6 ASEAN AND THE DYNAMICS OF GLOBALIZATION IN SOUTHEAST ASIA

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SUMMARY: I. Introduction II. The Importance of ASEAN to Malaysia III.GVC Participation IV.Deepening and Widening Economic Integration in ASEAN V.Conclusion VI.Bibliography

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I. INTRODUCTION

The importance of regional peace and security was the original motivation for Malaysia to join ASEAN (Tham, 2019), leading to Malaysia's active participation the region's cooperation and integration efforts. ASEAN is a cornerstone for Malaysia's foreign policy (Pero and Apandi 2018), leading to a prioritization of ASEAN economic integration (Ministry of Foreign Affairs, 2019). The region's market provides a crucial extension to the relatively small domestic market, thereby allowing Malaysian producers to reap economies of scale when they can penetrate the regional market. The government advocates intra-ASEAN trade while promoting the idea of turning ASEAN into a 'Producer Region'.

Globally, the fragmentation of the manufacturing production process, especially in the electrical and electronics as well as automotive industries led to the relocation of different segments of production from the developed world, especially North East Asia to the developing world in Southeast Asia (SEA), based on their comparative advantage in the production of these segments. Malaysia's relatively earlier economic liberalization for inflows of Foreign Direct Investment (FDI) and trade facilitated its earlier participation in the globalization of production processes in the region. Likewise, other countries in SEA also entered into the globalization of manufacturing production when they subsequently opened their respective economies for FDI and cross-border trade.

As ASEAN integration proceeded towards economic integration, trade liberalization under the ASEAN Free Trade Area (AFTA) in 1992 and the cooperation efforts made towards forging an ASEAN Economic Community in 2015, contributed towards the formation of regional production networks in ASEAN that was initially led by market forces. The multinationals (MNCs) operating in ASEAN helped to form regional value chains (RVCs) that spanned across the ASEAN member states, thereby contributing towards the manufacturing development in host states, including Malaysia. Post-2015, ASEAN economic integration continues to forge ahead, albeit at slower pace than planned.

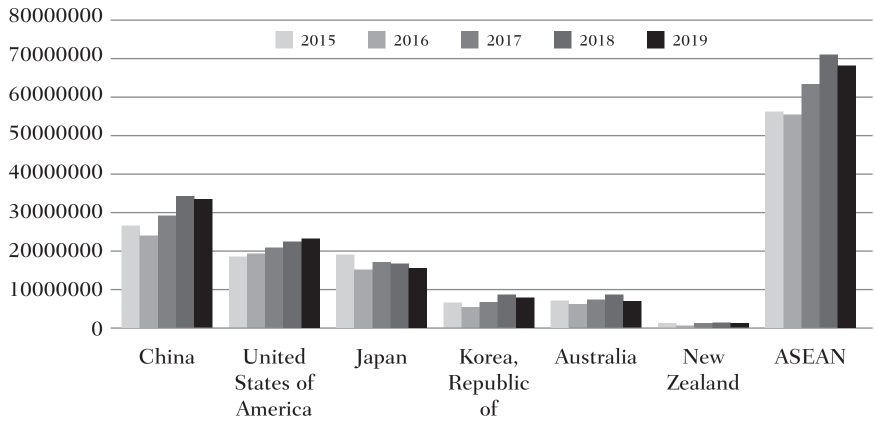
The opening up of China as "Factory Asia" with the entry of China in the World Trade Organization (WTO) in 2001 expedited China's integration into the RVCs in ASEAN, as reflected by the increasing trade ties between China and ASEAN. Trade liberalization measures in the ASEAN-China Free Trade Agreement (ACFTA) in 2004 provided further impetus towards the strengthening of trade ties between ASEAN and China. As China's manufacturing grew, so did its costs of production, especially labor costs. Consequently, manufacturing in China started relocating outwards, including in SEA countries with comparatively lower labor costs such as Vietnam. The trade conflict between the US and China that erupted in 2017 further accelerated this relocation. Likewise, the emergence of the Coronavirus pandemic (Covid-19) in 2020 and the resultant shift towards shortening RVCs increased the momentum to relocate export-oriented manufacturing production out of China. ASEAN member countries, including Malaysia, benefited from these investment relocation.

The objective of this chapter is to examine Malaysia's perspectives in the evolution of ASEAN and its participation in RVCs over time, amidst the changing dynamics of globalization especially in East Asia.

II. THE IMPORTANCE OF ASEAN TO MALAYSIA

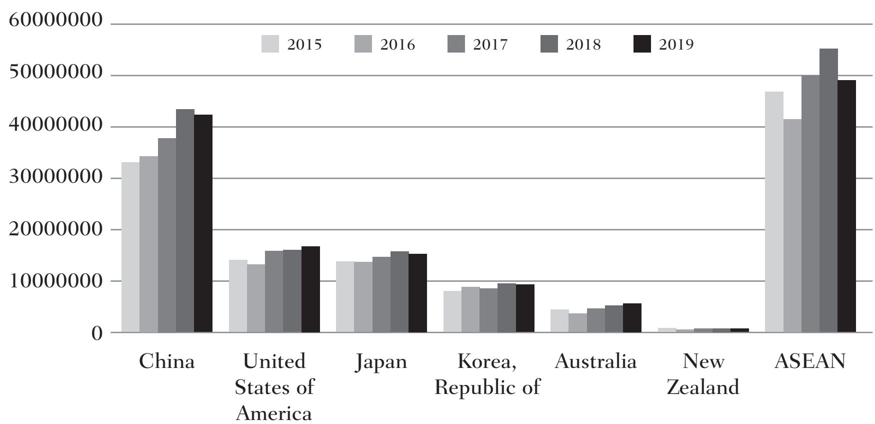
Malaysia is a relatively small, open economy that is dependent on international trade, with trade as a percentage of the Gross Domestic Product (GDP) registering 123 percent in 2019 (World Bank, https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS). ASEAN is the largest export partner, followed by China, the US, Japan and Korea (Figure 1). Likewise, these are also the main import partners of Malaysia (Figure 2).

FIGURE 1. EXPORTS TO MAIN TRADING PARTNERS, 2015-2019 (USD '000)



SOURCE: Created by the author based on data from ITC, Trade Map.

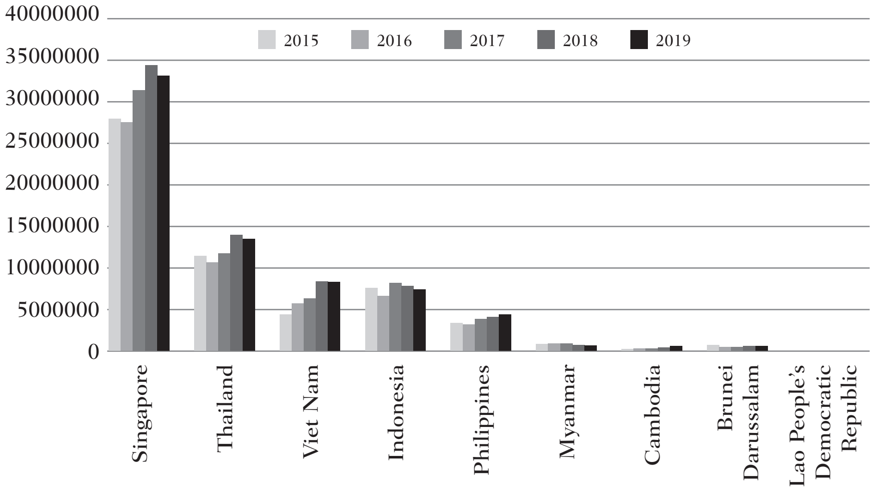
FIGURE 2. IMPORTS FROM MAIN TRADING PARTNERS, 2015-2019 (USD '000)



SOURCE: Created by the author based on data from ITC, Trade Map.

Within ASEAN, Singapore is the largest export destination due to historical links, geographical and cultural proximity, as well as Singapore's efficient logistics and banking services, which enabled the city-state to serve as the centre for entrepot trade in ASEAN (Figure 3). This is followed by Thailand, while the rapid industrialization in Vietnam and its opening up for FDI has propelled it to be the third largest export destination of Malaysia, overtaking Indonesia in 2018. Philippines remains the fourth largest export destination while the other member countries have a much smaller share as export destinations.

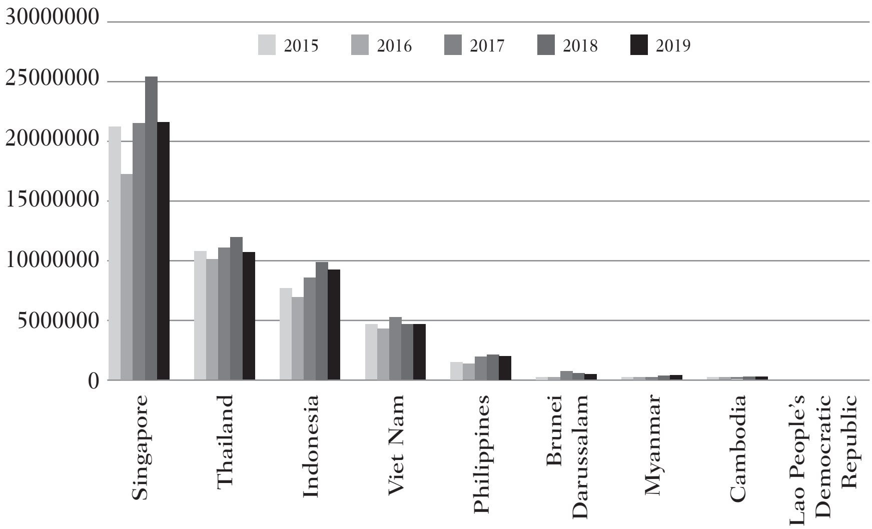
FIGURE 3. MALAYSIA'S EXPORTS TO ASEAN MEMBER COUNTRIES, 2015-2019 (USD'000)



SOURCE: Created by the author based on data from ITC, Trade Map.

Similarly, Singapore and Thailand are the two largest import countries, followed by Indonesia, Vietnam and the Philippines while the other AMS are also relatively less important importers (Figure 4).

FIGURE 4. MALAYSIA'S IMPORTS FROM ASEAN MEMBER COUNTRIES, 2015-2019 (USD'000)



SOURCE: Created by the author based on data from ITC, Trade Map.

The importance of ASEAN in Malaysia's trade can be attributed to the expansion of regional production networks, especially with the rise of China. Production-sharing networks in East Asia, including SEA, are found in various industries, especially in machinery and transportation equipment (Chen and Intal 2017). Overall, E&E parts and components account for the largest share of intra-ASEAN commodity trade, which is also Malaysia's main manufacturing export good. Malaysia is part of the region's trade in parts and components, especially in the E&E.

Within the region's production network for E&E, Singapore's geographical location and excellent logistics, enables it to act as a distribution centre for exports of electronics goods, in particular Integrated Circuits (ICs) (MAS, 2020). Malaysia as the largest trading partner of Singapore within ASEAN, channels its exports of ICs through Singapore and then onwards to the West, including the US and Mexico.

The pattern and extent of production sharing can be seen clearly in Malaysia's as well other ASEAN member states' participation in global value chains (GVCs) in the region, as examined in the next section.

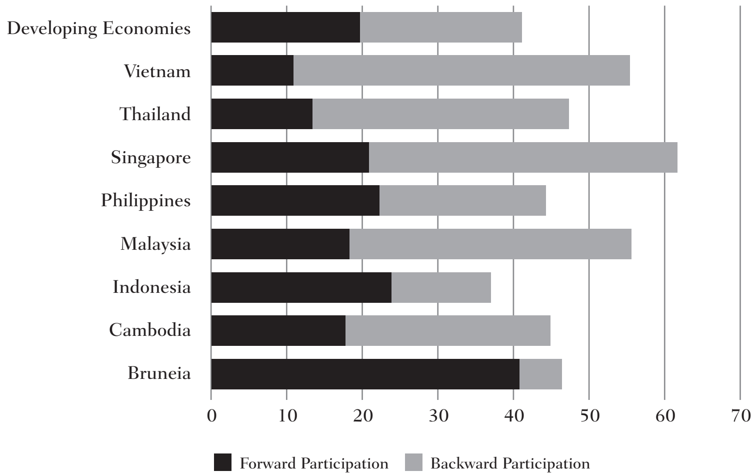
III. GVC PARTICIPATION

GVC PARTICIPATION IN MALAYSIA AND OTHER AMS

The most common indicator used to ascertain the extent to which an economy is connected to GVC for its foreign trade is the GVC participation index from the WTO (WTO undated (a)). There are two components in this indicator: backward and forward participation. Each economy participates in GVCs by importing foreign inputs to produce the goods and services they export (or what is called backward GVC participation) and also by exporting domestically produced inputs to partners in charge of downstream production stages (or forward GVC participation).

Based on Figure 5, the GVC participation index as percentage share of total gross exports in 2015 for developing economies is 41.4 percent. The data for AMS indicates a higher participation rate than the developing economies, with the exception of Indonesia. The latter is less connected to GVCs as its manufacturing sector is less export-oriented and largely dependent on domestic inputs rather than imported inputs for its manufacturing production (IDB and ADB 2019). Among the AMS, Singapore has the highest participation rate, followed by Vietnam, Malaysia and Thailand.

FIGURE 5. GVC PARTICIPATION INDEX, ASEAN 2015



SOURCE: Created by the author based on data from WTO
NOTE: There is no data available for Lao, PDR and Myanmar

The GVC participation index for developing economies also shows backward participation is slightly higher than the forward participation. This is also found to be the case for Malaysia, Singapore, Thailand, Vietnam, and Cambodia, reflecting their use of foreign inputs in their manufacturing production.

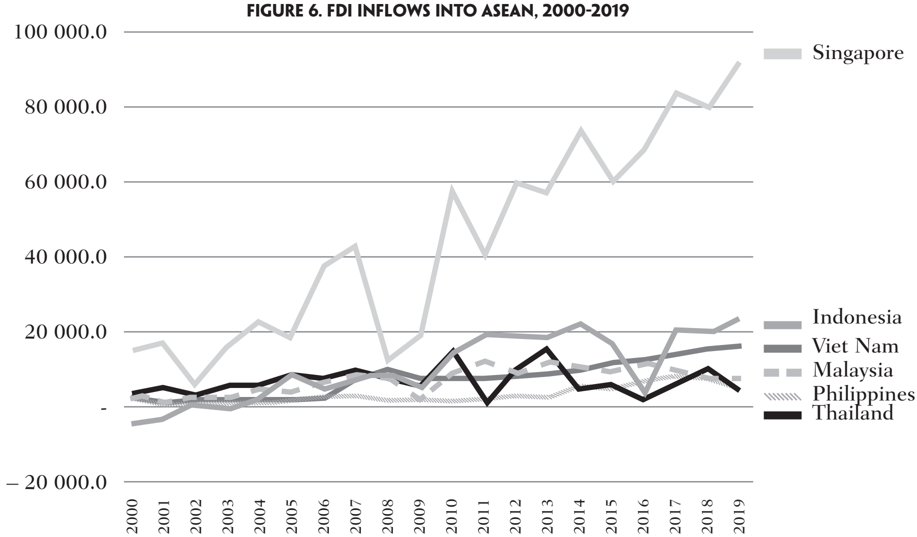
Brunei and Indonesia show a converse pattern. Brunei is an exception because it is oil dependent with little manufacturing activities. Oil and natural gas account for almost 90 percent of Brunei's exports, making its forward participation, which is ratio of the domestic value added sent to third economies to the economy's total gross exports considerably higher than its backward participation in GVCs.

Likewise, Indonesia is relatively more dependent on natural resources. The top exports of Indonesia are coal briquettes ($22.1 billion), palm oil ($16.7 billion), petroleum gas ($10.8 billion), crude petroleum ($5.52 billion), and rubber ($4.41billion), which together account for over 30 percent of Indonesia's total exports in 2018. The higher share of natural resources in Indonesia's total exports leads also to higher forward participation. The lower backward participation also indicates Indonesia's less developed manufacturing sector, which only contributed to about 20 percent to the country's Gross Domestic Product in 2018.

Forward participation is relatively lower in most AMS that that found for developing economies, except for service-oriented economies like Singapore and the Philippines, and primarily oil exporting economies such as Indonesia and Brunei (Figure 5).

The participation in GVCs is facilitated by inflows of FDI into Malaysia and other AMS. Malaysia first opened up for FDI with the shift from import-substitution to export-orientation in late 1960s. The opening up of Free Trade Zones (FTZs) in early 1970s provided impetus for the early inflows of FDI into the manufacturing sector, giving Malaysia an early mover advantage among the AMS. Subsequently, Malaysia became on the largest recipient of FDI in ASEAN when the Plaza Accord that brought about significant appreciation of the yen, triggered an outflow of labor-intensive manufacturing Japanese Direct Investments to Southeast Asia (Ambashi 2017). However, the onset of rising wages with demand outstripping supply in the early 1990s led to declining relative attractiveness of Malaysia compared to other AMS that are competing for FDI through FDI liberalization. This is especially the case for Vietnam and Indonesia after the Global Financial Crisis (GFC) in 2008 (Figure 6). By 2019, Malaysia had fallen to the fourth largest investment destination in ASEAN as compared to the second largest investment destination in 2000 (Figure 6).

FIGURE 6. FDI INFLOWS INTO ASEAN, 2000-2019



SOURCE: Created by the author based on data from UNCTAD

Tariff liberalization under the ASEAN Trade in Goods Agreement (ATIGA), also contributed to the overall attractiveness of ASEAN for FDI, complementing FDI liberalization measures at the national level and market-driven integration. In particular, the ASEAN-6 (namely, Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand), had eliminated 99.3 percent of all tariffs by 2019, while the corresponding figure for

Cambodia, Lao PDR, Myanmar, and Viet Nam (CLMV) is 97.7 percent (ASEAN Secretariat, 2017). Collectively, ASEAN has eliminated 98.6 percent of the total number of tariff lines in 2019. By 2017, ASEAN's weighted average effective applied tariff rates reached 2.0 percent, with average tariff rates of 1.8 percent for the ASEAN-6, and 2.7 percent for Cambodia, Laos, Myanmar and Vietnam.

At the sectoral level, backward participation in computer and electronic products is among the top three GVC-importing industries in the five main AMS (namely Malaysia, the Philippines, Singapore, Thailand and Vietnam), that are interconnected through the parts and components trade in this sector (WTO undated (b)). Backward participation in other sectors are quite diversified throughout these five countries due to different stages of development and export structure. For example, in Malaysia, the other two top backward participation sectors are food and beverages, and mining (energy products), while in Singapore, these are transport and storage and wholesale and retail trade.

The top three foreign input providers in these five AMS are linked with the top three investing countries, which are China, the United States and Japan, though it is not necessarily in the same order for each member country.

GVC LINKS WITH ASEAN

Over time, the composition of foreign inputs in the value added of ASEAN exports started to change. In the 1990s, the largest sources of foreign inputs were Japan and the US (ASEAN-Japan Center 2019). In 2000s, these two countries became less important and were replaced by China and ASEAN's inputs. China's inputs grew from a mere one percent in 1990 to two percent in 2000 and further to six percent in 2018. Similarly, ASEAN inputs grew from four percent in 1990 to six percent in 2000 and to eight percent of total value added exports by 2018. The decline in foreign value added by inputs from Japan is, however, partly off-set by local inputs and components produced by Japanese affiliates in ASEAN, as may also be the case for the US. In the same way, ASEAN inputs may be supplied by foreign affiliates producing in ASEAN as well as local suppliers.

The increasing use of ASEAN inputs have led to the emergence of regional networks or regional value chains (RVCs) in both upstream and downstream parts of GVCs. The increasing importance of RVC can be seen from the rising share of RVC participation in total GVC participation in ASEAN (Table 1). This grew progressively from 14 percent in 1990 (7.5/56.2) in 1990 to 20 percent in 2000 (12.1/61.4) and even higher to 25 percent in 2018 (15.5/60.9). GVC participation have remained almost the same since 2000.

TABLE 1. GVC AND RVC PARTICIPATION BY ASEAN, 1990-2018 (PERCENT OF TOTAL EXPORTS)

YEAR	FVA: FOREIGN VALUE ADDED			DVX: DOMESTIC VALUE ADDED			VALUE CHAIN PARTICIPATION	
	TOTAL (A) = (B+C)	CREATED OUTSIDE ASEAN (B)	CREATED WITHIN ASEAN (C)	TOTAL (D) = (E+F)	INCORPO-RATED OUTSIDE ASEAN (E)	INCORPO-RATED WITHIN ASEAN (F)	GVC PARTICI-PATION (A+D)	RVC PARTICI-PATION (C+F)
1990	37.6	33.9	3.8	18.6	14.8	3.8	56.2	7.5
1995	42.0	36.6	5.4	17.9	12.5	5.4	59.9	10.8
2000	41.0	35.0	6.0	20.4	14.3	6.0	61.4	12.1
2005	40.5	33.7	6.8	23.4	16.5	6.8	63.9	13.7
2010	38.3	30.8	7.5	25.6	18.0	7.5	63.9	15.1
2015	36.2	28.6	7.6	24.8	17.1	7.6	61.0	15.3
2018	35.8	28.1	7.7	25.1	17.4	7.7	60.9	15.5

SOURCE: Created by the author based on data from ASEAN-Japan Centre, 2019

Within ASEAN, the sources of inputs are Indonesia, Malaysia, Singapore and Thailand, which are mainly the top recipients of FDI in ASEAN, as shown in Figure 6. The CLMV countries accounted for less than three percent of total value added exports in 2018, although Vietnam is rapidly changing as a host recipient of FDI in ASEAN.

There are considerable sectoral differences in RVC participation with RVCs being largest in the E&E and less in automotive. Malaysia is actively engaged in both, as can be seen the following case studies.

CASE OF E&E

The production and export of semiconductors segment plays a significant role in Malaysia's economy as it contributes more than 40 percent of Malaysia's exports in E&E. Malaysia is the one of the world's leading location for semiconductor assembly and test operations and is home to six out of the 10 largest semiconductor companies in the world, including Texas Instruments, Freescale Semiconductor, Infineon and Intel.

At the same time, the E&E sector is an important component of ASEAN RVCs, as its total value added exports of USD384 billion in 2015 is the largest from the region (ASEAN-Japan Center 2019). Within ASEAN, Malaysia has the largest value added exports in electronics (USD116 billion), followed by the Philippines (USD51 billion), and Thailand (USD24 billion) in 2015 (Table 2). The foreign value added in these exports is highest in the Philippines (46 percent), followed by Malaysia (41 percent) and Thailand (36 percent) in the same year. It should be noted that the decrease in foreign value added and converse in domestic value added over time observed for Malaysia and the Philippines is contributed by the subsidiaries of multinationals operating in these countries as well as domestic enterprises.

The main sources of foreign value added in Malaysia and Thailand are ASEAN, China, the EU and Japan, with each country contributing approximately the same share. For the Philippines, the main contributor in terms of share in foreign value added is Japan, followed by the ASEAN, as a region.

Although all segments of the electronics value added chain are found in ASEAN, it is primarily focused on the production of intermediate and high-technology products, while R&D operations are less prevalent. Nevertheless, in 2019, it was reported that R&D and designing work related to chip making and read and write heads for hard disks are migrating to Penang. For example, Altera Corp, Intel Corp and Seagate Technology have reportedly invested in fresh R&D activities in Penang to develop the next generation 28-nanometre (NM) field programmable gate array (FPGA) chips, 45 NM and 32 NM chips, and a new range of read and write heads for hard disk drives (The Star 2009).

TABLE 2. VALUE ADDED EXPORTS OF ELECTRONICS FROM MALAYSIA, THE PHILIPPINES, AND THAILAND, 1990-2015 (USD MILLION)

YEAR	MALAYSIA			PHILIPPINES			THAILAND		
	TOTAL	FOREIGN VA	DOMESTIC VA	TOTAL	FOREIGN VA	DOMESTIC VA	TOTAL	FOREIGN VA	DOMESTIC VA
1990	10167	4830	5337	5568	4307	1262	2322	855	1466
1995	26940	15328	11612	10775	8755	2019	5646	2288	3358
2000	35485	16643	18842	15540	11039	4501	6423	2731	3692
2005	58583	26111	32472	25685	16988	8696	12377	4648	7729
2010	103478	44332	59146	44681	23361	21319	20104	7583	12521
2015	116694	47829	68865	51031	23677	27354	24497	8716	15781

SOURCE: Created by the author based on data from ASEAN-Japan Centre, 2019
NOTE: VA: Value added

CASE OF AUTOMOTIVE

The automotive sector generated a total of USD55 billion in ASEAN export value added in 2015 (Table 3). Thailand is the largest value added exporter, followed by Malaysia. As in the case of the E&E sector, most global auto companies are operating in ASEAN, especially from Japan and Korea.

TABLE 3. VALUE ADDED EXPORTS IN AUTOMOBILES FROM MALAYSIA AND THAILAND, 1990-2015 (USD MILLION)

YEAR	MALAYSIA			THAILAND		
	TOTAL	FOREIGN VA	DOMESTIC VA	TOTAL	FOREIGN VA	DOMESTIC VA
1990	272	117	155	2892	2056	836
1995	901	465	439	7553	5357	2196
2000	879	504	375	7920	5757	2164
2005	1420	824	596	16093	11327	4766
2010	2574	1393	1181	22222	15739	6483
2015	2797	1405	1392	27726	18947	8779

SOURCE: Created by the author based on data from ASEAN-Japan Centre, 2019
NOTE: VA: Value added

Within ASEAN, Thailand as the "Detroit of East Asia", is the largest exporter (USD 28 billion), followed by Malaysia (USD3 billion) in 2015 (Table 3). Although Indonesia is rapidly catching up, its production is more directed towards its large domestic market rather than exports.

The share of foreign value added in Malaysia peaked at 58 percent in 2015, after which it fell progressively to 50 percent in 2015 (Table 3). This can be attributed to the establishment of foreign subsidiaries of the global auto companies in the country to produce parts and components for both the local and export market, leading to a rise in the domestic content in auto value added exports. A similar pattern can be observed for Thailand, where the share of foreign value added declined from 71 percent in 1990 to 68 percent in 2015, as large auto companies established subsidiaries in Thailand to produce parts and components.

The contribution of large global auto manufacturers towards the development of RVCs in the region is best illustrated by Toyota's production strategy for ASEAN. The Toyota IMV (Innovative International Multi-Purpose Vehicle) project was established in 2002 for the international division of roles for vehicles made by Toyota for vehicles sold exclusively in overseas market.[1] A reciprocal parts supply system was created to access tariffs benefits and lower costs of production through economies of scale based on regional supply and manufacturing specialization. Toyota's facilities in Thailand concentrate on diesel engines, while its Indonesian facilities focus on gasoline engines, its Filipino facilities concentrate on transmission and constant velocity joints, and its Malaysian facilities focus on engine computers (Figure 7). This form of spatial specialization allows for complementary flows of parts and components between the countries in the region, thereby optimizing logistics costs.

1 See https://www.toyota-global.com/company/history_of_toyota/75years/text/leaping_forward_as_a_global_corporation/chapter4/section3/item1_b.html accessed 18 November 2020)

Apart from the contribution of Japan as technology partner as well as input suppliers, China has become an important provider of inputs over time. China's car manufacturer, Geely's equity purchase in Malaysia's former national car, Proton, in 2017, has added impetus to the sourcing of inputs from China, though this may reduce over time as Chinese suppliers to Geely have also moved their production to Malaysia, to increase localization (Tham 2020). The localization strategy will increase domestic content. Its main motivations are to access better tax advantages in Malaysia as the amount of excise taxes incurred is dependent on the extent of local content, reduce foreign exchange risks and to meet the rules of origin requirement for exporting to ASEAN, which is 40 percent.

IV. DEEPENING AND WIDENING ECONOMIC INTEGRATION IN ASEAN

As ASEAN moves towards 2025, it is progressively deepening economic integration. In particular, there is a concerted effort to improve trade facilitation, including improving processes as well as addressing the increasing non-tariff measures (NTMs) that have replaced the reduction in tariffs (ASEAN Secretariat 2019). There are progressive efforts to further liberalize investments and services. The latter is especially important as the services sector is relatively closed compared to manufacturing and moving up RVCs requires a greater participation of services in these chains, such as R&D services, marketing, and branding. This is particularly true for Malaysia where the shares of foreign services in the exports of manufactures and total exports are smaller than Singapore (Table 4), which has a relatively open services sector, thereby garnering most of the FDI in services in ASEAN. Malaysia needs to open up its services sector for FDI to increase its access of foreign service inputs which can enhance its efficiency in manufacturing and services as well as facilitate the export of services.

TABLE 4. SERVICES VA CONTENT OF EXPORTS, BY ORIGIN, FOR MALAYSIA AND SINGAPORE, 2015 (% SHARES IN MANUFACTURES AND TOTAL EXPORTS)

COUNTRY	EXPORTS OF MANUFACTURES		TOTAL EXPORTS	
	DOMESTIC SERVICES	FOREIGN SERVICES	DOMESTIC SERVICES	FOREIGN SERVICES
Malaysia	10.0	18.0	21.5	15.6
Singapore	19.7	27.5	42.8	26.0

SOURCE: Created by the author based on data from WTO (b)

The signing of the Regional Comprehensive Economic Partnership Agreement (RCEP) in November 2020 provides increasing opportunities for ASEAN, including Malaysia to reap the benefits of further trade and investment liberalization in the midst of increasing nationalistic sentiments and protection in recent years. The RCEP member countries account for about 30 percent of global GDP and population, making it the world's largest trade bloc. It has been estimated that the RCEP would boost global trade by USD500 billion in the next ten years (Kurlantzick 2020). It will help to improve the position of AMS, including Malaysia for the realignments of supply chains, be it from the US-China conflict or the on-going Coronavirus (Covid) pandemic. It therefore provides a timely boost to aid economic recovery in Malaysia and the region from the negative impact of the Covid-induced lockdown on the domestic economies as well as the bottoming out of the tourism and its related sectors due to travel restrictions imposed by the pandemic.

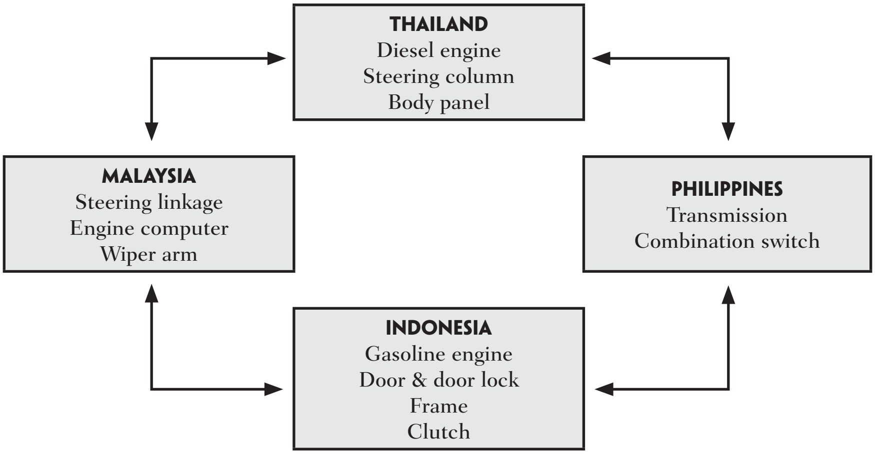
V. CONCLUSION

Malaysia's participation in globalization through the investment-trade nexus by integrating into GVCs and RVCs was facilitated by unilateral and regional trade and investment liberalization measures at the ASEAN level. At the unilateral level, Malaysia had an early mover advantage by opening up to FDI, ahead of most of its ASEAN neighbours (with the exception of Singapore) way back in the 1970s. Subsequent ASEAN efforts to reduce intra-regional tariffs under AFTA further encouraged more FDI into the region's economies, including Malaysia, to take advantage of the region's growth and expanding regional market with growing incomes and an increasing affluent middle income group.

The extension of regional integration to the ASEAN-Plus partners such as Japan, Korea, China, India, Australia and New Zealand, through bilateral agreements, expanded the market beyond ASEAN for all AMS, including Malaysia. China's entry into the WTO facilitated China's integration with GVCs and RVCs in ASEAN, especially with the enforcement of the ASEAN-China Free Trade Agreement in 2004. This is manifested in the increasing importance of China in ASEAN and Malaysia's trade and investments. China has been Malaysia's largest single country trading partner since 2010 and it was the largest investor in Malaysia's manufacturing sector from 2016 to 2019.

Thus, it is expected that Malaysia will continue to benefit from its integration with RVCs as ASEAN deepens integration within and expands integration and cooperation efforts under the RCEP.

FIGURE 7. TOYOTA IMV: DISTRIBUTION OF COMPONENTS PRODUCTION IN ASEAN



SOURCE: Adopted from Schröder,2020

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