ASEAN+3 RESEARCH GROUP

THE ROLE OF PRIVATE SECTOR DEVELOPMENT IN REGIONAL ECONOMIC GROWTH AND FINANCIAL INTEGRATION: THE ASEAN PERSPECTIVES

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1. Introduction and Overview of Development Paradigms

1.1 Over the years paradigms of economic development undergo various shifts in dimensions, ranging from basic needs to technical assistance, and from structural adjustment to integrated development programs. The state-led development policies emphasized during the 1960s and 1970s, while remain critical, are found to be inadequate, in assuring sustainable growth.

1.2 By the eighties, advocacy of the neoclassical market liberalism, dominate development thinking. Commonly referred as the Washington Consensus, the new paradigm relies heavily on pure market mechanisms as agent for promoting economic growth (Williamson 1993, 2000). Free market is viewed as universally efficient mechanism for efficient allocation of resources and promoting growth, lifting the role of the private sector as critical agent for sustainable development.

1.3 Within the World Bank Group (WBG), serious concerns over promotion of private sector as central in growth strategies emerged by late eighties (1987) where 'private sector development' in short PSD is cited as one of several 'programs of special emphasis'.[1] The private sector (and thus market forces and competition) gained common acceptance as efficient and more productive mean to economic dynamism. Market-oriented reforms became immediate task for donor-recipient countries as international aids are often preconditioned on these structural adjustment policies (SAP).

[1] Historical trends of WBG's PSD activities is described in World Bank (2002)

1.4 In nearly a decade after, skepticisms on the Washington Consensus were voiced as evidence pointed to below expectation outcomes of the market-oriented approach (Hayami 2003). A new paradigm, the Post-Washington Consensus, while retaining the role of the private sector, also recognizes the critical function of the government as playing significant role in achieving growth.

1.5 Of recent priorities are 'good governance' and 'good policy' that stimulate healthy pro-growth environment that churns private-interests for greater mobilization and efficient utilization of resources. With the new paradigm, the role of state is redefined primarily as architect of positive enabling environments planned in tandem with agendas for private initiatives, giving birth to the public-private smart partnership.

2. Private Sector Development in ASEAN: Scope and Status

2.1 Exact definition of the private sector is rather vague. OECD's (1994) description of the private sector as '*a basic organizing principal for economic activity where private ownership is an important factor*, *where markets and competition drive production and where private initiatives and risk-taking set activities in motion*' serves well. Promotions of private sectors assume critical aspect of sustainable growth specified not only in national plans but also frequently cited as part of strategies adopted by multilateral agencies and donor-countries.

2.2 Gains from PSD surpass monetary rewards encompassing other aspects of developmental progress including social (basic needs such as education and health), political (good governance, pluralistic civil society, efficient public sector), entrepreneurial (management skills, risk-taking, networking) dimensions, and various others.

2.3 The Asian Development Bank (ADB) incorporates the PSD as an integral component of its Poverty Reduction Strategy-PRS (ADB 1999, 2004). In addition to greater emphasis on pro-poor growth activities, the recently reviewed PRS that retains its major thrusts specifies the PSD as an important aspect of efforts toward eradicating poverty in Asia. In promoting the PSD within its member countries, three major objectives have been specified as ADB's PSD strategies, this includes; Creating Enabling Conditions; Generating Business Opportunities; and Catalyzing Private Investments (ADB 2000).

2.4 In generic description, the private sector embraced a broad range of agents ranging from 'large factories to one-women enterprises operating on a part-time basis' and from 'major investments by foreigners to a farmer who wants to raise chickens for the market using a rotating credit scheme'[2]. This broad coverage makes accurate measurement of the contribution of the private sector to be complicated task.

2.5 Crude estimates of the contributions of the private sector within the ASEAN-5 economies are shown in Table 1 and Figures 1 and 2. On the macro scale, in 2003, private activities dominate those of the public sector in term of their contributions to the Gross Domestic Products (GDP) of the ASEAN-5 countries. As illustrated in Table 1, consumption of the private sector contributes from 46 (Singapore) to 71 (Philippines) percents of GDP of ASEAN-5 nations. On the other hand, public consumption amounted from 9 (Indonesia) to about 14 (Malaysia) percents of the GDP.

2.6 Contribution of the private sector consumption while assuming significant portion of the aggregate demand is not directly related to country's standard of living. Descriptively, the level of private consumption's contribution to the GDP and per capita income is rank inversely. In 2003, Indonesia and Philippines rank as top-

[2] Cited from Schulpen and Gibbon (2001:16). Original source is Directorate-General for International Co-operation-Netherlands (DGIS) 2000. See also Pietila (2000) for guidelines for donors.

two in term of contribution of the private consumption but with respect to per capita income the two countries rank as the bottom-two.

2.7 Contribution to standard of living is best represented by country's gross capital formation that in large part reflecting investment by the private sector. Relative to 1990, contribution of capital formation in 2003 is lower for all ASEAN-5 countries owing to the late nineties economic crisis and global slowdown in 2001. Based on figures in 1990, ranking wise, positive association between capital formation and per capita income is quite obvious with Singapore, Malaysia and Thailand perform better that Philippines and Indonesia in both dimensions.

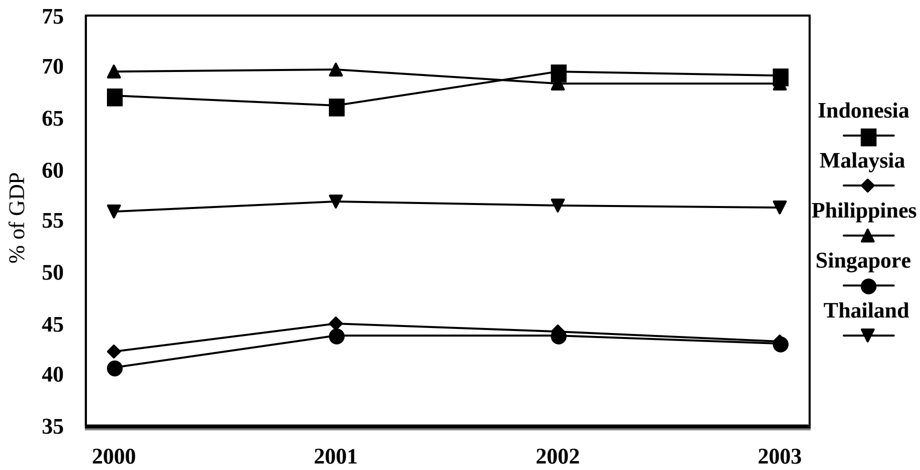
2.8 This tabulation supports the significant role played by the private sector in promoting growth within the ASEAN-5 region. Private sector consumption forms a significant portion of aggregate demand while its investment critically influences the standard of living achieved by a given country. Strategies to promote greater participation of the private sector must be formulated with specific details and designed effectively in assuring this engine of growth to run smoothly and achieving its maximum potential.

Table 1: ASEAN-5 Output Growth, Per Capita and Structure of Demand

Country	GDP Growth[a]		Per Capita GDP[b]		Private Consumption[c]		Government Consumption[c]		Gross Capital Formation[c]	
	1990	2003	1990	2003	1990	2003	1990	2003	1990	2003
Indonesia	9.0	4.1	638	954	58.9	69.3	8.8	9.2	30.7	16.0
Malaysia	9.0	5.2	2,432	4,151	51.8	43.3	13.8	13.7	32.4	21.8
Philippines	3.0	4.5	718	964	71.2	68.5	10.1	11.4	24.2	18.7
Singapore	9.0	1.1	12,281	21,523	46.1	43.1	10.1	11.9	36.4	13.4
Thailand	11.2	6.7	1,518	2,230	56.6	56.3	9.4	10.6	41.4	25.2

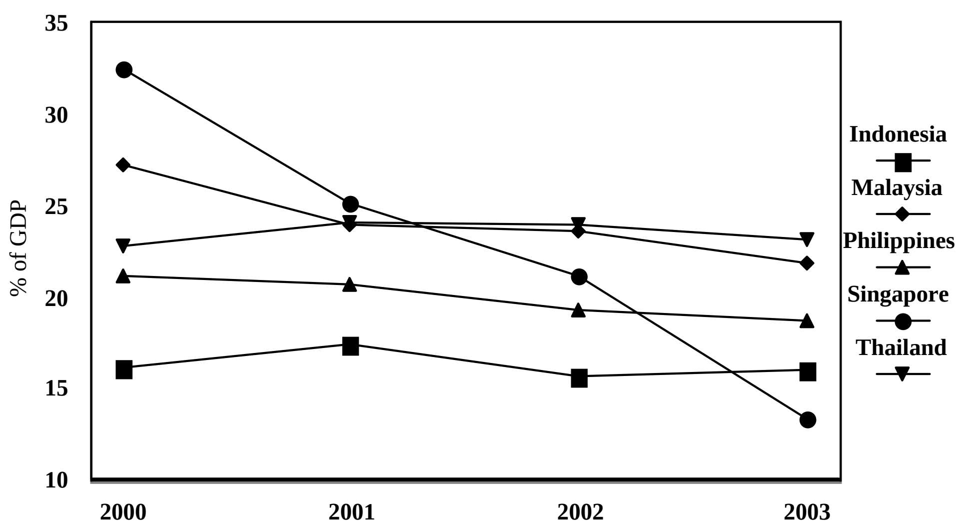
[a] Real GDP growth (% per annum), [b] GDI per capita at current market prices in USD, [c] Percent of GDP at current prices.
Source:
1. ADB 2004 Key Indicators.
2. ASEAN Statistical Yearbook 2004.

Figure 1: ASEAN-5 Private Consumption (% of GDP)



Source : World Development Indicators, World Bank

Figure 2: ASEAN-5 Gross Capital Formation (% of GDP)



Source: World Development Indicators, World Bank

3. Small and Medium Enterprises (SMEs) in ASEAN

3.1 For the ASEAN region, private sector participations are largely represented by activities of the Small and Medium Enterprises (SMEs), private business organizations that are limited in scale and/or volume of activities. The important role of SMEs in social development is highlighted by Ayyagari, Beck and Demirguc-Kunt (2003). Based on a new worldwide standardize database of SMEs (that incorporate six ASEAN countries) the study shows that SMEs' contribution to employment and GDP is significantly correlated with per capita GDP in a positive pattern. In addition, it also highlighted the greater role played by SMEs in a high income economies.

3.2 SMEs contribution to the East Asia economy is widely recognize. The Asia Pacific Economic Cooperation Forum (APEC) initiations for betterment of the SMEs can be traced back to Leaders' meeting in 1993. The APEC Committee of Trade and Investment that was set up in the same year included SMEs development as part of its agenda. Within the ASEAN community, recognition of the importance of SMEs as backbone to the ASEAN economies lead to the endorsement of the ASEAN Policy Blueprint for SME Development (APBSD) 2004-2014 during Thirty-Sixth Meeting of the ASEAN Economic Ministers 2004 in Jakarta, Indonesia. APBSD 2004-2014 outlines the framework to be adopted for SME development among ASEAN members. Specific details on mission, objectives, operational and output indicators are spelled for a strong, dynamic and efficient SME sector (ASEAN 2004).

3.3 Definition of the SMEs differs across countries.[3] A list of measurements is used to classify the SMEs, among them; employment scale, asset size, sales volume, shareholders funds, production capability, and etc. Table 2 documents several main definitions of SMEs adopted by major South East Asian nations. Despite

[3] This forms a major motivation for Ayyagari et al (2003) study cited earlier. Lack of comparable data prevents detail comparative analysis of SMEs across countries and regions. Nevertheless, the overall view that SMEs contribute to economic growth is widely accepted.

these mixed categorizations, the fact that SMEs form an important aspect of the ASEAN countries is undeniable. SMEs contribute significantly in various aspects of ASEAN-5 economies.

Table 2: ASEAN-5 Major Definitions for SMEs

Country	Definitions	Measures
Indonesia	Less than 100 employees	Employment
Malaysia	Manufacturing: up to 150 full time employees, annual sales turnover not exceeding RM25 million.	Employment Sales
Philippines	Small Enterprises: 10-99 employees, and between Peso 3 – 15 million in assets. Medium Enterprise: 100-199 employees, and Peso 15-60 million in assets.	Employment Assets
Singapore	Manufacturing – less than S$15 million in fixed assets. Services – less than 200 employees, and fixed assets less than S$15 million	Employment Fixed Assets
Thailand	Small Enterprises: • Manufacturing/Services: less than 50 employees, less than 50 million baht of fixed assets. • Trading/Wholesale: less than 25 employees, less than 50 million baht of fixed assets. • Trading/Retail: less than 15 employees, less than 30 million baht of fixed assets. Medium Enterprises: • Manufacturing/Services: 21-200 employees, 50 -200 million baht of fixed assets. • Trading/Wholesale: 26-50 employees, 50 -100 million baht of fixed assets. • Trading/Retail: 16 - 30 employees, 30 -60 million baht of fixed assets.	Employment Capital Fixed assets

Source: APEC SMEs' Profile (http://www.actetsme.org/)

3.4 Table 3 presents several indicators that highlight the importance of SMEs in ASEAN. Hall (1995) reports potential space to further expand SMEs contribution in job creation in ASEAN. It is shown that, compared to developed nations (US, Japan, Australia), East Asia's SMEs intensity is relatively low. For these developed countries, there is about one SME per 20 people, while in selected East Asia countries the intensity is significantly lower. As an example, there are about 44 and 1,800 people per SMEs in Singapore and Indonesia, respectively. Thus, in term of job creations (and growth) SMEs could be a major source for the ASEAN members to focus upon. It is also noted that ASEAN's SMEs participation in exports market is rather low. With force of globalization and regionalism within the ASEAN region (AFTA), embarkation into exports market would be a potential source for SMEs to expand their activities.

Table 3: Importance of SMEs in ASEAN-5 Economies

Country	Number of SMEs ('000s)	SMEs as % of all enterprises	SMEs' Employment as % of workforce	SMEs' Exports as % of total exports
Indonesia	105	97.0	42.0	10.6
Malaysia	20[a]	84.0	40.0	15.0
Philippines	78	99.5	66.2	n.a.
Singapore	69	91.5	51.8	16.0
Thailand	102	95.8	18.1	10.0

[a] Manufacturing enterprises only.

Source: APEC SMEs' Profile (http://www.actetsme.org/)

Harvie and Lee (2002, Table 1.2 page 6)

4. ASEAN PSD Environment

4.1 PSD Policies: Classifications and Elements

4.1.1 The fundamental thrust of developing the private sector is to strategize ways to bring the benefits of markets to help the poor. Hence, many ASEAN member countries instituted a development and institution and capacity building initiatives to foster a sound investment climate. To sustain the development of the region's private sector creation of sustainable employment and thus income, strategic policies were carefully thought. In an effort to achieve the objectives of PSD, policies in the region were instituted within 2 broad elements.[4] The first element involves initiatives provided by the state in generating environment that is conducive for private sector activities, also referred to as national and international elements (Schulpen & Gibbon, 2001). The second include elements at an industry and company level.

4.1.2 Both elements are hereby adapted as the macro and micro enablers. Macro elements efforts in creating an attractive investment climate include, among others; i. Macroeconomic policies instituted by the respective governments both monetary (e.g. monetary growth, inflation, interest rates, intermediation) and fiscal (e.g. trade policies, taxations, rules and regulations, licensing) policies; ii. Human Capital and Physical Infrastructure: Provisions of basic needs and infrastructures (e.g. health, education, telecommunications, energy, transportation, water and sanitation); iii. Good governance: transparency, enforcement of rights, fights against corruption. The degree of PSD also entails policies at the micro firm-level known as micro enablers. This includes access to technology, managerial and technical expertise, financing, information and networks, competency and entrepreneurship. In this report micro level enablers looks at the manner in which member countries provide conducive business environment with

[4] This discussion is significantly abstracted from Schulpen and Gibbon (2001). See Table 1.1 and 1.2 in Schulpen and Gibbon (2001) for more detail illustrations of these classifications.

respect to entry into the market and regulatory framework within each member country as indicated in the table below. The presence of both elements to achieve the objectives of the PSD will serve to foster a sound investment climate within countries.

4.2 The ASEAN Macro Enablers

4.2.1 A critical element of the PSD requires the government of ASEAN to maintain an enabling macro environment that is conducive for private activities. Stable macroeconomic environment not only conducive for domestic SMEs but also forms as attraction for foreign direct investments. Table 4 provides a brief backdrop of the ASEAN-5's macro environment and external indicators.

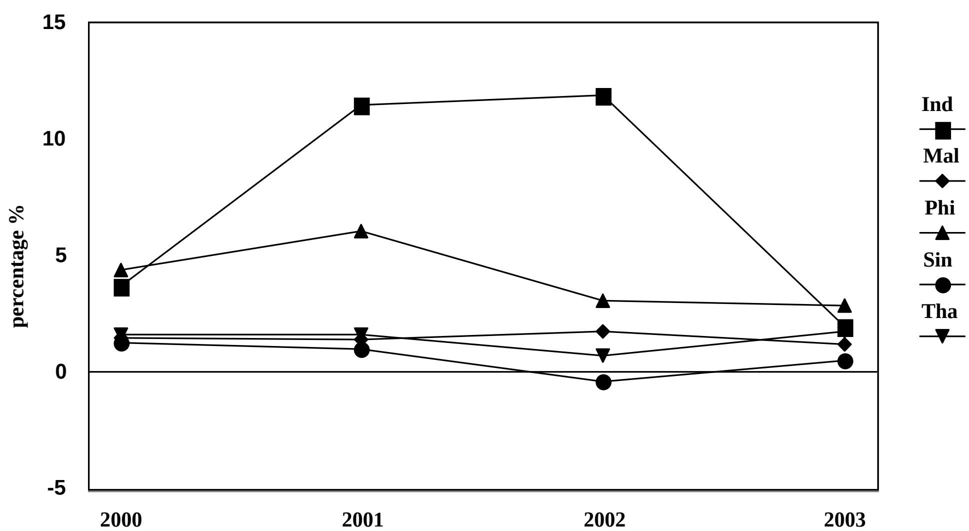
Table 4: ASEAN-5: Macro, External and Financial Depth

Indicators	1990-1997	2003
Macro:		
Growth of GDP (% per annum)	7.2	4.3
Unemployment	3.9	5.9
Inflation-Consumer Price Index (% per annum)	5.8	1.7
Government Finance (% of GDP)	2.9	-2.9
M2-money growth (% per annum)	8.6	7.1
Trade and Financial Development:		
Trade ((Exports + Imports) / GDP)	1.3	1.3
Financial Depth (M2 money/GDP)	0.66	0.84
Private Credit (Claims on Private Sector/GDP)	0.7	0.8

Source: ADB 2004 Key Indicators 2004.

4.2.2 The South East Asia remarkable achievement prior to the 1997-98 crisis is witnessed by its high real Gross Domestic Product (GDP) growth recorded for each of its economies, averaging at 7.2 percent annually from 1990 to 1997. As shown in Table 4, the high economic growth is achieved within relatively stable inflation environment (average inflation rate of from 1990-1997 is 5.8 percent annually). Figure 3 depicts ASEAN-5 inflation rates since year 2000. On average, inflation within this region is generally low at an average of 2.5% in the year 2000 and the highest was at 4.5% in the year 2001.

Figure 3 : ASEAN 5 Inflation rates



4.2.3 The highest inflation was recorded in Indonesia being more than 10% in the year 2001 and 2002. Nevertheless, these rates are significantly lower than records inflation achieved during the crisis years. Indonesia's new monetary framework that adopts inflation-targeting as its major thrust is expected to bring its inflation to a stable and low level. In 2003 Indonesia's inflation is recorded at 2.0%

indicating remarkable dropped in the rate of price change. Overall, low inflation rates were seen in the remaining ASEAN nations.

4.2.4 Over the years ASEAN-5 has recorded a sound and stable fiscal and monetary policies. Region's average fiscal balance is in surplus of about 2.9 percent of its GDP. This is further supported by steady monetary environment, with M2-money growing at a rate of 8.6 percent per annum, matching its growing real transaction needs. By 2003, about six years after the East Asia crisis and after going through global slowdown in 2001, ASEAN-5 economy reverts to a positive growth rate of 4.3 percent. Government fiscal balance is dragged to negative (but controllable) range of –2.9 percent of GDP and inflation is slightly higher compared to its level in pre-crisis years.

4.2.5 A significant and common policy track of these ASEAN nations in entering the nineties is the embarkation of financial openness and liberalization policies beginning since mid-eighties. In 1996, it is estimated that the region (including South Korea) as a whole attracts US$67,536 million of net private capital flows, representing nearly 48 percent of the amount received by Developing Member Countries (DMCs) of the ADB. The ASEAN-5 countries are highly integrated with the global sector as indicated by high trade ratio. Except for Indonesia, all countries carry trade ratio of greater than half of the GDP with average trade ratio for ASEAN-5 stood at 1.3.[5]

4.2.6 Table 5 presents ASEAN-5 trade (Exports + Imports) directions for selected years till 2003**.** Compared to 1993, ASEAN-5 total trade has increased significantly by about 80.6% in 2003. The share of intra-ASEAN trade has increased slightly

[5] The reported trade ratios are slightly distorted by the inclusion of Singapore being the most open economy where on average trade amounts to 277 percent of its GDP. Excluding Singapore, the average trade ratio for other ASEAN member countries in the nineties is 0.7. Trade rank begins with Malaysia (149 percent), Philippines (80 percent), Thailand (70 percent), and Indonesia (42 percent).

from 18.9% to about 21.6%. Despite slight increased in its share, intra-ASEAN trade has recorded significant rate of growth of 107% over the 10-year period. Intra-ASEAN trade is more than doubled by 2003, increasing from USD8,1071 million to USD167,468 million. Extra-ASEAN trade increased by about 75% over the same period. Singapore, Malaysia, and Thailand contribute significantly to intra-ASEAN trade with total contribution of 81%. Contributions of Indonesia and Philippines have also increased compared to their respective contributions in 1993.

Table 5: ASEAN-5 Trade Directions (USD millions)

A. Intra-ASEAN								
	1993	%	1995	%	2000	%	2003	%
Indonesia	7,656	9.4	10,695	8.7	17,665	10.9	18,756	11.2
Malaysia	21,891	27.0	30,958	25.3	40,343	24.8	40,960	24.5
Philippines	2,678	3.3	4,847	4.0	10,938	6.7	12,980	7.8
Singapore	37,167	45.8	56,308	46.1	71,075	43.7	66,929	40.0
Thailand	11,680	14.4	19,430	15.9	22,758	14.0	27,843	16.6
Total Intra-ASEAN	81,071	100.0	122,238	100.0	162,779	100.0	167,468	100.0
B. Extra-ASEAN								
	1993	%	1995	%	2000	%	2003	%
Indonesia	57,495	16.5	75,377	15.4	77,974	13.4	74,853	12.3
Malaysia	68,814	19.8	107,630	22.1	137,458	23.5	138,509	22.8
Philippines	26,294	7.6	34,188	7.0	58,528	10.0	60,748	10.0
Singapore	122,062	35.1	158,426	32.5	201,957	34.6	203,875	33.6
Thailand	72,839	21.0	112,489	23.0	107,879	18.5	128,366	21.2
Total Extra-ASEAN	347,504	100.0	488,109	100.0	583,796	100.0	606,351	100.0
	1993	%	1995	%	2000	%	2003	%
Intra-ASEAN	81,071	18.9	122,238	20.0	162,779	21.8	167,468	21.6
Extra-ASEAN	347,504	81.1	488,109	80.0	583,796	78.2	606,351	78.4
Total Trade	428,575	100.0	610,348	100.0	746,575	100.0	773,819	100.0

Source: ASEAN Statistical Yearbook 2004. The ASEAN Secretariat.

4.2.7 Table 6 provides the breakdown of direction of extra-ASEAN trade. The reported figures incorporate total trade (exports and imports) of all ASEAN-member countries. Trade integration between ASEAN and the plus-3 nations (South Korea, China and Japan) remain relatively stable since 1993. About 25% of extra-ASEAN trade goes to these East Asian nations with significant portion goes to Japan, followed by China and South Korea. It is important to note the declining contribution of Japan since mid-nineties. In 1993 Japan attracts 20% of extra-ASEAN trade but the percentage declines significantly to about 14% by 2003. This reduction has been replaced by trade with China that witnessed significant increased from only 2% to 7% in 2003. Despite this remarkable shift in the trade destinations, trade integration within ASEAN+3 remains stagnant at about 25%. In net, real gain of ASEAN+3 regional integration should be retrieved through trade-creation rather than within ASEAN+3 trade-divergence. Thus, more effective measures must be initiated to promote greater integration within the ASEAN+3 nations. The private sector can play greater role in benefiting from this integration process.

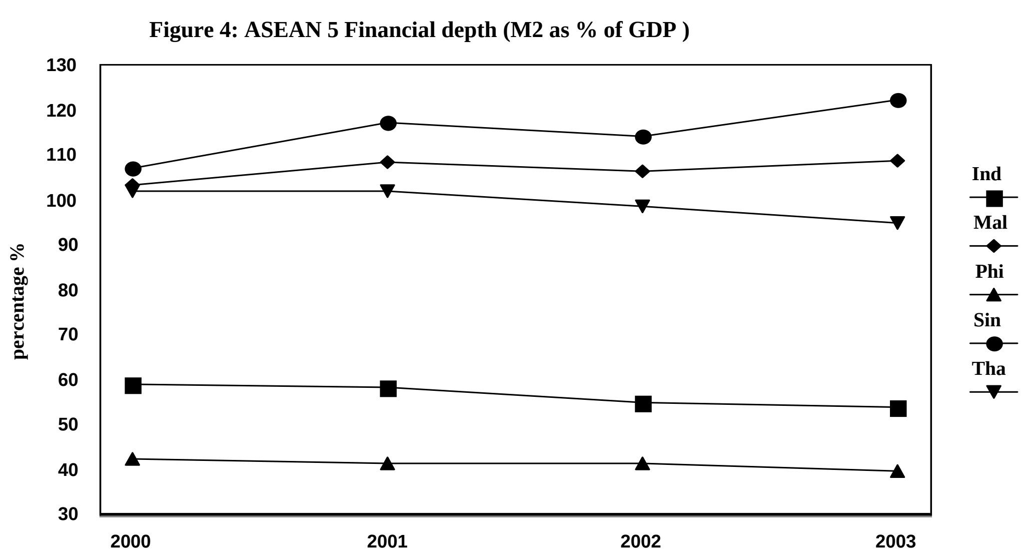
Table 6: Extra-ASEAN Trade Directions (USD millions)

Destinations	1993	%	1995	%	2000	%	2003	%
South Korea	13,274	3.1	19,920	3.2	29,635	3.9	32,100	4.1
China	8,865	2.1	13,331	2.2	32,316	4.3	55,222	7.0
Japan	86,655	20.2	121,216	19.7	116,191	15.4	108,312	13.7
Plus 3 Nations	108.794	25.3	154,467	25.1	178,142	23.6	195,634	24.8
Rest of the world	321,154	74.7	460,785	74.9	577,855	76.4	594,077	75.2
Extra-ASEAN Trade	429,948	100.0	615,252	100.0	755,997	100.0	789,711	100.0

Source: ASEAN Statistical Yearbook 2004. The ASEAN Secretariat.

4.2.8 Another critical macro-element that supports PSD is the level of financial development. As emphasized within the finance-growth literatures, financial development is an important element that supports growth (macro and micro levels) across countries (see Levine 1997, 2003 and Rajan and Zingales, 1998). As a whole, the level of financial development within ASEAN-5 is relatively high providing a sound platform for expansion of private activities. The average financial depth ratio (M2 money/GDP) for the region as a whole for the pre-crisis period (1990-97) is recorded at 0.66. Monetization of the ASEAN economies has increased markedly to 0.84 percent by 2003.

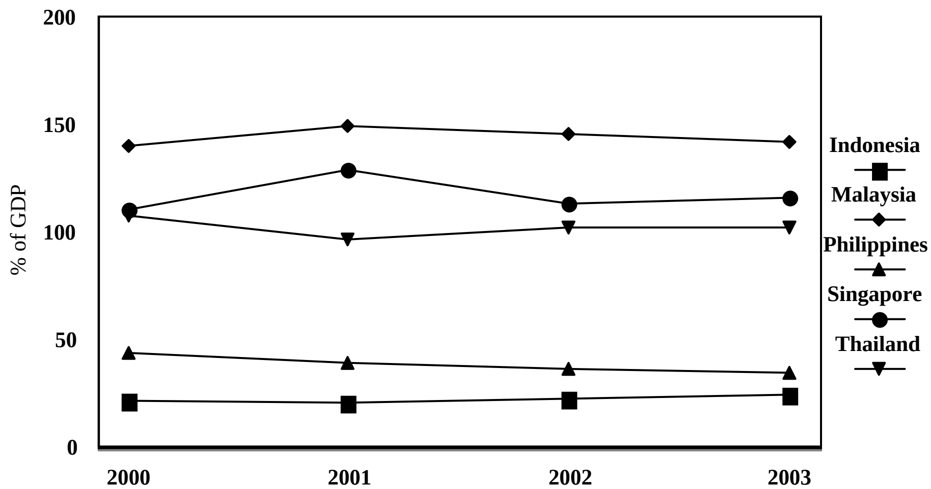
4.2.9 Figure 4 shows ASEAN-5 financial depth for year 2000 – 2003. Among the five nations, Singapore ranked the highest while Philippines at the lowest. Malaysia, Singapore and Thailand depict high level of financial development while Indonesia and Philippines remain significantly low. Greater financial development allows greater mobilization of resources and efficient utilization of domestic funds. Thus, for active involvement of the private sector, Indonesia and Philippines need to further strengthen this aspect of the economy.



4.2.10 Private sectors development and therefore economic development depends critically on the availability and accessibility of fund to be provided to these sectors. The strength of the financial system will also ensure that enough funds are supplied to the sectors. The level of issuance of credit to the private sector (claim on private sector/GDP) for ASEAN-5 stood at 0.7 during 1990-97 and increased slightly to 0.8 by 2003 (Table 4).

4.2.11 Figure 5 presents domestic credit provided to private sectors (% of GDP) since 1998. Over the four-year period, credit provided to these sectors is quite stable. The ASEAN-5 countries are ranked similar to the earlier patterns dictated for financial depth (M2 money/GDP). Malaysia, Singapore and Thailand are ranked together while Indonesia and Phillippines remain at the bottom. Domestic credit issuance to private sectors as a percentage of GDP in Malaysia, Singapore and Thailand exeeds 100%. Domestic financial system in Philippines and Indonesia provide only modest lending support for private sectors of the respective countries. The level of credit provided to the private sector is less than fifty percent for these two countries with Indonesia records the lowest level, an average percentage of 22.4% for the period 2000-2003. Malaysia records the highest percentage for all years, followed by Singapore and Thailand.

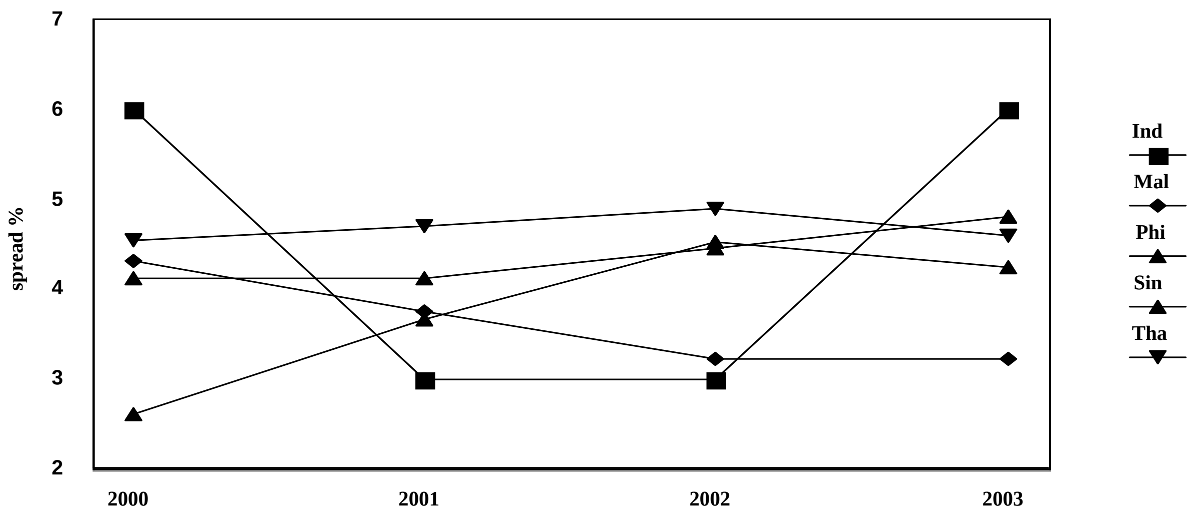
FIgure 5: ASEAN-5 Domestic Credit to Private Sectors (% of GDP)



Source: World Development Indicators, World Bank

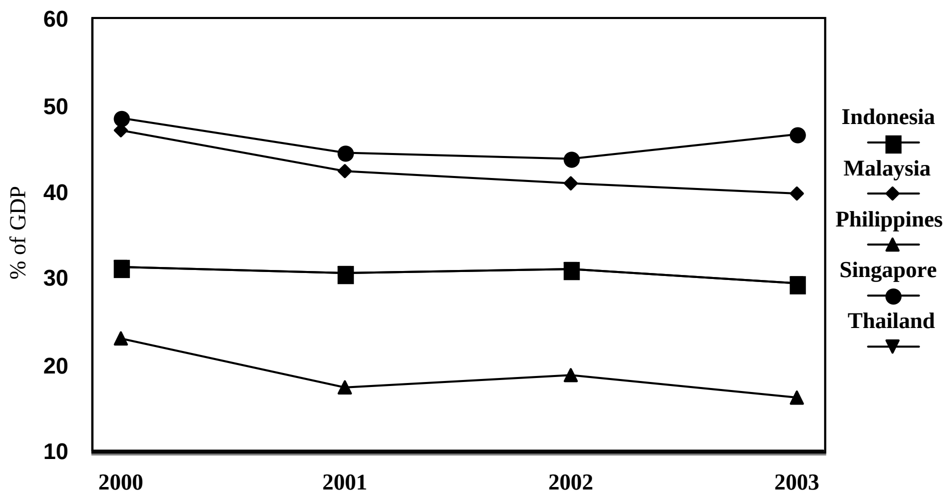
4.2.11 Intermediation cost for these ASEAN-5 nations are depicted in Figure 6. Average intermediation cost (indicated by the straight line) for ASEAN-5 stood at 4% in the year 2000, declining to 3.9% in the year 2001 before picking up again in the following years. In 2003, the spread is recorded at 4.6%**.** Malaysia's higher availability of credit is partly supported by its low intermediation cost. Average spread for Malaysia throughout the four-year period is 2.9% compared to Indonesia that records highest spread of 4.5%, almost double to Malaysia. Efficient intermediation process allows greater acessability of financing among Malaysian firms. It is critical to observe that the high spread recorded in Indonesia potentially limits credit availability in the economy.

Figure 6: ASEAN 5 Interest rates spread



4.2.12 Another possible explanation that contributes to the the low level of credit provided to private sectors in Indonesia and Philippines is the limited level of fund available in these countries as reflected by the level of domestic savings relatiove to GDP. Singapore has the highest level of domestic savings throughout the years, followed by Malaysia, Thailand, Indonesia and Philippines (see Figure 7). The low level of savings in Indonesia and Philippines is tied to the limited employment opportunity and poverty in these countries.

Figure 7: ASEAN-5 Gross Domestic Savings (% of GDP)



Source: World Development Indicators, World Bank

4.2.13 Overall, macro economic environment within ASEAN-5 is well suited for greater development of PSD. Neverheless, noticable differences are traced with respect to individual experience of the ASEAN-5 members. The above discussion shows that Indonesia's and Philippines' financial capacity is relatively lower than other members of ASEAN-5. Lower financial development partly hinders healthy development of PSD.

4.2.14 Actions to improve this limited financing can be taken within both internal and regional level.[6] Internally, governing authorities must actively engage in developing its domestic financial system. Recent studies shows that critical environment for financial development among others depend on legal environment that alleviates contract enforcement (Laporta, Lopez-de-Silanes, Shleifer and and Vishny, 1997, 1998) as well as its economic openness (Rajan and Zingales, 2003). Promotion of better governance and law enforcement and

[6] Wattanapruttipaisan (2003) provides several proposals for improving financing for ASEAN's SMEs. This includes; systematic disclosure of information and finance and governance, better SMEs' business planning, and supply side capacity building (credit information systems, risk scoring and benchmarking)

economic openness could be immidiate remedies to this low financial development.

4.2.15 With regards to regional effort, greater financial integration that allows regional savings to be benefited by all ASEAN members will enhance credit availaibilty within relatively lower income economies such as Indonesia and the Philippines.

4.3 The ASEAN Micro Enablers

4.3.1 At the micro level efforts to make ASEAN more attractive can be seen by how businesses are conducted with ease and at the lowest transaction costs possible. There has been evidence that business environment that promotes competition, private property rights, and sound contract enforcement boosts economic growth. (Thorsten Beck, Asli Demirguc-Kunt and Ross Levine,2003). In some country within ASEAN, it has been shown that a good government-business coordination will lead to a vibrant development of SME sector (Rajan, 2002). ASEAN Policy Blueprint for SME Development 2004-2014 emphasizes the importance of legal structure frameworks in order to promote SMEs competitiveness hence reducing bureaucracy in the setting up and operations of SMEs. A formal registration of SMEs, particularly those which are target beneficiaries of government support policies in each member country has been taken.

4.3.2 A comparative look into the time and cost involved in setting up a business and to enforce a contract in this region will further provides insights as to how firms have to navigate through bewildering menus of rules and regulations for registration purposes. Table 7 provides selected measurements that reflect business environments of ASEAN-5.

4.3.3 A conducive business environment starts with the speed and ease of setting up a company. Conducting business in Singapore is the least time consuming hence is the most attractive as it took the shortest time to startup a company. This implies government initiative to lessen bureaucracy. Malaysia appears to be having the highest red tapes when initiating a business. The legal framework within member countries exerts significant influence on the time to resolve any insolvency issues. Singapore took less than a year to resolve any issues that may arise from bankruptcy proceedings while Indonesia and Thailand both took six years to settle bankruptcy issues. An excellent legal and regulatory framework also facilitates in the shortest time to enforce a contract. Differences as to the standard of legal framework among member countries reveal Singapore as having the fastest time to enforce a contract (8 days) as against Indonesia that took the longest time (168 days).

Table 7: Business Regulatory Environment

Countries/Indicators	2003
Startup Business Time (In Days)	
	225
Indonesia	270
Malaysia	50
Singapore	210
Philippines	164
Thailand	
Years to resolve insolvency (In Years)	
	6
Indonesia	2.2
Malaysia	0.7
Singapore	2.6
Philippines	5.7
Thailand	
Time to enforce a contract (In Days)	
	168
Indonesia	31
Malaysia	8
Singapore	42
Philippines	59
Thailand	

Source: World Development Indicators, World Bank

4.3.4 The preceding discussions indicate that the configurations of permits and clearances are different among countries. Serious trimmings of rules must be made in countries that have the highest red tapes to make it easier for SMEs entrepreneur in member countries to get started hence giving them an earlier start to built capacity. The cost related to the red tapes in registration of businesses, costs to enforce a contract and costs to resolve insolvencies are aspects to be considered in providing support for SMEs for their capacity building activities.

4.3.5 Opaque discretion, over-bearing regulations and expensive delays tend to raise transaction costs, hence imposing a heavy burden in time and expenses on SMEs for compliance purposes. The following figures (Figures 8, 9, and 10) depict the costs incurred by the private sectors in each member in their effort to comply with existing rules and procedures. These are costs involve in registering a business, in enforcing a contract and in resolving an insolvency disputes among member countries' SMEs. Philippines and Malaysia are countries with the highest costs to set up a business (25% and 27% of GNI respectively). Charges in Singapore, on the contrary, are at its lowest (2% of GNI). Costs to enforce a contract were highest in Indonesia (270% of GNI while Malaysia and Singapore are the lowest, both at less than 25% of GNI. Costs to resolve insolvency are high in Thailand and Philippines at almost 40% of GNI as compared to Malaysia and Indonesia at only 20% of GNI. Singapore emerged once again as the country with the lowest costs.

4.3.6 All these costs can become a major impediment to the successful start-up, upgrading, expansion and diversification of private enterprises. Countries must make efforts to reduce these costs to discourage non-compliance activities, corruption practices and the proliferations of the grey markets or underground enterprises and transactions. Better business environment leads to efficient private sectors that benefit the economy as whole.

Figure 8: ASEAN 5 Cost to register a business

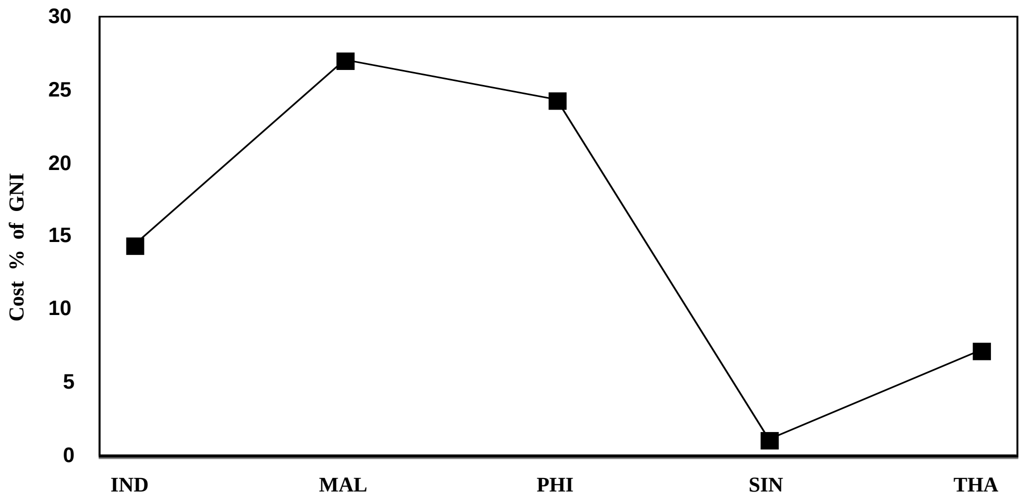


Figure 9: ASEAN 5 Cost to enforce a contract

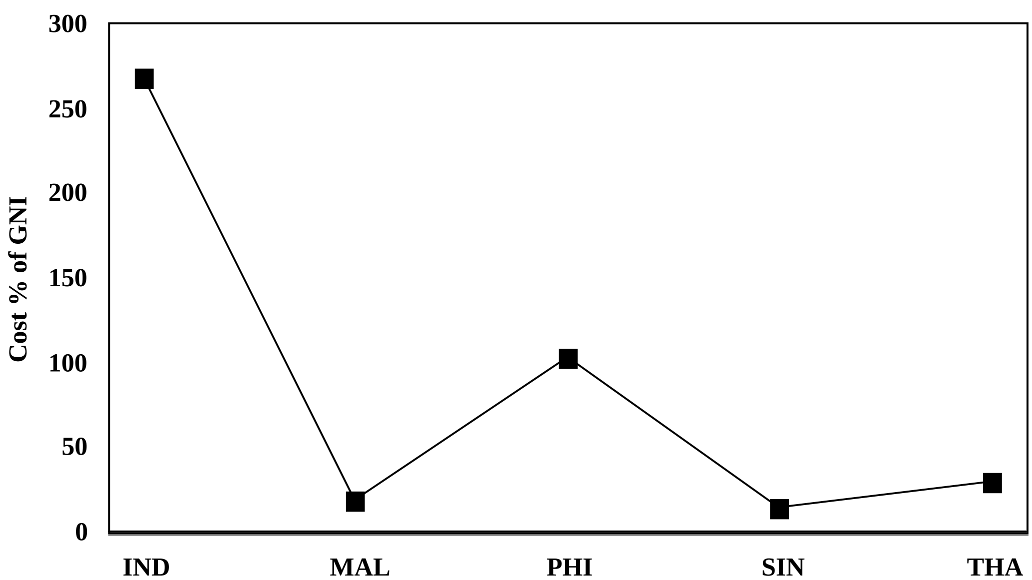
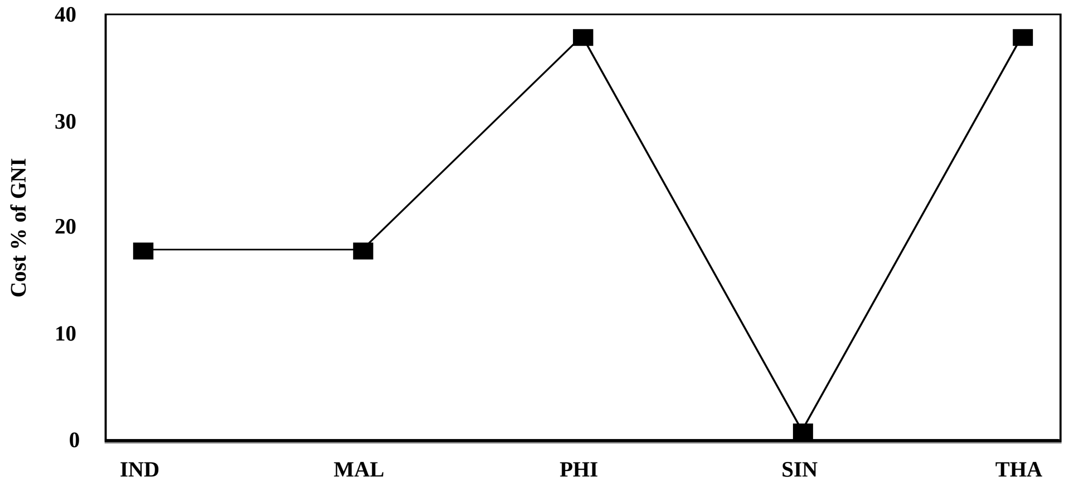


Figure 10:ASEAN 5 Cost to resolve an insolvency



5. ASEAN Financial Integration and Private Sector Development

5.1. Financial Integration

5.1.1. An important element that provides the basis for private sector activities is the ability of businesses to raise capital from the financial markets. Within a closed economy, the availability of finance significantly relies on the level of domestic savings and the degree and efficiency of financial development in mobilizing limited resources. The forces of liberalization and globalization witnessed within East Asian since mid-eighties have significantly remove these constraints on finance. In a comprehensive study covering over 95 countries, Bekaert et al. (2005) favour the pro-growth effect of financial liberalization. Equity market liberalization not only reduces constraints for external finance by increasing the availability of fund but also through its effect on better corporate governance insisted by foreign players.

5.1.2. The underlying force for economic and financial integration is the freedom to make economic decisions and to access different forms of finance, risk management techniques and investment and portfolio diversification opportunities. In general terms, 'integration' is the process by which segmented markets become open and unified so that participants enjoy the same unimpeded access (Brouwer, 1999). Thus integration of financial markets implies an increase in capital flows and a tendency for the prices and returns on traded financial assets in different countries to equalize on a common-currency basis.

5.1.3. Another gain on financial integration is that the macro-economic policy mix itself depends on the openness of the financial system (Fleming 1962; Mundell 1963). The degree of capital mobility, substitutability of financial assets, and flexibility of exchange rate, influence the ability of monetary authority to set its interest rates independently of interest rates in the rest of the world. One implication of integration is that the prices of goods and assets are determined in a broader competitive market. Economists generally argue that outcomes in competitive markets tend to be more efficient and equitable than otherwise. Financial integration that stimulates capital inflows and induces an appreciation in the real exchange rate could also potentially reduce country's international competitiveness (Dornbusch and Park, 1994; Kim, 1994; Park, 1994).

5.2. Benefits of PSD From Financial Integration

5.2.1. The favourable arguments that financial integration promotes economic development and welfare are not, however, uncontroversial. With respect to the 1997-98 East Asian crisis, Kaminsky and Reinhart (1999) and Hickson and Turner (1999) argue that the changing role of bank brought by liberalization and globalization adversely affect financial stability. Banking firms in the affected countries are enticed into riskier activities following greater liberalizations. Allen (2001) argues that the rush toward financial liberalization in the East Asia leads to debt-funded asset bubbles. Bursting bubbles adversely affects the banking sector (via borrowers default) and in turns the real sector.

5.2.2. Edey and Hviding (1995), suggested three gains from financial integration. These are; improvement in the internal efficiency in banking firms through a decline in the operating costs and some fall in interest margin, improvement in allocative efficiency through the removal of distortions in relative funding costs and greater opportunities for international portfolio diversification, and reduction in liquidity constraint that enables households to better smooth consumption over time. With the removal of impediments greater resources are mobilized that ultimately benefited the development of private sectors.

5.3 Efforts in Promoting Financial Integration

5.3.1 Within the East Asian region, several economic and financial integration initiatives have been initiated. The Asia Pacific Economic Co-operation (APEC) group that comprises majority of ASEAN members, constitute about a quarter of world income in 1990s, up from about 11% in 1970, has linked member countries through trade and investment. These linkages also may also be through the macroeconomic structure and policy (Brouwer, 1999).

5.3.2 The ASEAN+3 nations have initiated efforts at promoting financial integration indirectly or directly. The Asian Bond Markets Initiative (ABMI) continued to make progress. In promoting greater activities and participation, studies on regional settlement and clearing mechanism and on the impediments of cross-border bond investments and issuance have been conducted. Significant progress was also recorded in the implementation of the Chiang Mai Initiative (CMI). The network of bilateral swap arrangements has been expanded from 12 to 16 agreements since August 2003, bringing the total size of the network to US$36.5 billion.

5.3.3 Table 8 illustrates the status of East Asian financial integration based on development of corporate bond market. Development of corporate bond market across East Asia varies quite considerably. In term of nation's output (GDP), Malaysia (38%) and South Korea (23%) record relatively large corporate bond markets. Indonesia, Philippines and China have yet to develop their corporate bond market. In 2003, the amount of bonds investment worldwide amounted to more than US$9 trillion. Asian Bonds outstanding stood at US$190 billion, approximately 2% of global bonds market. Within the ASEAN+3 economies, ASEAN-5 nations receive a very small portion of global investment funds (0.5% of global investments). Plus-3 nations (South Korea, China and Japan) received 1.5% of this fund with Japan as the largest recipient of the total global investments. Japan receives slightly more than half (56%) of investments in Asian Bonds. The ASEAN-5 nations benefit marginally by each receiving less than 10%, with Malaysia receiving the highest (8% of total investment in Asian Bonds). Within the East Asian countries, Japan is also the largest investor in Asian bonds with US$10.8 billion or 6% of the total. Except for Singapore, most ASEAN-5 countries do not invest in Asian bond (with Malaysia's and Thailand's investments roundup to nearly 0% of the total). Based on these minimal participations in Asian Bond by the ASEAN+3 countries, there is a potential to intensify efforts in developing the Asian Bond market further.

Table 8: Asian Financial Integration: Bond Market Initiatives

	Size of Corporate Bond Markets (% of GDP)	Receiver of Investments in Asian Bonds		Investors in Asian Bond	
		US$ billion	%	US$ billion	%
South Korea	23.4	24.6	13	1.1	0.57
China	0.7	4.1	2		
Japan	16.9	107.5	56	10.8	6
Plus 3 Nations		136.2	71	11.9	6.57
Indonesia	1.5	4.2	2	0.2	0.01
Malaysia	38.1	14.4	8	0.1	0
Philippines	0.1	11.7	6	0.2	0.01
Singapore	5.1	11.5	6	9.9	5
Thailand	11.7	3.1	2	0.1	0

Source: IMF Report
Bank for International Settlement

5.3.4 ASEAN has been promoting regional investment area and member countries are collectively participating in this promotion. The major ASEAN economic integration activities include the ASEAN Investment Area (AIA), ASEAN Free Trade Area (AFTA) and the ASEAN Industrial Cooperation (AICO) scheme. These integration activities would be best facilitated by an integrated financial system that would be cost-effective and more efficient.

5.3.5 Ayyagari, Beck and Kunt (2003) underline the importance of access to financial services for a thriving SME sector. In stimulating greater SMEs activities, financial planning must incorporate underlying characters of the real sector including the special needs of the small business enterprises. Long and Rutkowska (1995) conclude in their study on the need of the fundamental infrastructure for a market based financial system to stabilize macro economy. Proper design of market infrastructure would open new means for small scale borrowers to tap the capital market.

5.3.6 According to several studies (Obstfeld 1986; Montiel 1993; Goldstein and Mussa 1993), there are several established ways to measure and analyze the degree of integration. These include; legal restrictions on the capital account, changes in capital flows, interest rate parity conditions, saving-investment correlations, inter-country consumption correlations and a range of other tests which seek to identify changes in real variables or structure economic relationships which are explicable in terms of financial integration. Brouwer (1999) further looked into several variables to study the capital flows in the East Asia study; these include, net capital inflow, direct investment inflows, portfolio inflows bank inflows and private non-bank inflows. Detail investigations on these dimensions of financial integration within ASEAN would be major inputs for policy makers in gauging the state of financial integration and formulation of new policies that would spur greater private sector participations.

6. Foreign Direct Investments (FDI) in ASEAN

6.1 Foreign direct investments (FDI) have played a crucial role in the economic growth of many countries and FDI flows have become an important channel for regional financial integrations. Jalilian and Weiss (2001) in their study on the link between FDI and poverty reduction in the ASEAN region find that approximately 40% of the poverty-reducing effects of FDI comes from economic growth and the effects are stronger in the ASEAN region than elsewhere. Kee and Mirza (2003) highlighted the importance of regional cooperation in promoting FDI in the ASEAN region. For these reasons, efforts in attracting FDI have become increasingly competitive among individual countries and regional groupings. It is generally accepted that increasing financial integration is often associated with more capital flows. Since investment implies the formation of capital which certainly requires funding, FDI indicators can therefore be associated with indicators of financial integration (Dennis and Yusof, 2003)[7]. In their research, Dennis and Yusof (2003) proposed a wide range of indicators for long-term capital flows or direct investment within ASEAN to examine the degree of financial integration within the ASEAN region.

6.2 Table 9 shows the annual inflows of FDI into ASEAN-5, by member countries, the plus-3 nations (South Korea, China and Japan) and the rest of the world. During the years 1995-2003, the FDI inflows into ASEAN-5 averaged $189,835 million.

Table 9: FDI Inflows into ASEAN-5 (US $ Million)

Source	1995	%	2000	%	2003	%	1995-2003	%
South Korea	423	1.7	-118	-0.6	103	0.7	957	0.5
China	125	0.5	14	0.1	9	0.1	481	0.3
Japan	5,508	21.8	781	3.7	1,734	11.9	25,343	13.3
Plus-3 Nations	6,055	23.9	677	3.2	1,845	12.6	26,782	14.1
Intra-ASEAN	3,853	15.2	894	4.2	1,900	13.0	22,519	11.9
Rest of the world	15,403	60.9	19,753	92.6	10,880	74.4	140,535	74.0
Total	25,311	100.0	21,325	100.0	14,625	100.0	189,835	100.0

Source: ASEAN Statistical Yearbook, 2004, Table VI.6.
* Excluding Cambodia; reinvested earnings of the Philippines (1999-onwards) and inter-company loan of Singapore (2003), as these data are not available at details by Source Countries.
Negative sign means disinvestments.

6.3 An examination of the share of the FDI inflows going into the ASEAN-5 countries reveals that in the years 1995-2003, on average, FDIs originated from ASEAN-5 member countries represented about 11.9% of the total FDI inflows. The remaining 14.1% and 74% of the FDI shares were flowing from the plus-3 nations and the rest of the world respectively. The ASEAN-5 member countries' share in FDI inflows into ASEAN declined since 1995, from 15.2% of the total

[7] Private capital flows encompass three major components, namely; foreign direct investment (FDI), portfolio flows and bank flows. Dennis and Yusof (2003) suggest that among the three, FDI represents a dominant form of private capital flows exceeding the flows from bank lending.

FDI inflows to merely 4.2% in 2000 before increasing to 13.0% in 2003. In particular, it is worth noting that in the year 2000, almost 93% of the FDI inflows into the ASEAN-5 countries came from the rest of the world. The share of FDI inflows from the rest of the world has also increased from 60.9% in 1995 to 74.4% in the year 2003. It is important to note that in the year 2003, the percentage of FDI inflows generated by the plus-3 nations has declined considerably to almost one half of the figure reported in 1995, i.e. from 23.9% in 1995 to 12.6% in 2003. Nevertheless, among the plus-3 nations, Japan generates the biggest share of the FDI inflows into the ASEAN-5 member countries. Based on the figures in Table 9, we can conclude that the rest of the world play a far more important role than the ASEAN-5 member countries and the plus-3 nations in generating the FDI flows into the ASEAN-5 region.

6.4 Table 10 provides the breakdown of share of intra-ASEAN FDI inflows of each of the ASEAN-5 countries. As shown, there is a degree of disparity in source of the intra-ASEAN FDI inflows. In particular, Malaysia, Singapore and Thailand rank high in terms of contribution to intra-ASEAN FDI inflows. The figures revealed that for the years 1995-2003, Malaysia's, Singapore's and Thailand's share of intra-ASEAN FDI inflows averaged at 31.1%, 29.2% and 26.0%, respectively. On the other hand, Philippines and Indonesia shared minimal portions of the FDI inflows with less than 10% each.

Table 10: Share of Intra-ASEAN-5 FDI Inflows (US $ Million)

	1995	2000	2003	1995-2003
Indonesia as % of total	609 15.8	-233 -26.0	384 20.2	1,857 8.2
Malaysia as % of total	1,677 43.5	258 28.9	251 13.2	7,009 31.1
Philippines as % of total	242 6.3	127 14.1	175 9.2	1,239 5.5
Singapore as % of total	1,165 30.2	353 39.5	420 22.10	6,575 29.2
Thailand as % of total	161 4.2	389 43.5	670 35.3	5,840 26.0
ASEAN-5 as % of total	3,853 100.00	894 100.00	1,900 100.00	22,519 100.00

Source: ASEAN Statistical Yearbook, 2004, Table VI.3. and Table VI.5.
Negative sign means disinvestments.

6.5 It is worth noting that the sizeable differences in the share of FDI inflows among the ASEAN-5 member countries could be taken as an evidence of the low degree of financial integration within the ASEAN-5 region. Furthermore, the low percentages of the intra-ASEAN FDI inflows especially for Indonesia and Philippines, raises an important question as to how the share of the two countries can be increased, if progress is to be made in achieving financial integration within the region. Part of the answers may lie in addressing a wide range of issues related to private sector development in the ASEAN-5 region.

6.6 Limited studies have been conducted to examine the important link between private sector development and financial integration in a regional context. Kee and Mirza in their work stressed that a strong private sector base is important in sustaining economic growth and in attracting intra-investment flows in the ASEAN region. Strong foundations for the private sector play a crucial role in helping to facilitate smoother intra-regional investment activities among the ASEAN member countries. Investment activities could range from investment approvals affecting the entry, operations and exit of investing firms to the regulations on foreign exchange transfers which may affect the returns from investments.

6.7 On the one hand, ASEAN-5 member countries with relatively good private sector development for example Malaysia, Singapore and Thailand have been associated with higher level of share in the intra-ASEAN FDI inflows as shown in Table 10. On the other hand, in countries where legislative and regulatory systems tend to be least developed, for example Indonesia and Philippines, the share of intra-ASEAN FDI inflows tend to record low percentages.

6.8 It is obvious that many of the obstacles that frequently impede the intra-regional financial integration are closely related to the private sector development in individual member countries. Based on a comprehensive survey, Mirza (2001) identified several types of policies and measures aim at encouraging FDI into and within ASEAN. Some of the specific measures are intended to establish an enabling environment for the FDI, for example building good physical and communication infrastructure, increased predictability and transparency of laws & rules, to name a few. Therefore, in a regional context, financial integration is likely to be successful only if all these challenges facing the private sectors are carefully and properly addressed.

7. Recommendations

Preceding discussions describe the status of private sector development (PSD) and surrounding forces that influence its progress within the ASEAN economies. The status of PSD is discussed with respect to macro and micro enablers in line with the progress of economic and financial integration among ASEAN nations. Based on these analyses, the following strategies are recommended in enhancing the role of PSD and simultaneously fostering regional integration process that is initiated by ASEAN members:

7.1 Stenghthening ASEAN SME Network

A critical aspect of promoting greater participations of the private sector (in large SMEs) in the integration process is the establishment of strong formal network that promote closer interactions among SMEs within ASEAN countries. With centralized network, a systematic compilation of information on ASEAN's SMEs that profiles their activities, specialization, scale, and capacity can be established. The established database of SMEs in ASEAN could be retrieved and shared throughout the network. Wide and strong networks allow speedier and accurate information dissemination that lead toward efficient and effective decisions making. This platform could also be used for searching and matching by SMEs across ASEAN as well as by non-ASEAN firms that are seeking potential partners. Aggressive promotions to link private participants across ASEAN will hopefully foster greater integration within the region.

7.2 Enhancing Financing for SMEs

7.2.1 Pro-SMEs Financial Structure

The availability and capability of private sector in sourcing financing at reasonable cost is a critical element for PSD. It is widely acknowledge that inability to access suitable financing is a major barrier for progress of private activities. As highlighted in the earlier section, an important aspect of assuring availability of sufficient finance is the existence of a well developed financial system. Sound institutional development and regulatory structure promote efficient mobilization of resources across the economy. Promotion of financial development should pay special attention to the underlying characteristics of the economy. With SMEs-dominating economy such as ASEAN, where agents can be largely classified as bank-dependent, plan for banking development must be consistent with the special needs and characteristics of SMEs. The banking industry must be structured such that lending to SMEs will be naturally promoted. Recent study by Berger et al. (2005) show significant evidence that smaller banks, compared to large banks, are more efficient in collecting and processing soft information which is a major feature of SMEs. Thus, small banks are argued to be friendlier to small-size borrowers who operate based on a less formal business and accounting reporting system. Thus, for promotion of the private sector activities, design of the financial system must be in line with the basic underlying characteristics of the economy.

7.2.2 Introduction of Pro-Integration Financing Schemes

In encouraging greater integration among ASEAN SMEs, special financing scheme that specially targeted at promoting cross-border activities can be set up at the regional level. Concerns over collections and payments can be reduced or eliminated via cross-border credit guarantee and/or insurance schemes provided by regional institutions. With the endorsement of regional institutions, enforcement costs will be less and cross-border activities among SMEs will be promoted. Export credit financing (pre and post) reduces wait-time and allows better management of cash flows particularly for firms with limited financing capacity. In addition, special financing scheme that tailor at reducing exchange rate uncertainty will also attract greater cross-border participations that promote greater integration among ASEAN SMEs.

7.2.3 Fostering Cross-Border Financing for SMEs through Regional Rating

With greater financial integration and openness, availability of funds in the local financial system will no longer be constrained by domestic savings. As noted by Koo and Maeng (2005), financial liberalization and openness in South Korea benefit small and non-chaebol firms more than their large counterparts. With greater openness, investments are less constrained by internal cash flows due to the increasing availability of external funds. In addition to this direct benefit, effort to integrate ASEAN financial sector should gives greater flexibility for cross-border financing that enhance credit accessibility by foreign SMEs in a particular country. Standard regional rating system for region's SMEs allows speedier and better assessments of credit standing of foreign SMEs. Given the greater opportunity in sourcing financing which is independent of the country of origin, regional savings can be mobilized optimally to benefit and encourage larger participations of SMEs in ASEAN region.

7.2.4 Establishment of Regional SME Bank

Establishment of special bank that specializes for SMEs is among the most recent initiatives of the Malaysian government in promoting SMEs development in Malaysia. The establishment of special bank for SME not only supplements SMEs' financing needs but also simultaneously provides other non-financial services such as business advisory and consultancy services. Accumulation of experience in working with SMEs enhances bankers' understanding of SMEs' needs and business environment. Thus, lending will be more profitable given the greater understanding of borrowers' requirements and achievement of economies of scale. Similarly, a concept of setting a special bank for SMEs can also be adopted at the regional level. Regional SME bank can be more focus in serving SMEs that operate at the regional level. Thus, greater cross-border activities will be promoted with the setup of regional SME bank.

7.3 Enhancement of Enablers: An Effective Role for the Public Sector

7.3.1 Pro-integration Micro-Enablers: Regulatory and Red-tapes

The post-Washington Consensus views have partly reframed the role of public and private sectors in promoting growth among developing nations. Instead of direct-ownership based participation, the public sector's main responsibility lies on constructing effective infrastructure (micro and macro) that are conducive for private sector transactions. As indicated in the analysis, micro-enablers within a significant part of ASEAN economies (except for Singapore), remain inefficient and thus prohibit faster growth of PSD. Excessive regulatory requirements and complications in the business operations, to a certain extent deter smooth growth of private sector activities. Operations in foreign nations often require host-country partners due to lack of familiarity with local requirements and contacts. While cross-country harmonization is not a guarantee for success, reducing barriers and red-tapes would be a motivating force in spurring private activities. Detailed and specific study on the status of micro-enablers within ASEAN member nations will be of great importance in setting strategies to enhance ASEAN micro-enablers that are pro-integration. Concerted effort at the regional level in promoting enhancement of micro-enablers guided with clear target and schedule would certainly be a plus for integration of economic and financial activities in ASEAN.

7.3.2 Macro-Enablers: Regional Surveillance for Regional Stability

Macro economic stability is a key enhancer for private sector activities. While there is no existing alarming signals that indicate persistence of ASEAN macro weaknesses, the bitter experience of the 1997-98 economic crisis highlights the vulnerability of highly open economy such as ASEAN countries to external turbulence. The crisis episode alerted the needs for gradual and planned economic and financial opening process. The fact that the crisis is closely related to the degree of financial openness and force of globalization does not form solid rejection toward liberalization and process of globalization. Instead, efforts to strengthen economic resilience and to improve the ‘how-to’ aspects of the financial openness and liberalization are called for to make the globalization process a winning outcome. Effective regional surveillance system tracking macroeconomic performances and cross-borders activities would provide early signals to policy makers. Speedier and systematic surveillance mechanism avoids sudden turns and distruptions such as those of 1997-98 and produces accurate information for policy reactions. With greater stability and predictable changes, private resources can be mobilized optimally toward producing greater output. Establishment of regional surveillance mechanism not only helps domestic policy makers but also promotes greater economic and financial integration among ASEAN members.

7.4 Strengthening SMEs Skills and Capacity: Regional Training and Consortium

The analysis indicated that ASEAN’s SMEs absorbed a significantly large number of the workforce. Nevertheless SMEs’ contribution in the export sector and the final gross domestic products (GDP) is relatively low. These suggest lack of efficiency and economies of scale within the operations of SMEs. Efficient operations require focused effort in training and development among SMEs operators. Training programs at the regional level not only serve to improve SMEs expertise but also expedite efforts to integrate ASEAN SMEs. Capacity building of SMEs can be achieved via formation of ASEAN SMEs Consortium. With larger scale, the potential for ASEAN’s SMEs to penetrate global market will therefore be greater. In addition, regional initiatives and projects would expand the supply and vendors-chain to include multiple nations. It is hope that these regional initiatives would bring greater competition among ASEAN’s SMEs, which represents a critical ingredient for industry’s long run efficiency. In addition, these will also encourage SMEs to operate at a greater scale and degree of integrations.

8. Summary and Conclusions

8.1 The preceding discussions highlight the status of PSD within the ASEAN-5 region with respect to regional economic growth and financial integration. Current perspective of development that emphasizes public-private smart partnership as core strategy for sustainable development is adopted for the ASEAN member countries. The role of government is being redefined as architect of positive enabling environments planned in tandem with agendas for private initiatives, giving birth to the public-private smart partnership.

8.2 The private sector assumes a very important role as engine of growth for ASEAN-5 countries. Its consumption spending and investment are associated with the nation’s GDP and per capita income, respectively. In large part, ASEAN’s private sector is represented by the SMEs. SMEs form a significant composition of the ASEAN private enterprises that absorb large portion of workforce within ASEAN. ASEAN SMEs intensity is low as compared to that of the developed nations. SMEs’ contribution in ASEAN exports market is also found to be relatively low. Thus, ASEAN economic integration via AFTA is seen as a potential space for the region’s SMEs to expand their activities and contribution to the ASEAN economies. Greater effort must be focused on motivating SMEs participation in the export market.

8.3 Analysis of the PSD is broken down into two perspectives; the macro enablers and micro enablers. From the perspectives of macro elements, overall, the region is geared toward greater participation of private activities. The region, despite being affected significantly by the late nineties economic crisis are now generally recovered. Macro economic environment shows promising potential for greater PSD. ASEAN monetary, fiscal, inflation, and trade pattern all point to a conducive macro-environment for ASEAN. Intra-ASEAN trade has increased remarkably over the 10-year period (1993-2003), indicating a strong improvement in ASEAN economic integration. The initiation of AFTA would lead to greater trade among ASEAN members. The emergence of China's economy has witnessed shift of extra-ASEAN trade (trade divergence) from Japan to China. Nevertheless, real gain from the trade creation is less observed. With respect to the extra-ASEAN trade, greater contribution can be expected from the ASEAN+3 initiatives.

8.4 Country specific analysis provides greater insight that highlighted room for improvement in specific nations. Of important note is the low level of financial development in Indonesia and Philippines. Selected measures of financial development indicate that Singapore, Malaysia and Thailand belong to the high-financial development group leaving Indonesia and Philippines behind. Limited access to financing and higher intermediation cost in these two countries could be a major obstacle for PSD to be promoted. Internal and external measures can be adopted as remedies to this lower financial development. With greater financial integration among ASEAN members, the region's higher savings could be mobilized to benefit lower-income countries.

8.5 PSD is also significantly influenced by the business environment in the ASEAN economies. Excessive bureaucracies and rulings interfere with the market in generating business efficiencies expected from the private sectors. Among the ASEAN-5 countries, Singapore's business environment is ranked as very conducive for private activities. Efforts to remove red-tapes and long procedures are called for to give better platform for the PSD to be enhanced. This is particularly true for Indonesia and Philippines and in some aspects for other ASEAN-5 members as well.

8.6 Existing measures of financial integration among East Asian economies point toward serious needs for effective efforts to promote higher degree of integration. East Asian currently receives minor portion of global bond funds. In term of Asian Bond, very minimal participations are recorded among ASEAN members.

Analysis of the flows of FDIs within the ASEAN major economies pointed to the need for better strategies to enhance intra-ASEAN FDIs. ASEAN has been a major region that attracts significant amount of world's FDIs. However, with respect to ASEAN integration, ASEAN's FDIs is still limited. Cross-borders activities among ASEAN entrepreneurs and businesses must be activated for greater economic interactions.

8.7 Based on the status analysis, eight recommendations are forwarded as strategies to promote greater participations of the private sector (largely SMEs) in the process of ASEAN economic and financial integration. These strategies cover four major aspects of the regional PSD/SMEs development; Strengthening ASEAN SMEs Network, Enhancement of SMEs Financing, Enhancement of PSD Enablers, and Strengthening Skills and Capacity of SMEs. Regional initiative form as an anchor to these proposals as existing initiatives are mostly country-specific with less emphasis on the economic and financial integration process.

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