SOUTHEAST ASIA IN THE GLOBAL ECONOMY

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SOUTHEAST ASIA IN THE GLOBAL ECONOMY

SECURING COMPETITIVENESS AND SOCIAL PROTECTION

EDITED BY
Helen E.S. Nesadurai
and **J. Soedradjad Djiwandono**

PONDER THE IMPROBABLE
S. RAJARATNAM SCHOOL OF INTERNATIONAL STUDIES
A Graduate School of Nanyang Technological University

ISEAS
INSTITUTE OF SOUTHEAST ASIAN STUDIES
Singapore

First published in Singapore in 2009 by
ISEAS Publishing
Institute of Southeast Asian Studies
30 Heng Mui Keng Terrace, Pasir Panjang
Singapore 119614

E-mail: publish@iseas.edu.sg
Website: bookshop.iseas.edu.sg

jointly with
S. Rajaratnam School of International Studies
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ISEAS Library Cataloguing-in-Publication Data

Southeast Asia in the global economy : securing competitiveness and social protection / edited by Helen E.S. Nesadurai and J. Soedradjad Djiwandono.
1. Competition—Southeast Asia—Congresses.
2. Competition—Government policy—Southeast Asia—Congresses.
3. Industrial policy—Southeast Asia—Congresses.
I. Nesadurai, Helen Sharmini.
II. Djiwandono, Joseph Soedradjad, 1938-
III. S. Rajaratnam School of International Studies.
IV. Workshop on Southeast Asia in the Global Economy: Avoiding the Problem of Globalisation's 'Missing Middle' (2005 : Singapore)

HD3616 A9S82 2009

ISBN 978-981-230-823-8 (hard cover)
ISBN 978-981-230-824-5 (PDF)

Typeset by International Typesetters Pte Ltd
Printed in Singapore by Mainland Press Pte Ltd

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ACKNOWLEDGEMENTS

Many people have been involved in the completion of this edited book, not least the book's contributors. Their patience as we editors put together this volume, delayed by the move by one of us from Singapore to Malaysia, is highly appreciated. Their insights have made possible this collaborative contribution to ongoing debates about the fate of Southeast Asia in a highly competitive world economy.

Special thanks are due to Ambassador Barry Desker, Dean of the S. Rajaratnam School of International Studies (RSIS, formerly, the Institute of Defence and Strategic Studies), a research graduate school of the Nanyang Technological University, Singapore, who generously allocated the funding that made possible the November 2005 Workshop in Singapore at which the various chapters in this book were first presented and debated. We are also grateful to the participants at that workshop whose active and lively participation helped the authors clarify many points of contention that emerged during the course of our deliberations.

We are also indebted to Ambassador Kesavapany of the Institute of Southeast Asian Studies for supporting the publication of this edited volume under the joint imprint of the Institute of Southeast Asian Studies (ISEAS) and the S. Rajaratnam School of International Studies. Mrs Triena Ong, Managing Editor and Head of ISEAS Publications, deserves special mention for her unwavering support for this book project. The support of the staff of ISEAS Publishing is also deeply appreciated.

Our final thanks go to the administrative staff at RSIS/IDSS who deserve special mention for their hard work, cheerful good humour and willingness to go the extra mile to ensure the successful completion of the workshop and the production of this book. Regina Arokiasamy's excellent administrative support before, during and well after the workshop has been invaluable to the editors, Peter Ee went out of his way to ensure the smooth running of the workshop, ably supported by Ben Ng, Adeline Lim and Yvonne Lee, while Caroline Ng made sure the project progressed smoothly and its financial needs efficiently addressed. Without the help and support of these and many others at RSIS, we, the editors, would not have been able to complete this book project.

Helen E. S. Nesadurai and J. Soedradjad Djiwandono
November 2007

ABBREVIATIONS

ACCA	Association of Certified Chartered Accountants
ADB	Asian Development Bank
AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
ASCC	ASEAN Socio-Cultural Community
ASEAN	Association of Southeast Asian Nations
AUSFTA	Australia-United States Free Trade Agreement
BBC	Brand-to-Brand Complementation Scheme (of ASEAN)
BI	Basic Infrastructure
BPO	Business Process Outsourcing
CECA	Comprehensive Economic Cooperation Agreement (between India and ASEAN)
CEO	Chief Executive Officer
CPF	Central Provident Fund (of Singapore)
CSR	Corporate Social Responsibility
EFTA	European Free Trade Area
EPF	Employees' Provident Fund (of Malaysia)
EU	European Union
FDI	Foreign Direct Investment
FSPSI	All Indonesia Workers Union Federation
FTA	Free Trade Agreements
G-21	Group of 21
GATT	General Agreement on Tariffs and Trade
GCF	Gross Capital Formation
GDCF	Gross Domestic Capital Formation
GDP	Gross Domestic Product
GIC	Government Investment Corporation (of Singapore)
GLC	Government Linked Company

GNI	Gross National Investment
GPF	Government Pension Fund (of Thailand)
GSIS	Government Service Insurance System (of the Philippines)
HR	Human Resources
HS	Harmonized System
HTI	High Technology Infrastructure
ICT	Information and Communication Technology
ILO	International Labour Organization
IMF	International Monetary Fund
IPR	Intellectual Property Rights
ISO	International Standards Organization
IT	Information Technology
JSEPA	Japan-Singapore Economic Partnership Agreement
KPO	Knowledge Process Outsourcing
MES	Minimum Efficiency Scale
MFN	Most Favoured Nation
MNCs/MNEs	Multinational Corporations/Multinational Enterprises
MSC	Multimedia Super Corridor (of Malaysia)
MTUC	Malaysian Trade Union Congress
NAFTA	North American Free Trade Area
NC	Network Cohesion
NEP	New Economic Policy (Malaysia)
NIS	National Innovation System
NS	Network Strength
NTUC	National Trades Union Congress (of Singapore)
OECD	Organization for Economic Cooperation and Development
PANEURO	Pan European Cumulation of Origin
PAP	People's Action Party (of Singapore)
PRC	People's Republic of China
PSA	Port of Singapore Authority
PT	Process Technology
R&D	Research and Development
SAP	Structural Adjustment Programme
SITC	Standard International Trade Classification
SME	Small and Medium-Scale Enterprises
SSO	Social Security Organization (of Thailand)
SSS	Social Security System (of the Philippines)
TI	Technological Intensity
UMNO	United Malays National Organization (of Malaysia)
UNCTAD	United Nations Conference on Trade and Development

USA/US	United States of America
USSFTA	United States-Singapore Free Trade Agreement
WEF	World Economic Forum
WTO	World Trade Organization

Currencies

AU$	Australian Dollar
Baht	Thai Baht
P	Philippine Peso
RM	Malaysian Ringgit
Rp	Indonesian Rupiah
S$	Singapore Dollar
US$	United States Dollar

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INTRODUCTION
Southeast Asia in the Global Economy

Helen E. S. Nesadurai and
J. Soedradjad Djiwandono

In a 2004 article in the journal *Foreign Affairs*, Professor Geoffrey Garret of the University of California in Los Angeles highlighted a problem increasingly identified as a key feature of globalization — what he called globalization's "missing middle". Garret (2004) argued that that while globalization has clearly benefited many, it has also squeezed those in the middle — certain middle-income countries in the international system as well as middle-income groups within states, particularly in the industrial world. Although Garret directed much of his remarks at Latin American and Eastern European countries, this issue is relevant to Southeast Asia as well. There is a growing sense that while globalization certainly benefited this region, especially from the 1990s' boom until the 1997 Asian financial crisis, Southeast Asia may be in danger of becoming globalization's "missing middle" if it is unable to maintain its attractiveness to global capital in an increasingly competitive world economy.

It was once believed that countries could avoid such a predicament and enhance their international competitiveness by leveraging lower labour and other costs, and/or become conversant in the knowledge economy. In fact, the region's development story showcases how both approaches have brought success to Southeast Asia. Today, both strategies seem fraught with potential problems and pitfalls, not least because of the looming presence of India and China, which seem to have "cornered" the market in both sets of activities. With both these Asian "giants" seemingly able to appropriate the entire range of economic activities that span the value chain, the worry is that Southeast Asia is in danger of becoming globalization's casualty, its "missing middle".

How Southeast Asia fares in the global economy will depend a great deal on what its leaders and policymakers do to ensure their respective economies adjust to the Chinese and Indian economic presence. That both these giants will need to be factored into governments' economic planning remains certain. In a recent World Bank study on the global implications of India's and China's economic rise, the Bank emphasized that despite the problems and challenges faced by these two countries, China and India will continue to grow at roughly twice the rate of the global economy over the next fifteen years.[1] Thus, while Bank officials point to the considerable opportunities that will be created by China's and India's economic dynamism and their integration into world markets, they also advise other governments to identify "niche" areas safe from the competition that these two Asian juggernauts will pose to virtually every country in the years to come.[2]

The importance of identifying economic niches in which countries have clear comparative or competitive advantage has been raised by scholars of Southeast Asia as well, including authors in this volume — Rahul Sen and Sadhana Srivastava writing on India in Chapter 2, and Liu Yunhua discussing China in Chapter 3. Half a decade ago, in reviewing Southeast Asia's traditional approach to growth and development following the 1997 Asian financial crisis, Freeman and Hew called on the region to move away from its preoccupation with cost competitiveness and to "make the transition from a conventional production-based economy to a knowledge-based one" (Freeman and Hew 2002, p. 4). They also advised governments to focus on niche areas of economic activity — specific areas where their countries' comparative advantage was greatest. This point on niche areas was also emphasized by Garret.

Garret (2004) suggested that globalization had been disappointing for many countries because they had not managed to find their particular niche in world markets. In particular, Garret called on countries to find ways to "tech-up" — to build up a large pool of skilled, creative labour that will, in turn, foster a climate of innovation and creativity. Winters and Yusuf, editors of the World Bank study mentioned previously, similarly emphasize skilled and innovative human resources and technological capability as vital for countries wishing to adjust to competition from China and India, and to sustain their own growth performances in the future. For these two writers, countries can only hope to avoid being hurt by competition posed by the Chinese and Indian powerhouses if they "invest heavily in the skills and technological capabilities of firms" (Winters and Yusuf 2007, p. 33).

STRIVING FOR COMPETITIVENESS

Despite Krugman's (1994) admonishment that competitiveness is a "dangerous obsession" for countries, we find governments, business firms, and international organizations such as the World Trade Organization (WTO), the World Bank, and the International Monetary Fund (IMF), continuing to emphasize the critical importance of competitiveness for countries. Likewise, the World Economic Forum (WEF),[3] a private, not-for-profit foundation that engages the world's leaders, captains of industry, leading opinion makers, and scholars, has been producing an annual Global Competitiveness Report since 1979,[4] with national governments each year eagerly waiting to see how their respective countries have fared in this annual "beauty" pageant. In the latest 2006–07 report, countries have been ranked according to their performance in nine pillars or areas identified to be critical in driving productivity and competitiveness (Lopez-Claros 2006, p. xiv). This approach, in fact, is an innovation in methodology for the WEF, developed by Professor Xavier Salai-i-Martin, and was adopted for the first time in compiling the 2006 index (Lopez-Claros 2006, p.xiv). The nine areas identified as critical for competitiveness have, in turn, been subdivided into three sub-indexes — basic requirements, efficiency enhancers, and innovation factors (see Table 1.1).

A closer look at the sub-indexes reveals the crucial role of technology and innovation in determining a country's productivity and competitiveness worldwide. In identifying Singapore, Japan, Hong Kong, and Taiwan as high performers in Asia, the Competitiveness Report emphasized their excellent basic infrastructure as well as their well-educated and well-trained workforce. The Report additionally pointed out that these countries were "operating on the outer boundaries of the technology frontier, both at the firm and consumer level" (Lopez-Claros 2006, p. xvi). In particular, the Report regards the capacity for innovation by firms and the sophistication of firm operations as key factors in determining national competitiveness.

Unfortunately, the sub-indexes also reveal that Southeast Asian countries need to take serious steps to enhance their technological readiness and innovation. Rajah Rasiah's findings in Chapter 5 of this volume — that firms in Southeast Asia lag behind those in Northeast Asia in terms of research and development (R&D) and technological enhancement activities — further confirms the need for governments and firms in Southeast Asia

TABLE 1.1
Global Competitiveness Rankings, 2006

Country	*Overall Index of Competitiveness Score (Rank)*	*Basic Requirements Score (Rank)*	*Efficiency Enhancers Score (Rank)*	*Innovation Factors Score (Rank)*
India	4.44 (43)	4.51 (60)	4.32 (41)	4.60 (26)
China	4.24 (54)	4.80 (44)	3.66 (71)	3.75 (57)
Singapore	5.63 (5)	6.13 (2)	5.63 (3)	5.11 (15)
Malaysia	5.11 (26)	5.44 (24)	4.89 (26)	4.91 (22)
Thailand	4.58 (35)	4.98 (38)	4.29 (43)	4.15 (36)
Indonesia	4.26 (50)	4.41 (68)	4.12 (50)	4.07 (41)
Philippines	4.00 (71)	4.19 (84)	3.85 (63)	3.63 (66)
Vietnam	3.89 (77)	4.37 (71)	3.45 (83)	3.32 (81)
Cambodia	3.39 (103)	3.83 (100)	2.94 (110)	3.05 (102)

Notes:

a. The maximum score possible is 7. A total of 125 countries were ranked.

b. Basic requirements cover four pillars or areas: institutions, infrastructure, macro-economic management, and health and primary education.

c. Efficiency enhancers include three pillars: higher education and training, market efficiency, and technological readiness.

d. Innovation factors cover two pillars: business sophistication, and innovation capacity.

Source: Compiled from *The Global Competitiveness Report 2006–2007* of the World Economic Forum.

to rethink their policies and strategies for technology and innovation. This point, surprisingly, seems to apply to Singapore as well. Despite its status as a high performer (ranked third) in the WEF's Global Competitiveness Index, Singapore was ranked at fifteenth position in the innovation sub-index with a score of 5.11 compared with an overall competitiveness score of 5.63 (see Table 1.1).

In fact, all nine pillars identified in the *Global Competitiveness Report* work in interconnected ways to drive overall productivity improvements in countries (Lopez-Claros 2006, p. xiv). This seems theoretical common sense. Firm-level technological capabilities are likely to depend not merely on what is done at the firm level, but also on the overall economic climate in which the firm is located. Whether a firm adopts new technologies or engages in firm-level innovative activities will depend, for instance, on the prevailing investment policy in the country, which helps determine whether firms engage in productive networks and relationships with other firms domestically and abroad. In an environment where there are local research and development (R&D) agencies and universities engaging in high quality scientific research, the relationships of films with such local bodies in the area of research and technology development are deemed to be crucial in helping them enhance their own technological and innovative capabilities. A separate Business Competitiveness Index from the WEF reiterates these points, emphasizing that the productivity firms can achieve depends a great deal on a range of macroeconomic, political, legal, and institutional features found in a country, particularly, its competition policy, the sophistication of its financial and equity markets, as well as the quality of its scientific research institutions (Lopez-Claros 2006, p. xxiv).

The theoretical case for a comprehensive treatment of the various factors that contribute to the competitiveness and productivity enhancements of firms, and the economy, more generally, is clear. In reality, however, it may be rather difficult to achieve, given the often weak capacity of many developing countries' governments in policy design, review, and implementation.[5] Many developing countries scored poorly in the overall competitiveness ranking because of this weakness. Nevertheless, Indonesia's rise of twenty-four rungs in the 2006 Business Competitiveness Index from its position in 2005 has been attributed to key improvements in government functions. In contrast, Vietnam fell in the rankings, which also illustrates the fluid nature of a country's competitiveness standing, and the continuous improvements that governments and firms need to make to sustain their competitive edge (Lopez-Claros 2006, p. xxvi). Such efforts clearly require so much more from policymakers who may opt for other, seemingly easier, policy options.

The continued use of low exchange rates in many parts of Southeast Asia to maintain cheap exports suggests that governments will continue to use other tools to manage their export competitiveness, even if such acts are criticized by the international community as ultimately destabilizing (Bowring 2006). What is needed, instead, is for governments and firms to engage in long-term productivity enhancements, particularly in the area of technological upgrading and innovation, as well as labour productivity, two areas in which Southeast Asia, with the exception of Singapore, displays weaknesses. Governments in the region are also beginning to embrace yet another strategy to boost their ability to access markets and foreign capital — bilateral free trade arrangements. Although these are seen as instruments to help firms compete on world markets by securing for them preferential access to the market of the bilateral partner, the anti-competitive effects of bilateral FTAs have yet to be acknowledged by policymakers.

Although trade economists theoretically regard regional cooperation schemes as second best policies of trade liberalization, compared with unilateral or multilateral liberalization, and, consequently, a potential stumbling block to global liberalization, the "new regionalism" of the 1990s tends to be supportive of globalization rather than being a form of resistance to it (Nesadurai 2003, p. 178). Both the ASEAN Free Trade Area (AFTA) and the ASEAN Economic Community, which are cooperative projects to enhance the integration of the Southeast Asian countries collectively into world markets, and to attract global capital to the region, are well known.

However, *bilateral* arrangements are now mushrooming in the region, a response to both the stalemate at the WTO since the abortive 1999 Seattle Ministerial Meeting and the slow pace of regional liberalization in ASEAN (Desker 2004). While bilateral arrangements are usually defended on grounds that they secure access to markets and capital in an uncertain trading environment, critics point to the market fragmentation to which bilateral arrangements can lead (Scollay and Gilbert 2001). Far more than the case of regionwide arrangements, it is the bilateral FTA that gives rise to what Bhagwati et al. (1998) have called the "spaghetti bowl" effect. Given the growing regionalization of production and the growth of intraregional trade in parts and components within Southeast Asia, regional liberalization makes more economic sense than bilateral FTAs, which cut across existing regional production networks in ways that also raise costs for firms already engaged in such relationships (Nesadurai 2003, pp. 182–84).

Heribert Dieter writing in Chapter 4 of this volume argues that not only do *bilateral* FTAs make poor economic sense, but unlike *regional* or plurilateral trading agreements, bilaterals are also suboptimal from the *political* point of view, particularly for developing countries that tend to be in a weaker negotiating position compared with their industrial country negotiating partner. Thus, Dieter also questions the common wisdom that bilateral FTAs tend to be adopted more for their political worth than their economic benefits. More than that, Dieter carefully traces the burden that bilateral FTAs pose for firms because of their complex rules of origin, and the complications such arrangements raise for transnational production in which firms participate. Thus, in assessing the value of bilateral FTAs, we need to consider not only their potential for securing market access — which Dieter argues has been oversold in any case — but we must also evaluate their implications for the cost competitiveness of firms.

While criticizing protectionist strategies as inappropriate responses by governments to the pressures of global competition, Garret (2004) also cautioned governments against rushing to sign more free trade agreements (whether bilateral, regional, or multilateral), which he argued are misguided efforts to ensure countries stay competitive globally. As already noted, Garret advocated instead an emphasis on a more fundamental task — enhancing the technological and innovative capacity of firms and people so that an innate, long-term capacity to respond to all manner of competitive challenges can be built up. For Garret, trade liberalization alone, in whatever form, is insufficient. Moreover, liberalization taking place through bilateral FTAs could inadvertently undermine competitiveness, as Dieter persuasively argues.

One key reason Paul Krugman (1994) criticized the growing obsession with international competitiveness was his concern that it might lead governments to adopt inappropriate and possibly self-defeating policies. If bilateral FTAs and the deliberate preference for undervalued exchange rates are policies that governments have adopted because of their perceived utility in enhancing their countries' international competitiveness, then Krugman was right to be concerned. These policies may be helpful in the short- to medium-term, but their long-run effects are unclear. Economists doubt that such policies can result in a sustained capacity by countries and firms to remain competitive internationally. These policies may be attractive to governments because they may be the "easier" option. Maintaining low exchange rates may yield immediate gains while a bilateral FTA clearly shows that the government in question has, at least formally, secured market opening for its domestic firms.

Yet, as the preceding discussion has shown, productivity and competitiveness are best enhanced through continuous efforts in upgrading human resources, and enhancing the technological and innovative capacities of firms. Governments have a key role in this regard. While the days of interventionist governments may be over, governments, nonetheless, are vital as providers of basic and high technology infrastructure, which firms then draw on to improve their own technological and innovative capacity.

IS COMPETITIVENESS EVERYTHING? SECURING SOCIAL PROTECTION

Krugman's (1994) point that an obsession with international competitiveness might well result in the adoption of inappropriate or misguided policies, also applies to the sphere of social protection, including labour standards. The common assumption has been that social protection policies will invariably raise firms' operating costs as well as reduce their ability to respond flexibly to the pressures of competition. Consequently, social protection in general, and pro-labour policies in particular, have been rejected by governments and firms as likely to undermine competitiveness. The financial crisis, however, coupled with ongoing domestic economic and social transformations in many parts of Southeast Asia, have brought concerns with economic security to the forefront of policy debates in the region (Nesadurai 2006). Even in China, the socio-economic insecurities arising from rapid industrialization and economic change have prompted the authorities to take the issue of social welfare and social protection seriously (Wang 2006).

Market integration, whether regionally or globally, carries with it both risk and uncertainty under conditions of globalization, which has also made it difficult for governments virtually everywhere to "achieve distributive compromises that accommodate and attenuate class, communal and regional conflicts" (Thakur 1997, p. 58). It is now increasingly recognized that deep and extensive global market integration — globalization — creates both winners and losers, thereby resulting in considerable dislocations between and within states even as global trade and investment increases (Kapstein 2000; Thomas 2002). Even strong proponents of free trade such as Jagdish Bhagwati acknowledge the downside of globalization, including its distributional effects (Cooper 2004).

Latin America in the new millennium best reveals the political consequences of globalization's distributional effects as many countries in that region embrace leftist politics (Castanda 2006). This tendency is viewed as an unsurprising legacy of a decade or more of neoliberal market reforms that have produced much social dislocation in the region. Fortunately, the leftist shift in countries such as Chile, Uruguay, and Brazil largely involves a stronger emphasis on social policy, albeit within a broad market framework, and is regarded as a wise and necessary policy shift after decades of the neoliberal economic message that simply liberalizing markets and making them more efficient and competitive would ultimately take care of the distribution question through the trickle-down effect. Unfortunately, countries such as Venezuela, Bolivia, and Argentina have embraced a far more strident, populist, nationalism that has so far seen a wave of nationalizations in the oil and gas and minerals sectors (Louth 2006) as the rising tide of discontent amongst groups suffering the worst effects of global capitalism are then exploited by politicians seeking power (Castanda 2006).

If the socio-economic and political consequences of participating and competing in the global capitalist economy are not adequately addressed by both firms and governments, then a backlash might well result as different groups in society challenge those who seek overall benefits for the economy from greater integration with global markets. The worry is that policymakers might be tempted to use the easiest or most visible policy instruments to address, or be seen by voters to address, such pressures — trade protectionism, the use of low exchange rates, and negotiating unending bilateral trade agreements. Miles Kahler (2006) identifies how the right kinds of institutions at the domestic, regional, and global levels can mitigate the economic insecurities associated with globalization. In particular, he argues that economic liberalization and the imperatives of competitiveness do not automatically imply shrinkage of the public sector and a shift to a stark form of the "night watchman" state. Instead, Kahler draws from a range of studies to point out that the "insurance functions of governments may increase under conditions of increasing economic openness" (Kahler 2006, p. 32). At the regional level, ASEAN's push for the ASEAN Socio-Cultural Community (ASCC) reflects growing concern among regional policymakers, as well as the region's civil society, that some form of regional mechanism to address issues of social protection for the losers of market integration is necessary. While such moves by the region's policymakers might have been prompted by instrumental considerations to enhance the political sustainability of regional and global market integration, there are sound, normative, human security reasons as well as to why social protection measures are vital in an era of rapid globalization.

The point to emphasize is the worldwide shift in thinking in the last decade towards embracing some form of social support system for individuals and groups caught up in the dislocations, insecurities, and uncertainties associated with contemporary globalization. In a 2001 edition, the arch liberal economic news journal, *The Economist*, acknowledged the importance of social safety nets, public services, and a limited amount of redistribution to ensure the sustainability of globalization (Crook 2001). More recently, Martin Wolf, a renowned proponent of globalization, noted in the *Financial Times* that "more generous government-financed services", which included at least education for the disadvantaged and universal health insurance, were needed if the United States was to remain a vibrant and internationally open society (Wolf 2007). What a growing number of authors are saying simply is that competitiveness and social support should not be seen in zero-sum terms — they have always been, and continue to remain, two sides of the same coin, both in theory and policy practice. It was only the neoliberal ideology (and its associated policies), which reigned supreme for much of the 1990s, that rendered them asunder.

SOUTHEAST ASIA: AVOIDING THE FATE OF THE "MISSING MIDDLE"

The issues raised by the preceding discussion were first debated in November 2005 at a workshop organized by the S. Rajaratnam School of International Studies (then known as the Institute of Defence and Strategic Studies, IDSS), a research graduate school of the Nanyang Technological University in Singapore. The themes first discussed at the 2005 workshop were subsequently expanded, with the various chapters in this edited volume focusing on a selected set of key competitiveness and social challenges that Southeast Asia needs to confront amidst globalization and the phenomenal rise of the Asian powerhouses, India and China.

While it is common to think of India and China as Southeast Asia's competitors, the two chapters that respectively discuss India and China emphasize the complementarities as well in the relationship of these two economic giants with Southeast Asia, or ASEAN. Both India and China have signed cooperative agreements with ASEAN, with the ASEAN-China Free Trade Agreement already in the implementation stage. Although India and ASEAN signed a Framework Agreement on Comprehensive Economic Cooperation in 2003, negotiations on an ASEAN-India free trade agreement continues well into 2007. The signing of both these agreements reflects the views of Southeast Asian governments that while both countries pose a competitive threat to their own economies, there are also benefits to be gained from closer economic cooperation and integration with India and China.

Thus, Rahul Sen and Sadhana Srivastava in Chapter 2 analyse in some detail the competitive, and especially the complementarities, in the economic structure and growth strategies of the ASEAN countries on the one hand, and India on the other. Examining trade, investment, services, and manpower flows between ASEAN and India, Sen and Srivastava conclude that while there is limited competition between the two entities in information technology (IT) services, ASEAN and India have a largely complementary economic relationship in a wide range of other economic sectors, which offers much scope for both parties to gain. Firms from ASEAN countries are already benefiting from contracts in India in a number of areas, including infrastructure development, while ASEAN already utilizes the expertise of the knowledge workers that India is now famous for. Thus, even in the area of IT services, both authors note the potential for cooperation. They see the future ASEAN-India FTA as a boon to both India and ASEAN, provided the agreement is comprehensive in coverage in order to maximize the gains in joint liberalization as the adverse consequences expected in some areas