
BNI

Maintaining Momentum

From shifting demographics to climate change, Southeast Asia confronts a host of challenges. Surmounting them will require both resilience and flexibility

Manu Bhaskaran

Southeast Asia scarcely disappoints with its capacity to produce uplifting surprises. Malaysia's voters recently proved the pundits wrong and elected a reformist government that is taking on that country's challenges with gusto. Since 1998, Indonesia has done the same by pulling off one of the most impressive democratic transitions among emerging market economies. Companies such as budget airline AirAsia have come seemingly from nowhere to become giants in their field, while Grab, the region's answer to ride-hailing firms, is just one of many unicorns to emerge.

Examples like these make me reasonably optimistic about the outlook for Southeast Asia in an increasingly turbulent global environment. Granted, it is not easy to generalize about a region that encompasses 643 million people in 10 nations as diverse as Lao P.D.R., an agricultural country of rugged mountains and forests, and Singapore, a gleaming city-state with one of the world's highest standards of living. But I am confident that the region will succeed in overcoming a host of global challenges, ranging from aging populations and climate change to advances in technology and the shifting currents of international trade and finance. Southeast Asia has successfully dealt with serious shocks in the past, not least the crisis of 1997–98, and it has emerged stronger. Its success in the future will depend on its ability to adjust flexibly to these global forces and on its resilience to the shocks and stresses that history tells us are inevitable.

Aging trends

How will Southeast Asia adapt? Let's start with demographics since so many other things follow from it. The region is undergoing a major demographic transition. Not only will population growth slow, aging trends will become more pronounced. While Singapore and Thailand will age faster, even countries with relatively young populations, such as Malaysia and the Philippines, will experience slower growth in their populations and labor forces. The era of plentiful and cheap labor, which helped the region industrialize through export-led and labor-intensive manufacturing, will be over, pretty much all over the region.

At the same time, the United Nations projects the urban population will expand from 49 percent of the current total to about 56 percent by 2030. That's another 80 million people jostling each other in towns and cities, competing for jobs and facilities. But, more positively, it also represents 80 million workers with a chance to be more productive and earn higher wages in a dynamic urban setting. These workers will make up a lucrative market for companies selling a wide variety of goods and services.

Might technological developments help the region cope with these demographic shifts? Advances in artificial intelligence, including robotics, together with innovations such as 3-D printing and new composite materials, will transform manufacturing processes, making them less labor-intensive while creating opportunities for new products. This will enable new ways of making things and change the drivers of competitiveness. There will be indirect effects as well. For example, aircraft manufacturers, taking advantage of new composite materials such as carbon fibers, have developed a class of super-long-haul aircraft that could bring more tourists to Southeast Asia as relatively cheap point-to-point travel options emerge.

Other examples:

- Wider use of SMAC (social, mobile, analytics, and cloud) should offer businesses many pathways to enhance profitability and reach out to consumers, who could benefit from goods and services that more directly meet their needs.
- Renewable energy will be used more widely, especially solar and wind power. This could reduce the region's reliance on polluting fossil fuels while enhancing energy security.
- An array of new biomedical therapies, some based on genomics, will transform medical treatments for a range of diseases and quite possibly raise not just life expectancy but the quality of life as well. New business activities could grow out of these innovations in a region that has seen some globally competitive medical hubs emerge, such as Bangkok.

As the region absorbs these new technologies, it will also have to deal with new forms of globalization

and regional integration. Yet the current pessimism about globalization may be excessive. There certainly has been a backlash in developed economies against free trade and immigration, but this is not the end of the game. Over time, this backlash is likely to produce, in both advanced economies and in Southeast Asia, a revised social compact and more balanced policies that can better compensate the losers from globalization through stronger safety nets and retraining programs.

Forms of integration

In the end, the region should still enjoy synergies from globalization and other modes of economic integration, but the form and shape of such integration could change. At one level, "whole-of-the-globe" multilateral initiatives will probably be more difficult to pull off. However, smaller-scale integration efforts such as subregional economic partnerships or cross-border trade are likely to expand. The 10-member Association of Southeast Asian Nations (ASEAN) is already mapping out practical plans for integration, such as the ASEAN Economic Community 2025 plan. This uniquely Southeast Asian approach to integration sets long-term goals and allows each country considerable flexibility to meet them, with the aim of improving the flow of goods, services, capital, data, and people.

The region has already enjoyed the benefits of many other forms of integration. One example is the Greater Mekong Sub-Region, where the northern ASEAN countries have worked together for more than 20 years to increase integration, with considerably improved transportation as well as rapidly growing trade and labor flows. Cross-border trade between Thailand and its neighbors has helped transform small towns into thriving hubs. Southeast Asia's integration efforts are likely to serve as models for other emerging market economies. This is important because countries exposed to such integration tend to have greater incentives to reform and improve their competitiveness—as happened during the past two decades of globalization.

Southeast Asia is also likely to remain highly integrated with the global economy. Continued exposure to global financial flows will pose two challenges. First, financial markets are subject to more frequent bouts of stress, occasional shocks, and outright crises. The root of the problem lies deep in the international financial architecture, and while some postcrisis reforms have helped strengthen the global financial system, emerging market economies in Southeast Asia and elsewhere will continue to be buffeted by large and volatile capital flows. In many cases, this may simply mean that unpredictable fluctuations in regional currencies complicate monetary policymaking and create uncertainty for businesses. But at other times, capital flows could be much more destabilizing, creating panic in currency, equity, and bond markets, with harmful consequences for economic growth and financial stability.

Second, China will become a much more tangible actor in global finance as its massive pool of savings is liberalized and flows out of the country. China has also launched several initiatives, such as Belt & Road, and financial institutions such as the New

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Development Bank and the Asian Infrastructure Investment Bank, which will become integral parts of the global financial architecture.

Climate change

Environmental challenges, including climate change, will be no less important. While it is hard to predict the economic damage likely to be wrought by rising sea levels and increasingly violent storms, the Asian Development Bank reckons that Southeast Asia will be among the world's hardest-hit regions [see related article on page 22]. The smoke from forest fires that envelops parts of Indonesia, Malaysia, and Singapore each year suggests that the damage can be extensive and painful.

Water scarcity, though less highlighted, is another potential source of conflict and economic trouble. Already, there are signs of stress, caused in part by a series of dams built on the upper reaches of the Mekong River, in China. These have been shown to change the flow of the nutrient-rich sediment as well as the annual flood pulse (the fluctuating flows of the river during different seasons) needed downstream to sustain fishing and other activities critical to the livelihoods of people in the lower Mekong Basin. Managing Southeast Asia's water resources and ensuring that enough safe water is made available equitably will not be easy.

New technologies

Let's look at what these global trends mean for the region, starting with the impact of technological advances. Predictions of wholesale displacement of workers seem overly pessimistic. Some displacement is normal in a market economy as new industries are born and others decline: at times this process accelerates; at times it slows. In coming decades, the pace of dislocation is likely to accelerate, but so will the pace of job creation. How many of us expected the Internet to spawn the cybersecurity industry, which employs hundreds of thousands of workers across the globe? The United States alone has a cybersecurity workforce estimated at 768,000, according to CompTIA, a technology association. Similarly, the advent of artificial intelligence and data analytics will create new jobs.

How will Southeast Asia cope with technological change and other developments that promise to shake up the existing structure of competitiveness? It is quite possible that reshoring of manufacturing to developed economies could gain more traction. Moreover, some technologies generate network effects that give bigger economies advantages over smaller ones. It is no coincidence that companies such as Alibaba, Alphabet, Facebook, and Tencent arose in China and the United States.

It is also likely that China will continue to move up the value chain, while India is likely to increase its presence in more niches of manufacturing as its infrastructure and business environment improve and its manufacturers are better able to exploit economies of scale. But all this does not mean that the export-led manufacturing model will be denied to late developers such as Indonesia and the Philippines, for two reasons.

First, existing industries cover a spectrum of activities, and it is unlikely that technology will transform every single one to such an extent that there is no longer scope for labor-intensive work. In industries such as textiles, garments, and footwear, for instance, there are limits to how much automation is possible.

Second, new technologies can invigorate developing economies in Southeast Asia. Look at how advances in communications and computers have helped the Philippines build an entirely new industry—business process outsourcing—from scratch. The multiplicity of emerging technologies could well offer more such opportunities.

Building resilience

To cope with this period of unsettling change, Southeast Asia needs to build resilience, or the capacity to bounce back from shocks and stresses. At the same time, it must remain flexible, to take advantage of the opportunities while mitigating the risks posed by longer-term challenges such as technological disruption and climate change.

Resilience has improved since the regional crisis of 1997. Economies are more diversified; governments have adopted more flexible exchange rate regimes; financial structures are much less prone to crises as banks, for example, are better capitalized; and the balance sheets of companies, households, financial institutions, and government are in better shape. For proof, just look at how well the region weathered the shocks and wild market movements of recent years, such as the global financial crisis, successive euro area crises, and the collapse in commodity prices.

To gauge how flexibly the region will respond to the transformations and dislocations it is likely to encounter, it helps to look both at spontaneous, bottom-up adjustment by companies and individuals and at policy-driven adjustment.

Bottom-up, spontaneous adjustment is largely in good shape. Companies in the region have a strong track record of transformation. There are those like AirAsia, a low-cost carrier that has grown to become Malaysia's largest airline, with affiliates across the region. Thai companies such as Charoen Pokphand Group and the Siam Cement Group have scaled up impressively in recent years to operate across the Mekong region and beyond.

Government support

In the realm of policy-driven adjustment, globally competitive clusters of activity have emerged across the region, which can be springboards for innovation. Many of these benefited from government support in the form of industrial master plans and incentives to develop industrial estates and attract foreign investors. A good example is the eastern seaboard of Thailand, which has become a major manufacturing hub for petrochemicals and automobiles. The Thai government is now seeking to transform this region into an expanded Eastern Economic Corridor. Malaysia has the Penang-Kulim corridor and the southern region of Iskandar, which are also globally competitive manufacturing and logistics clusters.

The key to improving policy-driven adjustments is to provide public goods such as infrastructure, education and skills training, research and development, and social safety nets. This is happening—witness the major turnaround in investment in infrastructure across the region after decades of slow progress.

Governments are also cutting regulation and tackling corruption. Indonesia has moved up the World Bank's ease of doing business rankings, and its anti-corruption agency has fearlessly prosecuted hundreds of officials, including a speaker of Parliament, regional governors, and senior ministry officials. This has gone a long way toward diminishing the culture of impunity, which makes corruption so difficult to eradicate. Malaysia's new government is also showing exemplary zeal in attacking corruption.

For Southeast Asia, the next couple of decades could prove exhilarating in terms of the opportunities presented by technology and global growth, but also tumultuous because of the continuing risks, such as those posed by an unreformed and unstable international financial architecture. There clearly is much hard work to be done. Policymakers still have not gotten everything right, but they are heading in the right direction. Companies are growing in scale and sophistication, helping the region's economies adjust flexibly and effectively to new challenges. Southeast Asia has had a good track record of responding to challenges over time. There is every reason to be confident that it will continue to do so. FD

MANU BHASKARAN has studied economic and political trends in Southeast Asia for more than 30 years. He is chief executive officer of Singapore-based Centennial Asia Advisors, a unit of Centennial Group, a strategic advisory firm based in Washington, DC. He previously worked in the administrative service of the Government of Singapore and as chief economist at SG Securities in Singapore.