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The state and economic enterprise

He Fan The long march to the mixed economy

Nicholas R. Lardy China's private firms key to medium-term growth

A. Tony Prasetyantono Banking on oil offers prospects of a new boom

Robert Alan Feldman Japan should sell assets and spend on research

Angela Cummine How Temasek drove Singapore's development . . . and more

ASIAN REVIEW: Tom Westland on Australia after the mining boom

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From the Editor's Desk

The relationship between the state and economic enterprise is a central choice that governments have to make in all economies. The role of the state and state-backed or state-owned enterprise in Asia's economic modernisation is a question of special interest.

Some argue that in all the economies of Asia that have enjoyed or are now prosecuting successful industrialisation—Japan, South Korea, Taiwan, Singapore, Indonesia, India and China, for example—the state has played a central role through active participation in economic enterprise. To others this is a controversial conclusion and they posit an alternative view, that successful Asian industrialisation is a story of removing the shackles of the state from economic enterprise. Lardy here and in his new book sees China's experience through this latter prism.

Nonetheless, state-backed or state-owned enterprises have been a prominent feature of Asian economies at some stage in their development and there is elevated interest in the role that state-owned enterprises play in the Chinese economy today with the surge in their investment abroad following China's 'going out' strategy over the past decade.

This issue of *EAFQ* looks in detail at the nature of China's state-owned enterprises as well as their impact on global investment and the role of state enterprises in other Asian economies at different stages of development.

The first step in understanding Chinese state-owned enterprises is the distinction that we need to make between the giant, central SOEs dominating strategic industries from Beijing and the tens of thousands of provincially and locally owned SOEs.

While SOEs remain a prominent feature of the Chinese economy, they now account for only 30 per cent of industrial output and even the huge central SOEs are supposed to run at arm's length from the state—an issue that is currently a focus of China's Third Plenum reform agenda. Market competition and the corporatisation and privatisation of many loss-making SOEs in the 1990s have seen the environment in which they operate change dramatically. That seems the way of the future.

In our regular Asian Review on major trends and developments, we cover the crucible of terror in Pakistan, the global growth of yoga, the Asian middle class and what it is not, and what's to become of the Australian economy now the party from the Chinese commodity boom is over.

Peter Drysdale

CONTENTS

3 HE FAN

The long march to the mixed economy

6 NICHOLAS R. LARDY

Private not state firms the medium-term key

8 PAUL HUBBARD AND PATRICK WILLIAMS

Some of China's SOEs are more equal than others

10 ZHAO CHANGWEN

Where there's a will there's a way to reform

12 MICHAEL V. GESTRIN

State-owned enterprises finding bigger role in global investment

15 TOM WESTLAND

ASIAN REVIEW: Australia's post-mining boom future still tied to Asia

19 IMTIAZ GUL

ASIAN REVIEW: Pakistan and the crucible of terror

23 ADRIAN C. HAYES

ASIAN REVIEW: The mixed blessing of Asia's growing middle class

27 SHAMEEM BLACK

ASIAN REVIEW: Pirates, spies, soul-stealers: spirituality transformed

31 HWOK-AUN LEE

Political preference crowding out enterprise

33 A. TONY PRASETANTONO

Banking on oil offers prospects of a new bonanza

35 PETER MCCAWLEY

Strengthening the state and market in ASEAN

37 ROBERT ALAN FELDMAN, TAKESHI YAMAGUCHI AND SHOKI OMORI

Why Japan should sell assets and spend big on research

40 ANGELA CUMMINE

How Temasek has driven Singapore's development

eastasiaforum.org

The long march to the mixed economy



HE FAN

AS IN other areas, the reform of state-owned enterprises (SOEs) in China has been a gradual process. Now, almost 25 years after SOE reforms began, the government must tackle new problems: breaking down special interests, distancing the state from the daily operation of enterprises—and associated issues of corruption—and improving the overall efficiency of the economy.

After China adopted a planned economy in the 1950s—and private enterprises basically disappeared—SOEs played the dominant role in China’s industrialisation. They produced everything from satellites to

matches. In the 1980s China launched market-oriented reform. A new type of enterprise, named Town and Villages Enterprises (TVEs), emerged. These were more like private enterprises but they operated under the name of collective ownership as political protection.

In the 1990s, under the leadership of then premier Zhu Rongji, China initiated a radical reform of SOEs. Under the mantra of ‘Grasp the large, release the small’, tens of thousands of weak SOEs were privatised or liquidated, millions of workers were laid off, and stronger SOEs were restructured and often listed on the stock market.

With these reforms, private

Laying rails for an intercity railway in Chengdu. Many of China’s state-owned enterprises are found in sectors like transportation and public utilities.

enterprises in China were able to achieve real prosperity and foreign investment flowed in. The SOEs’ share of the economy declined dramatically because many could not compete with private and foreign companies. Poorly performing SOEs had to rely on subsidies—a heavy burden for the government. Although this reform seemed risky, the government had made shrewd calculations. Compared with ‘shock therapy’ in the Soviet Union, China took a gradual approach exercising patience and caution. Before throwing SOEs into cold water,

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COVER: Has Asia's economic success been built on state monopoly? Some analysis suggests that the picture may be more mixed, and that private enterprise has played, and will play, a bigger role.
PICTURE: Andrew So.

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the government encouraged the development of private and foreign companies, which helped to absorb many laid-off workers. That is how such a radical reform did not cause serious damage to economic growth and social stability.

Today China's SOEs are very different from those in the 1990s. Now SOEs are fewer in number but much larger in size, especially those controlled by the central government. Rather than being scattered in competitive manufacturing sectors, many SOEs cluster in sectors of 'strategic importance', such as mining, energy, transportation, telecommunications, banking, and public utilities. There are also many SOEs controlled by local governments. They outnumber, but are often dwarfed by, their central counterparts. Those local SOEs are still involved in almost every industry—including information technology, machinery, automobiles, hotels, and hospitality—and their performance varies much more widely.

It is true that compared with private companies, SOEs are often inefficient, but unlike in the 1990s, now they reap handsome profits. So if SOEs do not financially burden the government and, even better, become cash cows, why bother to reform them at all?

The main reason why large SOEs are still profitable is that they enjoy monopoly privileges. In many sectors the existence of SOEs creates a barrier to entry for private investment. Even when private capital is allowed to enter, it often faces unfair competition. Ironically, even when these gigantic SOEs earned substantial profits, they did not contribute a commensurate amount to the government. They kept most of the revenue in their own pockets, meaning that there was no trickle-down to the general

public. Now these SOEs are becoming special interest groups with a strong resistance to reform. Some are more like independent kingdoms in their own industries. Rent-seeking activities also breed corruption, as made clear by the current anti-corruption campaign led by Xi Jinping: many corrupt SOE executives are being removed or even put in jail.

China's much-needed structural reform also relies on SOE reform. After the global financial crisis, it became clear that the traditional growth model of the last two decades was not sustainable, but the fiscal stimulus package announced in 2008, along with the extremely expansionary monetary policy adopted in 2009, caused many SOEs to become bloated and the return on assets to decline.

ECONOMIC growth is likely to slow in the future as China moves closer to the technological frontier and its demographic profile changes. But a large pool of surplus workers still needs to find jobs. They are unlikely to do so in SOEs that operate predominantly in capital-intensive sectors and thus cannot provide enough job opportunities. Instead it is private companies that are responsible for nearly all new job creation in China.

To rebalance the Chinese economy, the potential of the services sector needs to be unleashed. Breaking down the SOE monopolies is the only way forward. Without competition in the services sector, the supply of services by the SOEs is insufficient, quality is low, prices are high, and domestic demand is thus depressed. Encouraging more private investment will help to boost domestic consumption, reap the 'reform dividend' and sustain robust economic growth in the long run.

SOE reform is one of the priorities of the Third Plenum Report, a blueprint for reform released late in 2013 by the 18th Central Committee meeting of the Chinese Communist Party. The report includes the goal of raising the proportion of state capital earnings handed over to central finance to 30 per cent by 2020, up from 5–15 per cent for most SOEs. It promises to accelerate factor price reform in order to level the playing field. The government will also tighten control of SOEs by assigning discipline inspection teams as well as putting a ceiling for the salaries of senior SOE executives.

BUT THE buzzword is ‘mixed ownership economy’. The basic idea is to encourage private capital to be involved in SOE reform. This will help to improve the governance structure of SOEs and provide more room for the role of private capital. Many private entrepreneurs have complained that ‘state capital is moving forward, while private capital is moving backward’. They are referring to the renewed concentration of power in the state-controlled segment of the economy after the global financial crisis. A ‘mixed ownership economy’ aims to promote the integration of state and private capital. In the end, state and private capital will stand shoulder-to-shoulder and hand-in-hand.

Yet many private entrepreneurs tend to be unenthusiastic about the invitation. There is widespread scepticism about the extent to which private investors will have management control over corporatised SOEs. Full privatisation is out of the question for the Chinese Communist Party. So what will be the difference between this new round of SOE reform and the last major push?



Chinese President Xi Jinping: shady executives are targets of his anti-corruption campaign.

It is fair to say that privatisation is only one of alternative for SOE reform. A related reform is the establishment of capital investment companies. Before the Third Plenum meeting, an influential policy report—co-authored by Development Research Center, a think tank affiliated to the State Council, together with the World Bank—had already discussed this idea. Temasek, the holding company used by Singapore to manage its SOEs, has been mentioned. The advantage of the Temasek model, compared with current Chinese SOEs, is that it focuses purely on maximising shareholder value while, at the same time, keeping the daily operation of the SOEs at arms-length.

China already has Temasek-style sovereign wealth funds like the China Investment Corporation (CIC) and Central Huijin Investment. CIC is mainly responsible for investing a small part of China’s US\$4 trillion foreign exchange reserve, while Huijin has played an important role in reforming state-own banks. As China continues its reforms, more state equity is likely to be transferred to emerging state-owned capital

investment companies, both at the central and local level. Institutional investors—like social security funds, insurance funds and private equity funds—are also being encouraged to participate in the restructuring and reorganisation of SOEs.

This will bring a sea change to the Chinese economy. The government can free itself from the awkward situation of meddling with the daily operation of SOEs and concentrate on the task of maintaining fair market competition and property rights protection. It will also try to stimulate competition among the SOEs. If the enterprises are not performing well, the state-owned capital investment companies can reduce their investments or sell their shares. This will force SOEs to behave more like other market entities and increase efficiency.

THE clamour for SOE reform grows louder from all parts of China, and the government has taken the first step of a new long march toward the mixed economy. The process will be slow and controversial, but with changed rules, the game will be different. Large sell-offs of state capital are unlikely, but we should expect competition between SOEs and non-SOEs to become more transparent and fair. The main theme of the incoming Fourth Plenum is ‘rule by law’. This is the most important issue for the long-term stability of the Chinese economy. **EAFO**

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Private not state firms the medium-term key

NICHOLAS R. LARDY

VIRTUALLY every dimension of China's economic success over the past three-and-a-half decades can be attributed largely to the rise of markets and private businesses. Private firms account for almost all the growth in employment, most of the expansion of output and investment in manufacturing, and in recent years for over half of the growth in exports. Because they are more productive, private firms have largely displaced state firms in sectors that are open to entry. State firms remain completely dominant only in natural monopolies, such as electric power and rail transport, and in sectors where entry is restricted: upstream oil and gas, financial services, and telecommunications.

China has not developed a successful alternative model of economic growth. The pursuit of what some call 'state capitalism' has significantly reduced, rather than enhanced, China's economic growth. Where China has relied primarily on the market—agriculture, most of manufacturing, and in services such as retailing and restaurants—success has been obvious.

In coming to these conclusions my recent book *Markets over Mao: The Rise of Private Business in China* corrects four important misperceptions or myths about the Chinese economy. The first is that China's economy is dominated by state firms. The reality is very different. State firms now account for only

one-fifth of manufacturing output, compared to four-fifths when reform began. They account for only one-tenth of investment in manufacturing. State firms in all sectors account for only one-tenth of urban employment and only one-tenth of China's exports.

The second misperception is that China has one of the world's most powerful bureaucracies in terms of employment. Combined employment by government and party organs, including government agencies and public institutions as well as party bodies, including those employed at the central, provincial, and sub-provincial level, is about 40 million. This is greater than the population of many states. But the International Labor Organization, which measures government employment per 1000 residents, puts France in the clear lead with 95 employees per 1000 residents, the United States 74, Germany 53, Turkey and Mexico each 38, South Africa 32, while China has only 30.

The third misperception is that

More importantly, the return on assets of SASAC firms for the past six years has been persistently far less than their cost of capital

while state-owned enterprises are fewer in number, these firms are more powerful than ever. In particular, those who are critical of what they see as China's model of state capitalism charge that central SOEs earn astronomical profits, given the monopolies and protected markets they enjoy. Industrial policies in the Hu–Wen decade certainly seemed to favour state firms, especially those under the purview of the State Asset Supervision and Administration Commission (SASAC), established in 2003 just as Hu and Wen assumed office.

By 2013 the profits of SASAC's enterprises had quadrupled, seemingly supporting the view that SASAC was successfully creating 'national champions'. Less noticed, the share of profits of all non-financial corporations accruing to SASAC's firms fell slightly—they actually underperformed. More importantly, the return on assets of SASAC firms for the past six years has been persistently far less than their cost of capital. By 2013 the gap was 3.8 per cent compared to 6.8 per cent. In short, SASAC firms have been a huge drag on China's growth.

The fourth misperception is that private firms get little access to credit. As the *Financial Times* put it earlier this year, private firms 'are typically starved of cash. Meanwhile the larger state-owned enterprises enjoy easy access to loans'. The reality is quite different. According to data released by the People's Bank of China, private firms received 52 per cent of all credit



Workers assembling prams at the Kunshan factory of Goodbaby, China's largest manufacturer of infants' and children's products. The company is listed on the main board of the Hong Kong Stock Exchange, exports internationally, and has made several significant acquisitions in the United States and Europe.

flowing to firms from 2010–2012, while the share of state firms was only 32 per cent. This should not be a surprise. Given the much higher return on assets generated by private industrial firms, their interest coverage ratio, a common measure of credit worthiness, is more than twice that of state companies.

The implications of this analysis are fundamentally optimistic for China's growth over the medium term, if the reforms announced at the Third Plenum last year are actually carried out. As already noted, state firms don't dominate China's economy, but they are still a substantial drag on its growth. This is because their average

return on assets is not only well below that of private firms, but substantially less than the cost of capital. For example, in upstream oil and gas more than 90 per cent of output is produced by China's three national oil companies. But Sinopec and PetroChina, which together account for three-quarters of the assets of these three firms, have returns less than half that of Exxon-Mobile and Chevron. In services, the return on assets of state firms is only half that of private service providers. China Unicom and China Telecom earn only 2 per cent and 4 per cent, respectively, substantially below the cost of capital. Services now absorb over half of all investment but

the state share of services investment is four times that in manufacturing.

The party's pledge at the Third Plenum to eliminate all but natural monopolies, if implemented, will create enormous opportunities for new private firms in upstream oil and gas and for private service providers, not just in telecoms and financial services, but in other modern business services. This will reduce a substantial misallocation of capital and support China's growth over the medium term.

EAFQ

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Some of China's SOEs are more equal than others

PICTURE: AAP

PAUL HUBBARD AND
PATRICK WILLIAMS

THE decision by the Third Plenum of the Chinese Communist Party's 18th Central Committee late in 2013 was remarkable not only for promoting the 'decisive role of the market in allocating resources' but also for seeing this as being consistent with 'the dominant position of public ownership' and 'the leading role of the state-owned sector'.

State-owned enterprises (SOEs) remain ubiquitous in the Chinese economy despite three decades of market reform, although now they account for only 30 per cent of industrial output. Urban SOEs produced almost 80 per cent of industrial output at the beginning of market reforms in 1978. Ongoing market competition and the corporatisation and privatisation of many loss-making enterprises in the 1990s have seen the SOE share of the industrial sector shrink. But the decision to let go of small, loss-making operations wasn't a decision to quit particular economic sectors. State assets remain spread not just throughout the industrial sector but also in transport, real estate, construction and hospitality.

The ubiquity of SOEs in the modern Chinese economy doesn't imply their dominance of the economy. As a matter of policy, the state retains a majority shareholding in firms involved in defence, energy and telecommunications, as well as a majority stake in some industrial



A steel bar being cast at a Dongbei Special Steel Group plant in Dalian, in China's Liaoning province. Provincial state-owned enterprises compete strongly in the national market and globally.

leaders, but non-SOEs have more than twice the assets in ordinary competitive sectors of the economy. On average a significant volume of non-state capital is invested in SOEs. Of the US\$7 trillion dollars in net SOE assets, only \$3.2 trillion is state equity.

Not all SOEs have evolved in the same way.

To understand modern SOEs it's necessary to contrast the giant SOEs that dominate strategic industries from Beijing with the tens of thousands of provincial and locally owned SOEs that flourish across all sectors with

various degrees of state ownership.

China's largest companies are almost all central SOEs and state owned banks. Centrally directed SOEs controlled 72 per cent of the top 50 firms' total revenue in 2011, with the post office and other centralised financial enterprises controlling a further 17 per cent. Sinopec's 2011 revenue was only marginally below that of the Australian government. The Communist Party appoints the leaders of the most important state companies. They are displayed prominently in the

party's public Chinese Leadership Cadre Database, alongside Politburo members, government ministers, judges and provincial governors. By comparison, China's leading private firm, Huawei Technologies, is ranked just 39th in terms of revenue.

Looking further down the list, centrally directed SOEs and banks control more than half of the revenue of China's top 500 firms. Provincial SOEs are next, controlling roughly a quarter of the revenue. Provincial SOEs are highly fragmented, with supervision spread across 36 provincial-level asset management commissions and 442 sub-branches. Hebei Iron and Steel, for example, China's largest steel producer, accounted for less than 6 per cent of national steel output in 2013, while Nippon Steel produced 45 per cent of Japan's total.

ALTHOUGH provincial SOEs collectively control more state equity than the central government, they are more likely to be competing against each other as well as with private firms, and to be under local political pressure to be more profitable, rather than being positioned as 'national champions'.

The forces that have supported China's rapid development in the decades since the 1978 reforms are fading as the productivity benefits from structural change slow and China moves towards the technology frontier. Capital efficiency rather than gross investment will be an important determinant of the next phase of China's growth, so improving the efficiency of state-owned capital is a priority.

In 1993 the Third Plenum of the 14th Central Committee meeting established China's 'socialist market economy'. Twenty years of economic

development later, the decision by last year's Third Plenum to comprehensively deepen reform has not seen China back away from public ownership.

The decision states that 'we must unwaveringly consolidate and develop the public economy, persist in the dominant position of public ownership, give full play to the leading role of the state-owned sector, and continuously increase its vitality, controlling force and influence.'

But slowing growth and concerns about the misuse of state privilege for private gain mean that SOEs are attracting even closer scrutiny. The scope for local government rent-seeking by protecting local SOEs is being restricted by central government priorities to crack down on corruption and promote sustained economic growth.

Wholesale privatisation is not on the table, but non-state capital is being brought in to dilute the share of SOE assets held by the state. This should be palatable to China's policymakers and also, importantly, help to improve the overall performance of the economy through increased market discipline.

Giant central enterprises may be politically important to Beijing, but most SOEs are provincial or local businesses operating in competitive, rather than monopolistic, environments.

Provincial governments still try to create market environments that favour local SOEs, partly to protect local industry and partly to extract rent using state-protected monopolies. This is a reflex of local governments everywhere, but preventing it remains an acute challenge for China's central government.

Provincial SOEs only enjoy a 'leg up' until their activities reach the

provincial border. Neighbouring SOEs compete fiercely for profitable opportunities in the national and, increasingly, international markets. Industrial goods prices and price movements correlate across China, which reflects a competitive market. Competition curbs rent-seeking opportunities for local governments and spurs the continued corporatisation of provincial SOEs.

INSTEAD of worrying about SOEs per se, policymakers need to deal with anticompetitive market structures and socially harmful behaviour, irrespective of whether or not firms are state-owned. Foreign governments and businesses need to look beyond the 'state owned enterprise' label when assessing risk. A large, centrally controlled oil SOE is not the same as a provincial SOE in construction or hotels.

Chinese SOEs are here to stay for some time, even as the practical distinction between state and non-state enterprise fades away. And in sectors of particular political or strategic interest, the Chinese authorities will naturally consider all available instruments—not simply formal state ownership—in order to pursue their goals. [EAFQ](#)

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Where there's a will there's a way to reform

ZHAO CHANGWEN

THE further reform of China's state-owned enterprises has attracted a lot of attention and triggered debate since it was discussed last year at the third plenary session of the Chinese Communist Party's 18th Central Committee (the Third Plenum). Three areas need to be addressed if reforms are to be meaningful and comprehensive: reforming the property rights system of SOEs by developing a 'mixed ownership economy'; shifting from managing state assets to managing state capital; and promoting a modern corporate system.

At this stage the key to reforming the property rights system of SOEs under the 'mixed ownership' model lies in continuing the transformation from an old traditional enterprise system to the modern enterprise system. This will require a four-pronged approach.

First, corporatising the remaining wholly state-owned enterprises should be accelerated. According to the Chinese Ministry of Finance, 16 per cent of SOEs—more than 20,000—fall into this category, having not yet transformed into companies under China's Company Law.

Second, the parent companies of the 113 central SOEs under the State-owned Assets Supervision and Administration Commission (SASAC) should be corporatised. Currently only seven of them have diversified equities, while in most the state is the exclusive investor. By contrast, the majority

of these enterprises' subordinate companies are now incorporated, and some are already publicly listed on the stock market.

Third, the state should reduce the average proportion of shares it holds in enterprises. In 2012, there were 54,000 wholly state-owned companies in China, accounting for 37 per cent of all SOEs. Their total assets reached RMB 36.7 trillion (US\$5.9 trillion), or 41 per cent of the total. While a small number of industries related to national security can remain solely state-owned, most SOEs should diversify their equity structure and reduce their average percentage of state shares. This will improve governance structure by balancing the majority shareholder.

Fourth, the investment of state capital in major industries and key areas involved in national security and the economy should be redefined. More and more state capital should be distributed in the fields of public service, emerging and strategic industries, ecological protection, technological innovation and national security—instead of distributing in competitive fields. State-owned monopoly enterprises should also be encouraged to develop into mixed-ownership enterprises.

ANOTHER key area of reform is China's current system for managing state assets, which needs to be transformed into a new system for managing state capital. It is important that policy guidelines for this new management system be developed at the national level and include the

fundamental function of state capital and an operating earnings policy. The functions of capital owners and public administrators should be clearly defined. Separating the shareholder and regulatory functions of the State-owned Assets Supervision and Administration Commission will be crucial to avoid conflicts of interests. While the regulatory function can remain with the existing agencies, the investment arm must be assumed by the proposed government capital investment or operating company.

Efforts should be made to further explore the operational model of state capital to promote the idea of 'capital management', so as to increase the efficiency and performance of state capital. The next stage of reforms should focus on the authorised operational mechanism for state capital and establishing a number of specialised state investment and operational platforms. These proposed state capital investment and operational companies can take as examples the Temasek model in Singapore and the Central Huijin Investment model in Chinese state financial assets management which has improved corporate governance and reform in the banking sector.

While a number of state-owned capital operating companies needs to be established, some SOEs qualified in special industries could be reorganised into state capital investment companies. These two platforms could act as a firewall between the state capital owner and the enterprises. This would mean that SOEs had



China Ocean Shipping Company containers stacked in a Shanghai yard. Reforms mean state capital investments in key areas of the economy will be redefined.

more room for development and ultimately improve the efficiency and performance of state capital.

The Third Plenum decision emphasised the importance of ‘promoting a modern corporate system for SOEs.’ The question is: how to achieve that under the principle of ‘clearly established ownership, well-defined rights and responsibilities, separation of enterprise from administration, and scientific management’?

China’s existing SOEs can be classified into at least two categories: non-profit enterprises with policy intention and strategic objectives, and those which operate in fully competitive fields. According to the instructions of the third plenary session, China’s next stage of

development will witness more input and support for the former. On the other hand, the latter will have to compete with non-SOEs on an equal footing under the principle of full competition for resources, markets and services.

REFORM measures will differ across monopoly industries depending on their nature. Administrative monopolies—those that, by the grace of government, have had monopoly status conferred upon them—must be broken up. Reforms of natural monopoly industries will be aimed at separating enterprise from administration, government functions in managing public business, and state-owned capital management. For SOEs in competitive fields, the

assessment and evaluation systems should be developed based entirely on market economy standards.

But even with all of this, traditional regulation—with the structure of SASAC—can only produce a traditional corporate system. Establishing a modern corporate system requires a functional, arms-length regulatory system.

Narrowing the focus, the ‘enterprise system’ at the micro level should also be improved. The first step is to reform and improve the current senior manager selection mechanisms, the salary system, and assessment and evaluation mechanisms—all of which are essential to a modern corporate system.

For example, in most cases, when selecting and recruiting senior

managers for SOEs, the mechanism of party-cadre administrators is usually combined with the market mechanism. This is a special recruiting system. Unlike the professional managers that headhunting companies seek in the market, the senior managers of SOEs assume a dual identity: enterprise runner and leading cadre at a certain level.

This has both pros and cons. The upside is that these managers, as leading cadres, may have a stronger sense of responsibility and higher professional standards; the downside is the difficulty in efficiently combining these two systems and the effort required to improve them. The selection and recruitment of leading cadres also encounters the 'revolving door' problem. This occurs when the role exchange between government officials and enterprise managers introduces enterprise management experience into government departments and brings government management experience into enterprise operation—another pros-and-cons situation. The key problem lies in whether the departments concerned are willing to delegate powers.

The Third Plenum set out new tasks to deepen the reform of SOEs and made clear the key areas where change is needed. Though hardships are inevitable, as long as the reformers march in the right direction, with clear targets and appropriate methods, breakthroughs will be achieved. Where there is a will, there is a way. [EAFQ](#)

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State-owned enterprises finding bigger role in global investment

MICHAEL V. GESTRIN

STATE-owned enterprises have played a relatively minor role in the era of investment-driven globalisation that began in the 1970s. As recently as 2007, when annual flows of foreign direct investment by multinational enterprises reached a record US\$2 trillion, state-owned enterprises were sitting on the sidelines, accounting for only 3–4 per cent of international mergers and acquisitions, the main vehicles multinational enterprises use to acquire and control international operations.

This situation began to change with the onset of the global financial crisis in 2008. By 2009 state-owned enterprises had come to account for one fifth of international mergers and acquisitions. For some countries, especially among the resource-rich emerging economies, state-owned enterprises represent their main source of international capital.

There are reasons to believe that the emergence of state-owned enterprises as important sources of international investment might not be a transient phenomenon.

First among them is China. The combination of a sizeable state-owned enterprise sector in the domestic economy combined with the

government's policy of encouraging outward investment has seen the country make the transition from being mainly a capital importer to being one of the world's leading sources of foreign direct investment. And China is not the only source of international investment by state-owned (or controlled) enterprises. Emerging markets in the Middle East and Southeast Asia, as well as resource-rich industrialised countries such as Norway, have also become increasingly active international investors.

The emergence of multinational state-owned enterprises has become a cause for concern among governments. These concerns include potential threats to national security, the loss of control over natural resources and the possibility that state-owned enterprises enjoy advantages, such as preferential access to finance, which will give them an unfair competitive advantage against their private-sector counterparts.

In addition to these national-level concerns, international investments by state-owned enterprises give rise to a number of potential problems of a more multilateral nature.

At the top of the list there is the question of the long-term competitive viability of state-owned enterprises as international investors. One persistent

theme in international business literature has been the 'liability of foreignness' and the challenges faced by a multinational enterprise. This literature is rife with examples of spectacular business failures, usually involving overly ambitious expansion plans, including those of experienced multinational enterprises.

The rapid rise of state-owned enterprises as international investors is probably not due to a sudden surge in these firms' strategic agility and competitiveness. Rather, a combination of macroeconomic and policy factors has been pushing them to expand outside their domestic markets. This has especially been the case for Chinese state-owned firms. It therefore seems possible that the surge in international investment by SOEs represents an outward foreign direct investment bubble, driven in particular by China's energetic pro-outward-investment policies and fuelled by the country's foreign exchange reserves.

The collapse of the bubble, if indeed it exists, would significantly disrupt the global value chains into which state-owned multinational enterprises have integrated themselves. It would also affect the countries for which these enterprises have become major sources of capital (especially the resource-rich developing economies) and the home countries of SOEs that have squandered resources in support of overly ambitious international expansion strategies. In addition, governments that have used state-owned enterprises to secure access to resources they view as essential to their long-term national interest could find that their ability to acquire certain intermediate inputs is disrupted.

These are mostly potential rather than actual concerns. It is not difficult to find individual examples of all of these problems, but for the time being

there is no clear evidence of a systemic state-owned investment problem.

Nonetheless, governments have started to respond, although so far this response has been modest. At the national level a few countries (for example, Australia and Canada) have reviewed and clarified their review processes for investments by foreign state-owned enterprises. Internationally, bilateral investment treaties increasingly stipulate that investments by SOEs are covered. In addition, although it is too early in the negotiations to tell, the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership could eventually include provisions in support of competitive neutrality.

On the one hand, this limited policy response reflects the fact that, at a time when global investment flows remain 40 per cent below their pre-financial crisis levels, governments don't want to discourage any source of international investment. On the other hand, it probably also reflects the serious challenges involved in breaking new ground in international investment rule-making at a time when many features of the existing global investment regime are being challenged, including investor-state dispute settlement and the growing complexity of a system made up of

A few countries . . . have reviewed and clarified their review processes for investments by foreign state-owned enterprises

thousands of different bilateral and regional investment agreements.

Unfortunately, the lack of any clear initiative at the international or multilateral levels (such as was done to address concerns over investments by sovereign wealth funds in the Santiago Principles in 2009) holds the danger that governments will increasingly develop policy responses at the national level where the scope for opacity, political capture and ultimately protectionism is greatest.

As new actors in globalisation, state-owned enterprises reflect only one of the ways in which the nature of international investment and the structures of multinational enterprises continue to evolve. They can also be seen as an example of how the realities of globalisation are leaving the global investment policy regime behind. Just as laws and regulations support well-functioning markets at the domestic level by ensuring fair competition, encouraging innovation and supporting responsible business conduct, the same logic holds at the international level.

If nothing else, the rapid growth of international investments by state-owned enterprises and the policy concerns that these are raising have highlighted the need to develop new multilateral options to help governments deal with the policy challenges of multilateral investment.

EAFO

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The views expressed in this article should not be reported as representing the official views of the OECD or of its member countries. The opinions expressed and arguments are those of the author.

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Australia's post-mining boom future still tied to Asia

TOM WESTLAND

IT'S sometimes forgotten that the Industrial Revolution almost occurred in medieval China. As Robert Hartwell documented several decades ago, production of iron and steel during the period of the Northern Song dynasty reached per capita volumes that would be unmatched until Britain, centuries later, finally began its long journey to industrial maturity. China has overtaken Japan as

an economic power, and given the size of its population and the speed of its growth, it can only be a matter of time before it races past the United States.

Few countries have done so well out of China's belated economic awakening as Australia, which has sated much of the People's Republic's voracious appetite for overseas iron ore and metallurgical coal. Supply struggled to keep pace with demand and the prices of the raw materials for Chinese growth shot up: this

translated into an eye-watering increase in the Australian terms of trade. It has, in fact, been the largest such increase in Australia's terms of trade in history, which is no small feat, given that volatile export prices have been a long-standing phenomenon in Australian economic history. This has undeniably contributed strongly to the sunny economic conditions that have prevailed in Australia for much of the past decade.

But China's growth is both

slowing and changing character. The intensive investment in highways, railways and housing will give way to a gentler growth based on domestic consumption and a rising demand for services. Australia will continue to export resources to China—particularly energy, in the form of natural gas, with which Australia is well endowed. In the market for services it is evident that Australia—business as much as government—will need to think harder about its place in the Asian economic system.

Debate in Australia has turned to the twilight of the boom and the likelihood of an unpleasant economic adjustment to follow: both the short-term macroeconomic impact of declining terms of trade and the longer-term diversification to drive growth.

On the first question, there are two broad schools of thought: one, most publicly advocated by Professor Ross Garnaut, suggests that the decline in Australia's terms of trade will signal the end of the steady growth in real income enjoyed by Australians over the past few decades. Garnaut and his supporters warn that a substantial real depreciation will be required. The end of quantitative easing in the United States and a return to tighter money worldwide will help to bring down the value of the Australian dollar, as would looser monetary policy in Australia. But a nominal depreciation does not necessarily entail a real one: Garnaut prescribes therefore a period of lukewarm wage growth. With the price of tradeable goods increasing due to a nominal depreciation of the Australian dollar, this will mean lower real wages, an unfamiliar prospect to many Australians who have grown accustomed to regular and substantial income growth. Others, such as Professor Bob Gregory, who also

warns of declining incomes, argue that expansionary fiscal policy may be more effective than monetary policy in mitigating the shock to real income.

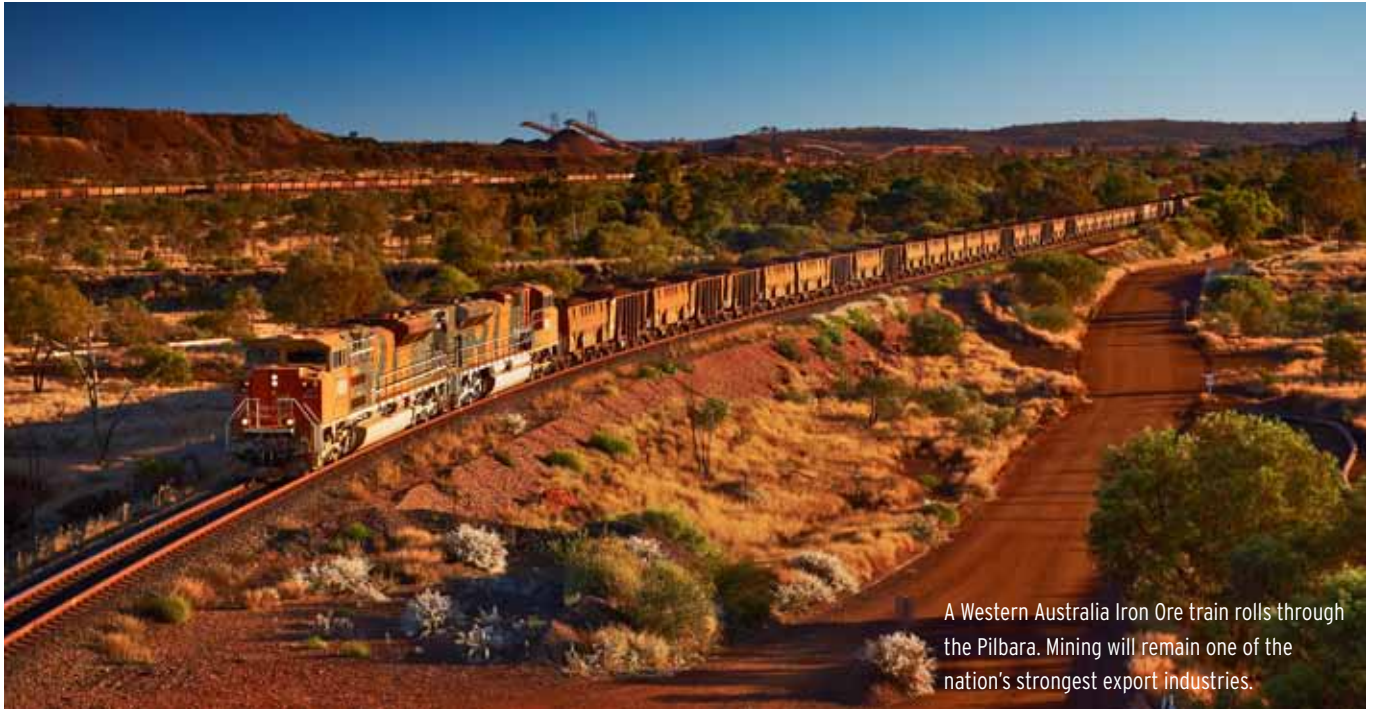
Several shades more optimistic than Garnaut is Reserve Bank of Australia board member John Edwards, who argues in his book *Beyond the Boom* that a decline in Chinese demand for minerals will not necessarily be so painful for Australia's economy. Edwards, noting the high concentration of foreign ownership in the Australian resources sector, argues that since a good proportion of the income increases delivered by the terms of trade shock accrued to foreign firms, so too will they absorb a large share of the pain from a decline in export prices. Edwards estimates that about half of mining profits remain in Australia, paid either to shareholders or to state and federal governments in company tax and mineral royalties. The rest accrues to foreign shareholders. By measuring the value-add attributable to the mining industry in terms of nominal GDP in 2002–03 and 2011–12, Edwards estimates that the increase in income for Australian residents attributable to the mining boom was about 3 per cent: a large number, to be sure, but nowhere nearly as large as many believe.

Australia . . . has traded with Asia since before European settlement: since the early 18th century, and possibly before

On more long-term challenges, there are two potentially serious problems: the consequences of the 'Dutch disease' effect (where natural resource development weakens manufacturing and other sectors) and the corrosion of institutional quality. The first phenomenon may result from the fact that, as demand for Australian resources has grown, the mining sector has sucked capital and labour away from other parts of the economy. Meanwhile the exchange rate has appreciated, rendering other Australian tradeable goods uncompetitive in world markets. While the boom lasts this is tolerable, and indeed necessary, as factors of production are freed from less-productive firms and make their way to the more productive mining sector. When the price for mining exports falls and the mining sector recedes in importance, it may take quite some time for the withered non-mining tradeable sector to regain its former vitality.

Perhaps contrary to some popular wisdom, Australia's macroeconomic institutions have managed the terms of trade shock with considerably more dexterity than at other times in the country's economic history. Whereas at other times of rising prices for Australian exports—such as wool during the Korean War—there was considerable volatility in prices and output growth, this time around, during the first terms of trade boom since the floating of the dollar, inflation has remained extraordinarily well-behaved and growth has been stable.

What is perhaps more worrying is a possible decline in the quality of Australian political institutions. There is indeed some cause for concern on this question. One example is Australia's seesawing fiscal balance. Counter-cyclical fiscal policy was



A Western Australia Iron Ore train rolls through the Pilbara. Mining will remain one of the nation's strongest export industries.

deployed during the global financial crisis and must take some of the credit for Australia's strong macroeconomic outcomes during a difficult period globally. There is no short-term urgency in restoring fiscal balance but the bumpy trajectory, largely a function of political considerations, is a somewhat troubling sign.

In general, though, the more important economic story is the future of Australian integration with its regional neighbours.

It is sometimes implied that economic links with Asia are only of recent importance. Australia in fact has traded with Asia since before European settlement: since the early 18th century, and possibly before, the Yolngu people of Arnhem Land traded the rights to fish for sea cucumber with Makassar traders from Sulawesi who would then sell them to Chinese merchants. The role played by Australian raw materials in the industrialisation of Japan and now China constitutes another long and prosperous chapter, but one that

is, if not over entirely, then at least no longer the entire story. With its neighbours, Australia is trying to create the arrangements to secure regional prosperity, most recently in the Regional Comprehensive Economic Partnership being forged between ASEAN and its regional partners.

AN ECONOMIC reorientation will be required for Australia to fashion a more mature place for itself in the Asian economy. This will mean developing a more dynamic services sector attuned to the needs of the middle class of Asia, a more capable and better-funded education system, and a more disciplined approach to building infrastructure. Australia should not look to compete with others in Asia but to position itself to complement production and economic activity in Asian supply chains.

An abundance of mineral resources has resulted in Australia's relative isolation from the value chains that are dispersing different production

stages across Asia. A large share of Australian exports is of unprocessed minerals, while the import content of Australian exports is a relatively feeble 15 per cent. This is not necessarily a bad thing, nor will Australia cease exporting natural resources. The mining industry will remain one of Australia's most redoubtable export industries. Coal and iron ore will continue to constitute an important part of the nation's export structure, while natural gas (in increasing demand in Japan as well as in China) and rare earths will complement the more traditional mineral exports.

Yet there is something of a mismatch between the destination of Australian resource exports, which are mainly sent to countries in the Asian region, and its service exports, which are still largely purchased by Australia's English-speaking partners. It seems only natural that Australia's service industries should attempt to secure a place for themselves in the production chains of an increasingly integrated Asian region.

One area in which Australian services already have a foothold is tertiary education. Institutions of higher learning in Australia already 'export' strongly to Chinese and other Asian students, with export income of about AU\$15 billion in 2012–13, but both earnings and Australia's share of international students have been declining in recent years. Earnings from Indian and Korean students in 2012–13 were down substantially on the preceding year (by 14.6 per cent and 12.7 per cent respectively).

Research collaboration with Chinese, Japanese and Indian academic researchers has been strong: indeed, much stronger than collaboration between Australian and Asian businesses. In 2010 only 4 per cent of Australian businesses collaborated on innovation with international partners: on this measure, Australia ranks 25th in the OECD. A fruitful avenue for businesses to pursue would be to draw on and learn from existing collaborations between Australian and Asian universities.

The *Australia in the Asian Century* white paper may have all but faded from political memory after the defeat of the government that commissioned it, but though one might quibble about various aspects of the document, it provided a compelling framework within which to judge Australian policy. Its other useful function was to underline some successes that have underpinned Australian prosperity and which policymakers would do well to cultivate and protect.

One achievement highlighted by the white paper is Australia's program of large-scale immigration from Asian nations since the end of the discriminatory White Australia Policy. The proportion of the Australian population with Asian heritage is

12 per cent. Indeed, the Pacific area has the highest number of migrants as a percentage of population of any region in the world, with the majority of these in Australia. Not only is multiculturalism enriching in a social and cultural sense (the basis upon which the policy is usually defended in Australia) but its contribution to Australia's economic future could well be large. Migrants bring language skills and a familiarity with the societies and economies whose needs Australian businesses will have to meet, and knowledge of the tastes and preferences of their consumers. Relatively open borders are therefore an essential long-term macroeconomic policy, one which Australian policymakers should carefully maintain.

A HIGH migrant intake, however, throws into relief other public policy problems that must be dealt with. There are also unquestionable deficiencies with Australia's stock of physical infrastructure: roads, ports and rail, among others. Numerous problems arise from the combination of very high rates of urbanisation and low density in cities. The cost of borrowing for the Australian federal government is attractively low, and need not deter governments from spending money on high-return projects. If fiscal policy is deployed to ease the transition from elevated terms of trade, then infrastructure investment seems a good choice.

Given the costs of construction in a high-wage economy, governments (federal and state) have to be disciplined about project selection. While the present government had, quite encouragingly, promised to submit all large infrastructure projects to cost-benefit analysis before they were funded, it has failed to honour

the commitment in power. This is a tendency that should be reversed. It would also be useful to introduce transparent price signals to those using government-funded infrastructure (for example, through congestion taxing) to ensure that roads that have already been built are used efficiently.

Not all of the reforms sketched above require government to be the unique or even the dominant driving influence. An increase in productivity to make up for the windfall income gains of ebbing export prices cannot be engineered by politicians, and Australian enterprises will have to think hard about the choices they make to expand their markets northwards. The economic potential of more comprehensive private-sector engagement with a rising Asia surely dwarfs the static efficiency gains obtained from, say, further reform to Australia's industrial relations system—perhaps the most commonly expressed wish of Australian business lobbies. If there is a role of government here, it is to provide the incentives and avenues to help society and business become more familiar with Australia's neighbourhood in Asia.

An old strain of Australian historiography stresses the defining role played by its distance from the British metropole. Now geography is surely the nation's greatest asset. Blessed by its resource endowments, Australia has prospered from the beginning of Chinese—and, more broadly—Asian prosperity. But it will have to think smarter and harder if it is to harvest the full range of economic possibility that has opened up, and will continue to expand, to its north. **EAFO**

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Pakistan and the crucible of terror



IMTIAZ GUL

WITHIN days of the terrorist attacks on the twin towers in New York and the Pentagon on 11 September 2001, Pakistan became an inseparable element in calculations about responding to al-Qaeda. Not only was Pakistan seen as a potential springboard for punitive action against the transnational organisation but it also came to be regarded as a crucible of terrorism.

The global image of Pakistan today is rooted in preconceptions about the country's role in international terrorism. It is often thought that the leaders of al-Qaeda and the Taliban are hiding in Pakistan, and that terrorist groups of all shades, including those inimical to India, China, the US

and the West at large, use Pakistani territory for their operations. Another preconception is that sections of the Pakistani military establishment maintain close links with such Islamist radical groups as the Haqqani Network, Afghan Taliban and Lashkar-e-Taiba (LeT), which focuses its attention on India.

These entrenched preconceptions form part of the global discourse on counter-terrorism that continues to stigmatise Pakistan. The situation is not without debilitating socio-political and economic costs. Pakistan has lost over 50,000 people since becoming part of the US-led war on terror. Its economy has suffered because of the ensuing security crisis. According to Pakistani journalist Ismail Khan, Pakistan's economy has suffered a

Mourners are overcome as they pass the site of a suicide bomb attack in Quetta in August 2013. The Taliban claimed responsibility for the attack upon a funeral procession.

US\$78 billion loss in the last 10 years due to terrorism alone.

Is Pakistan alone responsible or did US-led global geopolitics suck it into this dire situation? Or is it a combination of both?

In the 1980s, to counter the Soviet Union's invasion in Afghanistan, young jihadis ('holy warriors') were trained in Pakistan's semi-autonomous, practically lawless western border tribal areas—popularly known as the Federally Administered Tribal Areas (FATA). Since then, the area has served as a training ground for

terrorist activities both in Afghanistan and Pakistan. Militant networks nestled there recruit young men, brainwash and train them to be snipers and suicide bombers for missions against NATO troops in Afghanistan. They also train them to incite sectarian hatred and faith-based violence, or to attack domestic targets like schools and houses of worship in Pakistan. Since 2007, terrorist networks in Pakistan have frequently targeted political leaders, tribal leaders, minority Shia, schools as well as the military and the police.

Some of the world's most wanted and dangerous terrorists have been captured or killed through covert US intelligence operations or drone attacks in Pakistan, including Osama Bin Laden; Tahir Yuldasheve, co-founder of the Islamic Movement of Uzbekistan; Khalid Sheikh Mohammad, another al-Qaeda mastermind involved in the plotting of 9/11; Abu Zubaydah, a Saudi citizen believed to have been a link between Osama Bin Laden and other al-Qaeda cells; Mullah Abdul Ghani Baradar, an Afghan Taliban leader, arrested by the Pakistani authorities; and Ahmed Omar Saeed Sheikh, an al-Qaeda aligned kidnapper and murderer of *Wall Street Journal* reporter Daniel Pearl.

The Pakistani government estimates that more than 60 militant outfits are operating both overtly and covertly in Pakistan. Terrorist organisations have also successfully conducted two brazen jailbreaks, freeing hundreds of their detained members. At the forefront of most terrorist activities is the Tehreek-i-Taliban Pakistan (TTP), a home-grown franchise of al-Qaeda. It is allied with the infamous Haqqani Network, the East Turkestan Islamic Movement (ETIM)—a separatist group founded by Uighur Muslim

militants in western China—and the Islamic Movement of Uzbekistan (IMU), which claimed responsibility for the 8 June 2014 attack on Karachi International Airport.

In late August, several TTP commanders announced the creation of a new group called Jamaatul Ahrar. Led by Maulana Qasim Khurasani, the group vowed allegiance to the Islamic State of Iraq and Syria (ISIS). Most of its members have declared the Pakistani government and the military its enemy.

For over a decade most TTP, IMU and ETIM terrorists have used Waziristan, one of the seven FATA districts, as a sanctuary and training ground. The Afghan Taliban operate out of North Waziristan to mount terrorist attacks on Afghan and NATO troops. This finally prompted the Pakistani army to launch Zarb-e-Azb, a military operation to destroy and disrupt al-Qaeda-linked terrorist networks holed up in North Waziristan. Since the offensive began on 15 June 2014, the military claims to have killed over 500 mostly foreign militants, including Uzbeks and Chechens, as well as people from Dagestan, Kazakhstan and Turkmenistan.

It is quite ironic that the military had to move against those very groups that Pakistan's Inter-Services Intelligence (ISI) had once funded and trained, with CIA support, to counter

Many internal factors
have contributed to
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the Soviet threat in the region.

A number of radicals caught conducting terrorist activities overseas have been traced to Pakistan and have admitted receiving terrorist training from Islamist outfits in Waziristan. One such is Faisal Shehzad, a Pakistani-American who was arrested in May 2010 for attempting to bomb Times Square in New York. Abdul Rof, a British Muslim, (otherwise known as Richard Colvin Reid) also admitted to becoming 'radicalised' and training as a terrorist in Pakistan and Afghanistan by al-Qaeda. In December 2001 Rof attempted to detonate explosives packed into the shoes he was wearing on American Airlines Flight 63 from Paris to Miami. Omar Patek, the notorious Indonesian Islamist militant linked to the Bali bombings, was also arrested from the northern Pakistani town of Abbottabad in early 2011. Jordanian suicide bomber Humam Khalil Abu-Mulal al-Balawi, who killed seven CIA personnel at the forward operating base Chapman in eastern Afghanistan on 30 December 2009, had also passed through Pakistan.

The high number of local and foreign terrorists in, or transiting through, Pakistan underlines a bitter unintended consequence of a free-for-all anti-Soviet jihad mission in the early 1980s—militants inspired by the Muslim Brotherhood, al-Qaeda and the IMU have exploited Pakistan's porous governance, leaking law enforcement and security apparatus, and inadequate legal and administrative structures. The security establishment's inclination to maintain relations with non-state actors such as Lashkar-e-Taiba (LeT) or the Afghan Taliban or use them as foreign policy instruments has served as a facilitating factor for global jihadists.

It is therefore no surprise that as recently as August 2014, during his

visit to New Delhi, the US Secretary of State, John Kerry, reassured India that the United States would keep pressing Pakistan on its alleged support for LeT. India sees LeT as an arm of the ISI and a major irritant in its relations with Islamabad. At a press conference, Kerry equated LeT with al-Qaeda and pledged to work with India to disrupt both terrorist organisations. His statement was seen to imply that Pakistan willingly advocated state-sponsored terrorism and was a threat to both the US and India.

Many internal factors have contributed to Pakistan's weakness in the face of radical Islam. Its military establishment has a lopsided notion of 'strategic depth'; it is plagued by fundamental governance issues and questionable law-enforcement; and by elements in the military hobnobbing with non-state actors along the eastern borders. But global geopolitics also played a part, particularly Washington's campaigns first against the former Soviet Union and later against al-Qaeda. On both occasions, Pakistan found itself under the rule of military dictators who were looking for international legitimacy, and thus became willing partners in campaigns which were geo-political in nature but entailed disastrous socio-political consequences for the country.

During the anti-Moscow jihad, Pakistani army-led authorities welcomed every Tom, Dick and Harry from around the world. Despots like Egypt's Hosni Mubarak 'emptied their jails' to help shore up the jihadi forces in Afghanistan, with the help of over US\$6 billion that the CIA funnelled into the war. As intelligence commentators Paul Todd and Jonathan Bloch explain, 'the Saudis matched the United States in arms funding. A network of ISI-run training camps in both Pakistan and in Afghanistan



A volunteer at the site of an explosion in Peshawar in September 2013 in which 31 people died.

itself instructed over 35,000 foreign mujahideen from throughout the Islamic world by the early 1990s, a significant proportion from Saudi Arabia.'

This situation offered Pakistan an opportunity to realise its long-cherished dream of securing 'strategic depth' in Afghanistan by having a friendly and pliant government in Kabul, and so preclude the possibility of invasion from the west in a conflict with India. This at least was the premise when General Zia-ul-Haq (the then military ruler) decided to co-opt his security and intelligence apparatus into covertly fighting the CIA-funded war.

The US-led war on terror that began in October 2001 gave Pakistan, then under another military ruler, General Pervez Musharraf, another chance to stay relevant in Afghanistan and pursue 'strategic depth'. Cooperation

with the US-led coalition forces accompanied a quiet pursuit of the old policy that considered Afghan Taliban groups under Mullah Omar and the Haqqani Network to be 'strategic assets'. It also meant condoning their command and control centres on Pakistani territory by looking the other way.

The Afghan Taliban took advantage of this and began drawing manpower from inside Pakistan. Splinter groups of LeT, TTP, and many others recruited volunteers to fight coalition forces. They also facilitated the movement of al-Qaeda-linked American, British, Uzbek and African Muslims through Pakistan, creating a double jeopardy for Islamabad—pro-Pakistan Afghan Taliban and warlords in Waziristan began sheltering and helping local and foreign militants whom the Pakistan army was hunting.

As late as November 2013,

Pakistan again came under the global spotlight when the Saudi foreign minister reportedly asked Islamabad for manpower to reinforce the Syrian rebels in their efforts to dislodge the Assad regime. A Saudi State Department official declined to comment on the Saudi training program, but Pakistan did receive a loan of US\$1.5 billion in February 2013. Pakistan's Finance Minister, Ishaq Dar, initially refused to disclose the source but the government later conceded that the 'donation' had originated in Saudi Arabia. This triggered speculation that the Saudis may have asked to recruit ex-mujahideen who could be deployed in Syria.

Andrey Serenko, an expert from the Center of Contemporary Afghan Studies, says many fighters in Pakistan's tribal areas have just returned from fighting in Syria. A Taliban operative also confirmed Pakistani Taliban militants have set up a base to monitor 'the jihad' in that region. Hence, it seems that Taliban from Waziristan did lend a helping hand to the Saudis' 'jihad' against the Assad government.

Pakistan—unofficially and inadvertently—supports and sympathises with militant forces that, in essence, can qualify as extensions of the al-Qaeda-led conglomerate of global terrorism. The spirit of jihad that, for geopolitical objectives, had been instilled in the minds of thousands of Arab, Afghan and African crusaders eventually morphed into a quest for jihad aimed at 'cleansing' the world of US-led 'satanic imperialism'.

Pakistan's military used Islam to further its objectives. This was a huge risk which has had alarming consequences. General Zia-ul-Haq's strategy involved indoctrinating

During the CIA-led anti-Soviet war, radicalisation became a major policy instrument for the first time in Pakistan's history


Muslims with an extremist ideology for jihad in Afghanistan. During the CIA-led anti-Soviet war, radicalisation became a major policy instrument for the first time in Pakistan's history. In only four years hundreds of religious schools were created to provide quick extremist education.

During this period and the following two decades, not only was a significant faction of the Pakistani society radicalised, but the region also saw the emergence of several militant organisations, including Harkat-ul-Mujahideen (founded in the 1980s), al-Qaeda (founded in 1989), LeT in 1990, IMU in 1991, and Lashkar-e-Jhangvi (LeJ) in 1996. After the Soviets withdrew from Afghanistan in February 1989, the Taliban were able to capture the capital, Kabul, and most of Afghanistan during the ensuing civil war. This was possible because of official and private support from multiple Pakistani sources. Pakistan, Saudi Arabia and the UAE were quick to recognise the Taliban regime, which went on to host militants from all over the world, including thousands from Pakistan.

Geopolitics, as well as Pakistan's inherent porous governance, deficient rule of law, political instability and reliance on non-state actors to achieve foreign policy objectives have all

combined to render the country vulnerable to transnational Islamist networks. The official tolerance of religio-political groups with a radical pan-Islamist *Weltanschauung* creates space for the radicalisation of minds and even encourages radicals to peddle their anti-Western agenda, to the detriment of democracy.

Radicalism has infected Pakistan's security apparatus, exemplified by the conviction of Brigadier Ali Khan and three others in 2011 for their links to another ideologically radical outfit, Hizb ut-Tahrir. They also held radical views on Pakistan's cooperation with the US that resonated with calls by Ayman al-Zawahiri, the present chief of al-Qaeda, and the rank and file for a rebellion against the army leadership for its involvement in the war against terrorism. Both al-Qaeda and Hizb ut-Tahrir consider Pakistan to be the major impediment to their jihad against the West and its allies.

Pakistan currently faces the formidable challenge of reversing the consequences of its flawed policies of 'strategic depth' and containing the contagion of religious radicalisation. Until the government and its entire security apparatus drastically revises its strategic matrix, divorces itself from the radical groups it helped create and support, diagnoses the causes of internal insecurity, and draws up a comprehensive internal security strategy aimed at disrupting, destroying and pre-empting religious radicalisation, it will find it hard to shake off the image that Pakistan is the crucible of terrorism. 

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The mixed blessing of Asia's growing middle class

ADRIAN C. HAYES

EVERYBODY seems excited about the rise of a new, global middle class—especially in Asia. A report from Deutsche Bank states that ‘the burgeoning of Asia’s middle class makes it an important consumer market, an engine of economic growth in the region, and an important global political force.’ The McKinsey Global Institute is even more emphatic: ‘We are quite simply witnessing the biggest economic transformation the world

has ever seen as the populations of cities in emerging markets expand and enjoy rising incomes—producing a game-changing new wave of consumers with considerable spending power.’

But who are these people that are about to change the world? Are they really so deserving of our attention, and if so, why? What exactly is at stake in their rise?

For some development specialists, a defining characteristic of the growing middle class is that it represents

people who are no longer poor. Martin Ravallion of the World Bank defines the global middle class as individuals earning between US\$2–13 a day at 2005 purchasing power parity (PPP). The lower US\$2 threshold is chosen because it is the median of a number of poverty lines set by developing countries themselves, and the upper limit of US\$13 is chosen because this corresponds to the US poverty line in 2005. In this definition, a person is part of the middle class of the developing world ‘if that person is not



Queuing up at a Surabaya supermarket. Some analysts define the middle class as being made up of people who are ‘no longer poor’.

PICTURE: CHRIS STOWERS / PANOS PICTURES



A salesman explains the features of a new Nano Twist car to prospective buyers in Mumbai. Asia's middle class can be an engine of regional and global growth.

poor by developing country standards, though still poor by developed country standards.'

Using this definition, Ravallion and colleagues estimate that in the developing world approximately one person in three was in the middle class in 1990. In 2005 it was one in two. This means an extra 1.2 billion people joined the middle class in 15 years, with China accounting for about 632 million (52 per cent) and India 117 million (9.6 per cent). Careful analysis showed this was not the result of a simple horizontal shift in income distribution (whereby all incomes rise by a similar proportion), but rather of greater poverty reduction at the lower extremes and a 'bunching up' of people living just above the poverty line, so that in 2005 one person in six in the developing world was living on between US\$2–3 a day.

Trends in the population dynamics

of Asia's middle class are complex and highly dependent on the shape of overall income distribution (which itself is changing), but the overall pattern is clear: the middle class in Asia's emerging economies is growing faster than the population as a whole, and its aggregate income is growing faster still.

In its *Key Indicators for Asia and the Pacific 2010* report, the Asian Development Bank (ADB) adopts a similar approach to Ravallion and defines the middle class in terms of per capita consumption of between US\$2–20 per day (at 2005 PPP). This estimates that in developing Asia 1.9 billion people were already in the middle class in 2008, while 1.5 billion were still living on less than US\$2 per day. But the majority of the former were still living in the US\$2–4 range, leaving them at high risk of falling into poverty in the event of common

shocks such as illness, unemployment or too many unwanted pregnancies. The ADB calls these near-poor people the lower-middle class. Those living between US\$4–10 a day—that is, living above subsistence and able to buy at least some nonessential goods—they call middle-middle class; and those consuming US\$10–20 a day—corresponding roughly to the poverty lines of Brazil and Italy, respectively—are upper-middle class.

Using survey data collected by the World Bank from around the region the ADB estimates that in developing Asia the middle class made up about 21 per cent of the population in 1990 and 56 per cent in 2008, an absolute increase of more than 1.3 billion (or 236 per cent) in 18 years. Aggregate income (or expenditure) of the middle class over the same period increased at an even higher rate—by more than 350 per cent. By comparison,

total population size of developing Asia increased by only 26 per cent during these years. But it needs to be emphasised that most of this middle class in 2008 was still in the lower-middle category.

In a similar study, the ADB also estimates that China's middle class accounted for 63 per cent of the population in 2005, but 54 per cent of this was in the lower-middle category. In that same year, the Indian middle class accounted for 25 per cent of the population, with 82 per cent of this in the lower-middle category; in Indonesia the corresponding statistics are 47 and 75 per cent, respectively.

Given these figures, some economists argue that it makes more sense to define the new middle class in terms of their consumption rather than their simply being non-poor. In an influential analysis undertaken for the Organisation for Economic Co-operation and Development (OECD), Homi Kharas of the Brookings Institution argues that, while middle class is an ambiguous social classification, the term broadly reflects 'the ability to lead a comfortable life. The middle class usually enjoy stable housing, healthcare and educational opportunities (including college) for the children, reasonable retirement and job security, and discretionary income that can be spent on vacation and leisure pursuits'. He defines the global middle class as those households with expenditures between US\$10–100 per capita per day in PPP. By this definition there were 1845 million middle class people in the world in 2009, 525 million (or 28 per cent) of them in Asia and the Pacific.

To better understand trends in the growth of the global middle class, Kharas develops a scenario for GDP growth in 145 countries. The results are not a forecast but a view of what

the future might look like based on current levels and trends and certain assumptions. Under his scenario, the middle class of the Asia Pacific will grow to 1740 million in 2020 (representing 54 per cent of the global middle class at that time) and 3228 million in 2030 (66 per cent).

In this scenario, growth in aggregate spending by the Asia-Pacific middle class is similarly impressive. It accounted for 23 per cent of the global middle class total in 2009 (compared with North America and Europe's combined 64 per cent), and would reach 59 per cent in 2030, compared with North America and Europe dwindling to 30 per cent).

Comparative data on income and consumption are not very accurate and the statistics for the future are merely illustrative, but experts believe they are quite realistic. In other words, we can reasonably expect that in the next one or two decades Asia's rising middle class will become large and affluent enough to become a key driver of the global economy.

The shift in the world's economic centre of gravity back towards Asia is clear in this scenario. In 2009 the top five countries—in terms of total middle class consumption expressed as a percentage of total global middle

class consumption—were the US (21 per cent), Japan (8 per cent), Germany (6 per cent), France and the UK (both 4 per cent). In 2020 we might have China (13 per cent), US (12 per cent), India (11 per cent), Japan (6 per cent), and Germany (6 per cent); and in 2030 we could have India (23 per cent), China (18 per cent), US (7 per cent), Indonesia and Japan (both 4 per cent).

Kharas selected the lower bound of US\$10 in his definition of middle class because this was the average poverty line in the two advanced European countries with the strictest definition of poverty. Interestingly, comparative analysis also shows that when large cohorts are graduating into the middle class at around this level of income, this is close to a 'sweet spot' for economic growth. It's the point where a developing country can still reap maximum benefit from its cheap labour before its workers price themselves out of the global market. It is also a time of accelerating urbanisation, which if managed sufficiently well can foster a virtuous cycle leading to further rapid growth of the middle class.

As the middle class grows in size and affluence it can become a force of its own for further economic growth. A significant body of research shows how the middle class, when compared with powerful elites on the one hand or the poor on the other, includes population segments most committed to values aligned with sustained economic growth: they embrace competition and openness to the world; they admire innovation and entrepreneurship; they value education and personal development; and they have an insatiable demand for products and services to suit their needs for security, comfort and convenience. The enormous diversity of occupation and lifestyle in the

As the middle class grows in size and affluence it can become a force of its own for further economic growth

middle class can also be seen as a valuable asset.

But things can go wrong too. Kharas contrasts the experiences of Brazil and South Korea. During the 1960s and 1970s both followed similar trajectories: growth hovered around 6 per cent per annum for the best part of two decades and both became middle-income countries by the 1980s. Brazil reached an income level of US\$7600 per capita in 1980, and South Korea of US\$7700 in 1986. However Brazil's middle class was still only 29 per cent of the population in 1980, while South Korea's reached 53 per cent in 1986. For a virtuous growth cycle to eventuate and prove sustainable it is important that economic growth be relatively evenly distributed and that the middle class be allowed to expand. By 2010 94 per cent of South Korea's population was middle class. In Brazil it was only 38 per cent.

Thomas Piketty and others have shown that too much inequality is bad for growth, and even worse for general psychological wellbeing. In the case of Brazil the rising middle class was not strong enough to transform what the Massachusetts Institute of Technology's Danon Acemoglu calls the 'extractive institutions' strengthening the rule of the elite. The emergence of a rising middle class does not mean that future middle-class growth is guaranteed if the institutions supporting open competition and innovation are not in place.

With the right political support Asia's growing middle class can be an engine of economic growth regionally and globally, but its spending power also presents a challenge for achieving sustainable development. In the absence of transformational change to reduce externalities, more consumption means more demand on natural resources and more pollution.

A growing middle class . . . can also mean more social inequality, more pollution, more congestion

No one denies Asian populations the right to develop, but national leaders and policymakers everywhere have a responsibility to initiate mechanisms to decouple economic growth and environmental degradation.

Middle class people support reducing pollution in their own local environments where they can see and enjoy the benefits, but finding the will to support regional or global action—as is needed to mitigate climate change—is more difficult. As the British Royal Society puts it in its report *People and the Planet*:

'At present, consumption is closely linked to economic models based on growth. Improving the wellbeing of individuals so that humanity flourishes rather than survives requires moving from current economic measures to fully valuing natural capital. Decoupling economic activity from material and environmental

throughputs is needed urgently for example by reusing equipment and recycling materials, reducing waste, obtaining energy from renewable sources, and by consumers paying for the wider costs of their consumption. Changes to the current socio-economic model and institutions are needed to allow both people and the planet to flourish by collaboration as well as competition during this and subsequent centuries. This requires farsighted political leadership concentrating on long-term goals.'

This will be easier if middle class growth is inclusive and some of the new wealth is used to eradicate poverty, support public goods and protect the environment. The model of development we see in many Asian cities—where the middle class retreats into its own world of gated communities, private schools and private hospitals—is not ideal.

The rise of Asia's middle class may be part of the most momentous economic transformation in recent history, but national leaders need to make sure the right institutional structures are in place if this transformation is to produce long-term benefits for all. A lot is at stake. A growing middle class can mean more people lifted out of poverty and leading comfortable and productive lives. But it can also mean more social inequality, more pollution, more congestion, and more loss of natural capital and public goods. History shows that while the middle classes can to a large extent make their own destinies, political leadership is vital if their rise is to contribute to broad-based national prosperity. **EAFQ**

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EASTASIAFORUM

Quarterly

IN OUR NEXT ISSUE . . .

**Asia's
minorities**



A *sadhu* performs yoga exercises on the banks of the Sangam in Allahabad.

Pirates, spies, soul-stealers: spirituality transformed

SHAMEEM BLACK

IN THE past decade the worldwide yoga industry has become a multi-billion-dollar business. Yet, ironically, the one country where yoga does not yet thrive commercially is the very place from which yoga is thought to originate: India. Why should this be?

This paradox emerges, in part, because the practice known as 'yoga' around the world is a modern invention of the globalised and capitalist 20th century. A brief look at the history of yoga may help to explain why this industry has not had a

straightforward development in India.

Yoga in India has never represented an unbroken historical tradition. Indeed, as scholars are beginning to show, the very meaning of 'yoga' has varied widely from text to text and from period to period. While we're likely to think of yoga today as a set of distinctive postural practices, perhaps accompanied by breath control or meditation, 'yoga' has been variously understood in different parts of Indian history as a search to separate the spirit from bodily matter, as a quest to unite with the divine, as a tool to strengthen the nation,

as a means of magic, and as a form of military training. Although many of the postures, breath practices and meditations have their roots in classical and medieval Indian texts, their current configuration as a staple of globalised consumer culture is not exactly an ancient Indian tradition.

Until the middle of the 20th century, Indian yogis were often looked upon as scary, dreadlocked men who were more like pirates than Pilates instructors. Sects of yogis such as the Naths, for instance, raided colonial trade routes and created formidable armies of young ascetic

IS YOGA INDIA'S BUSINESS?

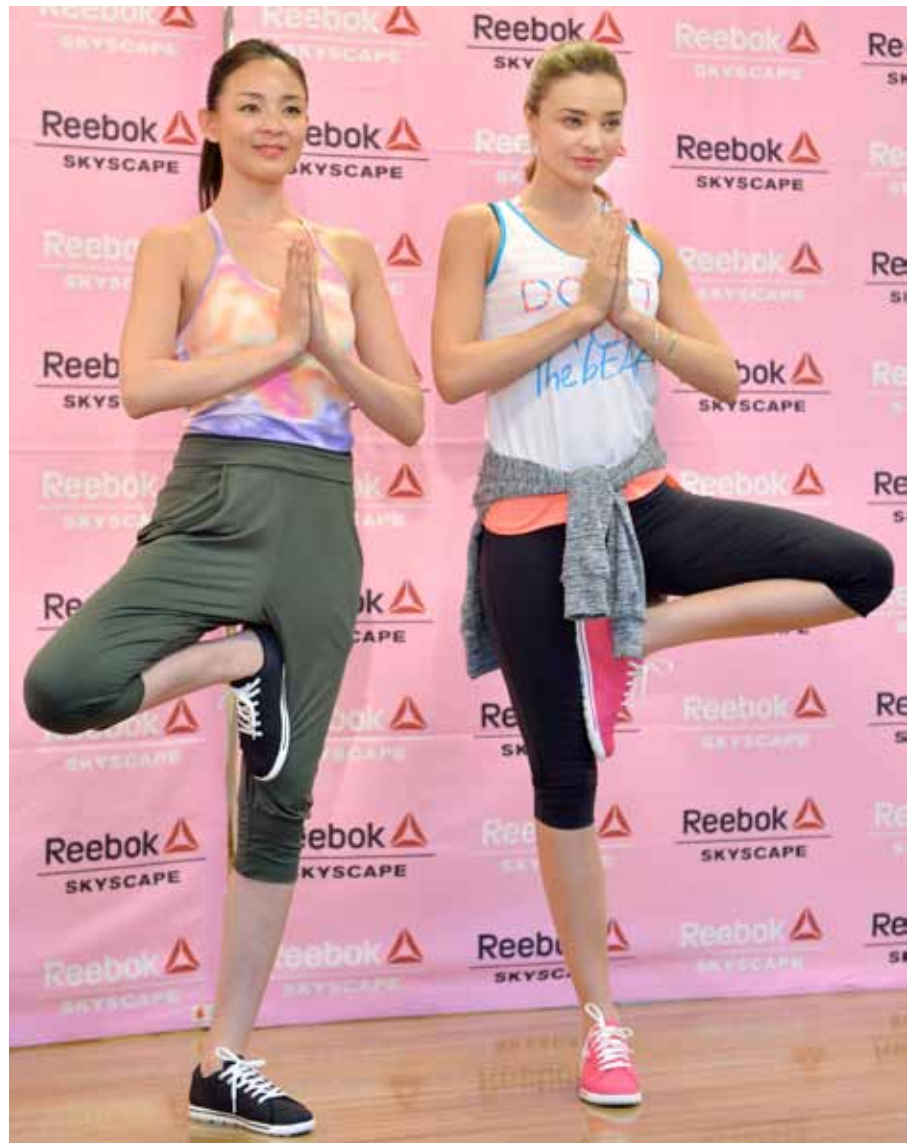
PICTURE: KAZUHIRO NOGI / AFP PHOTO / AAP

men. When the religious studies scholar David Gordon White looked to India's long tradition of stories about yogis he found that, before the 20th century, yogis were usually depicted as sorcerers, spies and soul-stealers. They did not do very many lotus poses.

In the early 20th century Indian innovators like Krishnamacharya, teaching young elites in the Mysore Palace, began to rehabilitate yoga as a modern physical pursuit that laid important foundations for the commercially successful global yoga industry we see today. These innovative and experimental yogis drew upon Indian textual lineages of yoga. They also, as the historian Mark Singleton argues, drew upon the Western physical culture movement of the early 20th century, where ideas about the moral value of cultivating one's body appealed to an Indian nationalism looking to combat colonial stereotypes of Indians as weak and effeminate. Thus the approach that gurus like Krishnamacharya and his contemporaries took represented a creative and globalised rethinking of what yoga could mean for the modern day.

Influential students of Krishnamacharya, such as Pattabhi Jois and B.K.S. Iyengar, continued to sow the seeds for a commercial yoga industry by 'branding' these emergent forms of postural yoga in the mid-20th century. They created formal institutions, named styles of yoga and authorised new generations of students to teach their particular lineages. Many (though not all) of today's yoga institutions trace some path back to these figures.

Ironically, this new postural yoga was often most appealing to students coming from outside India. Training spaces were often populated by students from the Western



From metaphysics to merchandising: models Shiho, left, and Miranda Kerr pose in Reebok's yoga training costume during a special presentation class in Tokyo in April 2014.

counterculture who transmitted these practices back to Europe and America. When the anthropologist Sarah Strauss went to study yoga in the Himalayas, she was surprised to find that the lingua franca of the ashram was not just Hindi, as she had expected, but also English and German. Lucy Edge's 2005 memoir *Yoga School Dropout*, an account of a British woman visiting many celebrated yoga schools in India, registers similar surprise. Having come

halfway around the world to India, Edge instead finds herself surrounded by Westerners. Sensitive to this phenomenon, Indian tourist boards in the 21st century have explicitly marketed yoga to foreigners, with regions associated with yoga promoted as Destination Wellness.

Indians have often perceived yoga in ways that are slightly at odds with the energetic commercial industry that began to flourish worldwide in the 1990s. When Lucy Edge's

memoir records conversations with Indians about yoga, her anecdotes are telling. In contrast to the idealised body emphasised in many globalised commercial yoga studios—the foundation for a yoga industry that not only teaches practices but also sells mats, clothes, food and lifestyle products—Edge finds something different. Her Indian interlocutors tend to think of yoga as something undramatic they do at home, usually with a focus on breath control or meditation rather than on poses, like having a glass of whiskey after a hard day's work.

This mundane perception of yoga resonates with a 2010 *Wall Street Journal* blog post that encouraged Indians to challenge their conceptions of yoga as a sedate grandmotherly pursuit. 'Practicing yoga [in India] is largely reserved for sweet old aunts and pot-bellied uncles,' the post bemoans. 'And the "practice" here is generally limited to pranayama (breathing) in the wee hours of the morning, often with the guidance of self-appointed guru Baba Ramdev on the TV in the living room.' The assumption seems to be that sweet old aunts and pot-bellied uncles don't care too much about shaping an idealised body, don't need to pay for classes and probably don't have a lot of disposable income to put into yoga pants anyway.

Yoga in India has also been historically promoted through robust alternatives to commercial studios. Nationalist Hindu groups, such as the Vivekananda Kendra, have frequently run camps to introduce yoga techniques to middle-class Indians. In these camps, learning yoga is often only one first step in a larger project of religious nation-building. While the Kendra welcomes people who just want to learn yoga, often for wellness or stress relief, what the group really

hopes is that these students will go on to support the Kendra's service mission in ways that go far beyond the mat. Religious organisations have sometimes turned to yoga as a way to make themselves relevant to ordinary people, as in the case of the Jain Svetambara Terapanth. In the late 20th century, the Terapanth reconstructed a lost ancient form of Jain yoga and began to offer classes in this practice to lay people. Such religiously-sponsored forms of yoga are often much more affordable than commercial studios. For example, a camp run by the Jain Terapanth in Delhi costs only 300 rupees (US\$5) to attend two 12-hour days, while a single class at the commercial Yoga Studio in New Delhi requires 600 rupees (\$US10) for 75 minutes.

In another irony, the Indian state has been reluctant to commercialise yoga to its fullest extent because it wants to maintain yoga as an icon of Indian cultural heritage. When yoga entrepreneurs, some Indian, began to be awarded copyrights for yoga sequences in other countries (most famously Bikram Choudhury's 'hot yoga' in the United States), the Indian government fought back. In 2011, it developed an online database of

Scholars have begun to discover that globalised yoga, for some, has enhanced rather than destroyed the 'Indianness' of the practice

traditional knowledge designed to contain images of 1300 yoga poses from traditional Indian texts, along with video demonstrations of some poses and citations to the first source in which each pose appears. The Indian state argued that this database could serve as a first point of reference for patent offices worldwide, so that nothing in the database could be claimed as a modern innovation. In protecting yoga as the traditional property of India, the state thus also prevents potential Indian yoga entrepreneurs from making money in particular ways.

Given the rapid growth of yoga across the world, the current situation in India is likely to change. Many major Indian cities already have their own commercial yoga studios, and as India's middle class grows, the combination of stressful lifestyles, chronic illnesses and increased disposable income is apt to produce a new generation of Indians who seek the same respite in yoga as their counterparts in the United States, Singapore or Germany. The seemingly sedate yoga guided by television-savvy Indian gurus like Baba Ramdev is also becoming increasingly entrepreneurial.

Yoga is also, through its promotion by Bollywood stars, beginning to appeal to an Indian youth culture. As standards of beauty and health in India shift from the plump ideal of a century ago to slender flexible figures, globalised yoga embodies that ideal for both young and middle-aged. And the quirky innovations that have occurred in yoga's peregrinations around the globe—hip-hop yoga, yoga for pets, circus yoga—may appeal to young Indians precisely because of their distance from stodgy stereotypes of ancient Indian tradition.

Yet, even though the Indian yoga



Students at a Sanskrit school take their daily yoga lesson at a ghat in Varanasi. Yoga has been understood in different ways throughout Indian history.

industry is almost certainly set to grow, one key question lurks: are yoga studios actually all that lucrative? It's hard not to be astounded by the financial success of Bikram Choudhury, who told *The Guardian* in 2006 that 'I'm making—I don't know—millions of dollars a day, \$10 million a month—who knows how much?' But owning a yoga studio, for most people, is a struggle. The emerging image of the studio owner, in a range of recent popular novels in the West, is not the yoga titan, but instead the struggling small business owner living on the margins of an unforgiving capitalist market in exercise trends and spiritual fads.

Matthew Remski, a studio owner in Canada, bemoans how commercial yoga's immersion within a rent economy makes studios very vulnerable. 'Many of the 10K/month club studios have been open for close

to a decade, and they have zero equity to show for it,' he writes. When rents rise, longstanding yoga studios can disappear overnight. Remski contrasts this phenomenon to the financial savvy of religious organisations, which have often raced to own their properties in order to inoculate themselves from the vicissitudes of the market. Yoga in India, unlike in the West, has much more of this institutional religious stability to draw upon. But as yoga in India moves beyond religious institutions into secular commercial ones, it is likely to confront similar challenges.

Will developing yoga commercially in India destroy precisely what makes yoga powerful, and even what makes it Indian? Perhaps. There is no doubt that the race to make money from yoga, to create branded forms, lifestyle signifiers and a vast range of imaginative (and unnecessary?)

products, has shifted the kind of cultural work that yoga does. But this doesn't mean that yoga necessarily ceases to be a transformative pursuit.

Scholars have begun to discover that globalised yoga, for some, has enhanced rather than destroyed the 'Indianness' of the practice. As Indians have begun to import commercial forms of globalising yoga, and to develop their own creative responses that invoke both tradition and modernity, they are not just making new kinds of money: they are making new kinds of cultural meaning. In the end, this may be the most valuable development of all. [EAFQ](#)

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Political preference crowding out enterprise

HWOK-AUN LEE

MALAYSIA'S government-linked companies (GLCs) are, relatively speaking, among the most extensive and powerful in the world in terms of capitalisation, market presence and socio-political mandate.

GLCs reportedly comprise 36 per cent of the Malaysian stock exchange's capitalisation and 54 per cent of the entities that make up the Kuala Lumpur Composite Index. The Malaysian government controls GLCs through its government-linked investment companies (GLICs)—gargantuan and powerful investment arms including Khazanah Nasional, Permodalan Nasional Berhad—and the Ministry of Finance.

GLC market presence varies by industry, as measured by share of value-added. Based on data from publicly listed companies, Asian Development Bank lead economist Jayant Menon estimates that in 2012 GLCs accounted for 93 per cent of income in utilities, 80 per cent in transportation and warehousing, and over 50 per cent in agriculture, banking, formation and communications, and retail trade. Menon further notes that GLCs invest at a higher rate than private companies due to their superior reserves and political connections, which give them added leverage and privilege. Menon argues that GLCs crowd out private capital, significantly accounting for Malaysia's anaemic private investment rate since the 1997–98 Asian financial crisis.

The statistical finding that GLCs crowd out more investment than they stimulate makes sense intuitively. It also appears to be consistent with the economic situation in Malaysia. But Menon's data limits his empirical analysis to publicly listed companies. The omission of privately held businesses, especially in manufacturing and in service industries such as retail, probably leads him to overstate the dominance of GLCs.

Yet the Malaysian government cannot deny the crowding-out phenomenon. As part of its GLC Transformation Program the government has committed itself to divesting certain GLCs. But, as expected, the divestment project targets smaller entities within its massive portfolio and has progressed behind schedule.

The durability of GLCs as a domain of government policy underscores the need for reform prescriptions to be informed by historical and political economy perspectives and to acknowledge GLCs' socio-political mandate. Developing the Bumiputera (ethnic Malay) Commercial and

... the program lacks a clear plan on how to move away from overt Bumiputera preference

Industrial Community (BCIC) has been at the forefront of policy since the New Economic Policy was launched in 1971. The BCIC passed through various phases, from reliance on state development agencies, to heavy industry, then to privatisation from the late 1980s until the Asian financial crisis, which saw the renationalisation of many failed companies.

These entities, rebranded as government-linked companies, have become the primary agents for the BCIC agenda, which remains, like it or not, an unfinished business and political imperative. In other words, affirmative action, through managerial development and preferential procurement, is deeply embedded and cannot be drastically rolled back.

Interestingly, criticisms of the BCIC never oppose the policy objective of Bumiputera participation and ownership. Instead arguments typically assume that scaling down GLCs, divestment and privatisation, and rolling back preferential treatment will jolt Bumiputera entrepreneurs and capitalists into emerging as a competitive, innovative force. Competitive Bumiputera capitalists, it is argued, should be the true beneficiaries of affirmative action. But this argument is invariably asserted as an article of faith, unsupported by evidence. Logically, the shortfalls of the BCIC agenda drive the conclusion that privatisation would diminish Bumiputera participation.

If the policy has failed to produce a critical mass of competitive

Bumiputera entrepreneurs—as it was widely supposed it would—wouldn't sudden removal almost definitely cause a downturn in Bumiputera participation? This would be a politically unpalatable outcome regardless of any boost it might bring to private investment rates. Failure or reluctance to openly acknowledge these eventualities and their political consequences often precludes robust examinations of GLC performance and their preparedness for phasing out their role in supporting the BCIC.

Malaysia's GLC policy, on the other hand, preserves its role in promoting the BCIC, but also introduces its share of equivocation. The GLC Transformation Program articulates merit-based selection as a key feature of the new government policy, implicitly distinguishing the current regime from former practices that bred inefficiency. This is only partly correct: 'merit-based' means selecting more capable Bumiputera managers, subcontractors and vendors over less capable Bumiputera managers, subcontractors and vendors.

Amid the misinformation, the program lacks a clear plan on how to move away from overt Bumiputera preference. The government needs to come clean and acknowledge that 'merit-based' selection remains exclusive to Bumiputera participations. A fuller transformation would entail ensuring that these Bumiputera business empowerment programs are conducted effectively, so that transition plans can also be developed to phase out overt ethnic preferences.

The GLC Transformation Program, under the oversight of the government investment agency Khazanah, involves the 17 largest and most strategically important GLCs, including Tenaga Nasional (power), Telekom (telecommunications), Malaysia



Celebrating the nation: students in Kuala Lumpur rehearse for Malaysia National Day. Government-linked companies remain an important part of Malaysia's socio-political framework.

Airlines, diversified conglomerate Sime Darby, CIMB Bank and Maybank.

Market conditions and the business performance of these GLCs vary. Some, such as CIMB, Maybank and Axiata (under Telekom) are expanding to be regional players, while others are confronted by structural challenges or, like Malaysia Airlines, beleaguered by recent tragedies.

Internal reviews of GLCs have written glowing reports. It is not surprising that GLCs generally outperform private companies, given their structural and political advantages. Also, GLCs have not, in the past decade, been engaged in the pervasive profligacy and profiteering seen in the 1990s.

GLCs continue to serve key roles providing services, generating profits for GLICs and other stakeholders, serving as training grounds for managers, directors and entrepreneurs through the employment they offer, and by providing linkages through procurement and subcontracting. But the efficacy and integrity of these programs has not been rigorously and independently analysed. Too much of the GLCs' and GLICs' operational performance, financial flows and pursuit of their socio-political mandate remain under-researched.

EAFO

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Banking on oil offers prospects of a new bonanza

A. TONY PRASETANTONO

INDONESIA'S 'oil bonanza' is now over. It ceased to be a net oil exporter and became a net importer in 2004. Indonesia currently produces only slightly above 800,000 barrels per day while the consumption level is about 1.4 million barrels per day. This leaves about 600,000 barrels for net import. In the golden era of oil in the 1980s and 1990s, Indonesia produced 1.6 billion barrels per day while total consumption was about 800,000 barrels per day.

Indonesia suspended its membership of the Organization of Petroleum Exporting Countries (OPEC) in 2009 due to this dramatic shift in its oil trading status. Because of the widening gap between supply and demand it will be difficult for Indonesia to return to OPEC in the future.

From the supply side, Indonesia's total oil reserves are now only four billion barrels. This accounts for approximately 1.2 per cent of the world's oil production. Indonesia is ranked 21st among the world's oil producers, with reserves far below the giants Iraq (140 billion barrels), Iran (160), Saudi Arabia (270) and, the largest, Venezuela (300). Indonesian reserves are still below Qatar (25), Algeria (12), Angola (9) and Ecuador (8).

But the oil business in Indonesia is still attractive. Net income (profit after tax) of Pertamina, the state-owned oil company, was US\$3 billion

in 2013. This was far above the most profitable bank in the country—Bank Rakyat Indonesia (BRI)—with US\$2 billion. As a benchmark, the biggest private holding company, Astra International, also booked a net income record, of almost US\$2 billion, in 2013. Astra International consists of 178 subsidiaries in areas that include the automotive sector, finance and banking, agribusiness, mining, infrastructure, heavy equipment, logistics, and the like.

Pertamina is the second-largest crude oil producer in Indonesia after Chevron Pacific Indonesia, which is a subsidiary of America's Chevron. In 2013, Pertamina—with revenues totalling US\$70.9 billion—ranked number 122 in the Fortune Global 500 list of companies. It currently produces 196,000 barrels of oil per day compared with 189,000 in the previous year, and accounts for about 20 per

Increased demand and the increased oil price are two factors that indicate that the oil business will continue to be attractive

cent of total Indonesian production. Other significant producers are Chevron (about 47 per cent), Total (10), Conoco Phillips (7), CNOOC (4), Chevron Indonesia (4), PHE-ONWJ (4) and Mobil Cepu (3).

In brief, the oil business is still big business in Indonesia—especially in light of declining prices for commodities such as coal and palm oil over the last few years. Unfortunately the financial sector, particularly the banking industry, has had only a minor role in the oil sector to date. There are two reasons for this. First, most oil operators in Indonesia are foreign companies. Only Pertamina and a relatively small oil and gas private company named Medco, owned by Arifin Panigoro and family, are domestic players. Other oil and gas companies are from the US, UK and China.

Second, most Indonesian banks have insufficient experience and exposure in oil sector lending. Indonesia has 119 commercial banks, many fewer than the 250 that operated in the pre-Asian financial crisis period (before 1997). Lending in the banking industry falls into four categories: corporate lending (lending for big companies, which is usually above US\$20 million), commercial lending (usually above US\$10 million), consumer lending (for consumption purposes), and the smallest lending category for micro, small and medium enterprises.

Typically, most banks are involved in consumer, commercial, and small-



A Pertamina worker cycles past barrels of fuel ready for shipment. The company accounts for about 20 per cent of Indonesia's crude oil production.

and medium-enterprise lending. They enjoy a huge margin of interest and high profitability. Indonesia is well known as a 'heaven' in the region for net interest margin (NIM) and profitability. Providing lending for small and medium enterprises can attract an interest rate of more than 20 per cent, compared with less than 10 per cent for corporate lending.

Only two state banks have experience in corporate lending: Bank Mandiri and Bank Negara Indonesia (BNI). Since 2013 both state banks have been involved in many transactions in the oil business. BNI, for instance, has been appointed as a trustee and paying agent to handle the sales contracts of liquefied natural gas (LNG) and liquefied petroleum gas (LPG) in Mahakam Block, East Kalimantan. Under this appointment, all payments generated from sales should be paid to the seller's account

in BNI. The estimated gas sale value is approximately US\$18 billion for a period of 10 years. As a result, BNI becomes the first state bank entering the trustee and paying agent business, whereas in the past all transactions were handled by foreign banks.

The oil sector is a huge business and provides a lot of opportunities for national banks, particularly state banks such as Bank Mandiri, BRI and BNI. In 2013, oil and gas industry transactions reached a total of US\$57.8 billion. Major business included oil transactions (US\$31.3 billion), pipeline gas (US\$12.4 billion), and both LNG and LPG (US\$14.1 billion).

These data show that the oil industry is not considered a 'sunset industry' for the banking sector. Increased demand and the increased oil price are two factors that indicate that the oil business will continue to be attractive and Indonesian banks

should have greater involvement its business. From the macroeconomic point of view, greater volumes of foreign currencies handled by local banks will help stabilise the rupiah. From the banking industry point of view, greater exposure will help state banks be more competitive regionally.

Indonesian commercial banks, particularly state banks, need to strengthen capital (to mitigate the risks in corporate lending) and elevate their capacity to handle 'sophisticated' business. These are two key factors if Indonesia's banks are to increase their role in the very dynamic oil business.

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Strengthening the state and market in ASEAN

PETER MCCAWLEY

AN EMBARRASSING fact about ASEAN governments that is generally avoided in public policy discussions is that the capacity of most ASEAN states is quite limited—much more limited than they, and the international community, generally wish to admit. Until it is recognised that state capacity is limited, it will be hard to understand the implications for public policy.

It is not easy to measure the capacity of a state. Essentially, the concept is closely related to the power it can exercise. Power, in turn, can be measured and exercised in various ways—including politically, coercively through the military and police, legally, and administratively.

Levels of taxation and expenditure are two important measures of the capacity of a state. The level of taxation is a good measure because it reflects the power of a state to collect revenues from citizens to provide public goods. From another point of view, expenditures are a better measure because the size of expenditures indicates the ability of a state to respond to the expectations of citizens and to provide the goods and services that citizens expect from their governments.

Surprisingly, statistics on levels of taxation and expenditure in ASEAN are somewhat opaque. The key data are not readily accessible. Having comparable figures on the fiscal capacity of ASEAN states more widely available would be a useful first.

Figures for government spending across ASEAN throw up some startling facts. As a benchmark, the average level of government spending in Australia and New Zealand in 2012 was around US\$16,800 per person. By comparison, the average level of government spending across ASEAN in the same year was around US\$730.

The figures for government spending across ASEAN naturally vary from country to country. In oil-rich Brunei the government spent over US\$15,000 per person in 2012. Government spending in Indonesia, the largest country in ASEAN, was slightly below the average, at about US\$600 per person. And in Myanmar, the fiscal capacity of government was very limited indeed, with annual spending at around US\$40 per person.

These extraordinary differences in per capita government spending may be interpreted in different ways. One view is that the different levels are

Reconsidering the role of the state is needed . . . because, quite simply, states in the region are trying to do too much with too little

not surprising because they reflect, naturally, the different levels of income per capita in the different countries. While this is doubtless true, it is also true that the expectations of ordinary citizens across ASEAN in a globalising world are increasingly influenced by international comparisons. While state capacity is limited, expectations of the state are not.

Another view is that international comparisons of this kind need to be adjusted for purchasing power parity (PPP) differences between countries. But while it is true that notable price differences exist between countries, these differences often reflect large disparities in the quality of goods and services. And PPP measurements often fail to allow for the fact that the prices of many goods on which governments spend their money are set in international markets. The world price of building infrastructure (quality-adjusted) is often quite similar in different countries.

This picture of the limited economic capacity of governments in most ASEAN countries is worrying. It suggests that it would be useful to undertake the painful and controversial task of reassessing strategies of state management and of public service delivery. What are the implications for policy and for the delivery of public programs? More broadly, what should the state's role be when resources are so sharply constrained?

Three main steps seem to be needed. First, there needs to be discussion of the generally-accepted



High-rise construction in Jakarta. The cost of building infrastructure, when adjusted for quality, is often quite similar in different countries.

paradigm of a strong economic state which, among other things, promises to protect the populace from the ravages of uncaring market forces. In fact, market forces are often dominant in poorly-regulated informal economies across ASEAN. Governments frequently try to impose regulation on these markets but generally fail.

A second step, therefore, would be to recognise the problems that arise when there are excessive expectations about the role that the state can play. Clearly ASEAN states cannot provide the range of services that are available in the OECD welfare states. It would be best if the challenges of designing governments to live with very limited budgets were more widely discussed.

It is hard to avoid the impression that, at least in the low-spending ASEAN states, many branches of government are badly over-stretched. Too often political leaders over-promise and under-deliver. Put simply,

governments are trying to do far too much with far too little. The result is a vicious circle: citizens become disillusioned with governments and see little reason for paying taxes or even user charges for government services, thus exacerbating the problem of limited resources for the public sector.

A third step towards reconsidering the role of the state is to define the role of government carefully. To be effective, this would need to go well beyond the dozens of programs of public management reform which have been outlined for ASEAN governments in recent years. The measures that are needed to match the functions of governments more closely would be controversial. Governments should identify strict economies in the range of services they provide, improve revenue collection procedures at all main levels of government (including by state-owned enterprises through higher user charges), and

systematically simplify administrative services. They should also review the scope of their activities to design an approach where governments 'steer, not row' and strengthen their ability to regulate the outsourced provision of services to communities.

Reconsidering the role of the state is needed not as a response to Western pro-market ideology but because, quite simply, states in the region are trying to do too much with too little. And both government failure and market failure are the result. Government failure often exacerbates market failure because overstretched governments cannot perform even basic regulatory functions properly. A pragmatic and determined approach to reform is needed to strengthen the operations of both governments and markets in the region. **EAFO**

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Why Japan should sell assets and spend big on research

ROBERT ALAN FELDMAN,
TAKESHI YAMAGUCHI
AND SHOKI OMORI

THE debate on fiscal reform in Japan has been heating up. The working assumption so far has been that tax hikes will be sufficient to solve the fiscal problem. Fortunately the fiscal debate has now gone beyond this innocent simplicity and spending control is finally on the agenda. So is privatisation, with the government promising it will 'implement public service reforms which aim for more efficient administrative work and privatisation'. But how much can privatisation actually contribute to fiscal reform? The answer depends not only on the proceeds from public asset sales but what they are used for.

There are divergent estimates for expected proceeds from privatisation. At the low end, non-obligatory holdings of equities by the central government totalled 9.2 trillion yen (around US\$86 billion). At the improbably high end, holdings of fixed assets by general government (including central government, local governments and the social security fund, on a consolidated basis) totalled 453 trillion yen (US\$4.2 trillion); shares and other equities 120 trillion (US\$1 trillion); fixed assets of public sector entities outside the general government 134 trillion yen (US\$1.2 trillion); and shares and other equities of such entities 59 trillion yen (US\$541 billion). The total is 766 trillion yen (US\$7 trillion). In addition, there are other government entities that are



Junichiro Koizumi: championed privatisation.

treated as private sector firms in the national accounts.

The next question is how much of the potential proceeds, however estimated, will be made available. After all, there are some entities that no one would ever consider privatising: for example, the Bank of Japan. In addition, there is the question of whether the potential resources are large or small. Some comparisons make 10 trillion yen (US\$93 billion) of proceeds seem large: this is equivalent to 10.3 years of government research and development spending, and to 2.2 years of defence spending. In contrast, other comparisons make 10 trillion seem small: the amount is the equivalent of only 21 per cent of current borrowing requirements, 20 per cent of central government tax revenue, 7 per cent of general government current receipts, and 0.9



Shinzo Abe: stock sales used to secure funds.

per cent of general government gross debt.

Outright asset sales were the key component in the privatisation programs in the 1980s, such as those involving Nippon Telephone and Telegraph (NTT), Japan Tobacco and Japan Rail. From the latter half of the Koizumi Cabinet (2001–2006) to the first Abe Cabinet (2006–2007), privatisation was positioned as an important pillar of reform, with privatisation of the post office the central initiative. Between 2007 and 2011 the government also sold some of the oil companies that had been taken over from the former Japan National Oil Corporation and some of the stock held by the government in the Japan Alcohol Corporation.

The plans from those years to privatise many of the state corporations were eventually revised,



Kansai International Airport, one of three specifically targeted for privatisation under legislation passed in 2013. One potential benefit is the introduction of unified management to airport operations, in contrast to the accepted practice whereby buildings, car parks and the airport apron are run by different bodies.

however, as the role of government institutions was reconsidered after the global financial crisis and the Great East Japan Earthquake. One example is the Development Bank of Japan (DBJ): the DBJ law was revised in July 2009 under the LDP administration and this effectively postponed privatisation of the bank.

As a part of the reform of independent administrative agencies, the cabinet decided in January 2012 upon a proposal to reorganise 64 of 102 entities through their abolition, privatisation and integration by April 2014. However, in January 2013, after the LDP returned to power, this decision was suspended ‘for some time’.

The Abe administration has proceeded steadily with the sale of government-held stock in order to secure funds. In early 2013, based on the Reconstruction Funds Securement Law, the government sold Japan Tobacco stock. In addition, in March 2014, the government sold some of its holdings of NTT stock to raise funds for a 5.5 trillion yen economic stimulus plan.

Under the structural reform strategy of Abenomics’ ‘third arrow’, there is an emphasis on public–private partnerships (PPPs). The first type of PPP is a concession-type PPP and is envisioned for airport and water and sewerage businesses. Under the second type, the government is

considering establishing ‘air rights’ for metropolitan expressways and selling them to the owners of land along the expressways. The third type of PPP is expected to make use of unused public real estate, such as the sites of closed school buildings and surplus land. The fourth type would be a traditional services-for-sale PPP in which the government would sell services produced by private companies; the consolidation of multiple facilities would result in economies of scale, and the private companies could boost their attractiveness.

Until now the operation of airports has been largely under state control, but airport concessions became possible with legislation passed in

2013. Three airports have so far been specifically targeted for privatisation: Sendai Airport, Kansai International Airport and Osaka-Itami International Airport. Benefits should be seen in two main areas. First, the concession system should enable efficient airport operation by granting the operating company the authority to decide what fees are charged. Second, the system should enable unified airport management. At state-run airports, different bodies manage the terminal buildings, the car parks and the airport apron, and conflicts can arise between these bodies. It should be possible to improve efficiency through unified management.

The most important point is how proceeds are used, and in particular whether they will help to accelerate productivity growth. Just how much productivity growth could the privatisation proceeds produce?

A hint of what is possible comes from the relationship between economy-wide research and development (R&D) spending and labour productivity growth. For mature OECD countries, each

The most important point is how proceeds are used, and in particular whether they will help to accelerate productivity growth

1 percentage point of GDP devoted to R&D tends to add about 0.4 per cent to productivity growth over the medium run. If Abe's goal of 2 per cent real GDP growth is to be met by raising productivity through research and development, then the ratio of R&D spending to GDP would have to rise from about 3.3 per cent now to about 6.5 per cent. This is the equivalent of about 16 trillion yen (US\$147 billion) per year of extra R&D spending, for the public and private sectors combined.

How could privatisation contribute to a rise of the R&D share of GDP? The

direct method would be to spend the proceeds of privatisation on R&D. This would require an ongoing and very aggressive program of privatisation. An indirect method would work through efficiency improvement: the shift to the private sector makes firms far more sensitive to efficient performance, including the adoption of new technology. The history of privatisation in Japan has shown some shift from direct to indirect privatisations.

An aggressive strategy of privatisation to fund productivity-boosting research could be just the tonic Japan needs. **EAFO**

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How Temasek has driven Singapore's development



Reaching high: Temasek now enjoys greater independence from the government's economic agenda.

PICTURE: HOW HWEE YOUNG / EPA / AAP

ANGELA CUMMINE

THIS year marks the 40th anniversary of Temasek, one of Singapore's two sovereign wealth funds (SWFs), along with the Government Investment Corporation (GIC). Set up in 1974 as part of the newly independent city-state's nation-building effort, Temasek has evolved from a sleepy holding company shepherding an initial portfolio of 35 inherited government-linked companies (GLCs) to a long-term, return-seeking investor with both wealth-management and development mandates.

Temasek is still a government holding company that acts as a shareholder on behalf of the Singaporean government. Today it pursues its developmental mandate by buying direct stakes mostly in Singaporean and Asian companies, and then reinvesting its proceeds from asset sales and dividend income into foreign assets, acting like a private equity fund.

As a result, Temasek is primarily a concentrated Asian equities investor. In 2013, 73 per cent of its portfolio was held in liquid, listed assets with 71 per cent allocated to assets in Singapore and Asia, making it one of the least diversified sovereign funds globally. A further 13 per cent was allocated to Australia and New Zealand, underscoring its geographic bias towards the Asia-Pacific.

The heavy regional orientation of Temasek's portfolio is a legacy of its original mission to assist in the

state-led development of Singapore and its neighbours. Following independence in 1965, Singapore lacked capital, infrastructure and job opportunities. In the absence of raw natural resources, the newly independent state commenced an aggressive industrialisation and economic development program.

To this end, the government acquired minority stakes and established start-ups in strategic sectors like transportation, industry, engineering and logistics to foster self-sufficiency and attract private investment. The new government also inherited ownership of several established aviation, telecommunication and defence companies from the British. Temasek was established to relieve the ministries of finance, trade and industry from the commercial management of these GLCs in which the state had a controlling stake.

Temasek remained a domestically focused holding company until the late 1970s, when it adopted a more outward-looking approach. At this time, the fund encouraged its portfolio companies to expand throughout the Pacific Rim and into the recently opened Chinese market, as well as to pursue mergers and acquisitions to become more internationally competitive.

During the early 1990s, as the Singaporean government further liberalised the domestic economy, Temasek acquired several more public service providers in broadcasting, utilities and electricity, overseeing their privatisation as part of the government's policy to increase competition. This continued sell-off of basic public assets resulted in the second major capital injection in Temasek since its creation.

Both this allocation of privatisation



Temasek CEO Ho Ching, who redefined the company's mission to the pursuit of long-term wealth creation.

proceeds generated through the government's competitiveness agenda and the continued commitment to predominantly domestic investments in companies that owned or provided critical resources or services reinforced Temasek's ongoing role in the state's economic apparatus.

This only began to change following the appointment of Ho Ching, daughter-in-law of Lee Kuan Yew, Singapore's founding prime minister and wife of current Prime Minister Lee Hsien Loong, to Temasek's board in 2002. In her role as Executive Director on the board, Ho was instrumental in introducing a new charter in 2002 that reinterpreted Temasek's role within the state. The 2002 charter recast Temasek's 'developmental' mission, moving the fund away from its historical domestic investment agenda aimed at diversifying and developing Singapore's economy to a new role 'as a commercial investment company to create and deliver sustainable long-term returns'.

Ho's ascent to CEO in 2004, a position she has held for a decade

barring a short hiatus in 2008, ensured this new vision of Temasek gained traction. The revised 2009 charter further emphasised Temasek's role as a commercial rather than strategic investor that must prioritise long-term wealth creation over the pursuit of the government's national economic objectives.

The realisation of this more arms-length mission from the government is made possible through Temasek's independent financing arrangements. Temasek has not received any regular financing from the government in its 40-year history besides the two ad-hoc injections of privatisation windfalls. This is striking for such an established fund. Several other SWFs also lack a stable funding mechanism (for instance, the China Investment Corporation, Australian Future Fund and the New Zealand Superannuation Fund), but these are relatively new funds, less than a decade old, with their permanent funding arrangements yet to formalise.

This set-up is also striking relative to its sister SWF in Singapore, the

GIC. The GIC was created with a portion of surplus foreign exchange reserves and receives an annual (discretionary) transfer from the government to help grow its principal. Temasek, on the other hand, has become entirely self-financing with five primary sources of funding: company dividends, divestment proceeds, distributions of fund investment earnings and, since 2005, long- and short-term debt issuances following the company's inaugural credit rating in 2004. Since then, the company has issued 13 medium-term bonds in US dollars, Singapore dollars and British sterling, totalling US\$9.3 billion, with a weighted average maturity of 14 plus years.

The use of debt instruments by Temasek places the fund in a niche club of sovereign investors. Abu Dhabi's Invest AD, Bahrain's Mumtalakat and Malaysia's Khazanah, also a sovereign development fund, have all issued bonds to generate capital. Perhaps the most well-known debt-financed sovereign fund is the China Investment Corporation (CIC). The CIC was established in 2007 through a Ministry of Finance bond issuance of US\$200 billion, which saddled the SWF with a daily liability of US\$40 million to service its debt. This liability increased in 2010 when CIC's domestic arm, Central Huijin, which controls a substantial proportion of China's state-owned financial institutions, undertook a domestic market issuance to help raise capital for its local banks.

Unlike CIC though, Temasek's multiple sources of funding alongside its securities have allowed it to use its debt instruments more creatively. In October 2010 Temasek announced the issue of a zero yield exchangeable bond with a three-year maturity. This bond was exchangeable into shares of

Standard Chartered Bank, a portfolio holding of Temasek, at a premium of 27 per cent.

As Schena and Chaturvedi of the Tufts University Fletcher School observed, '[t]he interesting dimension of the bond is Temasek's ability to systemically reduce its holding in an investee company at a premium over the current market price while enjoying nominally interest-free financing for three years.' A more fundamental implication of this funding strategy is the ability to help develop domestic capital markets. By undertaking its own debt raising activities, Temasek has expanded its access to short- and long-term debt and helped cultivate the local capital market.

Today Temasek invests with a higher degree of independence from the government's national economic agenda, although links to the state remain through the fund's board composition and governance arrangements. Four of Temasek's 10 board members are from the political elite—the Chairman, Mr Dhanabalan, a cabinet member from 1978-1994; the CEO and Executive Director Ho Ching, wife of Singapore's current

Formally, neither the President of the Republic of Singapore nor the Government of Singapore can influence Temasek's investment decisions

Prime Minister, Lee Hsien Loong; director Lim Boon Heng, a cabinet member from 1993-2011; and director Teo Ming Kian, former permanent secretary in various government ministries and executive chairman in key agencies. Formally, however, neither the President of the Republic of Singapore nor the Government of Singapore can influence Temasek's investment decisions.

Nonetheless, the company is still expected to help foster a strong Singapore, increasingly through philanthropy. In March this year, Temasek created the US\$31.8 million Temasek Emergency Preparedness (TEP) fund to help Singaporeans prepare and respond to emergencies. The TEP covers environmental disasters such as the haze that engulfed the country in 2013 and trauma from accidents or national crises like the SARS epidemic of 2003. This initiative forms a small portion of the US\$1.2 billion endowed to philanthropic causes through the Temasek Trust, highlighting that Temasek's role has transformed beyond pure nation-building to nation-insuring.

This all suggests that while the scope of Temasek's activities has changed considerably since its establishment in 1974, it continues to play a key role in fostering economic development and a strong Singaporean state. 

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