

# **REGIONAL OUTLOOK**

**Southeast Asia  
2003–2004**

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## **REGIONAL OUTLOOK** **Southeast Asia** **2003–2004**

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# PREFACE

**R***egional Outlook* was launched in 1992. Designed for the busy executive, professional, diplomat, journalist, and interested observer who face severe time constraints, this annual offers a succinct analysis of political and economic trends in the countries of Southeast Asia and the outlook for the forthcoming two years.

In this endeavour, it is impossible not to be overtaken by events. An analysis such as this serves best when it indicates patterns of developments, offers some insight into unfolding dynamics, and puts its finger on emerging issues and areas of change. In this way *Regional Outlook* aims to provide the necessary background for the reader to interpret new information and data.

The year 2002 was etched by the dynamics of post-11 September 2001 as the world watched how old strategic patterns were being reconfigured by that event. The uncertainties and anxieties are by no means over. The threat of terrorism dominates international discourse. Anti-terrorism sensitivities drive new strategic calculations. As 2002 moved into its final quarter, the prospect of the United States going to war with another Muslim country, Iraq, loomed heavily. Although an event occurring half-way round the world, the political and economic fallout would have implications for the security and stability of Southeast Asia.

After an economic slowdown in most Southeast Asian countries in 2001, a moderate recovery is expected in 2002. A pick-up in exports since the first half of 2002 was further buoyed by an improvement in domestic demand. Significant progress has been made in financial and corporate restructuring. In recent years, the more developed Southeast Asian economies such as Singapore and Malaysia have also been seriously exploring new sources of growth which are more domestic-based, such as education and health-care services, as well as tourism and biotechnology. Regional economic recovery will be fragile because of external risk factors such as a possible war in the Middle East, a "double-dip" recession in the United States and faltering global demand for electronics and ICT products. Anxiety about losing foreign investment to China continues. In the light of these challenges, ASEAN needs to work towards greater regional integration. Singapore Prime Minister Goh Chok Tong has proposed that the Association be turned into a full-fledged ASEAN Economic Community by the year 2020.

*Regional Outlook 2003-2004* was written by a team from within the Institute and without. We thank Mely Caballero-Anthony, Derek da Cunha, Soedradjad Djiwandono, Nick J. Freeman, John Funston, Russell Heng Hiang Khng, Denis Hew, David Koh, Lee Hock Guan, Lee Poh Onn, Mohammad Chatib Basri, Mohamad Yusop bin Awang Damit, Rahul Sen, Ramkishan Rajan, Sakulrat Montreevat, Mya Than, K.S. Nathan, Ngiam Kee Jin, Aladdin Rillo, Sharon Siddique, Daljit Singh, Anthony L. Smith, and Tin Maung Maung Than for their contributions. We also thank Russell Heng Hiang Khng and Denis Hew for editing the volume.

K. Kesavapany  
*Director*  
*Institute of Southeast Asian Studies*

15 November 2002



# INTRODUCTION

**F**or Southeast Asia, the 11 September 2001 terrorist attacks in the United States continued to cast a long shadow throughout 2002. The terms "11 September" or "9/11" have entered popular language. The event and its aftermath have made terrorism the top security preoccupation in the region. The fear is that an Al Qaeda or Al Qaeda-affiliated network of terrorists may be operating in the region. The October 2002 bomb incident in Bali, Indonesia, dramatized the reality of the terrorist threat in the region even though the debate continues over who its perpetrators and their international linkages are.

The escalation of terrorist activities threatens to dampen investors' interest in the region. It also scares away tourists. These economic repercussions add to the domestic political problems of many regional countries. In those countries that are Muslim-dominated or have a sizeable Muslim minority, the terrorist-linked security climate poses a host of political challenges. The response to the U.S.-led campaign against international terrorism becomes a sensitive issue. Ongoing domestic debates over the interpretation and practice of Islam become more fraught with sensitivities.

Apart from terrorism, governments in the region continue to face a whole range of issues related to good governance. For a few countries such as Cambodia, Indonesia, Malaysia, and the Philippines, election fever will rise as they face imminent elections in 2003, or at least no later than 2004. For some others where democratic elections are not a fact of political life, various forms of liberalization will continue. On the whole, no regime in the region faces any threat of total collapse. Other than the terrorist threat, economic performance will continue to be a major determinant of political stability.

A modest economic rebound is expected for Southeast Asia in 2002, buoyed by improvements in export performance and domestic demand. The previous year was a very tough one for the region as economic growth significantly decelerated, dragged down by the downturn in the United States and the European Union.

According to the International Monetary Fund's (IMF's) *World Economic Outlook* (September 2002), a U.S.-led global economic recovery is under way, reinforced by a pick-up in trade and production worldwide. Despite the economic recession and terrorist attacks in 2001, the U.S. economy has proven to be surprisingly resilient.

The economic outlook for Southeast Asia for 2003 and 2004 is cautiously positive. Domestic demand should continue to strengthen over the next two years. However, if excess capacity and weak bank lending continue to persist, while progress made in corporate restructuring remains sluggish, then growth prospects may be limited. Furthermore, the ongoing economic revival in the region is extremely fragile owing to several external risks. These risks include a faltering U.S. economic recovery, military conflict in the Middle East, rising oil prices, and the prospect of global deflation.

Amid all these uncertainties, policy-makers across Southeast Asia have also begun to re-examine their economic development strategies. The rapid economic growth experienced by the region during the last three decades was largely driven by foreign direct investments (FDI) from multinational corporations (MNCs) and export-oriented industries. This re-evaluation of economic strategies and policies would include seeking



new sources of growth as well as developing domestic small and medium-sized enterprises (SMEs).

Looking forward, should Southeast Asia worry over China's rapid economic rise? China is now widely considered the country of choice for foreign investments, especially in manufacturing. Furthermore, China is currently the largest recipient of FDI flows in the Asia-Pacific region. In contrast, FDI inflows to Southeast Asia have remained fairly stagnant, and amounting to less than a third of China's FDI.

Unless external developments turn for the worse, the regional economies should rebound moderately in the next two years. However, prospects for Southeast Asia over the mid- to long-term will largely depend on how successful regional policy-makers are in restructuring their economies and meeting the competitive challenges ahead.

Finally, we thank the authors and support staff who have made this volume possible.

Russell Heng Hiang Khng  
Denis Hew  
*Editors*

15 November 2002