translated into a significant reduction of poverty in the region. Among ASEAN countries with data, poverty incidences have declined in seven member countries although these vary widely across countries. Even so, income inequality has not been reduced in spite of accelerated economic growth in many of these countries.*

*Based on available data for selected countries in the ASEAN region, the proportion of households categorised as ‘always poor’, or ‘chronic poor’, ranges from a low of 4–6 per cent in Cambodia, Indonesia and Vietnam to a high of 11 per cent in the Philippines. On the other hand, the proportion of population categorised as ‘sometimes poor’, or ‘transient poor’, is much higher, ranging from a low of 19 per cent in Vietnam to 40 per cent in Cambodia.*

*This is exacerbated by the increasing frequency and severity of shocks, such as natural disasters, price hikes and financial crises, which adversely impact different segments of the population in varying degrees.*

*Unless appropriate safety nets are put in place, the recent gains in poverty reduction could be dampened by the increase in transient poverty resulting from more frequent shocks. The ability to cope with shocks is partly dependent on the distribution of assets, including human capital, physical and financial assets — the bottom segments of the population would have less ability to cope with shocks and be more likely to fall into poverty on experiencing shocks. Thus, reducing inequality, both in outcomes and opportunities, may increase the capacity of households to cope with shocks and enable the transient poor to recover more quickly from these shocks.*

*Keywords: Chronic poverty, inequality, safety nets, shocks, transient poverty*

## 1. Introduction

Strong economic growth in Asia has translated into significant reduction in poverty in the region. The Asian Development Bank (ADB) estimated that, in Asia, about 150 million people have moved out of extreme poverty between 2005 and 2008.<sup>2</sup> However, progress with regard to poverty reduction has been uneven within Asia and, consequently, the poverty rate remains highest in South Asia and lowest in East Asia.<sup>3</sup>

What has not received enough emphasis is that those classified as poor at a given point in time actually include both the chronic and transient poor. The 'chronic poor' are those who have been consistently poor over a period of time while the 'transient poor' are those who were previously non-poor but have fallen into poverty. Shocks, either natural or man-made, have pushed many of the non-poor into poverty. With the increasing frequency of shocks — due to climate change or increasing integration of national economies — one would expect the transient poor to increase, just as the number of the chronic poor would also swell should adequate safety nets not be put in place.

An issue that has regained prominence in development discussions is inequality. Together with fast economic growth, there has been an increase in income inequality. According to ADB, the Gini coefficient — a popular measure of income inequality — rose from 39 in the mid-1990s to 46 in the late 2000s.<sup>4</sup>

Reducing inequality is important for several reasons. Naschold summarises the links between poverty, inequality and growth.<sup>5</sup> Citing the conclusion of the *World development report 2000/01*, Naschold suggested that better distribution is possible without a reduction in economic growth. According to the report, there is no trade-off between equity and efficiency, and lower inequality can, in fact, create faster

growth. Naschold concluded that poverty reduction can be greatly enhanced through distributional policies and that evidence confirms that distribution is central to fighting poverty.

This chapter aims to show the importance of examining the issue of chronic and transient poverty. Unless appropriate safety nets are put in place, recent gains in poverty reduction in the ASEAN region could be dampened as transient poverty increases as a result of more frequent shocks. The ability to respond and cope with shocks is partly dependent on the distribution of assets, be it human capital, physical or financial assets. The bottom segments of the population therefore are likely to have less ability to cope with shocks and be more prone to falling into poverty upon experiencing shocks. Reducing inequality, both in outcomes and opportunities, may thus increase the capacity of the poor to cope with shocks and also enable the transient poor to recover more quickly from them.

## **2. Trends in Poverty and Inequality**

### *2.1 Poverty trends*

As mentioned in the Introduction, ADB estimates that, in Asia, about 150 million people have moved out of extreme poverty during the 2005–2008 period.<sup>6</sup> However, nearly two-thirds of the world's extremely poor still live in Asia. Progress in poverty reduction has been uneven within Asia, and the poverty rate remains highest in South Asia and lowest in East Asia.

Within Southeast Asia, poverty (based on the poverty line of USD 1.25 a day) has been practically eliminated in Malaysia and Thailand (Table 5.1). Laos has the highest headcount index while Cambodia, Indonesia, the Philippines and Vietnam have poverty rates that range between 16–19 per cent.



*Table 5.1: Poverty rates in Southeast Asian countries based on the poverty line of USD 1.25 a day (2005 purchasing power parity-adjusted).*

Country	Year of latest survey	Headcount index %	Poverty gap %	Poverty gap square
Cambodia	2009	18.60	3.51	0.96
Indonesia	2010	18.06	3.30	0.81
Laos	2008	33.88	8.92	3.33
Malaysia	2009	0.00	0.00	0.00
Thailand	2010	0.38	0.04	0.01
The Philippines	2009	18.42	3.72	1.00
Vietnam	2008	16.85	3.75	1.24

Source: 'PovcalNet: An online poverty analysis tool', Development Research Group of the World Bank, accessed 11 June 2013, <http://iresearch.worldbank.org/PovcalNet/index.htm>.

## 2.2 Chronic and transient poverty

Data on chronic poverty for ASEAN countries is scant, primarily because national statistical offices do not regularly collect panel data. Instead, data on poverty are usually sourced from cross-section data of household/family income and/or expenditure surveys. However, there has been increasing interest on the dynamics of poverty, which has led to increased production of data.

Available data on chronic and transient poverty for selected countries in the ASEAN region suggest that the proportion of households categorised as 'always poor', or chronic poor, ranged from a low of 4–6 per cent in Cambodia, Indonesia and Vietnam to a high of 11 per cent in the Philippines (Table 5.2). During this period, the proportion of population categorised as 'sometimes poor', or transient poor, was much higher, ranging from a low of 19 per cent in Vietnam to 40 per cent in Cambodia.

Table 5.2: Chronic and transient poverty in selected ASEAN countries.

Country	Time period	No. of waves	Proportion of households %		
			Always poor	Sometimes poor	Never poor
Cambodia	2001–2011	4	4.0	39.9	56.1
Indonesia	1993–2000	3	4.2	30.1	65.7
The Philippines	2003–2009	3	11.1	26.7	62.0
Vietnam	1992–1998	2	6.1	18.6	75.3

Note: Calculations for Cambodia were done using the 40th percentile poverty line.

Source: For Cambodia, see Kimsun Tong, 'Analysing chronic poverty in rural Cambodia: Evidence from panel data' (CDRI Working Paper Series No. 66, Phnom Penh: Cambodia Development Resource Institute [CDRI], 2012), 21; for Indonesia, see Wenefrida Widyanti et al., 'The relationship between chronic poverty and household dynamics: Evidence from Indonesia' (Working Paper, Jakarta: SMERU Research Institute, 2009), <http://www.smeru.or.id/report/workpaper/chronicpovertyhouseholdynamics/chronicpovertyhouseholdynamics.pdf>, 7; for the Philippines, see Celia Reyes et al., 'Dynamics of poverty in the Philippines: Distinguishing the chronic from the transient poor' (PIDS Discussion Paper Series No. 2011-31, Makati City: Philippine Institute for Development Studies [PIDS], 2011), 3; for Vietnam, see Bob Baulch and Edoardo Masset, 'Do monetary and non-monetary indicators tell the same story about chronic poverty? A study of Vietnam in the 1990s' (CPRC Working Paper No. 17, Manchester: Chronic Poverty Research Centre [CPRC], 2002), 8.

For the Philippines, Reyes et al. estimated that nearly half of those categorised as poor in 2009 were chronic poor using panel data from the Family Income and Expenditure Surveys (FIES) of 2003, 2006 and 2009.<sup>7</sup> Based on these three waves, nearly 11 per cent were found to be always poor or chronic poor, 27 per cent were sometimes poor, and 62 per cent were never poor (Table 5.2 and Figure 5.1).

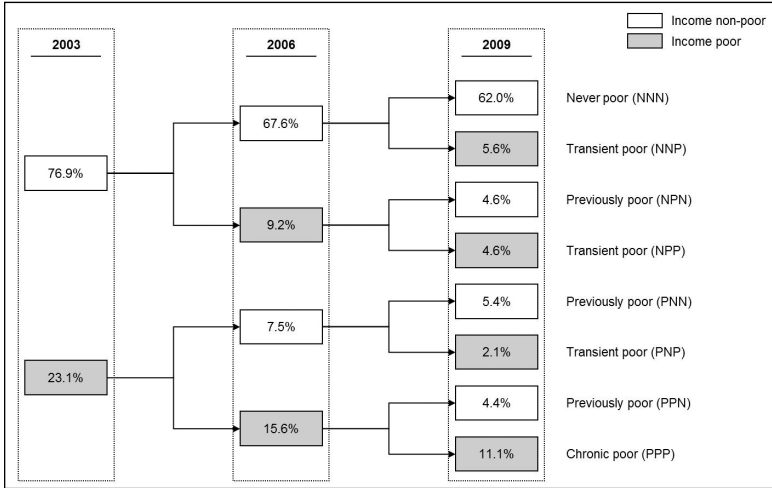


Figure 5.1: Movements in and out of poverty in the Philippines, 2003–2009.

NNN = non-poor non-poor non-poor; NNP = non-poor non-poor poor; NPN = non-poor poor non-poor; NPP = non-poor poor poor; PNN = poor non-poor non-poor; PNP = poor non-poor poor; PPN = poor poor non-poor; PPP = poor poor poor

Note: Totals may not add up to 100 per cent due to rounding.

Source: Celia Reyes et al., 'Dynamics of poverty in the Philippines: Distinguishing the chronic from the transient poor' (PIDS Discussion Paper Series No. 2011-31, Makati City: Philippine Institute for Development Studies [PIDS], 2011).

Similarly, using the Indonesian Family Life Survey (ILFS) for three waves (1993, 1997 and 2000), Widyanti et al. estimated the incidence of those who were poor in at least two waves in Indonesia to be around 14 per cent.<sup>8</sup> This figure included those who were always poor in the three waves (4.23 per cent) and those who were poor only in two waves (9.89 per cent).

In terms of poverty statistics beyond Southeast Asia, Jalan and Ravallion observed that chronic poverty, measured in squared poverty gaps, in four provinces of China — Guangdong, Guangxi, Guizhou and Yunnan — was 0.72272.<sup>9</sup> The measure of chronic poverty, in this study, was obtained using a sample of 5,854 households over a six-year period between 1985 and 1990.<sup>10</sup>

Meanwhile, Mehta, as cited by Amis<sup>11</sup>, found that 15 per cent of India's rural and urban populations were facing conditions of chronic or intense poverty. According to the KwaZulu-Natal Income Dynamics Study (KIDS) in South Africa, 13 per cent of the chronic poor were in urban areas.<sup>12</sup> Comparatively, in Uganda, 8 per cent of the urban population was in the chronic poor category.<sup>13</sup> Based on data from other countries, Amis therefore noted that a sizable segment of the population was sometimes poor in these countries (Table 5.3), and nearly half of those who were poor were moving in and out of poverty.<sup>14</sup>

*Table 5.3: Proportion of households who are always poor, sometimes poor and never poor for selected countries.*

Country	Time period	Proportion of households %		
		Always poor	Sometimes poor	Never poor
Cote d'Ivoire	1987–1988	25.0	22.0	53.0
Ethiopia	1994–1995	24.8	30.1	45.1
South Africa	1993–1998	22.7	31.5	45.8
Zimbabwe	1992–1995	10.6	59.6	29.8
India	1975–1983	21.8	65.8	12.4

Source: Philip Amis, 'Thinking about chronic urban poverty' (CPRC Working Paper No. 12, Manchester: Chronic Poverty Research Centre [CPRC], 2002), 5.

Much like Amis, Jayaraman<sup>15</sup> too found that, in many countries, the sometimes poor or transient poor made up significant segments of the population (Table 5.4).

Table 5.4: Studies decomposing the poor into relevant categories.

Country	No. of waves	Welfare measure	Proportion of households %		
			Always poor	Sometimes poor	Never poor
Chile	2	Income per capita	54.1	31.5	14.4
China	6	Expenditure per capita	6.2	47.8	46.0
Cote d'Ivoire	2	Expenditure per capita	14.5	20.2	65.3
Cote d'Ivoire	2	Expenditure per capita	13.0	22.9	64.1
Cote d'Ivoire	2	Expenditure per capita	25.0	22.0	53.0
Egypt	2	Average per capita consumption	19.02	20.46	60.52
Ethiopia	2	Expenditure per capita	24.8	30.1	45.1
Ethiopia	3	Median consumption expenditure	21.5	36.2	51.1
India	9	Income per capita	21.8	65.8	12.4
India	3	Income per capita	33.3	36.7	30.0
Indonesia	2	Expenditure per capita	8.6	19.8	71.6
Pakistan	5	Annual income	15.31	43	41.69
Pakistan	5	Income per adult equivalent	3.0	55.3	41.7

Russia	2	Income per capita	12.6	30.2	57.2
South Africa	2	Expenditure per capita	22.7	31.5	45.8
Zimbabwe	4	Income per capita	10.6	59.6	29.8

Source: Anuja Jayamaran, 'Poverty dynamics and household response: Disaster shocks in rural Bangladesh' (PhD dissertation, Pennsylvania State University, 2006), 24.

### *2.3 Inequality of outcomes and opportunities*

Discussion on inequality needs a dialogue on inequalities pertaining to outcomes and opportunities. As the previous section has highlighted, there is large variation in income, and therefore in poverty, across countries. This inequality of outcome can be linked to inequality of opportunities.

Inequality of outcome, according to Bourguignon, Ferreira and Menéndez, refers to the '... distribution of the joint product of the efforts of a person and the particular circumstances under which this effort is made. It is mostly concerned with income inequality.'<sup>16</sup> On the other hand, inequality of opportunities '... refers to the heterogeneity in those circumstances that lie beyond the control of the individual, but that nevertheless significantly affect the results of his efforts, and possibly the levels of those efforts themselves.'<sup>17</sup>

### *2.4 Inequality of income*

Performance with regard to reducing inequality has been mixed in Southeast Asia. The Gini coefficient, the most popular measure of inequality, assumes a value between 0 and 1, with a value of '0' indicating perfect equality and a value of '1' representing perfect

inequality. Therefore, the higher the value of the Gini, the more unequal is the distribution. The Gini coefficient has declined in some ASEAN countries, mostly notably in Thailand (Table 5.5). Cambodia, Malaysia, the Philippines and Vietnam have exhibited small declines in the Gini. In contrast, Indonesia and Laos have experienced large increases in the Gini, indicating worsening income inequality. Latest data from ADB show that income inequality is highest in Malaysia, with a Gini of 46.2, and lowest in Vietnam at 35.6.

Table 5.5: Trends in inequality in Southeast Asian countries.

Country	Time period		Gini coefficient			Quintile ratios		
	Earliest year	Latest year	1990s	2000s	Annualised growth rate %	1990s	2000s	Annualised growth rate %
Cambodia	1994	2008	38.3	37.9	-0.1	5.8	6.1	0.3
Indonesia	1990	2011	29.2	38.9	1.4	4.1	6.6	2.2
Laos	1992	2008	30.4	36.7	1.2	4.3	5.9	1.9
Malaysia	1992	2009	47.7	46.2	-0.2	11.4	11.3	0.0
The Philippines	1991	2009	43.8	43.0	-0.1	8.6	8.3	-0.2
Thailand	1990	2009	45.3	40.0	-0.6	8.8	7.1	-1.2
Vietnam	1992	2008	35.7	35.6	0.0	5.6	5.9	0.2

Note: Gini coefficients and income quintile share ratios — sourced from the earliest available data for the 1990s and the latest available data — were based on per capita expenditures, except for Malaysia, which were income based. Estimates for Indonesia combined the separate urban and rural distributions, weighted by share of urban/rural to total population.

Source: Asian Development Bank (ADB), *Asian development outlook 2012: Confronting rising inequality in Asia* (Manila: ADB, 2012), <http://www.adb.org/sites/default/files/publication/29704/ado2012.pdf>, 47.

Another measure of inequality is the income quintile share ratio, which is the ratio of the total income received by 20 per cent of the population with the highest incomes (the richest quintile) to that received by 20 per cent of the population with the lowest incomes (the poorest quintile). Among the seven countries in Southeast Asia with data, the highest quintile ratio was found for Malaysia (quintile ratio, 11.3), indicating that the income of the richest quintile was over 11 times higher than that of the poorest quintile (Table 5.5). On the other hand, the lowest quintile ratios were found for Laos and Vietnam (both at 5.9), indicating that the income of the richest quintile was nearly six times the income of the poorest quintile in these countries. As Table 5.5 shows, the disparity between the richest and poorest quintiles has narrowed significantly only in Thailand. The Philippines and Malaysia exhibited small increases while the other five countries experienced increases in the quintile ratio, suggesting bigger gaps between the richest and poorest quintiles in these countries with time.

ADB has cited technological progress, globalisation and market-oriented reforms as not only the primary drivers of growth in Asia but also the key forces behind the rise of inequality in the region.<sup>18</sup>

### *2.5 Inequality of opportunities*

The ADB development outlook 2012 shows estimates of inequality of opportunity in primary and secondary education, and access to basic infrastructure services (such as water, sanitation and electricity) for Bhutan, Indonesia, Pakistan, the Philippines, Sri Lanka and Vietnam.<sup>19</sup> The inequality of opportunity in primary and secondary education was lowest for Sri Lanka and highest for Pakistan.<sup>20</sup> The study found that per capita household expenditure was the most important contributing factor to inequality of opportunity with regard to access to secondary education.<sup>21</sup> Other important contributing factors were location of residence, educational attainment of the household head and gender of children.<sup>22</sup>



The report shows that inequality of opportunities with regard to basic infrastructure services was generally higher than that for education. In the case of access to sanitation, per capita household expenditure was the most important driver for inequality of opportunity.<sup>23</sup> Other important drivers were location of residence and educational qualifications of the household head.

### **3. Shocks and Coping Strategies**

Shocks, whether natural or man-made, can nudge the non-poor into poverty or the poor deeper into poverty. Unless there are safety nets to prevent households from falling into poverty or assist them in recovering more quickly from poverty, shocks would tend to increase the number of the poor. In the absence of safety nets, the non-poor who have fallen into poverty would become part of the transient poor. Given time, those who have the capacity or resources and/or those who receive assistance from the government and/or private sector would be able to move out of poverty quickly. On the other hand, those who do not have the capacity or resources, or are unable to obtain external assistance, may find themselves joining the chronic poor. This is especially true if the coping strategies adopted by households in response to shocks adversely impact their long-term productivity. For instance, if households cope with a catastrophic illness by selling their productive assets, or if households withdraw their children from school in response to an economic downturn, then this would reduce the household's ability to move out of poverty in the future.

This is where inequality of outcomes and opportunities would play an important role in determining the household's ability to recover more quickly from shocks. Households with greater income and assets would have lower chances of falling into chronic poverty. Similarly, those with higher educational attainment and better health status would be less likely to fall into poverty. Thus, it is important that opportunities are more equal.

Shocks affecting households are becoming more frequent. Because of economic integration, economies are more linked and consequently

more vulnerable to shocks. Instabilities in one country or region reverberate to other regions, and the impacts generally depend on how the various economies are interdependent. The 2009 global financial crisis demonstrated this interrelationship amply.

World prices of oil rose dramatically in 2007, peaking in July 2008 but dropping significantly during the second half of the year.<sup>24</sup> The oil price shock was due to strong demand amid stagnating world production. Food prices, particularly of rice, which also went up drastically and concomitantly, were likely related to biofuel policies of advanced countries, rising energy costs and the falling US dollar. Some rice-exporting countries even introduced export restrictions over concerns for food security.

For instance, in the Philippines, prices of rice, the staple food, and fuel rose significantly in 2008 following trends in the global market.<sup>25</sup> Although movements in the farmgate (producer) and retail (consumer) prices of rice were fairly stable during the period January 2006–December 2007, prices significantly increased starting January 2008.<sup>26</sup> The average retail price of rice for the period January 2008–September 2008, in fact, increased by 34 per cent, which was much higher than the 4 per cent growth seen in the previous year.<sup>26</sup> Similarly, farmgate prices went up by 27 per cent during the January 2008–September 2008 period when compared to the previous year, when growth was only 4 per cent.<sup>28</sup>

Meanwhile, fuel prices in the Philippines, which were largely stable during the 2006–2007 period, increased significantly in 2008.<sup>29</sup> During the January 2008–September 2008 period, the average price of unleaded gasoline increased by 32 per cent compared with 2007, when prices were 2 per cent lower than in 2006.<sup>30</sup> The average price of diesel too increased by 37 per cent in the January 2008–September 2008 period when compared to the previous year, which had seen a decline of 3 per cent.<sup>31</sup>

Extreme weather events are also becoming more frequent, putting at risk large segments of the population in affected countries. According to the *World risk report 2012*, the top 15 disaster prone countries are Vanuatu,

Tonga, the Philippines, Guatemala, Bangladesh, Solomon Islands, Costa Rica, Cambodia, Timor-Leste, El Salvador, Brunei Darussalam, Papua New Guinea, Mauritius, Nicaragua and Fiji.<sup>32</sup>

Coping strategies to shocks vary depending on the type of shock and the resources available to each household. The ability to cope with shocks also depends on the household’s access to resources. Reyes et al. found that, to cope with shocks, some households may initially change food consumption patterns and then withdraw children from school, forego medical treatment, or even sell productive assets.<sup>33</sup> However, while withdrawing children from school or foregoing medical treatment may lead to long-term adverse effects on human capital, selling productive assets to smooth consumption in the short term may cause the household to become chronically poor.

### 3.1 Strategies to cope with impacts of food and fuel price shocks

Reyes et al. found that, in response to the price shock in the Philippines, households adopted various coping mechanisms (Table 5.6).<sup>34</sup> For instance, some households modified their expenses on food, health and education, producing negative consequences in the long run. Others changed their health-seeking behaviour by shifting from private clinics/hospitals to government health centres/hospitals, with some even resorting to self-medication or shifting to herbal medicines. Other coping strategies adopted by households included tapping various fund sources and seeking additional sources of income.

Table 5.6: Coping strategies of households in response to price shock in the Philippines.

Major coping strategy	Rural households (Santa Rita) %		Urban households (Pasay) %	
	Poor	Non-poor	Poor	Non-poor
Changed health-seeking behaviour	60.6	38.8	24.1	18.5

Decreased electricity usage	45.5	22.2	6.1	12.3
Shifted to NFA rice	42.3	17.8	4.8	6.8
Changed electricity consumption pattern	36.6	26.5	36.5	43.5
Changed food consumption pattern	22.5	14.9	34.9	22.9
Food market preference changed to NFA rolling store/TNG	21.4	13.3	6.9	7.1
Children stopped attending school	8.5	6.7	4.8	0.8
Changed conduct of recreational/leisure activities	6.8	8.2	66.7	45.4
Shifted to low-cost cooking fuel	5.6	3.3	2.4	0.8
Transferred children from private to public schools	0.0	1.1	0.0	0.8
Decreased usage of cell phone	0.0	0.0	33.3	36.8
Shifted to cheaper means of transport	0.0	0.4	0.0	0.4

NFA = National Food Authority; TNG = Tindahan ni Gloria

Source: Celia Reyes et al., 'Analysis of the impact of the changes in the prices of rice and fuel on poverty in the Philippines' (PEP Policy Research Brief, Makati City: Partnership for Economic Policy [PEP], 2009), 62–3.

According to Reyes et al., among the rural poor, nearly 60 per cent coped with higher prices by changing their health-seeking behaviour while 46 per cent decreased their electricity usage and 42 per cent shifted to National Food Authority rice — all coping mechanisms that aimed to reduce expenditure. Interestingly, a smaller proportion of the rural non-poor also adopted similar strategies. On the other hand, the top coping

mechanism among households in the urban areas was to change their recreational activities (such as by foregoing certain leisure activities) — nearly two-thirds of the poor and 45 per cent of the non-poor in urban areas adopted this strategy. More than a third of the households in urban areas also changed their electricity consumption patterns. Many poor and non-poor households in urban and rural areas made changes to their food consumption patterns, such as by eating cheaper food items. The urban poor adopted this strategy more commonly to reduce food expenditures, with nearly 35 per cent of urban poor households reporting such responses to price shocks.

### 3.2 Strategies to cope with impacts of global financial crises

The world economy was subject to a financial shock in 2008, which started in the developed countries but quickly reverberated in the developing ones. Countries were affected in manifold ways, including declines in foreign demand for a country’s goods and services as well as declines in domestic output and employment. The affected economies also cut back on foreign workers. In the case of the Philippines, the latter was especially true. Although the Philippines was not as adversely affected as some other countries, impacts on affected households were significant, as shown by Reyes et al.<sup>35</sup> Households coped in various ways, including by reducing expenditure, changing food consumption patterns and even modifying health-seeking behaviour (Table 5.7). More importantly, results revealed that the coping strategies of households varied depending on the economic resources available to them, as indicated by the income groups shown in Table 5.7.

*Table 5.7: Coping strategies of households in response to the global financial crisis in the Philippines, by income group and income quintile.*

Coping strategy	Total	Income group		Income quintile				
		Bottom 40%	Top 60%	1	2	3	4	5
Unplugged appliances when not being used	78.2	72.9	80.7	70.4	74.6	78.7	83.9	79.4

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Turned off lights	70.4	68.4	71.4	65.2	70.7	70.0	74.1	70.0
Subscribed to promotions in communication	66.9	57.5	70.7	55.0	59.5	67.6	71.4	72.9
Lessened frequency of texting	58.7	55.1	60.1	52.2	57.4	59.2	61.8	59.4
Reduced times cooking food	46.9	40.3	50.5	38.5	41.9	48.9	53.0	49.6
Lessened times doing recreation	45.4	32.6	49.9	27.0	36.8	47.8	49.8	51.6
Shifted to cheaper brands (clothing)	44.9	40.2	47.7	37.6	42.6	48.2	48.8	46.1
Shifted to generic drugs/cheaper drug brands	42.9	39.9	44.6	38.5	41.1	41.7	48.0	44.2
Reduced expensive food	42.4	40.7	43.3	39.3	42.0	42.2	45.7	42.1
Lessened use of appliances	41.3	34.5	44.4	26.2	40.3	43.3	47.5	42.4
Shifted to <i>ukay ukay</i>	40.8	42.2	39.9	39.4	44.9	42.0	42.9	34.6
Recooked/ reheated leftovers	40.3	42.9	38.7	41.0	44.5	38.6	42.3	35.2
Used water containers	38.3	27.9	43.0	22.6	32.7	39.1	43.0	46.7
Shifted to cheaper food	37.2	43.3	33.6	42.4	44.1	38.3	35.0	27.3
Borrowed money	37.1	39.7	35.4	37.8	41.5	37.9	39.6	28.5
Used medicinal plants/herbal medicines	35.8	43.5	31.3	49.8	37.7	34.2	31.1	28.3

Postponed vacation	35.5	29.3	37.8	26.9	31.1	38.7	37.5	37.3
Lessened frequency of buying	35.5	32.3	37.3	29.1	35.1	34.9	38.7	38.4
Used secondhand uniforms/shoes	34.3	37.7	31.7	40.6	34.9	32.4	35.1	26.0
Lessened times of washing clothes	33.7	20.4	39.9	13.5	26.6	36.3	42.4	40.7
Shifted to government health centres and hospitals	31.7	37.7	28.1	37.6	37.9	33.3	29.4	21.1
Shifted to cheaper modes of transportation	30.9	27.4	32.7	26.8	27.9	32.8	33.7	31.7
Reduced times heating water	29.7	25.8	31.8	25.1	26.5	30.3	33.0	32.2
Shortened time allotted to activities using water	29.1	22.7	32.0	18.9	26.1	34.4	32.6	29.3
Used secondhand books	26.9	28.6	25.7	31.6	25.8	26.0	29.4	20.2

Source: Celia Reyes et al., 'The impact of global financial crisis on poverty in the Philippines' (PEP Policy Research Paper, Makati City: Poverty and Economic Policy [PEP], 2009), 38.

### 3.3 Strategies to cope with natural disasters

Reyes et al., while surveying the aftermath of Typhoon Sendong — one of the most damaging typhoons to hit the Philippines in terms of loss of lives and economic damage — found that many households in the study area (Opol municipality in Mindanao in the Philippines) were affected. More than three-fourths of the households surveyed experienced a reduction in income and assets, with 40 per cent reporting job losses and 55 per cent experiencing increased expenses (Table 5.8).

*Table 5.8: Impacts of Typhoon Sendong on households in Barangay Barra, Opol, Misamis Oriental.*

Impact	Percentage of households		
	Bottom 40%	Top 60%	All households
Job loss	43.4	38.5	40.3
Decrease in income	81.1	75.8	77.8
Asset loss	77.4	76.9	77.1
Increase in expenses	54.7	59.3	57.6

Source: Author's estimates based on data collected during a household survey in Opol in May 2012.

The households affected by Typhoon Sendong coped with the disaster in various ways, including assistance from the government and private sector, and by changing food consumption patterns, borrowing money and engaging in additional work (Table 5.9).

*Table 5.9: Percentage of households who adopted the following coping strategies in response to Typhoon Sendong.*

Coping strategy	Percentage of households		
	Bottom 40%	Top 60%	All
Received assistance from the government	70	63	65
Received assistance from the private sector	32	37	35
Shifted to cheaper food items	30	23	26
Borrowed money	13	25	21
Limited use of electricity	19	21	20



Ate more ready-to-cook food (i.e., noodles)	19	18	18
Transferred to temporary housing/evacuation centre	24	14	18
Reduced food portions	23	13	17
Limited use of water	13	16	15
Ate less preferred food	17	13	15
Received financial support from relatives	13	14	14
Member sought additional job	11	15	14
Consumed staple food only	13	10	11
Skipped meals	13	10	11
Member engaged in entrepreneurial activity as additional job	11	11	11

Source: Author's estimates based on data collected during a household survey in Opol in May 2012.

As these data indicate, man-made and natural calamities affect various households differently. The ability of households to cope with these shocks depends both on the severity of the shock as well as the resources available to them. In many instances, coping strategies adopted by households have longer-term impacts on the members of these households. For instance, adopting certain strategies, such as selling off productive assets to smooth consumption in the short term, may affect a household's chances of recovering from the shock and instead cause it to move into chronic poverty and not just transient poverty.

#### **4. Policy Implications**

Improving risk management and mitigation could help to reduce transient poverty and thereby chronic poverty. Action is therefore called for at multiple levels, including the household, national and regional levels.

First, it is imperative that measurement and monitoring of chronic and transient poverty be improved, as the failure to distinguish between chronic and transient poverty has led to an undifferentiated approach to poverty reduction, which has not been as effective in reducing poverty. Data from these assessments would become the basis for more appropriate interventions.

Second, social protection programmes play an important role in helping affected households deal with various shocks. Appropriate safety nets not only prevent households from falling into poverty but also help them move out of transient poverty more quickly should they fall into poverty.

Third, while it might be harder to reduce inequality of outcomes, inequality of opportunities can be more easily reduced through government programmes. In the absence of such measures, inequality of income would be higher, thus perpetuating the cycles of inequality of opportunity and outcome for future generations.

And, last, increased opportunities with regard to education, health and basic services will improve risk management. In the same way, reducing inequality of opportunities will improve the ability of households to recover from shocks. While transient poverty may increase as a result of shocks, more equal opportunities will improve the households' chances, even among the poor, of recovering from these shocks and moving out of poverty more quickly.

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## Chapter Five

# Once the Land is Gone: Land Redevelopment and Livelihood Adaptations on the Outskirts of Hanoi, Vietnam

*Danielle Labbé*<sup>1</sup>

*This chapter explores the impacts that two of the earliest new towns built on the margins of Hanoi, the Vietnamese capital city, have had on the everyday life and livelihood strategies of the preexisting populations of two former rural settlements located next to them. Combining a longer-term perspective with the social disaggregation approach allows us to critically revisit frameworks of analysis founded on the notions of urban segregation, socioeconomic marginalisation and infrastructural splintering that predominate in the literature about the impacts of large land redevelopment on preexisting populations in the ASEAN. While we do not dispute the fact that the land dispossession that makes large land redevelopments possible disrupts the socioeconomic life of the preexisting population, we find that, after a few years, local populations hold a rather positive view of the new urban environment built on their land and that they can — and actually do — experiment with various livelihood strategies once projects are built and inhabited. Rather than drawing attention away from the difficulties faced by former peasants during the transition out of agrarian life, this study highlights the need to identify the conditions that underpin households' livelihood adaptations in order to develop more appropriate policy measures and to apply them earlier on during the land redevelopment process.*

*Keywords: Land dispossession, livelihoods, new towns, periurbanization, Vietnam*

### 1. Introduction

The periurban landscape of ASEAN metropolises is undergoing profound transformations. What Jones has called the 'thoroughgoing urbanisation of Southeast Asia'<sup>2</sup> is typified by the functional and spatial expansion of urban areas into rural territories, often well beyond established city boundaries. In the process, formerly agrarian places become dynamic sites of encounter between urban and rural built forms, activities and

ways of life. As first noted by the geographer Terry McGee during the early 1990s, the resulting 'extended metropolitan regions' belie prevailing conceptions of a neat cleavage between city and countryside.<sup>3</sup>

This chapter focuses on one of the drivers of this transformation process: the construction of so-called 'new towns'<sup>4</sup>. In this study, this expression is used to refer to large-scale, master-planned communities built from scratch on the outskirts of existing cities. This model of urban development has evolved considerably since it first appeared in Southeast Asia in the mid-20th century.<sup>5</sup> Today, most projects are dominated by the residential function, but they can also include commercial spaces, high-rise office towers, private amenities (e.g., schools and medical clinics) and exclusive recreational spaces (e.g., golf courses, pools and fitness centres). These projects are generally developed for profit by private corporate actors (sometimes in partnership with local governments), and most of them are geared towards the region's rising middle- and upper-middle classes.

For nearly three decades now, the production of new towns on the peripheries of cities has held the favour of planning authorities across the ASEAN. In official discourse, this policy orientation is justified by a 'need' to produce orderly, modern urban spaces and to sustain national construction industries as part of larger economic development programmes.<sup>6</sup> This governmental support for the new town model of urban development persists despite repeated warnings about these projects' adverse effects on urban development in the region. Since the early 1990s, scholars and urban specialists have warned governments and planners to look beyond the bright, modern urban futures promised by new towns. These authors have instead emphasised the highly uneven distribution of new towns' benefits across rapidly urbanising societies and territories.<sup>7</sup>

An important issue raised by the above-cited studies (and many others) concerns the destabilising effects that these projects have on preexisting, local socioeconomic and socio-spatial dynamics. This scholarship shows that the individuals and communities living and working on the

territories on which large redevelopments take place (erstwhile villagers, rural migrants, etc.) are hit the hardest by the raft of social, economic, environmental and political changes that follow from the implementation of new towns.

These same studies identify four main processes through which the implementation of large land redevelopments negatively impacts local people's lives in the ASEAN:

First, and perhaps most disruptive, are land acquisition and population displacement operations. Throughout the region, households are often poorly or insufficiently compensated for their land, in particular in cases of unclear or informal land titles. Resettlement, when it occurs, further contributes to a reshuffling of social networks and can lead to a deterritorialisation of local communities, understood here as the weakening of the economic, political and cultural bonds tying people to specific places.<sup>8</sup>

Second, and following from the above, the loss of land threatens the continuation of old income-earning activities, which are often the foundation of personal and community identity. This problem is particularly acute in the case of agricultural land conversions. It is compounded by insufficient compensations and by the weakness (or lack) of labour retraining programmes put in place by governments or private developers to palliate for the loss of livelihoods.<sup>9</sup>

Third, large land redevelopment projects can trigger environmental and biophysical degradations through, for instance, the destructuring of flood control mechanisms (e.g., filling out of canals, ponds and other water retention areas), rises in air pollution, soil contamination, etc.<sup>10</sup>

Fourth, and finally, are the changes that follow from the commercialisation of projects and from the afflux of wealthy suburbanising dwellers in periurban zones. These changes include, for instance, the stronger penetration of urban market forces (including steep increases in land

prices), the intensification of road traffic and the diffusion of new 'urban ways of life' in erstwhile (yet rapidly changing) rural zones.<sup>11</sup>

These four broad types of negative externalities underpin the severe critique of new towns found in the scholarship on ASEAN's urbanisation process. This critique is founded on the idea that master-planned communities create sealed-off, premium enclaves of consumption and residence for middle- and upper-income groups while marginalising the lower-income populations living in the surrounding, 'unplanned' settlements. New town, it is argued, price out these lower-income groups and exclude them from new urban services and amenities.<sup>12</sup> Some authors further conceptualise this socio-spatial divide between the haves and the have-nots as a form of infrastructural 'splintering', such as that discussed by Graham and Marvin<sup>13</sup>, that is socially regressive patterns of essential services provision between the more affluent and poorer parts of cities.<sup>14</sup>

These negative impacts of new town developments on formerly agrarian communities and other groups living on the periphery of large urban centres deserve the attention of ASEAN planning authorities and of the international agencies advising them. The marginalisation and segregation problems pointed out in the literature should be on the agenda of public planners and governments, if only in view of the growing prevalence of the new town model of urban development in the region. Yet, this chapter argues that, in order to act appropriately on the problems raised in the scholarly literature, policymakers in the ASEAN need more detailed empirical research on the longer-term impacts that new towns have on the urbanising territories and that they need to pay closer attention to the multifaceted and varied effect that these projects have on the populations surrounding them.

Thus far, the existing scholarship on the relationship between large land redevelopments and preexisting periurban populations has mainly focused on the socioeconomic disruptions that occur early on during the land redevelopment process. This scholarly attention to the early years in the



land redevelopment process is understandable: land appropriation and resettlement operations cause major social disruptions that can degenerate into violence or threaten the political stability of an entire region.<sup>15</sup>

Yet, by focusing only on the first steps in the implementation of new towns, the literature has left unattended the transformations that follow from the conversion of farmlands to urban uses and the coping mechanisms deployed by local communities and their governments once the new town is built and inhabited. As Garschagen, Renaud and Birkmann remarked, we have a very limited understanding of the relationship between the multiple processes of changes that follow from the construction of a new, planned neighbourhood and the adaptation mechanisms of the population affected by such a project.<sup>16</sup> Little is known, for instance, about the ways in which people adapt (or not) to the commercialisation of new urban space in their locality, about their perceptions and reactions to the reshuffling of social relations that occur as large number of middle-class suburbanising dwellers settle in erstwhile rural zones and, perhaps more importantly, about their capacity (or lack thereof) to take advantage of new socioeconomic opportunities that arise from this new urban space and population.

This exploratory study begins to answer these questions through the case study of two periurban communities on the outskirts of Hanoi that were affected by the construction of new towns about 10 years ago. The following documents what happened to members of these erstwhile agrarian communities once the lands they had farmed for centuries had been appropriated and turned into new, modern urban places inhabited by suburbanising dwellers. The questions driving this study are: how has the new town impacted the livelihoods<sup>17</sup> of preexisting households living and working on the city's edge? How did these people adapt (or not) to the various socioeconomic and socio-spatial changes brought about by each land redevelopment project? And, how do they perceive these changes now that the redevelopment process is completed and their locality is fully integrated into the urban fabric?

The exploration of these questions builds on 16 in-depth interviews conducted between June 2013 and August 2013 with heads of households and local leaders living in two former periurban villages of Hanoi called Hoang Liet and Trung Kinh.<sup>18</sup> We selected these two sites because their agricultural lands were appropriated for the construction of new towns about a decade ago. This allowed us to investigate local households' livelihood trajectories over an extended period of time.

Constraints associated with carrying out research on a politically sensitive issue (i.e., forced land acquisition) in a communist context limited our ability to freely select the households to be interviewed. Informants had to be selected in close collaboration with local ward leaders who tended to introduce us to exemplary families. We, however, sought to select informants with various profiles in terms of gender, age, educational qualifications, household size and composition, and land holdings and livelihood diversification prior to the construction of the new town. We also interviewed local leaders and members of the local government in each community (e.g., head and vice-head of residential groups, chair of local party branches, head and vice-head of the Women Union, etc.).<sup>19</sup>

In line with existing research on this theme, we found that the years following the land acquisition were difficult ones, especially for households that had depended on farming for their subsistence. Yet, we also observed that, after a few years, individuals and families began to experiment with a multitude of livelihood strategies to adapt to their new surroundings. Many of these people tapped into new economic opportunities stemming from the rapid urbanisation of their locality.

While this suggests that socioeconomic opportunities and beneficial relationships can develop between new towns and surrounding populations, it does not mean that the transition into an urban life was a smooth process for all households. Echoing recent studies on the impact of industrialisation on rural households in Vietnam<sup>20</sup>, non-farm income opportunities in our two study sites were, and still are, unevenly

shared among households. Important barriers hamper some households' capacity to engage successfully with new, post-agrarian lives. These barriers relate to age, educational levels, and access to economic and natural capital (especially residential land). Disaggregating the impacts that new towns have on an increasingly diversified periurban population, and identifying the most vulnerable households, is therefore an essential step in the formulation of appropriate policies to support the people affected by large land redevelopments.

The remainder of this chapter is organised as follows. Section one briefly reviews the emergence of new towns in Vietnam in the 1990s and describes in more detail the two sites selected for this study. Section two reviews the differentiated impacts that each project had on the preexisting population of Hoang Liet and Trung Kinh, and identifies the main barriers faced by households in the transition to a post-agrarian life. Section three discusses households' assessment of the socioeconomic and socio-spatial *obstacles* and *opportunities* brought about by the new towns over the last decade. Section four highlights the central role played by access to residential land in determining households' capacity to re-establish stable livelihoods once their agricultural land was gone. The conclusion sums up the main findings of the study and discusses theoretical and policy implications.

## **2. New Towns and Villages: Two Case Studies in the Region of Hanoi**

Vietnam is one of the latest locations to be permeated by what might be called Asia's contemporary new town movement. What is locally known as the 'new urban area' (*khu đô thị mới*) model of urban development took form in the 1990s, about a decade after the first *đổi mới* reforms.<sup>21</sup> Corporate actors in the construction sector were then encouraged to redevelop vast tracts of agricultural land in the periurban zones of major urban centres into planned urban areas that could accommodate the country's rapidly growing urban population. Planning policies prescribed the construction of large, integrated compounds, where good quality,

affordable housing would be provided in modern, multifunctional environments, ultimately allowing the realisation of an urban vision of order, civilisation and modernity.<sup>22</sup>

According to the Ministry of Construction, at the beginning of 2010, Vietnam had a total of 632 new urban areas covering over 100,000 hectares (ha).<sup>23</sup> The province of Hanoi alone, on which this study focuses, has approved about 250 projects since the late 1990s, of which about a dozen are now completed and inhabited.

Vietnam's new urban areas share many features with the new towns criticised by the literature on the ASEAN urban development process reviewed in the introduction of this chapter. These are planned settlements, built from scratch on vast tracts of periurban land (most often productive agricultural lands). Concentrated in the densely populated territories surrounding Vietnamese cities, these projects almost invariably involve the compulsorily acquisition of land-use rights from local people and also, in some cases, population displacements.

New urban area projects, however, vary considerably in terms of functional composition, area and population. They range from predominantly residential compounds of 5 ha or less to projects of up to 500 ha that are expected to shelter over 50,000 residents upon completion. Compounds of less than 10 ha are dominated by commodity housing while larger ones generally include commercial and office spaces, public parks, and, in some cases, resettlement housing and public, semi-public or private amenities (such as schools, daycare, medical clinics, etc.).

As mentioned in the introduction, the two projects selected for this study were among the first new urban areas to be built in Vietnam. Our first case, called Linh Dam, is located 8 km south of Hanoi's centre while the second one, called Trung Hoa-Nhan Chinh (hereafter, THNC), is located about 5 km to the west of the historic city. The construction of Linh Dam began in 1999 and was completed in 2008 while that of THNC started in 2000 and was completed in 2007. Both land redevelopment

projects were carried out by state-owned enterprises that have since been partly privatised. Linh Dam was developed by the Housing and Urban Development Corporation (HUD) while THNC was developed by the Vinaconex Corporation.

The first residents started to move into the two new urban areas around the year 2002 and both neighbourhoods were fully occupied by 2005 or so. Today, the population of Linh Dam reaches 7,800 people on a total area of 148 ha while THNC boasts nearly 15,000 residents on an area of 33 ha. Residents in each project are mainly Vietnamese and belong in majority to the middle- and upper-middle classes, which emerged following the *đổi mới* reforms. Both projects also shelter a sizeable number of Asian and Western expatriates.

The two new urban areas are dominated by the housing function (a mix of high-rise residential towers and single family ‘villas’), but they also include commercial and office spaces. These two new urban areas, it is important to note, are not surrounded by walls. Although poorly connected to the local road network, they can be freely accessed by surrounding populations. The activities that visitors and users can engage in within the limits of each project are, however, controlled by the private enterprises managing each project.<sup>24</sup> For instance, informal street vending and the use of sidewalks for commercial activities — two informal practices very common in the inner city — are forbidden in both areas.

Linh Dam and THNC were built on agricultural lands previously farmed by periurban people living in former rural villages, which are now directly adjacent to these projects. In this research, we focused on the experience of the populations living in two of these former villages: Hoang Liet, which is located next to Linh Dam, and Trung Kinh, which is located next to THNC.

Local officials estimated that, before the land expropriation, about two-thirds of Hoang Liet’s households and about half of Trung Kinh’s held land-use rights over agricultural plots that had been redistributed to native

residents in the wake of the agricultural de-collectivisation process during 1988–1993. As is the case throughout the rest of the Red River Delta region, households in our two study sites had access to limited farmland areas ranging from 700–1,800 sq. m per household.

Prior to the land acquisition, the agricultural regimes in the two villages consisted of two crops of wet-rice followed by a winter crop of potatoes, onions and corn. Again, echoing the situation observed in the rest of the Red River Delta region, households in both sites reported that their agricultural yield was essentially for self-consumption. Surpluses, when they occurred, were used to feed the fowls and pigs that families raised next to their houses.<sup>25</sup>

If they derived limited revenues from agriculture, the population of the two sites selected for this study benefited greatly from their proximity to the inner city. This privileged location gave households in Hoang Liet and Trung Kinh access to diverse income streams associated with the urban economy that developed during the early years of the *đổi mới* — and in some cases before that.<sup>26</sup> As we will see later in this chapter, a majority of households in our two study sites had already diversified their livelihoods into non-farm activities before land acquisition. This is important, as it distinguishes the people we studied from the population of localities in more isolated and poorer rural areas who have fewer venues for alternative employment once their access to productive agricultural lands is cut.<sup>27</sup>

Between 1999 and 2003, the use right to agricultural land held by the population of Hoang Liet and Trung Kinh were progressively ‘revoked’<sup>28</sup> by the state, converted to urban uses and then reallocated to HUD and Vinaconex for redevelopment. In both cases, villagers were forewarned about the land acquisition operations about 6–12 months ahead of time.

The Vietnamese Law on Land<sup>29</sup> prescribes compensation packages for dispossessed households that include both money for the loss of land and support for farmers to re-establish a stable livelihood. The

money component is calculated based on the agricultural productivity of the land and the type of crops (annual or perennials) cultivated. The law also requires the local government to support evicted households through retraining or jobs. This should be calculated at 30 per cent of the land value over a period of 30 years. In our two cases, and as will be further discussed below, households only received a lump sum payment disbursed in cash that supposedly accounted for the value of the retraining programmes that the local government would have otherwise had to put in place. The rates offered to expropriated villagers are compiled in Table 6.1.

Table 6.1: Compensation rates for agricultural land-use right in Hoang Liet and Trung Kinh households, 1998–2003 (in USD<sup>30</sup> per sq. m).

Year	Hoang Liet	Trung Kinh
1998–1999	2.60–4.00	3.50
2001	5.00–6.50	6.50
2003	12.00	Not available

Source: Interview data.

In retrospect, households assessed these state-stipulated rates as unacceptably low.<sup>31</sup> Interviewees in our two research sites, however, explained that, in the late 1990s and early 2000s, they accepted such meager compensations without complaint because of their limited legal rights over publicly owned agricultural lands and because expropriations were state-led operations. Illustrating this view, a local leader of Hoang Liet remarked: '[T]his is the country's land [*đất là của quốc gia*]. We only own the right to use it. When the state needs it, we have to give it back no matter if we are willing to or not.'<sup>32</sup>

### 3. Fending for Oneself in a (Post-)Communist Urban World

The construction of Linh Dam and THNC had differentiated impacts on the various groups of people living around each project. We observed, for instance, that those households that had already fully exited agriculture

by the time of the expropriation were only minimally impacted by the construction of a new town in their vicinity. Land redevelopment hit households that still depended on agriculture for their daily subsistence at the time of the expropriation much harder.

The difference between these two household groups was not only related to whether or not they were excluded from access to productive land. Rather, the magnitude of the shock caused by land redevelopment appears to have also been determined by the households' specific livelihood strategies and by their ability to access urban occupations that could provide them with a steady source of income to meet their basic needs. Illustrating the importance of the livelihood diversification factor, Mr Hao<sup>33</sup>, a 43-year-old resident of Hoang Liet whose family left farming in the 1980s to run a soup stall in one of Hanoi's inner city markets, explained: 'My family was already selling [soup at the market] when the project began, so we had fewer difficulties than other households. The people that had no jobs besides farming, they met much more obstacles.'<sup>34</sup>

As mentioned in Section one, a majority of families in our study sites had started to take on off-farm activities by the time of land expropriation. Yet, a good proportion of households in each village still relied on rice farming to meet their basic nutritional needs at the time of expropriation. Local leaders estimated that about two-thirds of the households in Hoang Liet and about half of those in Trung Kinh were in this situation by the late 1990s. The most common livelihood strategy at the time consisted of what DiGregorio has called a 'two-legged pattern', where households supplemented subsistence farming with small commodity production, petty trading and wage work as service providers and labourers.<sup>35</sup>

In cases where farming still played a central role in ensuring a household's subsistence within this 'two-legged' pattern, the first years following the land expropriation were generally 'very harsh ones' (*vất vả lắm*).<sup>36</sup> Most problematic, informants indicated, were the loss of self-provisioning capacities and the concomitant problem of having to buy rice — the key staple in the Vietnamese diet — in a volatile and inflationary market.



Illustrating this problem, in the two villages studied, is the fact that the monthly bill for rice alone for a household of five can easily reach 1.5 million VND (or, USD 90). This amount is the equivalent of the minimum wage plus overtime that industrial workers make in the factories built around Hanoi.

In the first year following the expropriation, ex-farming households in each village relied on the compensations received from the state to meet their daily needs. However, former peasants were well aware that this was only a short-term strategy and that they would soon need to find alternative income-earning activities to make a living. When villagers started to look for work outside of their locality, they measured the difficulties that they would have to overcome in order to, using their own expression, 'stabilise' (*ổn đĩnh*) their livelihoods.<sup>37</sup> Describing the situation, Mr Long, a 54-year-old ex-farmer from Hoang Liet, recalled: 'The third year [after the expropriation], we really started to struggle. We then figured that it was hard to earn money outside of farming. These years were very hard ...'.<sup>38</sup>

Members of ex-farming households, such as Mr Long, emphasised the numerous obstacles in their transition out of agriculture. These obstacles overlap with the findings of recent studies on the impacts of land appropriation for industrial development on rural populations in Vietnam.<sup>39</sup> Problems listed by our informants related to: the lack of non-farm work skills, limited educational achievement, age, ill or dependent family members, and limited financial or natural capital. These hurdles are important and deserve the attention of policymakers, as their specific combination has shaped the income-generation strategies available to each household and therefore determined their capacities to make a transition to a sustainable non-agrarian life.

The situation at our two study sites proved particularly difficult for villagers aged between 30 and 55 years, who often left school between grades five and ten. As observed in other Red River Delta villages<sup>40</sup>,

this group can hardly compete for qualified or semi-qualified jobs with the thousands of high school and college graduates who flood Hanoi's labour market every year. Even waged work in the factories set up in the region over the last 10 years is out of reach for these individuals, as industrial employers prefer to hire young female workers with at least a high school diploma.<sup>41</sup>

In interviews, ex-farmers echoed the critical perspective discussed in the introduction of this chapter, which states that large land redevelopments across the ASEAN marginalise preexisting people by limiting their access to the means (cash, natural resources, jobs, training, etc.) to re-establish a sustainable livelihood once their agricultural land is gone.<sup>42</sup> Many informants lamented the fact that they had been let down by a communist state which, up to the forced acquisition of their agricultural land, had supported their livelihoods by giving them access to publicly owned natural assets on which they could grow food. Looking back, some informants felt that they were left to fend for themselves in a harsh urban job market. Summing up this view, Mrs Thu from Hoang Liet remarked:

In this village, we all had to look for jobs by ourselves. Neither the state nor the developer helped us. There were no jobs created at all. From the day of the expropriation until now, people here have had to figure it out by themselves.<sup>43</sup>

This criticism stems from a context where local governments and land developers at both sites convinced farming households to let their agricultural land go by telling them that vocational training and jobs would be created in their locality after the expropriation, which would facilitate their entry into the urban labour market. As mentioned in Section one, these promises never materialised. As Mrs Oanh, a 44-year-old ex-farmer from Trung Kinh, remarked, the local authorities simply never mentioned the issue of labour retraining once the compensation process was completed.

Beside compensations [in cash], they promised to set up companies and factories here that would recruit the children of people having lost their land. [But] since the land acquisition, I haven't seen any announcement about this. Now, my children are grown up and I wish they would be recruited. I want to remind them of their promise but I don't know whom to ask about this.<sup>44</sup>

In Hoang Liet, the People's Committee of the ward (legally charged to retrain farmers) forsake the organisation of vocational training in favour of increasing the cash compensations handed to ex-farming households. Theoretically, this extra sum was to be spent on vocational training for jobs that former peasants would find in the region. For reasons that need to be further investigated, only a small minority of households used their compensation money to retrain themselves or invested this sum into their children's education.

Looking back, ex-farmers in both villages concluded that they had been cheated by the local authorities and developers. This has contributed to the erosion of the trust that these people have in their local governments. And, as word spread about the difficulties faced by evicted farmers, such as those of Hoang Liet and Trung Kinh, villagers in other periurban and rural areas of Hanoi have become increasingly reluctant to let their agricultural land-use rights go for urban redevelopment purposes.<sup>45</sup>

#### **4. New Towns: Clean, Modern, Beautiful but Jobless**

Considering the hardship that followed from the reallocation of their land-use rights, the villagers of Hoang Liet and Trung Kinh hold surprisingly positive views of the new town built next to their village. Rather than holding a grudge against these projects and the population inhabiting them, the people that we interviewed praised the various ways in which the new towns have improved their lives. Illustrating this view, Mrs Chi remarked: 'Generally speaking, since we have the new urban area of THNC, the whole locality has become more spacious, it is cleaner and more beautiful. Moreover, transportation is more convenient.'<sup>46</sup>

To understand such comments, it is important to keep in mind that the construction of Linh Dam and THNC was but one component of a broader urban development process. Besides the construction of these two new urban areas, the state and private investors have massively invested in the built environment, proceeded to undertake major infrastructural upgrades, and improved service provision in and around the two research sites. Throughout the 2000s, both areas benefited from the construction and enlargement of roads that now link each village more directly and efficiently to the inner city. During this same period, each village saw its inner roads paved, they were connected to the much more stable urban electric power grid, and the municipal piped water network replaced the individual wells previously used by households.

Interviewees, it is also important to note, did not draw a sharp distinction between the construction of the new urban area next to their village and the broader changes that occurred around them as their locality was absorbed into the city's space. Contrary to the view of the scholarly critics discussed in the introduction<sup>47</sup>, the people of Trung Kinh and Hoang Liet do not perceive Linh Dam and THNC as vectors of splintering urbanism that have segregated them from the rest of the city but rather as mechanisms of infrastructural integration. This perspective is clearly expressed by Mr Anh from Trung Kinh when he said: 'When the [new urban area] was implemented, land was also seized to build better infrastructure. Roads were raised to higher levels, water then started to flow more easily, more great buildings came about, along with better environmental sanitation.'<sup>48</sup>

Along the same lines, rather than seeing them as exclusionary, interviewees regarded the urban amenities and services set up within the confines of each new town as useful additions to their everyday life. While they cannot afford the private schools, luxurious spas and upscale cafés available in Linh Dam and THNC, periurban residents living around each project make extensive use of the new public spaces built in both developments. They use the new streets, squares, plazas and parks almost daily to walk and exercise. Several interviewees also indicated

that, while they still rely on traditional open-air markets to meet most of their daily needs, they enjoy having easy access to the supermarkets built in each new urban area.<sup>49</sup>

Villagers were, however, more critical when we broached the matter of income-generation opportunities. A small minority of villagers who were lucky enough to own or could afford to buy a plot of land located at the interface between the village and the new project has opened businesses in these locations (e.g., cafes, tea shops, restaurants, etc.). This locational advantage allows these villagers to make good use of the opportunities offered by the new pool of customers that reside and work in the new town. Hence, Mr Hao, who now operates a tea shop on the ground floor of his house next to THNC, explains:

If there was no new urban area, I wouldn't sell drinks like this. Because of the arrival of this project and because of the widening of the road, there are more and more offices established around here, so opening this business is reasonable.<sup>50, 51</sup>

Yet, a majority of villagers did not find jobs linked to the new urban areas built on the land they used to farm. When asked how the construction of Linh Dam benefited her village, Mrs Quynh, a local leader of Hoang Liet, answered: 'There is no benefit for us, no influence on our economy, because we do not get any income from [the new urban area].'<sup>52</sup> Similar assessments were made by other local leaders at each site who estimated that only 1–2 per cent of their constituents hold a job in THNC or Linh Dam.

This is not because the two neighbourhoods did not hire the kind of unskilled labour available in nearby villages. On the contrary, both Housing and Urban Development Corporation Service (HUDS) and Vinasinco have recruited hundreds of men and women to guard indoor and outdoor parking areas, sweep the streets, collect garbage and maintain parks in the new urban areas that they manage. Moreover, the hundreds of middle- and upper-middle class households that reside in each project depend on an army of domestic workers to provide them with daily cleaning, cooking and childcare services.

Further research is needed to understand why, in this context, so few villagers — and, in particular, the largely underemployed group of middle-aged ex-farmers — have taken on jobs in the new towns. When asked to explain this situation, informants indicated that the developers did not prioritise them or facilitate their access to these jobs.<sup>53</sup> Emphasising the importance of social capital in Hanoi's labour market, some people mentioned that getting a job in the two new urban areas required connections with the managing enterprises, which they do not have. A local leader of Hoang Liet emphasises this point when he states:

There are villagers working in the KDTM but only a few, mainly security [guards]. It was mostly people from other places who came to work there, for the sanitation company, cutting grass, trimming trees, [ensuring the] security of the new urban area. [...] In most cases, they were introduced by an acquaintance.<sup>54</sup>

Other informants, however, explained the low level of employment of ex-farming households in the two new urban areas in terms of the occupational preferences of their members. These informants indicated that the type of wage work offered in the new neighbourhoods does not suit ex-farmers who prefer to be self-employed. They also indicated that the wages offered by HUDS and Vinasinco are generally considered to be too low. Illustrating this issue, Mrs Thuc, a 77-year-old resident of Trung Kinh, recalled:

[The investor of Trung Hoa-Nhan Chinh] did create jobs, but only a few. There were about 10 people who were accepted to be [security] guards there. But they almost all left as they got bored. That's because the salary is low. Out of them all, only Mrs My stayed on the job ...<sup>55</sup>

As we will see below, a third (yet partial) explanation for why some villagers did not venture beyond their village's territory to find work is that they found more interesting livelihood opportunities right next to their houses.

## 5. Capitalising on Residential Land

Faced with limited work opportunities in the city and in the new urban areas built next to their villages, the majority of former peasants in Hoang Liet and Trung Kinh fell back onto a key asset still available to them: their residential land. Local leaders from both villages estimate that the main income-earning activity of ex-farmers in their locality is the rental of rooms in makeshift buildings that households erect next to their main residence. This livelihood strategy is now very common in former rural settlements surrounding large cities and industrial parks throughout Vietnam.<sup>56</sup>

In our study sites, these rooms are rented to seasonal workers and students from provinces outside of Hanoi, who come to study in the capital's colleges and universities. Groups of 2–6 workers or students often rent a single room, which they share. Of the 16 households interviewed for this project, 10 have built a *nhà trọ* (or, lodging house) next to their main residence. In our research sites, the number of rooms for rent in these buildings varied from 2–16, and rental rates ranged from 700,000 to 2 million VND (approximately USD 30–87) per room per month.

Next to housing upgrades and the purchase of a motorbike, the construction of so-called lodging houses was the most common way in which ex-farming families invested the compensation they received during the expropriation process. The handing out of a single lump sum payment to households in compensation for their agricultural land, instead of multiple, smaller instalments over an extended period of time, is one of the factors that made this livelihood strategy possible in both Hoang Liet and Trung Kinh, as access to large amounts of money was instrumental in the construction of lodging houses. Indeed, the very low income that most households derived from previous livelihood activities (including agriculture) did not allow them to generate savings. Moreover, access to capital from banks and other credit institutions is largely inaccessible to ex-farmers.<sup>57</sup>

In interviews, the heads of households who derive most of their income from room rentals assess their post-agrarian livelihood in rather positive terms. These people explained that room renting is a much less strenuous income-earning activity than the backbreaking work they used to carry out in the paddy fields. Overall, interviewees consider that this activity provides them with a more stable livelihood than farming, which was subject to climatic vagaries. Encapsulating these two ideas, Mr Minh, a retired farmer from Hoang Liet, remarked:

Life is much better now than during the farming time [ ... ] Life now, compared with the time we worked in the fields, has become more developed. We don't have to go through strenuous days, our minds are more relaxed. When we worked in the fields, we had to calculate a lot. Things were always uncertain. Because the land here is low, sometimes we planted rice but lost the entire crop to floods.<sup>58</sup>

The option of building a lodging house is not, however, available to all households. As mentioned earlier, to do so, families must have access to financial capital to pay for the necessary construction materials and labour. Households must also own enough residential land to build a new structure next to their main residence. This point is emphasised by Mr Hao when he explains: '[My family] had land left by our ancestors so we could build [a lodging house]. In fact, we wouldn't have been able to build if we did not have that land already, even if we had money.'<sup>59</sup>

In this exploratory study, we met a number of ex-farming households who could not meet these two conditions. In many cases, these families now have precarious livelihood situations and have among their members the most vulnerable people in each village. Several factors have accounted for the situation of these households; factors which often combined with each other to hamper these people's ability to leverage their compensation into a sustainable livelihood.



In some cases, households held use rights to very small areas of agricultural land at the time of expropriation, which meant that the cash compensation that they were entitled to was too small to allow them to invest in the construction of a lodging house. Some households decided to split the compensation they received between their members rather than pooling it together to invest in a common income-generating activity, such as building rooms for rent or setting up a small shop. Other households decided to spend their compensation on other activities, such as the upgrading of their own house, the purchase of a motorbike, or the acquisition of new furniture and appliances. In a context of shrinking access to public healthcare, others still chose or had to spend this money on medical care for one of their family members. Some simply did not own enough residential land and, with the spike in land prices that followed from the urbanisation of their locality, were unable to acquire more to build rooms for rent.

The livelihood strategies most commonly adopted by members of these families is a combination of petty trade and service provision. These activities are mostly carried out in the informal sector. Informants whose livelihoods rely on these activities report lower and less stable incomes than members of households who operate a lodging house. They also face difficulties associated with the increasingly strict policing of informal economic activities in urban Vietnam. This is the case for Mrs Oanh, who has been quoted at length below:

My family received 45 million [VND in compensation; approximately USD 2,500]. It was not enough to build a house and since my husband and I were jobless, we decided to invest into buying a motorbike and some goods which we could retail to make a living [ ... ] We came to the decision that my husband was to use the motorbike as a taxi and I was going to hawk. However, sales were bad and the police continually chased out hawkers at the market. I found it too hard and therefore I decided to set up a small shop in front of my house. Although I don't make as much as I did at the market, it is less strenuous and it leaves me time to do housework. My husband could work as a motorbike-taxi for a while but with the development of taxicabs, he now has fewer

customers. Now, he stays home and sometimes repairs or washes motorbikes or else he helps me selling stuff.<sup>60</sup>

## **6. Conclusion**

This chapter explored the impacts that two of the earliest new towns built on the margins of the Vietnamese capital city have had on the population of two former rural settlements located next to them. The combination of a longer-term perspective and the social disaggregation approach allowed us to critically revisit the frameworks of analysis founded on the notions of urban segregation, socioeconomic marginalisation and infrastructural splintering that predominate in the literature about the impacts of large land redevelopment on preexisting populations in the ASEAN. This scholarship contends that large residential redevelopments in Southeast Asia polarise social classes and marginalise the lower-income populations living on their margins by destabilising their livelihoods and social networks, pricing them out, and excluding them physically from basic urban services and amenities.

Findings from Hoang Liet and Trung Kinh do not dispute the view that new towns are problematic for ASEAN's future urbanism. There is no doubt that the forced land acquisitions that allowed the construction of the new urban areas of Linh Dam and THNC have disrupted the socioeconomic life of these two erstwhile village populations. As observed elsewhere in the ASEAN<sup>61</sup>, the conversion of farmland to post-agrarian uses has destabilised local patterns of work and the life cycle expectations of communities that were once dominated by the values and traditions of the countryside.

In line with existing studies<sup>62</sup>, we found that these shocks were felt most intensely during the early years following the expropriation. However, looking beyond the difficult first years has brought a more detailed understanding of the ways in which local people deal with the various obstacles and benefits brought along by the land redevelopment process. By looking at how surrounding populations assess new town developments several years after they were completed, we found that these people hold

a rather positive view of these projects, and this was despite the various problems that their implementation had caused their households.

In contradiction with the view that new towns exacerbate infrastructural splintering<sup>63</sup>, we observed that, from the perspective of affected households, the construction of the new town was not distinct from a broader process of urban change that brought important material improvements in their lives. Respondents view the upgrades in transportation infrastructure and the connection of their houses to municipal networks (such as water, sanitation, electricity, etc.) as positive factors of integration into the city. Similarly, they do not see the new towns built next to their village as vectors of segregation but rather as places that provide them with new (and better) recreational space and services. This positive perception of new town development on the edge of Hanoi must be taken into account before claiming that 'the planned city sweeps the poor away'.<sup>64</sup>

The longer-term perspective adopted in this chapter further contributes to a better understanding of the ways in which households that lost access to agricultural lands adapt (or not) to new socioeconomic conditions. In the case of Hoang Liet and Trung Kinh, we found that local people do experiment with various livelihood strategies once new town projects are built and inhabited. As such, the difficulties that many households have met during the early years of the expropriation process gradually waned and gave way to new income-generating activities that took advantage of the construction of the new town and, more generally, of the urbanisation of their locality. Successful livelihood experiments that were observed in our two study sites included the construction and rental of outer buildings to seasonal workers and students, and the conversion of residential spaces into shops.

This is not to say that less attention should be paid to the difficulties faced by former peasants during the early years of the transition out of agrarian life. Rather, by identifying the successful livelihood strategies developed by households over time and the conditions that underpin their

success, we may be able to develop more appropriate policy measures and apply them earlier on during the land redevelopment process to facilitate households' adaptation.

The observation that some households in Hoang Liet and Trung Kinh could re-establish stable livelihoods a few years after their agricultural land was gone while others failed to do so therefore has important research and policy implications. This observation points to the need to move beyond a mere critique of new town projects to identify the specific circumstances and practices that either mitigate or, conversely, aggravate the socioeconomic and socio-spatial disruptions caused by these land redevelopments. In thinking about policy actions to mitigate the negative impacts of farmlands' conversion to post-agrarian uses, it is important to identify and consider the specific needs and vulnerability of the population living on the edge of large Southeast Asian cities. As Hall, Hirsch and Li<sup>65</sup> have convincingly argued in their study of access to (and exclusion from) land in Southeast Asia, we need to analyse the impacts that new towns have on surrounding populations not only in terms of who is excluded, how and with what consequences but also in terms of who gains from the redevelopment process.

This also highlights the importance of disaggregating the capacities, needs and expectations of an increasingly diversified periurban population. Periurban settlements in Vietnam — and throughout the ASEAN region, for that matter — are not populated by an undifferentiated 'lower-class' populace, as some of the literature reviewed in the introduction of this chapter could lead one to believe. On the contrary, the people of the peripheral zones surrounding Southeast Asian cities present increasingly complex socioeconomic composition, with diversified livelihoods, mobility patterns and residential trajectories.<sup>66</sup>

Echoing findings from recent studies about the impact of land acquisition on agrarian populations in the Red River Delta region<sup>67</sup>, we observed that households which had partially or entirely moved out of agriculture in the years prior to the expropriation were only marginally affected by

the land redevelopment process. These households could be called the 'winners' of the land redevelopment process, which boosted their previous income-generating activities, provided them with new economic opportunities, and improved infrastructural conditions and amenities in their locality.

The possibility for these households to move out of agriculture before the expropriation process was facilitated by the location of Hoang Liet and Trung Kinh at a short distance from Hanoi. This allowed erstwhile rural people to diversify their livelihood strategies early on during the urbanisation process by responding to the growing demands for goods and services in urban zones. Such advantage, it should be emphasised, is obviously unavailable to people living in periurban places situated further out in the city's hinterland.

In the specific case of Hoang Liet and Trung Kinh, we also found that those ex-farming households that had access to natural capital in the form of large residential land areas could re-establish a stable income earning activity after their agricultural land was gone. Local households tapped into this asset to build rooms that they rent to the hundreds of seasonal migrants looking for cheap accommodation on the edges of Hanoi. We further observed that, although limited, the disbursement of compensation as a one-off cash payment (rather than in several instalments over a longer period of time) was instrumental in making this livelihood adaptation strategy possible. In the same way, although to a lesser degree, the sums received in compensation for their agricultural land allowed other households to set up a shop within their residential space.

Conversely, erstwhile farmers who only had access to limited residential lands struggled to re-establish stable livelihoods after expropriation. In many cases, the problem of limited access to residential land was compounded by other factors that combined to limit these households' capacity to find new income sources. Among other obstacles, we found that labour market constraints, low educational achievements and the occupational preferences of ex-farmers aged 30–55 years for self-employment left them with few alternatives outside of hawking and

informal service provision. These people need much stronger support from the state and private developers — in the form, for instance, of appropriate vocational classes or access to credit — than what they are currently receiving.

More systematic research is, of course, needed to identify other circumstances and practices that affect the livelihood trajectories of periurbanites affected by large land redevelopments. Yet, this exploratory study has identified a series of factors that has either hampered or facilitated the transition of households in Hoang Liet and Trung Kinh into urban life. The findings of this study provide arguments that support the development of policy actions that are better tailored to the particular needs of the local people affected by land redevelopment processes. The state and developers would benefit from offering a variety of compensation packages better fitted to the differentiated needs of affected households. These packages could, for instance, combine lump sum cash compensations with compensations ‘by land’, privileged access to micro-credit programmes and vocational training. These options would support a broader array of post-agrarian livelihood alternatives than the current blanket policy approach, as is currently used in Vietnam.

## Endnotes

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- 2 Gavin W. Jones, ‘The thoroughgoing urbanization of East and Southeast Asia’, *Asia Pacific Viewpoint* 38, no. 3 (1997): 237–49.
- 3 Terry G. McGee and Ira M. Robinson, eds, *The mega-urban regions of Southeast Asia* (Vancouver: UBC Press, 1995); Tim Bunnell, D. Parthasarathy and Eric C. Thompson, *Cleavage, connection and conflict in rural, urban and contemporary Asia* (Dordrecht: Springer, 2013).
- 4 Depending on the projects’ size, distance to an existing urban centre, functional composition and country, the literature alternately calls the new urban living environments discussed in this chapter ‘new towns’, ‘master planned communities’, ‘satellite cities’, ‘new suburban estates’, or ‘mega-urban projects’.

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- 6 Gavin Shatkin, 'Planning privatopolis: Representation and contestation in the development of urban integrated mega-projects', in *Worlding cities: Asian experiments and the art of being global*, eds Ananya Roy and Aiwha Ong (London: Blackwell, 2011).
- 7 See among many others, John Connell, 'Beyond Manila: Walls, malls, and private spaces', *Environment and Planning A* 31 (1999): 417–39; Percival and Waley, 'Articulating intra-Asian urbanism', op. cit.; Philip. F. Kelly, *Landscapes of globalization: Human geographies of economic change in the Philippines* (London: Routledge, 2000); Tommy Firman, 'Rural to urban land conversion in Indonesia during boom and bust period', *Land Use Policy* 17, no. 1 (2000): 13–20; Arnisson Andre C. Ortega, 'Desakota and beyond: Neoliberal production of suburban space in Manila's fringe', *Urban Geography* 33, no. 8 (2012): 1,118–43; James E. Spencer, 'An emergent landscape of inequality in Southeast Asia: Cementing socio-spatial inequalities in Viet Nam', *Globalization* 7, no. 3 (2010): 431–43; Michael Douglass, 'Globopolis or cosmopolis? — Alternative futures of city life in East Asia' (paper presented at the Fifth East-Asian Regional Conference in Alternative Geography, Seoul, 13–16 December 2008).
- 8 Dereck Hall, Philip Hirsch and Tania Li, *Powers of exclusion: Land dilemmas in Southeast Asia* (Honolulu: University of Hawai'i Press, 2011); Ortega, 'Desakota and beyond', op. cit.; Tim Bunnell and Alice M. Nah, 'Counter-global cases for place: Contesting displacement in globalising Kuala Lumpur metropolitan area', *Urban Studies* 41, no. 12 (2004): 2,447–67.

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- 10 Edsel E. Sajor and Rutmanee Ongsakul, 'Mixed land use and equity in water governance in peri-urban Bangkok', *International Journal of Urban and Regional Research* 31, no. 4 (2007): 782–801; Robin M. Leichenko and William D. Solecki, 'Environmental justice: The making of new metropolitan landscapes in developing countries', *Society & Natural Resources: An International Journal* 21, no. 7 (2008): 611–24; Duong Duc Dai, Le Thi Ngan and Nguyen Thi Dien, 'Difficulties in transition among livelihoods under agricultural land conversion for industrialization: Perspective of human development', *Mediterranean Journal of Social Sciences* 4, no. 10 (2013): 259–67; Matthias Garschagen, Fabrice G. Renaud and Jörn Birkmann, 'Dynamic resilience of peri-urban agriculturalists in the Mekong Delta under pressures of socio-economic transformation and climate change', *Advances in Global Change Research* 45 (2011): 141–63.
- 11 Danielle Labbé, *Land politics and livelihoods on the margins of Hanoi, 1920–2010* (Vancouver: UBC Press, 2014); DiGregorio, 'Into the land rush', op. cit.
- 12 Tommy Firman, 'New town development in Jakarta metropolitan region: A perspective of spatial segregation', *Habitat International* 28 (2004): 349–68; Douglass, 'Globopolis or cosmopolis?', op. cit.; Derlik Hudalah, Haryo Winarso and Johan Woltjer, 'Peri-urbanisation in East Asia: A new challenge for planning?' *International Development Planning Review* 29, no. 4 (2007): 503–19; Michael Waibel, 'The development of Saigon South new urban area: A sign of an increasing internationalization and polarization in Vietnamese society', *Pacific News* 22 (2004): 10–13.



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- 16 Garschagen, Renaud and Birkmann, 'Dynamic resilience of peri-urban agriculturalists in the Mekong Delta under pressures of socio-economic transformation and climate change', op. cit.
- 17 This study borrows Ellis' definition of livelihoods, which is understood as: '... [t]he assets (natural, physical, financial and social), the activities, and the access to these (mediated by institutions and social relations) that together determine the living gained by the individual or household'. See, Frank Ellis, *Rural livelihoods and diversity in developing countries* (Oxford: Oxford University Press, 2000), 10.
- 18 Data for this study were collected in collaboration with the Department of Urban Sociology at the Vietnamese Academy of Social Sciences, Hanoi.
- 19 Interviews lasted about one hour and were conducted in Vietnamese, with consecutive interpretation in English. Most interviews were conducted at the place of residence of the interviewee. Our semi-structured interview schedule covered four main themes: the evolution of livelihood strategies, support from land developers and governments, socioeconomic opportunities and obstacles, and socio-spatial relationships with the new town. All interviews were recorded, transcribed and translated into English.

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- 21 The *đổi mới* (often translated as 'renovation') refers to a series of state reforms that have given market mechanisms a greater role in the national economy, yet remain within the framework of a one-party, communist ruling system.
- 22 Danielle Labbé and Julie-Anne Boudreau, 'Understanding the causes of urban fragmentation in Hanoi: The case of new urban areas', *International Development Planning Review* 33, no. 3 (2011): 273–91.
- 23 'Vietnam has a total 632 new urban areas', Vietnam Business Asia, 12 July 2010, <http://www.intellasia.net/vietnam-has-total-632-new-urban-areas-132007>.
- 24 During the early 2000s, both companies set up subsidiary enterprises: Vinasinco in Trung Hoa-Nhan Chinh (THNC) and the Housing and Urban Development Corporation Service (HUDS) in Linh Dam. These enterprises were charged with commercialising the newly built spaces in each redevelopment. Since then, they have also ensured the maintenance of high-rise towers, collection of management fees, regulation of public space usage, and operation of parking and commercial spaces.
- 25 Interviews with TH-01, 19 June 2013; TH-02, 26 June 2013; LH-02, 8 July 2013; and, LH-07, 15 July 2013.
- 26 Danielle Labbé, 'Eating by points and coupons is not enough (1965–80)', in *Land politics and livelihoods on the margins of Hanoi, 1920–2010*, op. cit., 67–94.
- 27 Joop De Wit, 'Tracing the welfare and livelihood choices of farm households following displacement through land recovery in Vietnam' (Working Paper No. 574, Rotterdam: The Institute of Social Studies, 2011).

- 28 Perhaps due to its perceived association with more liberal land regimes, the term 'expropriation' is carefully avoided in the Vietnamese legislation, which instead uses the expression 'land clearance' (*giải phóng mặt bằng*) or 'land-use right revocation' (*thu hồi quyền sử dụng đất*).
- 29 C.f., Land Law 1998 and 2001, reproduced in *Luật đất đai – Land law* (Ho Chi Minh City: Giao Thông Vận Tải Publishers, 2008).
- 30 Values are adjusted to account for inflation.
- 31 This assessment echoes the opinion of many Red River Delta households expropriated for land redevelopment over the last 15 years. See, DiGregorio, 'Into the land rush', op. cit.; De Wit, 'Tracing the welfare and livelihood choices of farm households following displacement through land recovery in Vietnam', op. cit.; Culas, Nguyen and Nguyen, 'Norms and practices in contemporary rural Vietnam', op. cit.
- 32 Interview with LH-03, 7 July 2013.
- 33 Pseudonyms are used throughout this chapter to protect informants' anonymity.
- 34 Interview with LH-06, 28 June 2013.
- 35 DiGregorio, 'Into the land rush', op. cit.; Hoang Xuan Thanh, Dang Nguyen Anh and Cecilia Tacoli, 'Livelihood diversification and rural-urban linkages in Vietnam's Red River Delta' (Working Paper on Rural-Urban Interactions and Livelihood Strategies No. 11, Washington, D.C.: International Food Policy Research Institute, 2005).
- 36 Interviews with LH-06, 28 June 2013; and, LH-08, 15 July 2013.
- 37 Interviews with LH-03, 7 July 2013; LH-06, 28 June 2013; TH-01, 19 June 2013; TH-03, 22 June 2013; and, TH-05, 22 June 2013.
- 38 Interview with LH-08, 15 July 2013.
- 39 Nguyen, Lebailly and Vu, 'Agricultural land conversion for industrialization', op. cit.; Tran, 'Farmland acquisition and household livelihoods in Hanoi's peri-urban areas', op. cit.
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- 41 Nguyen Vinh Quang et al., *The impact of urbanisation on agriculture in Hanoi: Results of interviews with district and municipality officials* (The Hague: Centre for Agricultural Research and Ecological Studies, 2005).
- 42 Kelly, *Landscapes of globalization*, op. cit.; Rigg et al., 'Reconfiguring rural spaces and remaking rural lives in central Thailand', op. cit.; Hall, Hirsch and Li, *Powers of exclusion*, op. cit.
- 43 Interview with LH-05, 14 July 2013.
- 44 Interview with TH-04, 26 June 2013.
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## **ABOUT THE ASEAN-CANADA RESEARCH PARTNERSHIP**

While Canada has been a dialogue partner to ASEAN since 1977, the deepening of ASEAN and Canada Track 1 relations in recent years has increased collaborative efforts in addressing pertinent regional issues of common interest. However, improved relations at the Track 1 level will require more groundwork at the Track 2 and 3 levels.

It is with this in mind that the ASEAN-Canada Research Partnership was initiated by the RSIS Centre for NTS Studies and the Institute of Asian Research (IAR) in the University of British Columbia. Supported by the International Development Research Centre (IDRC), Canada, this initiative is also a response to growing interest within the Canadian and Southeast Asian research communities to jointly examine ASEAN's role and impacts, and exchange experiences in order to explore development opportunities and address social, economic and environmental problems.

The ASEAN-Canada Research Partnership seeks to build stronger research capacity and partnership between and among Canada and ASEAN countries, institutions and individuals. Specifically, it seeks to:

- Enhance understanding of Southeast Asia development dynamics and ASEAN's role in addressing such dynamics.
- Facilitate knowledge, experience and skills exchange among Southeast Asian and Canadian scholars.
- Strengthen ASEAN-Canada relations through the establishment of an informal research network among think tanks, academic institutions, government officials, multilateral agencies and other stakeholders.
- Contribute to the ASEAN-Canada Plan of Action by providing a shared evidence base for policies and interventions.

The partnership covers two themes over the course of the three years. The first theme 'Towards Balanced Growth — Alternative Development Models and Redistribution Mechanisms' (2012–2013) seeks to address the challenge of finding development options or policy sets that achieve the ASEAN goals of greater regional integration and strong economic growth but without the increased inequality that has become pervasive

in the last two decades. The second theme 'Natural Resources Management for Sustainable Growth' (2013–2014) seeks to find means of improving systems for managing natural resources to allow sustainable economic growth without degrading common resources as illustrated by increased atmospheric pollution and concentrations of greenhouse gases, overharvesting and degradation of forest resources, as well as overharvesting of oceans and depletion of fisheries.

The ASEAN-Canada Research Partnership was officially launched on 20 January 2012 along the sidelines of the commemoration of the 35th Anniversary of ASEAN-Canada relations at the ASEAN Secretariat, Jakarta, Indonesia.

# **ABOUT THE RSIS CENTRE FOR NON-TRADITIONAL SECURITY (NTS) STUDIES, NTU**

The **RSIS Centre for Non-Traditional Security (NTS) Studies** conducts research and produces policy-relevant analyses aimed at furthering awareness and building capacity to address NTS issues and challenges in the Asia-Pacific region and beyond.

To fulfil this mission, the Centre aims to:

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- Provide a platform for scholars and policymakers within and outside Asia to discuss and analyse NTS issues in the region.
- Network with institutions and organisations worldwide to exchange information, insights and experiences in the area of NTS.
- Engage policymakers on the importance of NTS in guiding political responses to NTS emergencies and develop strategies to mitigate the risks to state and human security.
- Contribute to building the institutional capacity of governments, and regional and international organisations to respond to NTS challenges.

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The Centre is the Coordinator of the ASEAN-Canada Research Partnership (2012–2015) supported by the International Development Research Centre (IDRC), Canada. It also serves as the Secretariat of the initiative.

In 2009, the Centre was chosen by the MacArthur Foundation as a lead institution for its three-year Asia Security Initiative (2009–2012), to develop policy research capacity and recommend policies on the critical security challenges facing the Asia-Pacific.

It is also a founding member and the Secretariat for the Consortium of Non-Traditional Security (NTS) Studies in Asia (NTS-Asia).

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The School's activities are aimed at assisting policymakers to develop comprehensive approaches to strategic thinking on issues related to security and stability in the Asia-Pacific and their implications for Singapore.

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