EAST ASIAN REGIONAL OUTLOOK

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PACIFIC BASIN DYNAMISM PERSISTS

Center of World growth

--7%/year, 1960-1980

Center of World Social Innovation
--Reconcile growth & distribution
--Reconcile market economy & strong government leadership
econcile (partly) labor discipline & rapid wage growth
Center of Global Political Dynamism
--both wars U.S. has fought since WWII
--Japanese & 4 Tigers' Growth Seduced China into reform
--Superior Chinese & Japanese Growth forcing USSR into reform
--Gorbachev's Vladivostok Initiative recognizes USSR must come to terms with the Pacific Basin Miracle

Center of Global Capital Markets
--Taiwan will shortly have $60 billion reserves

--See following pages on Japan

Smaller countries are outpacing Japan

Surpassed Japan's share of world trade in 1980

Growth rates have been much higher than Japan's for all of 1980s

Difficult years of 1980s have consolidated Pacific Asian dominance

Pace of industrial transfer has accelerated

Principal Third world competitors have decisively lost

Gain in market share of world trade during three bad years nearly as great as gain during 20 good years:

1960-1980: 4.3% to 6.5%
1980-1983: 6.5% to 8.2%

JAPAN I: EMPEROR OF THE FINANCIAL WORLD

World's 4 largest banks; 8 of 10

World's 4 largest investment houses
- Nomura's investment trust grows $3B/mo
- Nomura caused collapse of the perpetual FRN market in one day: 12/4/86

World's largest FX reserves: Dec 1986, $180B
-passed Saudi Arabian record

Japan holds 1/3 of all world banking assets: $1.2T of 3.4 trillion in December 1986

Japan's stock market is more heavily capitalized than any other as of April 1987:
$2.7T vs US 2.6T

NTT is world's most heavily capitalized firm
-more than whole West German stock market

Japan's stock market yielded world's best returns 1976-86

Japan's annual capital flows to the U.S. exceed twice total US personal savings

Japan's capital exports were $80B last year

Japan's savings in 1987 are $39B/mo, of which $10B are going overseas each month

Foreign exchange trading in Tokyo now exceeds $90B/year, which is Europe's peak level

At current price levels, Japanese land is worth more than all of America

Appropriately, world's richest men is Japanese:
Yoshiaki Tsutsumi, a land magnate & miser, is worth $21B

JAPAN IS BECOMING ARBITER OF WORLD ECONOMY

Huge capital outflows are increasingly purchasing commanding positions
- not just portfolio like Saudi Arabia
- $500 M in Goldman Sachs
- auto parts
- semiconductor firms

US banks look desperately to Japan for a soltion to the 3rd World debt problem

- Bank of America pleads for a $350M Japanese capital infusion

Increasingly, the core of economic policy in many countries is a response to Japan:

Some protect themselves with tariffs & quotas
- France

Some emulate Japanese technology policy
- US computer research consortium
- Reagan's Pentagon program on superconductors

Some desperately seek Japanese investment

The common theme of all of these is that Japan acts & the world reacts

JAPAN IS NONETHELESS TERRIFIED

Despite current recovery, more vulnerable to depression than any other OECD country

Depression scenario:

- Current cost cutting reduces employment in thousands of small firms
- That reduces consumer demand
- Firms cut profits abroad to maintain market share in face of strong yen
  - Seek to maintain profitability at home
  - Retail margins squeezed
- Retailing system collapses
- Severe unemployment
- Stock market weakens
- Many firms making money only out of speculation go under

Short of depression, many Japanese firms face huge FX losses

- To keep yen down, firms, banks keep funds overseas
- Nippon Life lost Yen 7T during earlier decline of dollar

The Japanese economy is currently recovering

The Japanese remain terrified

How do we explain this paradox?

THERE ARE TWO JAPANESE ECONOMIES

The one you & I live with

The one Japanese live in

The competitive, modern manufacturing economy employs only 7% of the work force

Most of the rest works in a protected, Third World economy

--6 layers of wholesalers absorbing what would otherwise be mass unemployment

Agriculture: rice prices 8-10x world price, government buys wheat at 10x Canadian price

Before, Chinese wall between international competitive economy & local Third World economy, but now:

-US pressures on agricultre
-financial liberalization;
-wholesalers at risk

Land market mirrors the economy

94% of all land is held off the market

All agricultural land is given special protection, so it's virtually never sold

Sunshine laws make it impossible to build high rise buildings on most urban land

Taxes on land sales so high that few people sell

-Taxes on sales within 2 years of purchase were 84% of profit, now 94%

Note: land boom is over
higher interest rates
higher taxes: 84%--94%
Japanese land isn't really worth more than US land; there's just a huge weight of money on a tiny fraction of the land

JAPANESE STOCK MARKET ALSO REFLECTS DUAL ECONOMY

Japan has the world's largest 3rd World Stock Market

Perhaps 2/3 of total shares are held by sister companies

Majority of remaining shares controlled by 4 securities firms

That leaves a tiny minority of traded shares

A huge weight of money is sitting on those few shares:

- Huge domestic savings
- Huge trade surplus
- Easy money
- Fear that putting money outside Japan means FX loss
- Lack of productive investments inside Japan

Result: Channeling of a tidal wave of money into 2 narrow channels: estate, stock markets

But now:

- Interest rates rising
- Real estate no longer attractive
- Trade surplus declining
- Productive economic growth reviving

Terrible Risk of stable exchange rates

- Stable exchange rates ===> tidal wave of money reverses, seeks profits abroad
- A year ago, a brief period of stable exchange rates caused the market to drop 3000 points
- Stable exchange rates caused purchases of foreign securities to double in June 87 as compared with May $5.4B-10.1B
- Real economic recovery could create another outlet for funds

Summary: Invest in Japan stocks at your own risk

KOREA: THE NEW JAPAN?

1986 RECORD

GNP	+12.5%
CPI	+1.3%
WPI	-2.7%
CURRENT ACCOUNT	+$4.6 Billion
1987Q1 growth	+15.6% annual rate

JAPAN EARLY 1960S/KOREA MID-1980s

EXPORT FIRST CARS TO U.S. (1960/1985)
HOLD OLYMPICS AS DIPLOMATIC DEBUT (1964/1988)
CURRENT ACCOUNT BALANCE TURNS AROUND

EXPORT GROWTH

27.1% COMPOUNDED 1970-85
14.1% COMPOUNDED 1980-85
14.1% TO YEAR 2000 WOULD YIELD EXPORTS COMPARABLE TO JAPAN, US IN 1986

RISKS

PROTECTIONISM: MAXIMUM $2 BILLION WITHOUT ADJUSTMENT
REVALUATION: $1.2 BILLION/10% PRIOR TO ADJUSTMENT
OIL PRICES: MANAGED 1973, 1978 INCREASES
INTEREST RATES: SURVIVED EARLY 1980S
RECESSION: HAS GROWN IN EVERY YEAR OF WORLD RECESSION
POLITICS: COMPARE 1980

KOREA: THE NEW PHILIPPINES?

Top leadership exceedingly unpopular

- Failure to rise to the challenge of political reform
- Kwangju
- Repressive labor & campus policies
- Management Style

Shift in popular priorities

- Before, overwhelming concern with
  - fear of war
  - food & clothing

- Now, rising concern for personal & political dignity

Differences from Philippines

- Korea is run by institutions
- Military/police are competent & loyal (to system, not Chun)
- Consensus on management of economy
  - -present system, with reduced role for chaebol

Long term: If present political crisis overcome,
Korea may gradually overwhelm Japan

- Korea is more cosmopolitan
- Korea adjusts faster internally than Japan
  - --e.g., labor market, wholesalers
- Korea adjusts faster externally than Japan
  - --e.g., to U.S. pressures
- More of the Korean economy is competitive than Japan's

If labor issue is badly fumbled, could have a brief "Polish interlude"

--Probability low, time period probably short

PHILIPPINE PROSPECTS I:
THE MARCOS LEGACY

A large foreign debt, now approaching $28 billion

A similar burden of domestic debt

A huge lag in seizing export markets as compared with Pacific Asian competitors

Concentrated ownership by the government of a vast array of economic enterprises

The crippling, as part of the Marcos search for political monopoly, of all the society's most vital institutions: competitive business, the military, the educational system, the judiciary, the Congress, and the political party system

Pervasive poverty and severe inequality

Political illegitimacy

Widespread hostility to foreign investment and to the kinds of economic policies that created economic takeoffs in other Pacific Asian countries

PHILIPPINE PROSPECTS II:
POLITICAL LEGITIMACY

New constitution

Restoration of the integrity of the upper levels of judiciary

Restoration of freedom of the press

Free and honest parliamentary elections

New parliament opened

Most human rights abuses by the armed forces curtailed

Restoration of free labor movement

Resounding victory in the May 11 parliamentary elections

--unquestionably an endorsemet of Aquino leadership

Defeat of four coup attempts and other destabilization efforts by the Marcos right

At least temporary containment of destabilization efforts by Leninist left.

PHILIPPINE PROSPECTS III: DEBT AND FINANCIAL MANAGEMENT

Inflation under 5% annual rate in 1987 so far

Agreement with 483 foreign banks on a rescheduling with concessionary terms

Similar agreement with government creditors

Met all agreed IMF conditions except one

--on money supply, not a big problem

Stabilized the peso at a sustainable level;

Curtailed capital flight

Broadened the tax base

Substantially reformed the tax law

Transferred sequestered and non-performing assets from the development banks to the Asset Privatization Trust

PHILIPPINE PROSPECTS IV:
ECONOMIC RECOVERY AND REFORM

5.5 percent annual growth rate in 1987

Trade reform

- --Eliminated export duties on all items except logs.
- --Eliminated most quotas and bans
- --Final tariffs remain to be seen

Privatization

- --Three quarters of APT assets under judicial process
- --National security/nationalism/patronage arguments over best of remainder

Land reform

- --Sound basic concept, poorly thought through
- --Very weak capability for implementation

Removal of monopolies

- --Largely accomplished, except for cocont sector which is the most important for popular livelihood

Investment Code

- --Philippines will continue to be less attractive than Thailand in most sectors
- --Investment climate behind the rules is unsupportive
- --40% constitutional limit on foreign ownership

PHILIPPINE PROSPECTS V:
MILITARY AND ADMINISTRATIVE REFORM

Military

--abuses curtailed

--more merit promotions

Civilian

--more honesty at the top

--more business competition

No thoroughgoing reorganization

PHILIPPINE PROSPECTS V:
THE DEMOCRACY SYNDROME

Parallels to South Korea 1960, Thailand 1973-'76:

Right frightened by riots, demonstrations, socialist ideas

Left alienated by lack of reform

Middle class fearfully withdraws

Military is criticized but not purged & reorganized

Eventual outcome without change of course: successful military coup

Only possible course to success:

- Merit rather than loyalty as criterion for senior officials
- Technocratic rather than ideological civil administration
- Reorganize military for guerrilla warfare rather than patronage

HONG KONG

BRITISH COLONY, REVERTS TO CHINA IN 1997

CHINA HAS GUARANTEED AUTONOMY, CAPITALIST SYSTEM TO 2047

CHINA'S GUARANTEES CREDIBLE:
- --CHINA NEEDS HONG KONG AS A FINANCIAL CAPITAL, TECHNOLOGICAL WINDOW
- --CHINA HAS PROTECTED HONG KONG EVEN IN MOST RADICAL PERIODS
- --CHINA USING HONG KONG AUTONOMY TO PERSUADE TAIWAN TO ACCEPT SIMILAR FORMULA
- --CHINA HAS ALWAYS HONORED INTERNATIONAL AGREEMENTS

CHINA COULD NONETHELESS MAKE SERIES OF MISTAKES THAT COULD REDUCE HONG KONG DYNAMISM

--WOULD REDUCE OPPORTUNITY, NOT CREATE UNACCEPTABLE RISK

HONG KONG IS INTERNALLY STABLE

ECONOMY

GROWTH RATE AMONG WORLD'S HIGHEST

EXTREMELY ADAPTABLE

ECONOMIC ROLES
- --FINANCIAL CAPITAL OF ASIA (BEING SUPERSEDED BY JAPAN AS DISTRIBUTION CAPITAL)
- --FINANCIAL CAPITAL OF CHINA
- --FOREIGN INVESTMENT CAPITAL OF CHINA
- --TECHNOLOGY/ENTREPRENEURIAL CAPITAL OF CHINA
- --SOCIAL CONTACTS CAPITAL OF CHINA
- --REGIONAL ENTREPOT
- --MAJOR LIGHT INDUSTRIAL EXPORTER TO WEST

--ALL THESE ROLES ARE STRENGTHENING, NOT WEAKENING

CHINA INSISTS UPON HIGHLY CONSERVATIVE FINANCIAL MANAGEMENT
- --VETOES CENTRAL PROVIDENT FUND

SOVEREIGN RISK INDICATORS 1985:

NET FOREIGN DEBT: MINUS US$8.9 BILLION

SINGAPORE

STRUCTURE: DEMOCRACY DOMINATED BY LEE KWAN YEW'S PEOPLE'S ACTION PARTY, WHICH HAS NEVER LOST MORE THAN TWO SEATS

HIGHLY STABLE, DUE TO EXTRAORDINARY ECONOMIC ACHIEVEMENTS

--IDEOLOGICAL CONSENSUS, CONSTITUTIONAL CONSENSUS, RACIAL HARMONY

EXTREMELY COMPETENT GOVERNING INSTITUTIONS

SMOOTH SUCCESSION IS LIKELY

MILD RESENTMENT HAS EMERGED OVER LEE'S EXCESSIVE PATERNALISM

SINGAPORE'S ECONOMY

TINY BUT EXTREMELY DYNAMIC ECONOMY, BASED ON LIGHT INDUSTRY, SERVICES, ENTREPOT

COMPETITOR OF HONG KONG AS A FINANCIAL CENTER, REGIONAL HEADQUARTERS FOR MULTINATIONAL CORPORATIONS

HISTORICALLY ONE OF THE WORLD'S FASTEST GROWING ECONOMIES

--THIRD WORLD'S MOST PROSPEROUS ECONOMY, BUILT SINCE 1959

HIGHLY EXPORT DEPENDENT: TRADE = 343% OF GNP

STALLED OUT, 1985-'86, DUE TO:

--EXCESSIVE REGULATION
--REAL ESTATE OVERBUILDING
--EXCESSIVELY RAPID WAGE RISES
--DECLINE OF KEY INDUSTRIES (SHIPBUILDING, OIL SERVICES)
--SQUEEZE BY INDONESIA, MALAYSIA ON KEY ENTREPOT FUNCTIONS
--RAZING OF INTERESTING TOURIST SITES

BASIC STRENGTHS REMAIN INTACT, PROBLEMS BEING ADDRESSED, ECONOMY BEGINNING TO SHOW INITIAL SIGNS OF COMEBACK

--ECONOMIC GROWTH, 1987Q2, 7.5% ANNUAL RATE

WILL REMAIN SUCCESSFUL ENTREPOT & ADMINISTRATIVE CENTER

--NOT A CENTER OF TECHNOLOGICAL INNOVATION & MFG CHALLENGE, DUE TO OVERREGULATION, IMPEDED INFORMATION FLOW, SHORTAGE OF SKILLS

--HENCE NOT A DIRECT COMPETITOR OF KOREA, TAIWAN

TAIWAN

MORE INSTITUTIONALIZED POLITICS THAN KOREA

--STRONG ONE-PARTY STATE, DOMINATED BY KUOMINTANG PARTY
--BROAD POPULAR SUPPORT DUE TO RAPID GROWTH, EGALITARIANISM
--STABLE SUCCESSION ARRANGEMENTS

OPPOSITION VOCAL BUT DEEPLY DIVIDED

--CURRENTLY BEING ALLOWED TO ORGANIZE FOR FIRST TIME

CHIANG CHING KUO HAS CONTINUOUSLY REFORMED POLITICS

--CURRENT REFORMS IN SERIOUS DIFFICULTY
ENTRENCHED KMT OPPOSITION
OPPOSITION TEMPTED TOWARD INDEPENDENCE
--BUT THIS IS NOT DESTABILIZING

GOVERNMENT INSTITUTIONS EXTRAORDINARILY COMPETENT

CURRENT WEAK LEADERSHIP DUE TO ADVANCED AGE OF PRESIDENT & MOST OF CABINET

ONE OF WORLD'S FASTEST GROWING, MOST EGALITARIAN ECONOMIES

HIGHLY DIVERSIFIED PRODUCER OF LIGHT & HEAVY INDUSTRY

HIGHLY DIVERSIFIED OWNERSHIP

EXTREMELY RESILIENT ECONOMY OF SMALL FIRMS

FRAGMENTED MARKET

FINANCES MANAGED WITH EXTREME CONSERVATISM

HUGE FOREIGN & DOMESTIC ASSETS OF BANKS WILL FORCE RAPID LIBERALIZATION: WILL HIT $60 BILLION FOREIGN ASSETS SOON

--HENCE MAJOR CAPITAL MARKET OPPORTUNITIES

THAILAND'S POLITICS

STRUCTURE: BALANCE AMONG CIVILIAN POLITICIANS, MILITARY, CIVIL BUREAUCRACY, KING

PRIVATE BUSINESS & ESPECIALLY BANKERS PLAY LEADING ROLE

DELICATE BALANCE LEADS TO FREQUENT CHANGES OF TOP LEADERS VIA ELECTIONS, ATTEMPTED COUPS

BASIC INSTITUTIONS, ECONOMIC POLICIES EXTREMELY STABLE, COMPETENT

--LEADERSHIP CHANGES MAINTAIN BALANCE, PRESERVE SYSTEM STABILITY

--MILITARY PROTECTS SECURITY, KING PROTECTS LONG-TERM FINANCES, POLITICIANS PROTECT SOCIAL INTERESTS, BUREAUCRACIES MAINTAIN CONTINUITY & IMPLEMENT POLICY

VIETNAMESE/CAMBODIAN WARFARE AN IRRITANT, NOT A THREAT

THAILAND'S ECONOMY

LONG TERM: ONE OF WORLD'S OUTSTANDING PERFORMERS

--TYPICAL PERFORMANCE IN GOOD YEARS BEFORE 1980: 7% GROWTH

CURRENTLY SUFFERING FROM WEAK COMMODITY PRICES, GROWING 5-6%

HIGHLY DIVERSIFIED AGRICULTURE & LIGHT INDUSTRY

DIVERSIFIED OWNERSHIP & CONTROL

MARKET ORIENTATION AND DIVERSIFICATION MAKE IT RESILIENT

STRONG INFLUENCE OF BANKERS MEANS MOST INDUSTRY CONSERVATIVELY FINANCED

ALLOWED DEBT TO BECOME LARGE, NOW CONTROLLING IT

INDONESIA'S POLITICS

HIGHLY PERSONAL RULE BY SUHARTO BASED ON STRONG MILITARY ROLE AND DOMINANT PARTY ORGANIZED AROUND CIVIL SERVICE AND MILITARY

ELECTIONS DO NOT PRESENT SERIOUS CHALLENGE TO REGIME, BUT ALLOW OPPOSITION GROUPS TO ASSERT THEIR INTERESTS

MULTI-ETHNIC SOCIETY WITH MANY TENSIONS, ESPECIALLY CHINESE-PRIBUMI AND MUSLIM FUNDAMENTALIST-NON-FUNDAMENTALIST

--RECENT HIGHLY AUSPICIOUS GOVERNMENT-MUSLIM ACCOMMODATION

--MILITARY UNITY, ECONOMIC COMPETENCE, SENSIBLE MANAGEMENT KEEP TENSIONS WITHIN BOUNDS

POVERTY AND UNEMPLOYMENT ARE MASSIVE PROBLEMS

ECONOMIC STRINGENCY HEIGHTENS STRAINS WITH CHINESE AND MUSLIM FUNDAMENTALISTS AND WITH PETITION OF 50 GROUP THAT DEMANDS MORE DEMOCRACY

INDONESIA'S ECONOMY

ECONOMY BASED ON OIL/GAS, DIVERSIFIED AGRICULTURE, RAW MATERIALS

--EXCESSIVE DEPENDENCE ON OIL/GAS

--OVEREMPHASIS ON PROTECTED HEAVY INDUSTRY

--NON-OIL EXPORTS VERY WEAK

--FINANCIAL MARKETS FAIRLY PRIMITIVE

BEST MANAGEMENT OF ANY POPULOUS OPEC COUNTRY

--SOUND INSTITUTIONS, MANAGED IN NATIONAL INTEREST

--DIDN'T GO BUST LIKE MEXICO, NIGERIA

--BUDGET RESTRAINT USUALLY GREATER THAN NECESSARY

--MAKING SUBSTANTIAL EFFORTS TO DEVELOP NON-OIL EXPORTS

NONETHELESS, OIL PRICES IN LOW TEENS WILL SQUEEZE INDONESIA SEVERELY AND CREATE RISK OF RESCHEDULING

REGIME ACKNOWLEDGES VITAL NEED FOR NON-OIL EXPORTS, RESULTANT NEED TO LIBERALIZE TRADE & DISBAND MARCOS-STYLE MONOPOLIES

--BUT POLICIES ARE GUTTED IN IMPLEMENTATION

--INDONESIA WILL TEETER ON THE BRINK UNTIL IMPLEMENTED

MALAYSIA

Uneasy balance of politically dominant Malays, economically dominant Chinese, prosperous Indian minority

Stable since independence, with two major exceptions

--1969 ethnic riots

--breakup with Singapore

Highly diversified: agriculture, natural resources, light manufacturing

One of Asia's most market oriented economies

Until recently, thick financial cushion, rapid growth

Central goal of leadership has shifted from more egalitarian ownership structure to building a moderate Islamic society

Malay-Chinese relationships are polarizing severely

Sound administrative institutions, except financial ones

Recent economic policies have clearly failed
--Look East
--Heavy industry, Proton Saga car
--Financial games/scandals
Carrian
Attempts to corner tin maket
Coops. Makuwasa, Employee Provident Fund/stocks
Selling off most profitable state firms

Consequences of social tension, political fragmentation, economic stresses:

--capital flight
--low investment
--repudiation of alliance by most Chinese

Growth improving with higher commodity prices, but strategic direction somewhat ominous

MAJOR SOCIALIST COUNTRIES

CHINA

--LEADERSHIP THAT WILL FACE THE ISSUES SQUARELY

--INSTITUTIONS THAT CAN IMPLEMENT CHANGE

--PARTY, ARMY, MINISTRY, PROVINCIAL GOVTS

--REVOLUTIONIZED AGRICULTURE

--OPENED CHINA TO THE WORLD

--BUT FALTERED IN URBAN REFORMS
CHOICE: SEOUL VS MOSCOW

--ALSO LEANING BACK IN MOSCOW'S DIRECTION IN FOREIGN POLICY
DISILLUSIONED WITH WESTERN INVESTORS
UNABLE TO DELIVER ENOUGH TO COMPETE
DISILLUSIONED WITH REAGAN
MAKING GREAT GAINS BY REDUCING TENSIONS WITH USSR

--CAN GROW 6-7% BY JUST IMPLEMENTING OLD REFORMS

INDIA

--LACKS DECISIVE LEADERSHIP

--LACKS INSTITUTIONS

MRS. GANDHI UPHELD THE FERDINAND MARCOS APPROACH TO NATIONAL LEADERSHIP: DESTROY ALL ALTERNATIVE BASES OF POWER

RESULT: WEAK CABINET, PARLIAMENT, CONGRESS PARTY, STATE GOVTS, STATE FIRMS, ETHNIC POLARIZATION

--OPPOSITION TO RAJIV:
CONGRESS PARTY ESTABLISHMENT
LIBERAL REFORMERS
HIS CLOSEST ASSOCIATES
MUSLIMS, SIKHS, GURKHAS
PAKISTAN, BANGLADESH, CHINA

USSR

--LEADERSHIP FACING ISSUES SQUARELY

--INSTITUTIONAL OPPOSITION

--SO FAR: ANTI-ALCOHOLISM, ANTI-CORRUPTION, PROMOTING YOUNGER, BETTER-TRAINED WORKERS, BUT NOT STRUCTURAL CHANGE

--EMPHASIS ON REVOLUTIONARY GOALS, POLITICAL REFORM MAY BE DISASTROUS