

# Identifying Asia's Engines for Economic Growth

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## I. INTRODUCTION

Identifying Asia's engines for economic growth has to be done on both domestic and regional levels, as the economic strength of individual countries comprises the strength of the region as a whole. Conversely, regional policies affect domestic situations. In line with this framework, three of the four models we suggest - **human capital development**, **small and medium enterprises (SMEs)**, and corporate governance - are primarily domestic in nature. On the regional level, we take a closer look at **free trade agreements (FTAs)**.

- **Human Capital Development:** Human capital development can be achieved by the two-pronged model of vocational schools (to harness employment potential) and Business Accelerator Programs (to foster entrepreneurship).
- **Small and Medium Enterprises (SMEs):** SMEs channel the entrepreneurial spirit to promote productivity. This necessitates the active support of the educational sector, the government, the private sector, and external organisations.
- **Corporate Governance:** There is a need to complement the existing checks and balances in the stakeholder model by introducing Independent Agencies, which institutionalize transparency and accountability.
- **Free Trade Agreements (FTAs):** FTAs make a positive contribution, as long as they support the economic growth of individual countries and, more importantly, serve the interests of the entire region and promote eventual global integration.

## II. HUMAN CAPITAL DEVELOPMENT

Human capital development is important for two reasons: self-sustainability and economic productivity. First, the ability of individuals to provide for themselves is directly related to the amount and nature of skills possessed. Second, the degree of human capital development determines the pace of a country's economic growth.

### A. Vocational Education

In a lot of countries in Asia, vocational education has never been considered a viable alternative, perhaps because of the high premium placed on formal academic education, which has its own set of problems. However, vocational education has a very important role to play in developing the skills of eventual employees, especially now that these potential employees are facing serious competition, first among those who are entering the workforce at the same time and second, between the fresh entrants and those who are struggling to keep their jobs.

To remedy that, we suggest that the importance and potential of vocational schools be better emphasized, something that the government of Thailand is doing through the Department for Social Development. Indeed, we believe that vocational schools have economic value, in that they enable immediate

absorption into the workforce. They are also an asset, as far as foreign direct investment (FDI) is concerned. Furthermore, we suggest that the concept of life-learning process form the backbone of vocational schools. Life-learning process is when citizens are encouraged to invest constantly in the development of new skills. This ensures that they will not be too dependent on any one skill and that, when competition gets the better of them, they will still be able to support themselves and their families.

## **B. Business Accelerator Programs**

On a general level, the formal educational system in Asia falls short of its responsibility to develop human capital because classroom learning focuses primarily on concepts, theories, and examinations, which leads to an insulation from real-world problems and practical applications. The detrimental effects of such a system are a noted lack of innovation.

As a solution, we suggest that there be a conscious effort to instill the value of creativity from a young age, primarily through the educational system. Once this necessary underpinning of creativity is in place, we suggest Business Accelerator Programs as a model to foster entrepreneurial spirit.

A Business Accelerator is a collaboration of universities, the private sector (i.e. local financial investors), and the local community, with the necessary support of government. Students are to come up with business models that can be utilized by one of three groups: the students themselves, domestic entrepreneurs, and disadvantaged sectors of society, such as the minority groups in the Philippines. These business models will be reviewed and, if deemed promising, fully supported by either the private sector or local government.

This collaboration is based on the premise of mutual gain. First, students are given a venue to put their academic learning into practice. Second, governments are able to tap into students' potential to help them direct the economic growth of particular regions in whatever way. Finally, the private sector benefits because it is able to impart its knowledge to students and, in that way, fulfill its responsibility to society.

For instance, in the One Tambon, One Product of Thailand, business accelerators could spur innovation that would help the producers of that one product to differentiate themselves, capitalize on their own competitive advantages, and, hence, enhance their productivity. This idea is already being implemented by specific educational institutions around the region, and this trend, once modified by our suggestions, is something we do want to promote.

The ideal situation is for this collaboration to result in the formation of small and medium enterprises (SMEs). This brings us, then, to the importance of SMEs as an engine of growth.

## **III. SMALL AND MEDIUM INDUSTRIES**

In the area of industries, we believe that the engine for Asia's growth lies in the proliferation of small and medium enterprises (SMEs). The reasons to support our identification of SMEs as an engine of growth are as follows:

### **i. SMEs are a catalyst for domestic entrepreneurship:**

SMEs commonly start from domestic backgrounds usually initiated and established as family business (i.e. the handicraft SMEs in Indonesia and Malaysia). Thus, the initiative to develop and grow will come directly from society itself, especially because people will now have a direct stake in this, and not from the government only. This will establish self-awareness in trying to have a better economic life in each member of society. This will eventually create an eagerness for progress within the country as a whole.

### **ii. SME drives innovation:**

SMEs, being small-scale, require a higher level of involvement from their workers. Due to the shortages of workers and resources, employees in SMEs are normally involved in various sectors of the company (i.e. production, marketing and even management) at the same time. Dynamic workers exposed to a range of work experiences will acquire innovative skill sets which should enable their businesses to become more competitive.

### iii. SME increases country's employment rate

Small industries use technologies that require a lot of workers. Thus they are able to create more job opportunities compared to large-scale companies. Technologies that are used in small scale industries are primarily man-based. As a result, small industries depend on workers to ensure growth. And as the companies grow, more workers are needed to continue the operation.

While the potential of SMEs can be clearly seen, there are several factors that still impede their development within the Asian economy. First is the low level of awareness with regards to the benefits of SMEs. Also, due to small resources SMEs are exposed to higher risks of failing and therefore necessitate cooperative external structures. Thus, we propose the following:



#### i. Education

Innovation, being a prominent component of SME, can be developed from our human capital development model. Governments need to raise the level of awareness about SMEs at education institutions by providing students with opportunities to run their own SMEs through a business accelerator program.

#### ii. Government Incentives

Governments can encourage the blooming of SMEs through the provision of incentives such as tax breaks. Asia can adapt the Malaysian model whereby newly established SMEs are exempted from business taxation. The surplus in profits can be channeled back to the development of the SME itself. Complicated and time-consuming bureaucratic procedures should be deregulated to drive more entrepreneurs into SME ventures. Governments also bear the responsibility of hastening the removal of disincentives, which impede the growth of SMEs. Public sector personnel who leave the public service to set up SMEs should be able to retain their pension privileges, as is the policy that is being pursued in Japan.

#### iii. Private Sector Funding

With the increase in SMEs, there is a need to establish SME-specific funding institutions. These institutions should be able to offer SMEs more flexible loan systems (i.e. lower interest and longer repayment periods).

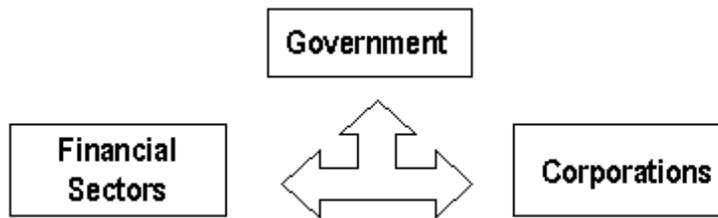
#### iv. Empowerment of NGOs, Student Organisations and SME Development Centers)

NGOs and student organisations play important roles in providing the framework for developing SMEs in rural regions. Governments should acknowledge their efforts and provide more support for these organizations. In particular, we believe that the government should allocate a special fund under the monitoring of an NGO. This fund can be used later on in an easy re-financing scheme for failing SMEs. Another alternative in utilizing the funds is to offer potential entrepreneurs with loans using their potentially successful business plans as intangible collateral.



## IV. CORPORATE GOVERNANCE

### Illustration of the need for corporate governance



The financial crisis of 1997 highlighted the necessity of corporate governance. Before the crisis, lending policies were not conducted in an objective manner, partially due to the lack of independent loan officers and the management of large companies and, more importantly, the absence of institutional checks and balances and transparency. Weak lending policies resulted in high non-performing loans (NPLs). Given an environment which lacked accountability and transparency, companies had the option of not revealing their financial situation. This situation placed investors at risk.

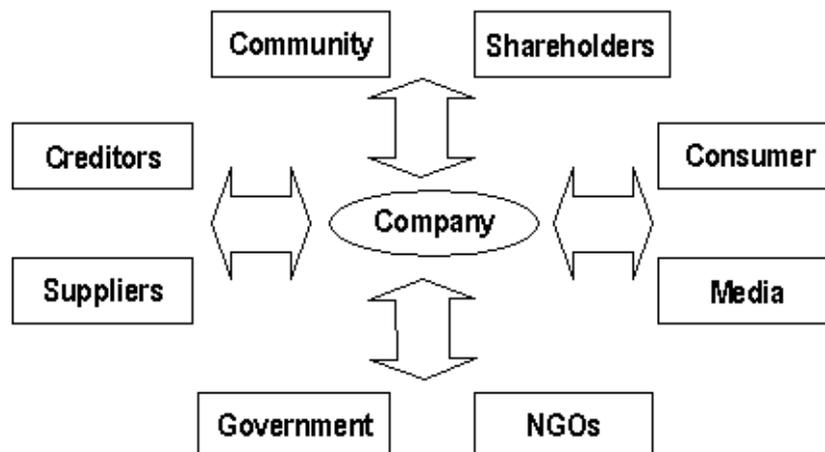
As such, economic growth in the region was threatened. To remedy this, we suggest Asia places more emphasis on corporate governance as a catalyst for investment and sustainable growth.

### The Stakeholder Approach

Companies do not interact only with shareholders, as is the common perception, but with stakeholders who include shareholders, consumers, media, non-governmental organizations (NGOs), governments, suppliers, creditors, and the community at large.

Companies provide shareholders with profits. In turn, shareholders, as owners of their business, can choose to withdraw from the relationship should they feel that the need arises. On the extreme end of the spectrum, consumers, in their capacity as the end buyer and with their ability to shape company policies, can also serve as either an incentive or a disincentive, while governments are responsible for legislation that helps regulate corporate behavior and ensures that effective enforcement mechanisms are in place.

### Corporate governance: Stakeholder approach



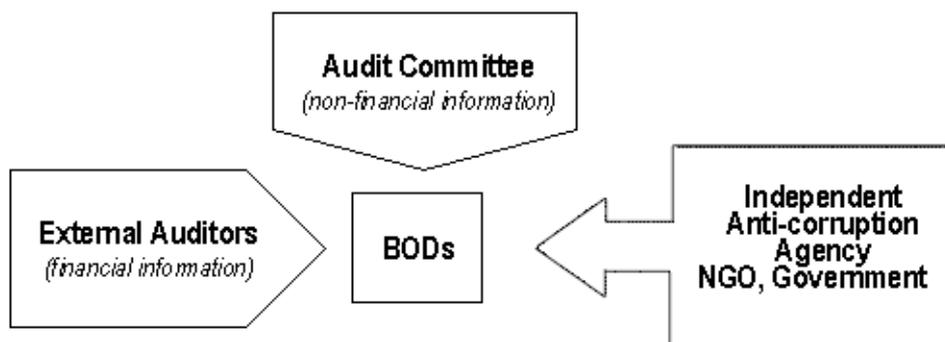
The media, being the medium of information exchange between companies and the various stakeholders, affects companies. Also, NGOs have become more important as they are representatives of certain groups of society.

Creditors also play an important role in the activities of companies. Suppliers and companies are connected by the supply chain where the relationship is based on interdependence. Because of the mutual dependence and constitution of financial health, we underscore the importance of corporate governance (although it should come across as a major factor, rather than a determinant). Eventually,

communities are indirectly affected by companies' levels of transparency through the weakening of the economy.

## The way to make the control system effective

The existing control system for corporate governance for big companies consists of auditors, an audit committee and shareholders. However, existing models of corporate governance have failed dramatically, as witnessed in Enron and WorldCom, due to the inherent conflict of interest embedded within the existing system where it is a problem of "who monitors the monitor" for external auditors and where monitoring bodies like the audit committee are not performing optimally. Therefore, we need a better control system to ensure good corporate governance.



As a result, we propose the formation of an independent anti-corruption agency comprised of independent auditors who do not have conflicting interests with any companies at all in order to cross-check the control system itself.

## How can the agency be formed?

We believe that a system based on connections could be a danger because of patronage networks. Then, the question that comes-up is how to form the independent anti-corruption agency to enhance the existing control system. There are many alternative forms of organisations that the agency can take, such as governmental form, or the form of an NGO.

At present, some countries have already established and implemented a governmental system. For instance, in Japan a governmental independent anti-corruption agency does exist. The way it works is the agency first warns the companies when there is a suspicious case. The next stage is to conduct public hearings, and finally the case is filed in the court of justice with the agency as a plaintiff in the particular case.

This agency will be an example of one way to conduct our proposal with the main goal to ensure that transparency and accountability do exist in the business sector. Such an independent agency that we propose can be from the government sector, a non-governmental organization (NGO), or even in the form of a mutual fund from companies themselves. This will be the choice of the countries that want to implement this model and the details will differ according to the internal interests and situations of each country. However, we hope that this initiative will create a new norm in the business sector.

In addition, a long-term solution that we would like to suggest is to implement and reap the long term benefits of tweaking the educational system, which will inculcate common values like ethics as suggested in the Human Capital Development section.

## V. REGIONAL FRAMEWORK

### A. Economic

The active pursuit of Free Trade Agreements has a two-fold underlying approach. In general, forming FTAs allows for the stimulation of investments through the classical dynamic effects of trade. Hence, the proliferation of FTAs surrounding ASEAN, including other bilateral FTAs amongst member nations, brings about a necessary stimulus to the various weak economies in ASEAN. Also, the active pursuit of

FTAs can be viewed as a form of damage control as it highlights the region as a whole to be outward-looking in light of the various negativities associated with ASEAN, despite their weak economies.

As such, the pursuit of FTAs is a form of long-term policy reaping the dynamic effects of stimulating trade and gathering investment. Such long-term views of putting forth the correct policy of encouraging FTAs will enable ASEAN to maintain its relevance and economic competitiveness.

## **Problems with the Region and How We Should be Forward Looking**

However, the success of regional agreements in the form of AFTA have been impeded as member nations are still reeling from recent events (i.e. the Asian financial crises and terrorists attacks) and there is an inequality in the pace towards market cohesion. As such, nations may have different political and economic priorities and agendas. This has then led to a trend where faster member nations resort to forming other bilateral FTAs. For example, Singapore is the leading country in ASEAN in terms of building free trade links with the rest of the economic communities, and has already succeeded in setting up 5 FTAs, with 7 FTAs under negotiations.

While these bilateral efforts have been criticized for undermining the overall efforts of AFTA and being politically insensitive, there is good reason to believe that both bilateral and multilateral efforts can co-exist and contribute towards the same ultimate goal of integrating the ASEAN region as a singular market, followed by larger Asia. For example, stronger economies like Singapore and Thailand can go ahead with their bilateral efforts and act as pathfinders “to show the way” for the weaker economies like Myanmar and Cambodia. But while there are many advantages to forming bilateral FTAs with distant economic countries or communities, geographical distance cannot be entirely eliminated even with modern technologies. The ASEAN region (or for that matter, the larger Asian region) is still a huge market with many benefits that can be harnessed.

But at a regional level, since Myanmar and Cambodia have no capacity to pursue FTAs bilaterally, then the notion of AFTA will still be useful as they are allowed to participate regionally at a comfortable pace with the more advanced regional economies facilitating growth. Given the current backdrop of other successful multilateral efforts like NAFTA and the EU, it is also a goal that regional integration in the form of ASEAN be extended to include the larger Asian region, followed by a linking of interdependence with other economic communities. Notably, weaker economies themselves must first learn to be self-sufficient and develop themselves internally without being over-reliant on FDI for growth, in order for this to be realized.

On the whole, the dual track policy of allowing advanced countries to fast track their economies through bilateral FTAs to co-exist with AFTA (which is a regional FTA) also permits faster economies to proceed without having to wait for slower members and without being seen as undermining the ASEAN spirit. What we are saying is that in the case of Singapore, it may not be the best or the only thing that Asia has to offer, but rather it is the epitome of the potential of the region in the long run. After all, the notion is “more business for the region means more business for individual countries”.

While it is suggested that FTAs are an effective tool for enhancing Asian prosperity, they are not the best. To make this preferential approach effective in the long run, a simultaneous approach of regional and global integration is still necessary, even though the pace of each integration will be different. This is understood based on the following argument: While FTAs can promote competition in the region, and in the long-run, a regionally efficient outcome may be realized, such an outcome is not always efficient globally. This suggests that regional integration such as AFTA can certainly realize economic growth in the short to medium term, but it is no guarantee for growth in the long run.

*“The pursuit of FTAs is a form of long-term policy reaping the dynamic effects of stimulating trade and gathering investment.”*

## Recommendations

We propose the following factors that can help bilateral efforts lead to an eventually successful fostering of regional multilateral agreements:

1. Ensure that there is mutual trust between nations.
2. Ensure that the pursuit of bilateral agreements does not undermine other countries or take precedence over regional agreements.
3. Promote the region actively as a whole.
4. Promote intra-ASEAN investment.
5. Use its function as a bulwark against protectionism
6. Help harmonize economic rules, systems or institutions in many areas that will otherwise be politically difficult to change through the use of external pressure as a motive.

## B. Socio-Political

A pressing concern is security, and governments are pressed to respond in a determined but sensitive way to counter terrorism while not offending certain communities or segments. The proposal of an ASEAN Security Community (ASC) by Indonesia has other ASEAN nations expressing little interest, especially if it resembles a defense pact. Yet the idea itself has symbolic value and allows the pooling of resources that member nations already have, the finding of institutional and legal means to prevent and solve conflicts, as well as providing an impetus for and complimenting the formation of the ASEAN Economic Community (AEC). It is ideal when both proposals are combined and implemented together, as the notion of a cohesive economic entity cannot come into being without a basis of security.

Hence, the rejuvenated commitment towards the realization of the AEC as well as cooperation towards regional stability shows integration internally, while the various FTAs represent ASEAN's outreach to the rest of the world. We also cannot deny the potential threat to future peace and stability amongst Asian countries because of diversity, which is presently well-managed by current political leaders. To avoid such future threats, intimate cross-cultural exchanges which promote social-level harmony are greatly necessary.

## VI. CONCLUSION

Asia remains one of the most dynamic, diversified and complex regions in the world. Thus, regional economic cohesion can only be achieved through a concerted effort by every Asian nation. Ultimately, we believe that whether our recommendations are implemented is secondary to knowing that these issues have now been raised and addressed. Hopefully, our proposals will increase the awareness of the existing problems and lift the level of dialogue within leaders of the ASEAN region and Asia at large.

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