



**Directorate of
Intelligence**

~~Confidential~~

25X1

**Southeast Asia:
A New Look at Industrial
Development Strategies**

25X1

A Research Paper

~~Confidential~~

*EA 83-10063
April 1983*

Copy **295**

Page Denied



**Directorate of
Intelligence**

Confidential

25X1

Southeast Asia: A New Look at Industrial Development Strategies

25X1

A Research Paper

This paper was prepared by [redacted] Office
of East Asian Analysis. Comments and queries are
welcome and may be directed to the Chief,
Southeast Asia Division, OEA, [redacted]

25X1

25X1

This paper was coordinated with the National
Intelligence Council [redacted]

25X1

Confidential

*EA 83-10063
April 1983*

Confidential

25X1

**Southeast Asia:
A New Look at Industrial
Development Strategies**

25X1

Summary

*Information available
as of 18 March 1983
was used in this report.*

Singapore and Malaysia, in our judgment, will during the 1980s remain the front-runners in industrial development among the five countries that belong to the Association of Southeast Asian Nations (ASEAN). The three larger member countries—the Philippines, Thailand, and Indonesia—will lag behind, partly because political elites control economic interests that would be damaged by moves to open the economy to competition.

Singapore, already a newly industrializing country, is pushing its “second industrial revolution” to move into knowledge-intensive and high-technology manufacturing industries. Malaysia is developing heavy industries based on indigenous resources and is improving capabilities to manufacture and export labor-intensive products. Singapore and Malaysia will continue to attract foreign investment and will, we believe, receive a disproportionate share of the equity capital flowing into ASEAN countries. Both countries are also investing heavily in human capital by strengthening educational and technical training to meet the increasing demand for skilled workers.

The Philippines will find it difficult to ease trade restrictions and foreign investment regulations because of the political strength of industrialists who have close connections with President Marcos. In addition:

- Recent natural gas production problems in Thailand have raised uncertainty about the gas-based industrial development strategy.
- Indonesia’s energy-based plans are being reviewed as the country’s financial position deteriorates, and its industrial development program now seems likely to slow.

Although growth will probably be slower than in the 1970s, we believe the ASEAN countries as a group should continue to outpace most other developing countries. The region is well endowed with natural resources, has a comparatively well-educated and rapidly growing labor force, and is politically stable compared with other Third World areas.

Confidential



25X1

The ASEAN countries are not likely to compete against the United States in a wide range of products in this decade, but we believe they will be successful in exploiting market opportunities in specific products or services, such as electronic components, that now originate in the United States and other industrial countries. In any case, US firms will continue to find Southeast Asia a relatively profitable investment location, and we believe will increasingly move some production operations in high-technology industries to the region to take advantage of low wages.



25X1

Confidential

Contents

	<i>Page</i>
Summary	iii
Moving Into the 1980s	1
Country Strategies	1
Singapore: High Tech's the Name of the Game	1
Malaysia: Looking Good and Looking East	2
Thailand: Potholes in the Development Road	5
The Philippines: Still at the Starting Gate	5
Indonesia: End of the Oil Boom?	6
The Development Race: Front-Runners and Laggards	7
Implications for the United States	9

Appendixes

A.	Southeast Asia: Industrial Development in the 1970s	11
B.	Southeast Asia: Foreign Direct Investment	13

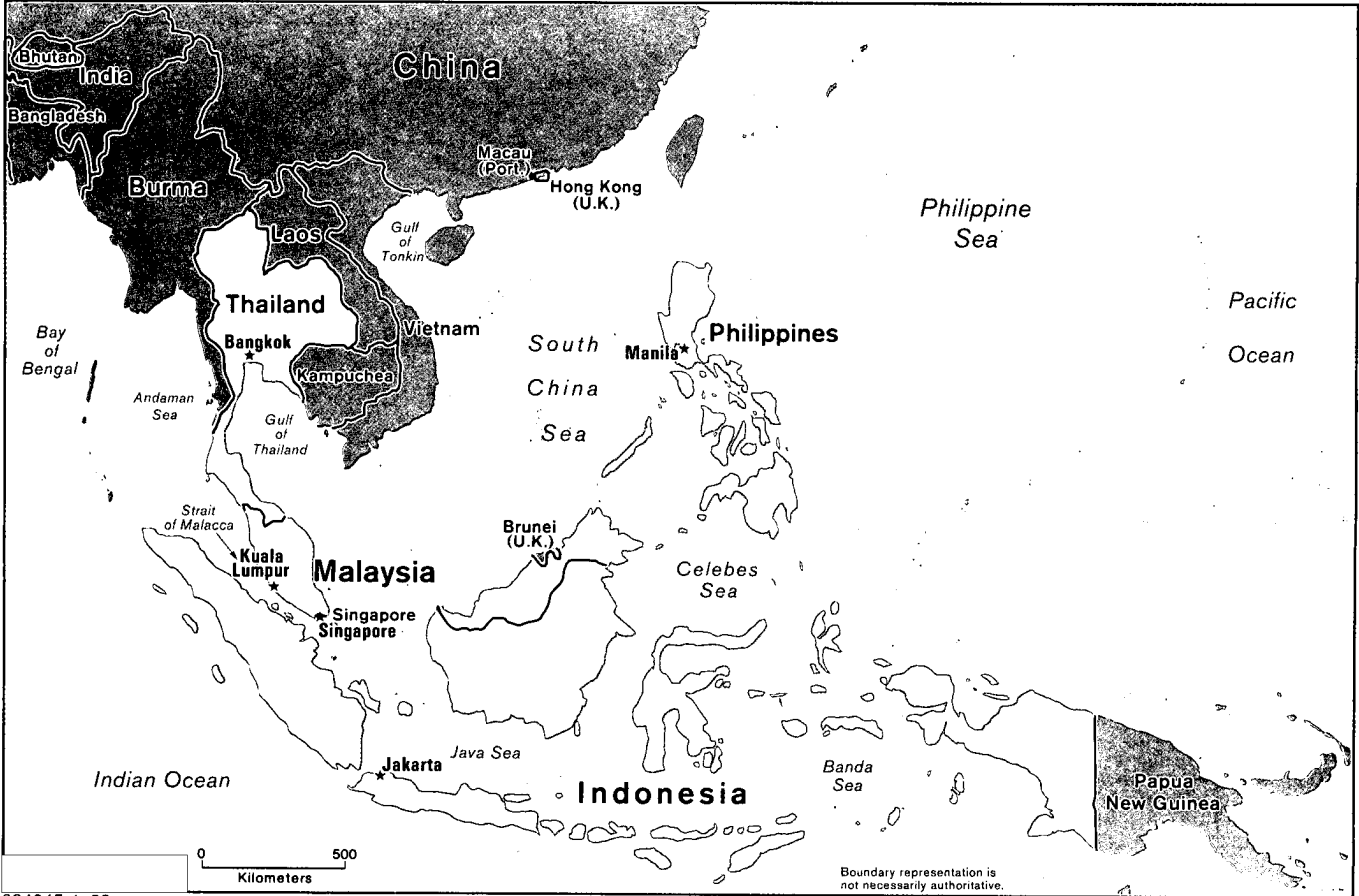
Tables

1.	Indonesia: Selected Industrial Projects	6
2.	US Direct Investment in LDCs: A Comparison	9
3.	Southeast Asia: Growth in Perspective	11

Figures

1.	Association of Southeast Asian Nations (ASEAN)	vi
2.	Malaysia: Selected Areas of Industrial Development	4
3.	Indonesia: Selected Industrial Projects	8
4.	Southeast Asia: Manufacturing as a Share of GDP	12

Figure 1
Association of Southeast Asian Nations (ASEAN)



Confidential

[Redacted]

25X1

**Southeast Asia:
A New Look at Industrial
Development Strategies** [Redacted]

25X1

Moving Into the 1980s

The Philippines, Thailand, Indonesia, Singapore, and Malaysia—the five countries that are members of the Association of Southeast Asian Nations (ASEAN)—for the most part have weathered the current world-wide recession fairly well¹ (see appendix A). The region's overall 4-percent growth last year was high by international standards, although rates ranged from Singapore's 6.3-percent growth to the Philippines's 2.6 percent. Weak foreign demand cut manufactured exports, however, and even Singapore's well-balanced economy, according to government data, did not escape unscathed; output in the electronics sector declined in 1982 and exports stagnated. [Redacted]

Although it probably has slowed some projects, the recession has not forced revisions of the industrial development strategies in any of the countries, in our judgment. They continue both to emphasize resource-based heavy industries and, at the same time, to pursue policies to develop exports of light consumer goods, electronics products, and other labor-intensive products. Singapore is pressing ahead with its "second industrial revolution" to move into knowledge-intensive and high-technology manufacturing industries. [Redacted]

Indeed, Southeast Asia's economic prospects remain relatively bright compared with other LDCs. In our judgment, the region's strongest asset is the favorable mix of natural and human resources. Compared with most other areas, the region's population is relatively well educated and work oriented—especially in Malaysia and Singapore. Political and economic consequences notwithstanding, rapid labor force growth

[Redacted]

in the Philippines, Thailand, and Indonesia will hold down wage rates, which will make their labor-intensive exports more attractive on world markets. [Redacted]

25X1

Country Strategies

Singapore: High Tech's the Name of the Game.

According to government development plans, Singapore recognizes that growth in the 1980s based on labor-intensive production will be limited by its small labor force and growing competition from China and neighboring Asian countries. As a result, it is looking to high-technology manufacturing and service-based industries to maintain rapid export growth.³ The government is encouraging the establishment of manufacturing facilities in areas such as industrial electronics, avionics, optics, and specialized oilfield equipment. In addition, the city-state is intensifying efforts to export existing product lines to nontraditional markets. For example, Singapore recently broke into the lucrative Soviet market for offshore oil rigs with a \$100-125 million contract. [Redacted]

25X1

25X1

25X1

To complement these manufacturing industries, the city-state is pushing development of computer software, engineering design, and financial and professional services. According to government planners,

25X1

³ The corollary, of course, is how well the economies will absorb new entrants to the labor force, when they already face underemployment and unemployment. For example, Indonesia, the world's fifth most populous country, cannot adequately employ its labor force now, and the need to create jobs will increase in the 1980s when the labor force will grow much more rapidly than the population. [Redacted]

25X1

25X1

[Redacted]

25X1

Confidential

Confidential

Singapore also hopes to strengthen its position as a major Asian financial market. The country is already a center for Asian loans and is emerging as an important loan syndication center in direct competition with Hong Kong. According to US Embassy reporting, Singapore expects to gain from the uncertainty over Hong Kong's future as the 1997 expiration date of the United Kingdom's lease on the New Territories draws closer. [redacted]

In addition, the Singapore Government continues to try innovative approaches to spur development. The government, for example, established a Trade Development Board in January 1983 to promote exports and negotiate international trade agreements. The Board is modeled on the successful Economic Development Board, the country's one-stop investment agency, and will engage in commercial activities—including the formation of companies, joint ventures, and partnerships. [redacted]

Singapore is also emphasizing education and technical training to meet the increased need for skilled workers in the high-technology industries. University enrollment is being expanded, and a Skills Development Fund is providing financial assistance to firms seeking to upgrade employee skills. In cooperation with the West German, French, and Japanese Governments, technological training institutes aimed at a broad range of advanced technical skills have been established. The German-Singapore Institute, which began operation last year with an enrollment of 400, will train production engineering technicians in machinery processes, tool and die making and design, and other processes. The French program began operation this year and is training technicians in microprocessor and computer applications. The Japan-Singapore Institute, financed by the Japanese Government, is focusing on computer applications—primarily professional training in software technology. [redacted]

Malaysia: Looking Good and Looking East. Malaysia's industrial development plans envisage establishing import-substituting heavy industries and encouraging export-oriented, labor-intensive manufacturing. We believe plentiful energy reserves, largely offshore natural gas, will support a proposed heavy industrial

center in East Malaysia, including projects in petrochemicals, steel, cement, and possibly zinc and copper smelters.⁴ In our judgment, Malaysia will have little trouble financing this program because of an excellent international credit rating and a proven ability to attract foreign investment. According to government plans, output from these plants will be used primarily for import-substitution and to encourage development of the relatively backward east coast of Peninsular Malaysia as well as Sarawak and Sabah. [redacted]

Malaysia is emphasizing its budding steel industry to fill anticipated growing domestic requirements. A \$500 million iron and steel complex with a capacity of 600,000 tons per year is scheduled to open in 1985, as is a cold rolling mill costing \$250 million. The government is also moving ahead with an aggressive auto industry development policy. Tariffs have been increased on imported motor vehicles, and Prime Minister Mahathir has labeled the effort a "personal project." We believe Kuala Lumpur recognizes that the industry will be uncompetitive, [redacted]

[redacted] Kuala Lumpur is prepared to accept this because the industry will be an important source of demand for domestic steel, machinery, and tires. The Heavy Industry Corporation of Malaysia and Mitsubishi Motors will collaborate on production of parts and assembled vehicles with a goal of 90,000 units per year for the domestic market. [redacted]

Malaysia is also moving to strengthen its well-established capabilities to manufacture and export labor-intensive light manufactures. Electronic component manufacturers, for example, are modernizing their operations by using minicomputers and microprocessors to automate their production lines, [redacted] In addition, Malaysia is also actively promoting its products on world markets. Kuala Lumpur plans to expand the number of trade offices operating in large trading centers overseas to provide information on export opportunities to Malaysian

⁴ Gas reserves of 34 trillion cubic feet also allow Malaysia to export gas. Liquefied natural gas shipments to Japan, amounting to 6 million metric tons per year over a 20-year contract period, began this year from Bintulu in Sarawak. [redacted]

Confidential

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Confidential

Southeast Asia: Foreign Investment Incentives

25X1

Foreign investors continue to be attracted to Southeast Asia because of low wages, rich resources, and relative political stability. Over \$15 billion in foreign direct investment flowed into ASEAN countries during 1975-81 (see appendix B). Malaysia and Singapore are pursuing policies to attract foreign investment, but in Thailand, Indonesia, and the Philippines, we believe, strict regulations and nationalism have impeded foreign investment and will continue to do so.

NEP, we believe new foreign investment would slow. For the time being, however, the Mahathir government is stressing pragmatism and flexibility.

The Thai Government is attempting to encourage new foreign investment, but complicated immigration and residence procedures, legal prohibitions against foreign ownership of property, and red tape in general inhibit foreign investors. Overall, we believe the government will find it difficult to liberalize foreign investment regulations because Sino-Thai businessmen with close connections to the military-bureaucratic elite generally oppose any such reform. Nevertheless, Prime Minister Prem has led missions to the United States, Australia, New Zealand, Japan, and the EC to encourage investment in Thailand. Bangkok also hopes to capture capital moving out of Hong Kong.

Singapore is in the forefront of the NICs in encouraging multinational firms to move into knowledge-intensive industries, and Prime Minister Lee Kuan Yew is determined to maintain the lead. The Economic Development Board—the highly successful government institution tasked with directing private investment—has initiated tax incentives to encourage investment in high-technology industries. Firms are eligible for numerous financial incentives including:

- Accelerated depreciation on fixed investment.
- Tax holidays for five to 10 years.
- Tax exemptions on export profits.

The Philippines has only recently agreed to restructure foreign investment regulations in return for continued financial assistance from the World Bank and the IMF. Complicated regulations, nationalistic voices among the technocrats who frame economic policy, and past decisions to borrow abroad have kept foreign investors from playing a major role in the Philippine economy. Moreover, we believe fundamental reform of foreign investment rules will be slow, largely because of political considerations.

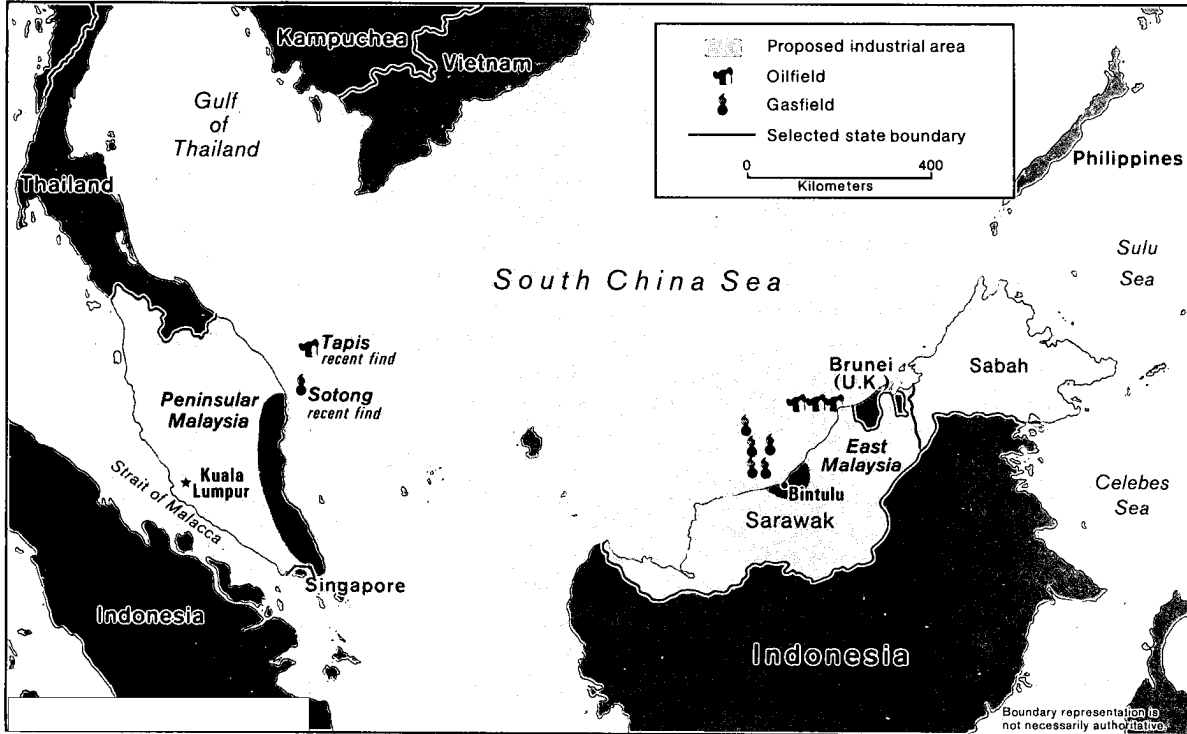
Malaysia is encouraging foreign investment and joint ventures and is exploring the possibility of encouraging basic "smokestack" industries operating in developed countries—especially in Japan—to relocate in Malaysia. Moreover, at a recent ASEAN economic ministers' meeting, Malaysia announced that it will not participate in government-sponsored ASEAN industrial projects, but instead would promote private joint ventures within ASEAN. Malaysia's investment incentives are designed to provide total or partial relief from income taxes for companies investing in new enterprises or expanding existing ones.

Indonesia probably has the most obstructive foreign investment regulations and the least cooperative bureaucracy in ASEAN. President Soeharto has not hesitated to impose stringent conditions on foreign investors to expand employment opportunities for native Indonesians and to protect business interests of influential groups in Indonesia's elite. He has issued presidential directives limiting the employment of expatriate employees and requiring foreign firms to use Indonesian subcontractors, even at the cost of discouraging some investment or increasing the cost of some projects. Despite Indonesia's professed interest in encouraging foreign investment, we believe progress will be hard to come by.

Kuala Lumpur's highly nationalistic New Economic Policy (NEP) could pose a threat to foreign investment, however. The fundamental objective of the plan is to put 30 percent of Malaysia's corporate wealth into Malay hands by 1990. By 1980, after the NEP had been in effect for 10 years, Malays owned only 12 percent, a considerable part via government trusts. Should the government begin to strictly enforce the

Confidential

Figure 2
Malaysia: Selected Areas of Industrial Development



634049 4-83

firms. The government is also providing financial assistance in the form of tax deductions for export sales. According to the government, large trading corporations may be established to obtain new market outlets by entering into joint ventures with multinational corporations. [redacted]

Like Singapore, Malaysia is emphasizing education and training. Six new trade schools are being built that will provide training in engineering and machine tools. In addition, the Malaysian Ministry of Labor's two industrial training institutes are currently being expanded to meet the demand for skills in metal and foundry works, tool and die making, electronics production, and printing. The government also plans to build another three institutes during the next five years to provide training in heavy plant fittings and maintenance, engineering, and automation. [redacted]

Prime Minister Mahathir is trying to make his "look East" policy an integral part of Malaysia's industrial development program. Mahathir has proposed Japanese and South Korean development as models for industrialization. The Japanese work ethic and discipline are particularly appealing to Mahathir, whose controversial book published in 1970 criticized Malaysians for not measuring up to other races such as the aggressive Japanese and Chinese.⁵ One goal of the Prime Minister is to send students to Japan for apprenticeships or practical training in manufacturing industries. Malaysians currently studying abroad, however, are concentrated in the West with 15,000 students in the United States and roughly 15,000 to 20,000 in the United Kingdom. [redacted]

⁵ Mahathir's book, *The Malay Dilemma*, was banned soon after its publication because of the highly charged atmosphere following race riots in 1969. [redacted]

25X1

25X1

25X1

25X1
ZSAI
ZSAI

Confidential

Despite Mahathir's efforts during the past year, the policy has yet to catch on with the Malays or with Kuala Lumpur's Western-oriented cabinet ministers and bureaucracy. Mahathir attempted to give the initiative new momentum during his trip to Japan in January 1983. The \$200 million Japanese credit he obtained on the trip should quiet critics of the policy for the time being, according to the US Embassy. [redacted]

been postponed to 1985. [redacted] it is doubtful that sufficient gas will be available when construction is completed to run the separation plant at capacity. At present, Bangkok is going ahead only with the \$400 million first phase of its petrochemical industry program—construction of an ethylene plant—while it reconsiders the size and scope of the industry. [redacted]

25X1
25X1

Thailand: Potholes in the Development Road. As part of Thailand's overall development strategy, Bangkok is attempting to improve the efficiency of labor-intensive manufacturing activities under a five-year program with the World Bank that began in 1982. In return for \$325 million in structural adjustment loans from the Bank in 1982-83, Thailand has promised to:

- Lower tariff barriers.
- Promote exports through rebates and export credits.
- Extend export promotion incentives to small business. [redacted]

Because gas production can no longer be counted on to finance the heavy industry program, we believe foreign loans or investment will have to provide much of the required capital. Although Thailand has a good international credit rating, we believe the government prefers a mix of both international borrowing and foreign investment. In our opinion, however, cumbersome foreign investment regulations and investor concern over political stability will deter foreign investors and in turn slow the pace of the industrial development. [redacted]

25X1

25X1

As in Malaysia, natural gas is at the heart of Thai industrial development strategy. As originally planned, natural gasfields in the Gulf of Thailand were to support the development of a large industrial manufacturing center in southern Thailand, including a \$3.5 billion LNG plant capable of generating \$1 billion annually in export earnings. Natural gas would provide both fuel and feedstock for a number of industries ranging from petrochemicals and fertilizers to metals and cement, according to the Thai Government. According to initial government estimates, cumulative investment in the gas-based industrial program would have reached nearly \$4 billion by 1990. [redacted]

The Philippines: Still at the Starting Gate. The Philippines has only recently embarked on an industrial restructuring program aimed at putting its manufactured export performance on a par with the other ASEAN countries. In our judgment, the Philippines missed out on most of the economic success Southeast Asia enjoyed in the 1970s. Real wages in manufacturing, for example, are no higher than they were in 1970, and per capita exports are among the lowest in Southeast Asia. [redacted]

25X1

The once optimistic outlook for gas, however, is now clouded, along with the industrial development plans. Because of recent production problems, one of the US oil companies developing the gasfields has lowered its estimate of recoverable reserves in the Erawan field, the largest in the Gulf of Thailand, by nearly two-thirds to 480 billion cubic feet. [redacted]

Over the next five years the Philippine strategy is to shift from import-substituting industries to labor-intensive, export-competitive manufacturing operations, according to Philippine planning officials. Existing import-substitution industries will be modernized and expanded, and the government will try to spur development of capital-intensive intermediate-goods industries, such as steel and machinery, which, in our judgment, the domestic Philippine economy is capable of supporting. The key objectives of the 1983-87 development plan are to generate jobs for the rapidly growing labor force (projected to increase 3.7 percent

25X1

25X1

The uncertainty over gas reserves is already causing cutbacks in some sectors. Bangkok has shelved plans for the LNG export facility, and completion of a \$300 million gas separation plant to produce feedstocks has

Confidential

Confidential

annually by the mid-1980s), reduce dependence on exports of primary agricultural and mineral commodities, and generate foreign exchange savings for investment.⁶ [redacted]

To improve the international competitiveness of its manufacturing sector, the government is liberalizing tariffs and trade policy and has promised to streamline foreign investment regulations. The moves have been required by the International Monetary Fund (IMF) and the World Bank in exchange for continued balance-of-payments assistance while restructuring of the economy moves ahead. Over the past few months Manila completed negotiations for credits totaling some \$550 million from the IMF and resumed negotiations on a \$300 million structural adjustment loan from the World Bank. Although the government's record in implementing specific reforms mandated by the IMF and the World Bank so far is good, how fast and how far Manila proceeds with the new program, we believe, will determine the success or failure of the strategy. [redacted]

The key to heavy industry development is the government's proposed 11 major industrial projects—including a copper smelter, fertilizer plant, diesel engine plant, integrated steel mill, aluminum smelter, and petrochemical complex. According to government planners, these plants will provide links with existing extractive and light-manufacturing industries. Despite some criticism from the private sector and from several technocrats within the government, seven of the projects are under way and Manila claims they will provide the foundation for future industrial growth. [redacted]

The original price tag was projected at \$6 billion, but major modifications have brought the cost down to around \$4 billion. The current poor state of the Philippine economy, financial strains, and potential debt repayment problems will force further cutbacks

⁶ The plan has been criticized by official creditors and even the Philippine National Assembly for, among other things, ignoring the need for population planning. [redacted]

Table 1
Indonesia: Selected
Industrial Projects

Million US \$

Krakatau Steel Mill expansion	2,700
Asahan aluminum plant expansion	2,000
Arun LNG plant expansion	850
Badak LNG plant expansion	995
Dumai Refinery hydrocracker	1,450
Balikpapan Refinery expansion	1,480
Cilacap Refinery expansion	1,160
Aceh olefins complex	2,850
Aceh urea plant	400
Pladju aromatics center	1,500
Badak urea and ammonia plant	210
Leces newsprint plant	210
Six other pulp and paper plants	1,100
Suralaya electric powerplant	800
Musi Oil Refinery	1,020

or construction delays, in our judgment.⁷ Moreover, we do not believe these projects will generate large foreign exchange savings for many years because the technology and equipment will have to be imported and several of the projects will require imported raw materials. [redacted]

Indonesia: End of the Oil Boom? The 1979-80 oil boom encouraged Indonesian technocrats—with the support of President Soeharto—to press ahead with an ambitious industrialization program. In 1981-82 alone, the government signed contracts for projects valued at \$9.5 billion, bringing the value of industrial plants under way or in advanced planning stages to more than \$15 billion. [redacted]

The current phase of the industrialization strategy emphasizes resource-based heavy industry which is intended to provide a competitive edge that would

Confidential

25X1

25X1

25X1

25X1

25X1

25X1
25X1
25X1

Confidential

enable Indonesia to expand exports and reduce imports of industrial goods. Work under way in North Sumatra and East Kalimantan, for example, will double the capacity of LNG plants to 15 million metric tons per year. Expansion of three petroleum refineries will double the country's refining capacity to more than 800,000 b/d by the mid-1980s and eliminate the need to ship crude oil to Singapore for processing into refined products for Indonesia's domestic market. According to the government, the petrochemical and fertilizer plants under construction in Sumatra and Kalimantan will use Indonesia's abundant natural gas or naphtha as feedstock to supply both domestic and foreign markets. [redacted]

In the metals industries, government planners envisage the Krakatau Steel Mill and the Asahan Aluminum Plant (on the islands of Java and Sumatra, respectively) acting as magnets for private investment in ancillary machinery and metalworking industries. Although the Indonesian market is certainly capable of supporting a domestic steel and aluminum industry, we believe foreign investment in ancillary industries may be slower than anticipated by the government because of Indonesia's restrictive foreign investment regulations and competition from other ASEAN nations for the same types of investment. [redacted]

On the basis of World Bank projections of Indonesia's export prospects, we believe the technocrats in early 1982 had counted on several more years of balance-of-payments surpluses to finance the industrial development program. By then, the new industries would help to reduce import requirements or supplement industrial exports. The sharp reversal in Indonesia's export performance since 1980 and the recent reduction in international oil prices, however, are forcing the government to review its development policy options, and we believe construction of several projects, such as the steel and aluminum plants and new petrochemical plants, will be slowed to avoid a financial crisis.⁸ [redacted]

[redacted]

The Development Race: Front-Runners and Laggards
We believe Malaysia and Singapore will come closest to reaching their goals and will remain the front-runners in Southeast Asia's industrial development during the 1980s. [redacted]

[redacted] the labor forces in Singapore and Malaysia are the most disciplined and industrious in the region, and both countries seem well on the way to producing steady streams of highly trained workers. They view advanced technical training as the key to overcoming the problem of relatively small pools of skilled labor, which could slow the move toward more advanced methods of manufacturing. Both countries are expanding investment in human capital with greater emphasis on science, engineering, and technical training. [redacted]

In addition, both countries are open to foreign trade and investment; they have received nearly 80 percent of the foreign direct investment in the region since 1979. Singapore already leads the region in attracting multinational firms that will, we believe, aid efforts to improve the technical capabilities of the labor force. In our judgment, Malaysia's considerable and diverse resources will help make it a strong competitor in resource-based manufacturing industries. For both countries, the English-language abilities of the labor force enhance efforts to attract foreign investment. Observers of Southeast Asia often cite language as a barrier to the development of advanced industries in other Asian countries. [redacted]

The Philippines, Thailand, and Indonesia will, in our judgment, be ASEAN's laggards in industrialization during the 1980s and will remain heavily dependent on primary products. The problems are similar in all three countries; politically powerful elites control economic interests that would be damaged by opening the economy to competition. In the Philippines, for example, many business leaders who are opposed to economic reforms exert influence because of their close association with President Marcos. They control

25X1
25X1

25X1
25X1

25X1

25X1

25X1
25X1

Confidential

Confidential

Figure 3
Indonesia: Selected Industrial Projects



634050 4-83

25X1

Project	Location
1. Krakatau steel mill	Cilegon, western Java
2. Asahan aluminum plant	Asahan, northern Sumatra
3. Arun liquefied natural gas (LNG) plant	northern Sumatra
4. Badak LNG plant	Bontang, eastern Kalimantan
5. Dumai refinery	central Sumatra
6. Balikpapan refinery	Balikpapan, eastern Kalimantan
7. Cilicap refinery	Cilicap, southern Java
8. Aceh olefins complex	northern Sumatra
9. Aceh urea plant	northern Sumatra
10. Pladju aromatics center	Pladju, southern Sumatra
11. Badak urea plant	Muara Badak, eastern Kalimantan
12. Leces newsprint plant	Probolinggo, eastern Java
13. Suralaya power plant	western Java
14. Musi refinery	Palembang, southern Sumatra

Confidential

major sectors of the economy, particularly in agro-processing industries, and benefit from special legislation or selective enforcement of government regulations. Tariff reform and import licensing will press Marcos's allies by exposing their interests to more efficient—and previously excluded—foreign competition. In Thailand, businessmen with close ties to the political, military, and bureaucratic elite oppose both tariff and foreign investment regulation reform. Widespread corruption in the Indonesian bureaucracy, extending to the highest levels of government, with resulting inefficiencies in business, will be nearly impossible to control without a major overhaul of the Soeharto regime. In our view, this is unlikely, largely because the military has well-entrenched and lucrative business interests, and it is with the military's backing that Soeharto remains in power. Equally important, all three countries will face increased competition in world markets for labor-intensive manufactured products from both China and other Asian countries.

Implications for the United States

If the Southeast Asian countries continue along their current industrial development paths, they will provide both competition and opportunities for the United States. We believe Singapore, for example, is likely to capture a larger share of some service markets now dominated by US and other foreign firms.⁹ In oil-related activities, Singapore will expand its role as a testing and analysis center performing laboratory functions now concentrated in petroleum centers such as Houston. In Indonesia, oil industry policies call for increasing domestic participation in all phases of the industry—primarily affecting US oil firms, which produce over 80 percent of the country's oil and gas.¹⁰

⁹ Singapore is only one of the NICs which will strengthen its competitive position in world markets during the 1980s.

¹⁰ Despite the soft world oil market, Indonesia is continuing to push nationalist policies that would increase domestic participation. In its latest move, Jakarta recently ordered foreign oil companies to replace expatriates with native Indonesians in certain skilled drilling rig jobs.

Table 2 *Million US \$*
US Direct Investment in LDCs:
A Comparison ^a

	1980	1981
Total	49,543	51,469
ASEAN	4,770	6,346
Indonesia	1,314	1,861
Malaysia	632	849
Philippines	1,259	1,294
Singapore	1,204	1,791
Thailand	361	551
Latin America	38,882	38,883
Africa	3,778	4,282
Middle East	2,113	1,958

^aData are cumulative for yearend.

[Redacted]

None of the Southeast Asian countries, however, will compete against the United States in a broad range of products, in our view. Heavy industrial products, such as steel and aluminum, will not pose a threat to US markets because they will serve as import substitutes. Rather, we believe Southeast Asian countries will search out market niches to exploit, such as specialized services in Singapore's case, or small electronic components such as Thailand already supplies to the US space shuttle program. In addition, many US industry analysts believe, as we do, that high-technology industries in the developed countries will increasingly move some production operations—and jobs—to Asian countries, including Southeast Asia, to take advantage of low wage costs. The recent announcement by a US manufacturer of home computers and video games that it plans to transfer some production operations to Hong Kong and Taiwan underscores this trend. Additional US firms producing similar products are eyeing Malaysia, where US electronics manufacturers are already strongly represented, and the Philippines,

25X1
25X1

25X1

25X1
25X1

25X1

25X1
25X1

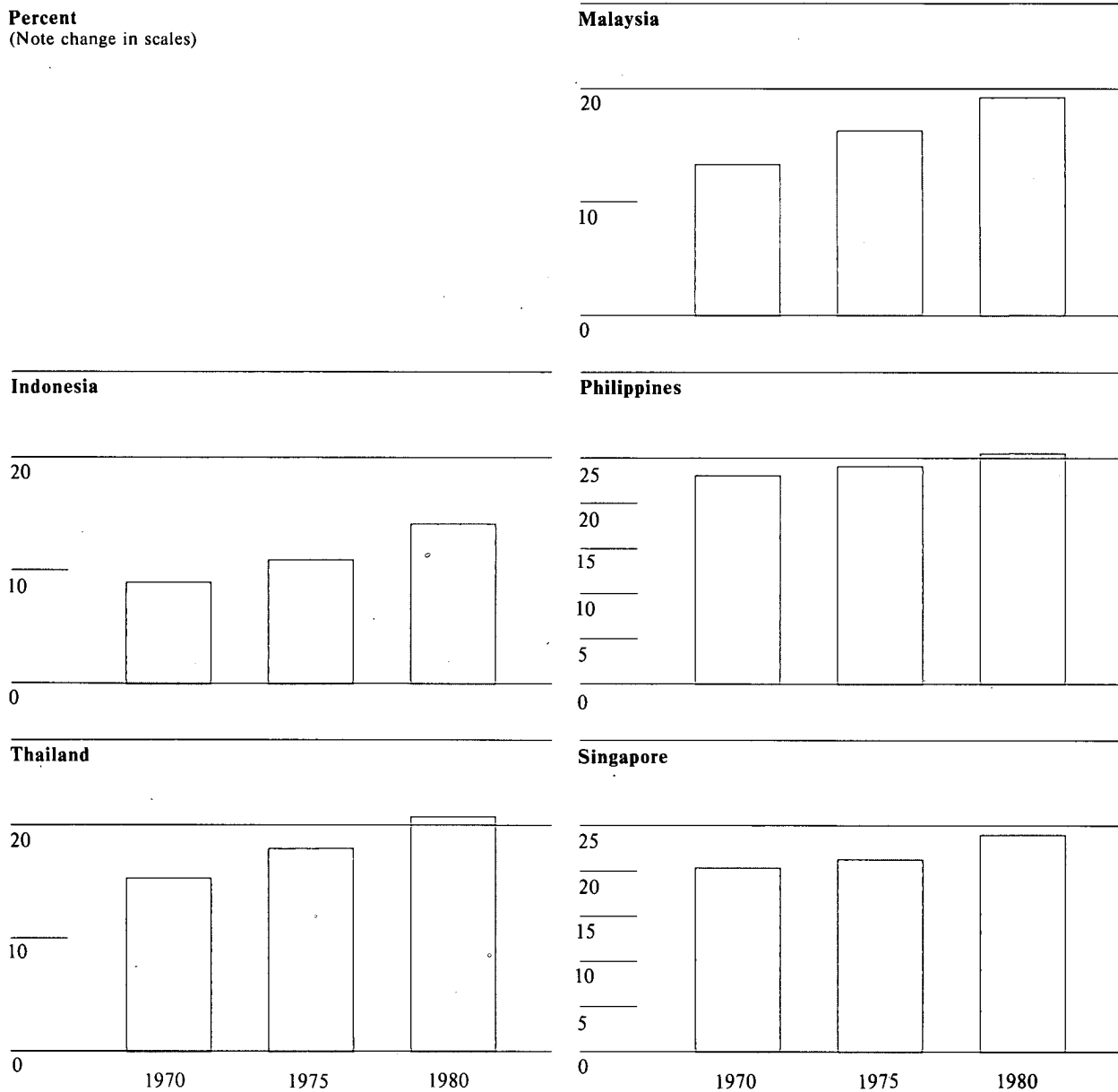
On the positive side, US firms should continue to find Southeast Asian countries profitable and relatively stable investment locations, as well as lucrative mar-



25X1

Figure 4
Southeast Asia: Manufacturing as a Share of Gross Domestic Product

Percent
(Note change in scales)



Appendix B

Southeast Asia: Foreign Direct Investment ^a

Million US \$

	1975	1976	1977	1978	1979	1980	1981
Total	1,621	1,588	1,308	1,763	1,990	3,175	4,032
Indonesia	476	344	235	279	226	184	152
Malaysia	350	381	406	500	574	876	1,317
Philippines	98	132	226	194	199	260	475
Singapore	611	651	335	739	941	1,669	1,797
Thailand	86	80	106	51	50	186	291

^a Data are annual flows reported by IMF *Balance of Payments Yearbook*.

25X1

Confidential