

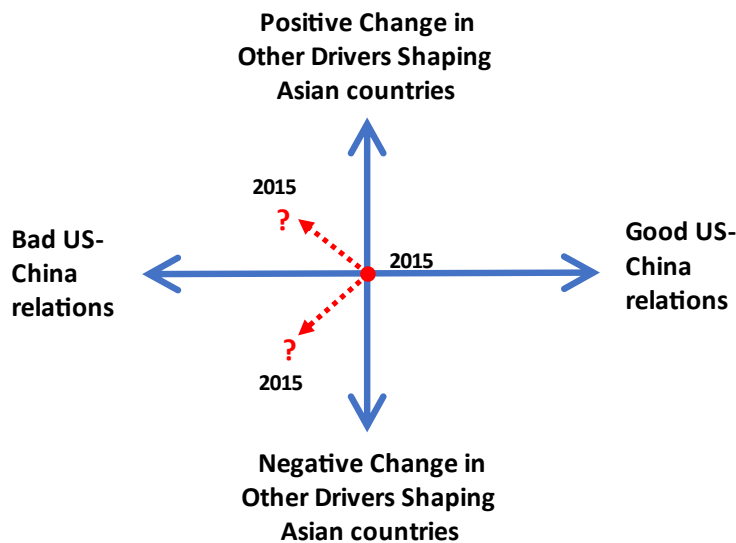
ASIAN INTELLIGENCE

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Where Asian Countries Are Heading



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REGIONAL OVERVIEW

Changes in US-China relations

Perhaps the most critical external influence shaping the future of every country in this report is the relationship between the US and China. Other big variables include climate change, the outcome of Russia's invasion of Ukraine, the possibility of future pandemics, organized crime and global terrorism, and disruptive technological change. However, even these variables will be shaped by how the two most significant powers in the world, the US and China, decide to approach them. Will they cooperate and seek mutually beneficial solutions, or will they refuse to cooperate, giving these other variables the space they need to be much more unsettling for everyone concerned?

The trend of US-China relations has been deteriorating for several years now. Recent headlines paint a picture of both governments treating the other as an enemy, prompting moves to disengage with each for the sake of their national security. The differences in the responses of Washington and Beijing to Russia's invasion of Ukraine have raised speculation that the world might be splitting into rival blocs, sort of a Cold War II, with one group of countries generally supporting the US position and another group supporting China's position, with the differences between the groups determined mainly by their relative economic and security dependencies.

This could be the direction in which US-China relations are heading, but straight-line thinking from a single point in time is rarely accurate. It is worthwhile looking at history and seeing how the US-China relationship has changed directions several times. Moreover, as strained as the US-China relationship is looking today, there was a time not that long ago when it was much worse. As a starting point, look back to World War II. The US supported China in the war against Japan. During this brief period, the US had a moderately cooperative relationship with both the Nationalists under Chiang Kai-shek and the Communists under Mao Zedong. The US Army Observation Group, commonly known

as the Dixie Mission, lived with Mao and his colleagues in the mountainous city of Yan'an, Shaanxi, and worked closely with the Communists to rescue American pilots downed in North China after bombing Japan.

For illustration, consider the US-China relationship to be a line running from "bad" to "good", with bad on the left and good on the right. During WWII, the US relationship with the Chinese Communist Party was an alliance of convenience that would be indicated by a point a bit to the right of the mid-point of this axis.

Graph 1: The Worst Period of US-China Relations



However, after WWII through the start of the Korean War, the relationship deteriorated fast and steadily to an extreme point on the left of the axis. This was when the US military actively fought against China's PLA on the Korean peninsula (the worst point in the relationship). US-China relations stayed frozen at a highly negative point for the next two decades. There was little direct contact at the government-to-government or business-to-business levels and no cooperation in dealing with significant challenges. Most problems were dealt with without consulting the other side.

This was the status quo until 1972 when former President Richard Nixon made his breakthrough visit to China. There was gradual movement from left to right along this axis for many years, but it never reached an extreme point on the right or "good" side. Most of the improvement was in economic matters, including trade and investment – so much so that by the turn of the century, the economic links between the two countries were extensive, which contrasted sharply with almost no links before 1972.

However, significant political differences remained during this period of rapprochement. It was only in 2001 that China was able to gain membership in the WTO – due mainly to the reluctance of the US to grant China permanent Most-

Graph 2: US-China Rapprochement



Favored Nation trading status until that year. In the immediate aftermath of the collapse of the Soviet Union, the US-China relationship continued to improve. That is, it moved to the right along the axis. At its strongest point, it might have regained most of the ground it lost since WWII and moved back to a location close to the middle of the Bad-Good axis.

Even after the collapse of the Soviet Union, a growing number of US national security experts considered China’s effort to expand its global influence to be one of the most significant threats to the US. Beginning with the election of Donald Trump as president in 2016, Washington adopted a harder line toward China on trade, investment, and other economic issues as well, while the US and China have been unable so far to move closer on other issues, including the fight against COVID or how best to respond to the Ukraine-Russia conflict. This brings us where we are today – moving in a deteriorating direction, or to the left, along the Bad-Good axis. It is still a long way from the highly negative point hit during the Korean War, but both Washington and Beijing seem to be emphasizing confrontation over cooperation.

Graph 3: The Current Direction of Change in US – China Relations



The net impact of these forces has been to shift US-China relations back to the left – toward the “bad” end of the axis, as shown in Graph 3. They are not yet at an extreme point. The two governments are still going through the motions of cooperating on issues like fighting climate change. Despite threatening rhetoric, the status quo on significant points of disagreement like the status of Taiwan and the South China Sea has prevailed. Most importantly, the two sides have not disengaged economically in substantive ways. Two-way trade and direct

investment remain large. China plays a vital role in the supply chains of many US companies. Communication links remain intact, and both governments are still trying to operate within the common frameworks established by bodies like the WTO.

However, the rhetoric of both Beijing and Washington is becoming more confrontational. Finger-pointing is increasing on both sides, and there is little genuine cooperation in addressing shared problems like COVID-19, inflation, and supply chain shortages. One noticeable switch in roles in recent years is that since the election of Donald Trump, the US government seems to be moving away from its former commitment to embracing globalization and towards a policy that is more protectionist, while China is now pushing globalization harder and avoiding conflicts in which sanctions and other isolating measures are called for.

President Joe Biden’s recent trip to Asia made it clear that he is trying to strengthen relations with key allies like Japan and South Korea, including ways to cooperate more in countering China’s growing influence in the region. He seems to be trying to build a bloc of allies in the region that intentionally excludes China. However, it is essential to note that even close allies of the US like Singapore have warned against going too far in that direction. At the same time, major US business interests in Asia are worried that recent calls in Washington advocating “decoupling” would be counter-productive.

Much of the rhetoric and actions coming out of Beijing are just as destabilizing. China’s display of force by joining with Russian bombers in practice runs over the Sea of Japan as President Biden attended the Quad summit in Tokyo did not favorably impress any of China’s neighbors, with the possible exception of North Korea (and, of course, Russia). Moreover, President Xi Jinping’s continued threats to use force to take over Taiwan are just as destabilizing as Mr. Biden’s comments to use the US military to defend Taiwan if China invades.

People have a right to be worried about the direction in which China-US relations are headed. However, it is another thing to run like Chicken Little

and shout that the sky is falling. There is still time and a good reason to be hopeful that the direction of the relationship will change and become more cooperative than it is at present, at least when it comes to dealing with the big, mutual problems. Rather than forecast what will happen, therefore, it is probably more productive and helpful to think of signposts that need to be monitored to spot possible directional changes. If the pessimists are correct and the US and China are moving to the “bad” extreme of the relationship axis, there will be plenty more evidence that this is happening.

The US and China would be acting more like enemies on this axis’s “bad” side. Each government would do even more to treat the other as their most significant national security threat. At the same time, the populations of both countries would become strongly biased against the other, interfering with personal exchanges, tourism, and business interactions.

Cooperation would be difficult in a bad US-China relationship, even on problems shared by both, like climate change and COVID-type health risks. Instead, each side would blame the other and insist they make changes. There would be little sharing of information. Indeed, there would be strong efforts to block information flows, and the information classified as “sensitive” would be very broad.

This means firewalls would be erected on the internet, and cloud services would be segregated. The news would be highly filtered and biased. There would be limited or no cooperation in fighting cross-border money laundering or other crime. Companies from one country would be discriminated against in the other country in terms of being allowed to make direct investments, bid for projects, and access local capital. There would be new export and import barriers. The thrust of a bad relationship would be to decouple the US and China economies as much as possible and limit access to the local market.

For an example of an extreme point in this driver, look at how Washington is trying to isolate Russia in the wake of the Ukraine War. There are sanctions against companies and influential individuals. Face-to-face interactions are limited. Travel is restricted. Assets are frozen. The threat of

military confrontations has increased sharply, and each side tries to pressure allies to support their position by applying sanctions against the other side. Trade, investment, social media platforms, and access to capital markets would be weaponized, focusing on isolating and hurting the other side as much as possible rather than maximizing the economic benefit for all.

The Ukraine-Russia War helps identify the likely extreme features of the bad US-China relations scenario. From the perspective of the US, it might like to think its success in pulling together its European allies and other governments more distant from the conflict like Japan, South Korea, Australia, and Canada places it in a firm global majority. However, it is worth remembering that at this point in the conflict (in June 2022), many countries have not condemned Vladimir Putin’s blatant violation of international law. They include China, India, Vietnam, South Africa, and 31 other countries, the combined populations of which, including Russia’s, comes to more than half of the world. In other words, if the bad US-China relations scenario were to degenerate into a complete decoupling with the US trying to isolate China as much as possible, there would still be many places around the world that would not sanction China and might even give it active support.

Features that would define a change in direction toward good US-China relations would be a continuing high level of trade between the US and China, high levels of direct investment in both directions, and a large flow of people involved with business travel and education. There would be a great deal of economic competition in this scenario, but the US and China would stay members of the same bodies like the World Trade Organization and might even become joint founding members of some new ones. They would compete within a framework of shared ground rules and standards.

This “good” side of this axis would be conducive to an environment in which globalization is promoted, with China and the US both playing prominent roles in defining the rules-based multilateral system. Importantly, those standards would include how typical US multinationals and banks can co-exist with Chinese state-owned

companies in these same industries. Chinese companies could list on US stock markets, implying agreement on specific accounting and governance standards. Over time, this scenario would find new ways to cooperate and set standards on new technologies and challenges, including regulating social media and developing new frontiers like space.

The “good” side of the axis would include a high level of transparency, including sharing data on credit cards, the flow of news and information over the internet, and corporate reporting requirements. There would also be a high level of cooperation between the governments of the US and China in fighting money laundering and other crimes. An extradition agreement would be in place that deters alleged criminals from taking advantage of jurisdictional differences to avoid prosecution.

The US and China would be close allies at the axis’ most extreme right point. They would conduct

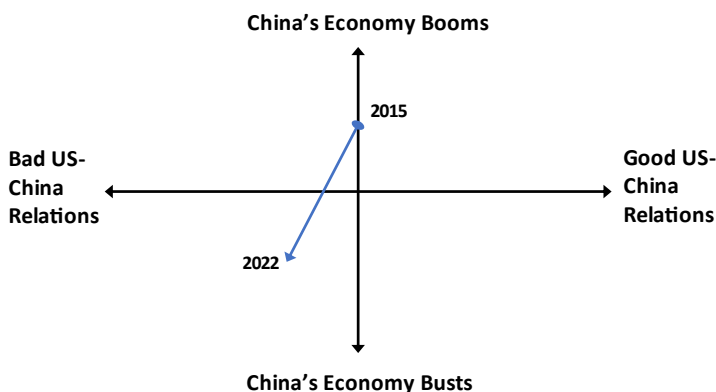
joint military exercises, cooperate on international disaster relief, and closely coordinate research into infectious diseases and reactions to cross-border health disasters and shared threats like climate change. Current differences that exist over the South China Sea and the status of Taiwan would be resolved in ways that are acceptable to both Beijing and Washington. When disputes arise, the two governments would have mutually acceptable mechanisms to ensure they can be discussed and resolved peacefully. As the two most powerful countries in the world, it is only natural that China and the US will have their differences, but if their relations are moving in a more favorable direction, they will find ways to manage them peacefully at the negotiating table, while spending more of their time, money and effort on solving mutual problems and threats. In the end, whether they like it or not, they have to share the same stage. It will be easier for all concerned, including the other actors, if they can do so without trying to elbow the other into a corner.

CHINA

Comments

Xi Jinping is China’s strongest leader since Mao Zedong. The two leaders have in common the emphasis that ideology still matters in Communist China. What differentiates them is that Mao could preside over a China that marked time economically for a quarter of a century. In contrast, Xi probably requires a moderately strong economy to retain his mandate. He could survive a string of two or three bad years, but probably not much longer.

The Economy Is Key to Xi Jinping’s Future



Mainland Chinese have sacrificed a lot since the Communist takeover in 1949. From the early 1980s until just before the COVID-19 pandemic, they started to enjoy the benefits that flow from rapid economic growth. The country’s Communist leadership was able to take credit for this period of prosperity to justify its continued unchallenged rule over the country. However, Mainland Chinese have been called upon again to sacrifice for the past two years. The past six months have been especially painful for some who have benefitted most from the long period of prosperity – the population of Shanghai and other major cities locked down by the government’s zero-COVID policy.

The growing questions are whether the current government's mandate might be more vulnerable now than before and if China could be heading for a messy leadership change? Part of the answer to these questions lies in the future of US-China relations. Still, it is essential to look beyond that variable to the broader issue of the performance of China's economy. The only reason anyone in China is even considering that Xi Jinping's grip on power might be vulnerable is the economy's ongoing slowdown. This is why the movement in the graph here has fallen down the vertical axis as much as it has in recent years.

However, this situation is reversible. Once the pandemic subsides enough for the government to reopen the economy, GDP growth could return above 6% p.a. in real terms, which would probably be enough to satisfy the general population, provided the growth is distributed throughout the population and not so heavily concentrated among a few well-placed entrepreneurs or politicians that the resulting inequality causes widespread resentment. A return to this kind of balanced growth would push China's location along the vertical axis back up to where it was in 2015.

With this kind of rapid growth, it does not matter if China's relations with the US are good or bad. The government would have the support it needs at home to stay in power and preserve political stability. On the other hand, if the government is unable to reverse the current weak trend in the economy, it also does not matter if China's relations with the US are good or bad; it could lose enough domestic support that factionalism intensifies within the Communist Party, causing greater political instability.

This does not mean China's relations with the US are irrelevant. The better the relationship, the easier it should be for China to shift its economy into a higher gear. It would be easier to grow trade and investment with the US and its allies. It would not have to worry about damaging trade sanctions, and it could cooperate with the US in battling complex mutual problems like climate change. In contrast, if China's relationship with the US is bad, it would be much more isolated. It would be more challenging to generate growth through exports. To produce the economic results that would be needed to satisfy the local population, the government would have to find a solution to a problem that so far has dogged it since Deng Xiaoping came to power, namely, how to generate domestic consumer demand so it can drive growth, reducing China's need to rely on fixed investments and exports. A successful shift in this direction is certainly possible and, ultimately, probably necessary. Still, the timelimit for restructuring the economy in this way would be much shorter in the bad US-China relations scenario than in the good one, in which the other, more established engines of growth would still be working too.

Hopefully, April was China's low point. That was a month when growth probably declined, and unemployment rose. The government is now scrambling to stimulate the economy through higher spending on infrastructure, financed by more state-bank lending. There will be a surge in consumer spending in the short term, but that is only because Shanghai consumers are finally allowed to leave their homes and go shopping again. This resurgence will likely be temporary unless the government does something much more drastic to sustain it. The economic numbers for the third quarter will probably be impressive enough to give the government the evidence it needs to claim recovery is underway before the autumn's 20th National Congress, which is expected to endorse Mr. Xi for an unprecedented third term as CCP leader. However, the full-year GDP growth for 2022 still might not reach 4%, and if the economy continues to falter in 2023, Mr. Xi's political problems could mount.

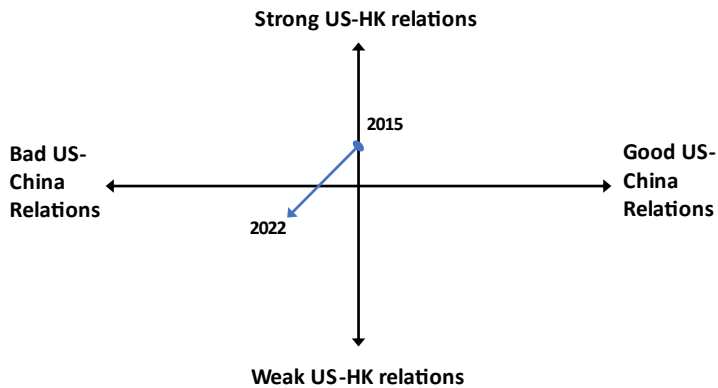
HONG KONG

Comments

US relations with Hong Kong are moving in the same negative direction as US relations with China. This is another indication of how the "one-country, two-system" model supposed to apply to Hong Kong is being

eroded by Beijing's actions to tighten its control over Hong Kong. Washington is critical of those changes and how Beijing is forcing them on Hong Kong.

Distinctions between HK and China Are Blurring



More significantly, Washington is becoming critical of Hong Kong too. This stands in contrast to its approach to governments of other Chinese cities. For example, the US government rarely comments on the policies executed by the local governments in Shanghai or even Urumqi or Lhasa (the capitals of two other provinces that the US State Department singles out for human rights abuses including lack of religious freedom). Instead, it focuses its criticism on the national government in Beijing. However, in the case of Hong Kong, the US State Department has recently been singling out the SAR government for compromising religious freedom and denying Hong Kong residents the right to assemble peacefully in

remembrance of the 4 June 1989 Tiananmen massacre.

In response, Hong Kong government officials and much of the local media in Hong Kong, which now is much more prone to reflect Beijing's views than in years past, have told the US to mind its own business and focus on solving its domestic problems, which they then go on to list in great detail. Every Hong Kong Chief Executive since the 1997 handover has had to be careful to voice support for Beijing's policies and not to make any comments on foreign policy matters, which are Beijing's preserve. However, since the crackdown on the Occupy Central protestors in 2014 and, even more so, since the passage of new security law in 2020, the local government has been taking a very public role in both silencing dissent and justifying its actions in the face of mounting foreign criticism, led by the US. The result has been a deterioration in Hong Kong's relations with the US that, although closely connected to the decline in China's relations with the US, is still not identical.

In many ways, Hong Kong's relations with the US are still better than those between China and the US. There is still closer coordination between the judicial systems of Hong Kong and the US than between China and the US (although it is possible that difference could also disappear in the future). It is easier for US companies to set up in Hong Kong and vice versa than for US companies to do so in the Mainland (or for Chinese companies to set up in the US). The US government still treats Hong Kong as an independent customs territory and economic entity separate from the PRC. The US and Hong Kong governments have historically worked together to maintain and strengthen measures to prevent the illegal diversion of controlled items, fight global terrorism, and combat money laundering. There is also strong cooperation in protecting intellectual property rights.

However, after the PRC's decision to unilaterally impose national security legislation on the SAR, Washington decided that Hong Kong was no longer sufficiently autonomous to justify differential treatment in relation to the PRC under the US-Hong Kong Policy Act of 1992. The President's Executive Order on Hong Kong Normalization, issued on July 14, 2020, suspended or eliminated special and differential treatment for Hong Kong, including export controls; imports; immigration; the extradition and transfer of sentenced persons; training for law enforcement and security services; shipping tax; and cultural exchange programs.

Sooner or later, it may be impossible to distinguish US relations with Hong Kong from those with China. In a two-dimensional grid, this would be represented by the further movement of the arrow in the grid to the left along the horizontal axis and down the vertical axis to an extreme position in the lower-left quadrant. Of course, another possibility would be for the US to improve its relations with China and Hong Kong, which would move the direction of the arrow in the opposite direction into the upper-right quadrant. However, what seems to be happening is that, in the case of Hong Kong, our two-dimensional grid might collapse into a single one-dimensional axis that carries the single label: US relations with China. There are other options, including something closer to the current status quo. However, at some point in the future, it is possible that US policy toward China and Hong Kong becomes so indistinguishable (much as US policy currently is toward China and Shanghai) that the two-dimensional grid might collapse into a single one-dimensional axis that measures US relations with China.

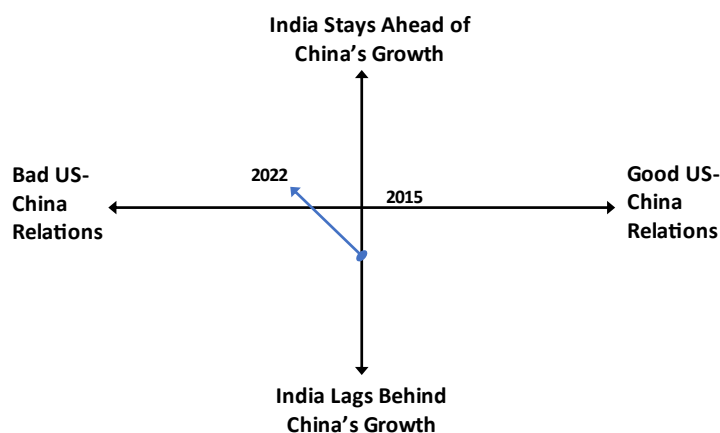
INDIA

Comments

India and China will not become close friends, let alone allies, anytime in the foreseeable future. They are natural rivals in almost every way, and it is not a friendly rivalry. One of the few things they might cooperate on in a big way in the future is the fight against climate change, and even that could be a stretch. The desire of both countries to promote their individual economic development could continue to take precedence over the need to reduce carbon emissions and air pollution that, when viewed from a satellite in space, looks like a giant black cloud stretching from the Sub-continent to Northeast Asia.

The countries have very different political systems, and each is confident that it is superior to the other. They are also rivals for having the largest population in the world. China might be slightly larger than India today, but India is growing faster and is expected to surpass China soon. This is only going to intensify competition for world resources like oil.

India's Rivalry With China Deepens



China's economic performance has left India in the dust of its wake. The PRC's GDP has grown faster than India's since the early 1980s. It has only been relatively recently that India has been able to grow faster than China. That will be the case in 2022 and is one reason why India's current position on the vertical axis of the graph here is higher than in 2015. India's GDP growth surpassed China's in four of these seven years. However, China's growth still exceeded India's in 18 of the 22 years since this Century started. The difference in performance is even more lopsidedly in favor of China in terms of exports, foreign direct investment inflows and outflows, and physical infrastructure development.

Perhaps most upsetting from India's perspective, China's capability to project its military power is also growing faster than India's. India has about 130 warships, roughly one-third of China's naval fleet comprising 350 ships and submarines. Moreover, China is making more headway in expanding its influence in countries that

neighbor India than India is increasing its influence over these countries. Where India has been making more headway than China is in strengthening its ties with countries like the US, Japan, and Australia – so much so that India is the fourth member of the Quad, which is an alliance of nations designed to strengthen security in the Indo-Pacific region mainly by acting as a counter-balance to China’s expanding influence in this region. Interestingly, both China and India seem to be competing to retain influence with Russia, but that is more an attempt by Moscow to maintain stable ties with these two countries when the US and EU are trying to isolate it on the world stage. In fact, Russia needs China right now a lot more than it needs India.

From India’s perspective, it is more important to stay above the mid-point on the vertical axis than the position along the horizontal axis. Essentially, any deterioration in US-China relations is often accompanied by an improvement in India-US relations. In contrast, improving US-China relations might leave India more alone when dealing with tensions along its shared border with China. Although India’s success in raising its GDP growth rate this year is one reason there has been significant movement up the vertical axis, the bigger reason is China’s failure to support its economy. If China’s economic slump is short-lived, India’s position could move back to where it was in 2015, which is not where it wants to be, especially since, even amid the current weak economy, China is having success in boosting its exports to India and registering a large trade surplus. That is leaving India feeling especially vulnerable.

INDONESIA

Comments

Indonesia has long prioritized domestic concerns over global ones. It is highly protective of its sovereignty. It is not about to be drawn into a debate between the US and China on matters that do not affect Indonesia directly. It would be wrong to pick a vertical axis for the scenario grid here that measures whether Indonesia’s support is tilting toward the US or China’s position. Neither Jakarta’s current nor any likely future government would advocate joining one bloc over the other. Jakarta is determined not to be a member of any bloc other than that of the “non-aligned nations.” Its foreign policy choices will be based mainly on what it thinks works best for Indonesia.

However, this does not mean that Indonesia is equally concerned about the US and China. Jakarta spends much more time worrying about China than it does about the US. How Indonesia manages its relationship with Beijing has significant implications for social stability in Indonesia, the performance of its economy, the development of the country’s physical infrastructure, and the outcome of future elections. In contrast, Indonesia’s relations with the US do not have nearly as far-reaching implications for the archipelago.

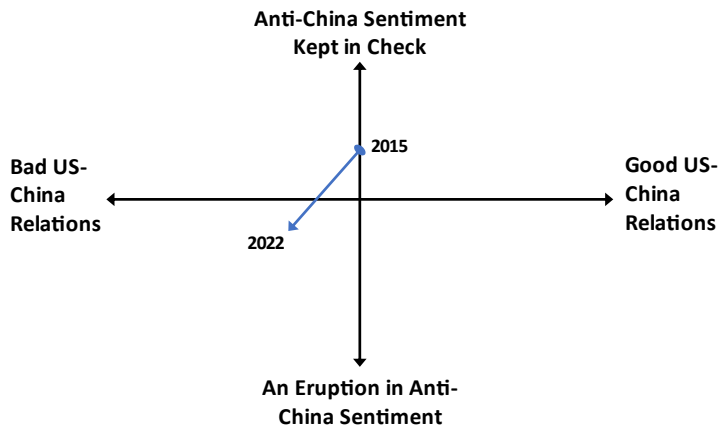
The starting point for understanding the special place for China in Indonesia’s thinking is to recognize how strong the bias of average Indonesians is against ethnic Chinese. This prejudice goes deep. They might be suppressed most of the time, but they have the potential to erupt in disruptive ways on short notice.

No Indonesian government can ignore these sensitivities. Many politicians and special interest groups (like Islamic extremists) play on fears that the Chinese “are taking over Indonesia” to broaden their grassroots support base. Ethnic Chinese make up just 1.2% of the country’s population but control many sectors that are not in state hands and own a disproportionate share of the wealth. Most ethnic-Chinese Indonesians are either Christians, Buddhists, or Confucianists, with less than 5% of them Muslim, the country’s dominant religion.

In the mid-1960s, hundreds of thousands of suspected communists – most of Chinese descent –were killed after the military had alleged that they had instigated an attempted coup. Ethnic Chinese were also the

primary victims of the bloody 1998 riots. They were scapegoated for the country's economic downturn during the Asian Financial Crisis because of their involvement in the economy.

Differences With China Surfacing More



Since then, China has worked hard to strengthen its relations with Indonesia. Beijing not only wants access to Indonesia's natural resources but also recognizes that, as the largest country in Southeast Asia, Indonesia is critical to shaping the policies of ASEAN and this group's approach toward China. Beijing has used economics to win favor with Indonesia, and to a large extent, it has succeeded. Every recent Indonesian government has tried to keep a lid on local prejudices so Indonesia could benefit economically from China's rapid growth. From a point reasonably deep in the lower half of the vertical axis, relations between Indonesia and China moved up the vertical axis to where they were well above the mid-point by 2015. Even today,

the governments of both Indonesia and China are trying to deal with their differences quietly in the background while publicly stressing points of cooperation. Last year, China was Indonesia's second-biggest foreign investor, with US\$4.8 billion in realized investment, behind Singapore. It was also Indonesia's largest trading partner last year, with total trade amounting to US\$71.4 billion.

Still, the movement has reversed recently, and Indonesia-China relations have deteriorated to below the mid-point again. Several factors are responsible. First, in the 2019 elections, several political candidates echoed the allegations made by Islamic extremists that President Joko Widodo was moving too close to China and that Beijing had even sent troops to Indonesia to help the government deal with local demonstrators. There was no validity to these allegations, but they still resonated with parts of the population, where resentment was already building over the large number of Mainland Chinese workers who had moved to Indonesia to work on China-owned and financed projects. This played on the deep suspicions that the Chinese were benefiting at the expense of Indonesian workers.

Local sentiment turned even more negative after COVID started. Its suspected origins in China caused further resentment in Indonesia, which was caught utterly unprepared by the pandemic. The slump in the Indonesian economy and rise in local unemployment made Chinese workers in the country an even bigger target.

For some inexplicable reason, Beijing has now chosen to raise its claims to waters that Indonesia has long claimed. Jakarta can no longer assert that it is one of the few countries bordering the South China Sea that does not have rival territorial claims with China. The situation has gotten so bad that late in 2021, Beijing ordered Indonesia to halt drilling for oil and natural gas in the Natunas maritime territory. This ended Indonesia's previous assertion that none of China's claims affected Indonesia and has elevated tensions over natural resources.

Indonesia is still keeping very quiet about China's change in the official status quo, preferring to address it instead through quiet diplomatic channels. However, while avoiding confrontational rhetoric, Jakarta has raised its military profile in the Natunas and stepped up its military cooperation with the US. This August, the two countries will hold their annual Garuda Shield joint military exercise in Indonesia's South Sumatra

archipelago and the east of Borneo Island. China has already protested the military exercises, saying they potentially destabilize the entire area.

Beijing could have difficulty reversing the deteriorating trend in relations with Indonesia over the next couple of years. The slowdown in the Mainland’s economy has reduced its economic leverage. This problem could be compounded if its financial limitations force China to scale back some of its higher-profile investments in Indonesia.

Indonesia will also be gearing up for the next general elections in early 2024. President Widodo cannot run again, so the issue of his administration moving too close to China will probably not figure as highly as it did in the last election. However, rival candidates will probably try to outdo each other in their criticism of Mainland China’s activities in Indonesia. Such a policy wins votes. Recent private surveys show that only 43% of Indonesians polled felt China’s growth was good for Indonesia. Only 42% said they trusted China to act responsibly, and 49% thought China would threaten Indonesia over the next decade.

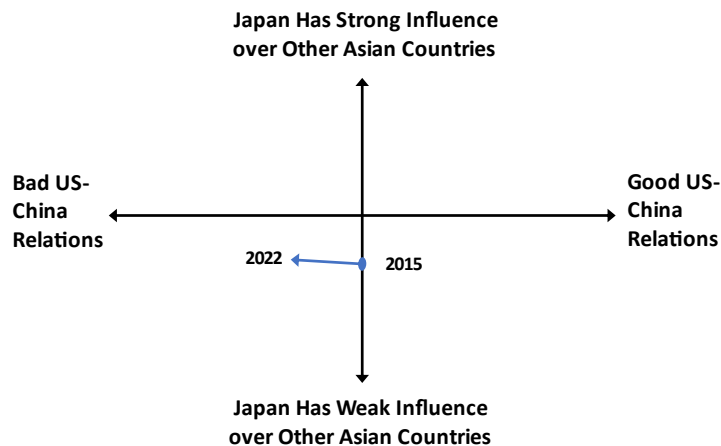
JAPAN

Comment

Japan has been articulating more hawkish views toward China since Fumio Kishida became prime minister last year. He has also moved fast to show that Japan is entirely in step with the Biden administration on most significant issues, including China, North Korea, Taiwan, and Russia’s invasion of Ukraine. He is planning to attend the NATO summit at the end of this month in Madrid, which would make him the first Japanese leader to participate in a gathering of the Western alliance. Mr. Kishida has called for a similar coordinated approach to protect stability in the Indo-Pacific region against aggressive actions by China that could heighten tensions in the region.

Mr. Kishida has been directly critical of China. However, his indirect criticism has been more frequent and reflects how he is trying to push Japan, arguing that Japan needs to coordinate closely with other liberal democracies to prevent any unilateral attempt to change borders by force in East Asia. Mr. Kishida argues that security in Europe is “indivisible” from the security of Asia and the Pacific. He is careful to point out that there is no indication that China is planning an imminent military action against Taiwan but also notes that the conflict in Ukraine should be a warning not to be complacent about the possibility of a Chinese attack on Taiwan.

Japan Struggles to Engage with Asia



It is with other countries in Asia where the Japanese prime minister is trying his hardest to complement US policy to counter China’s growing influence. When former US President Donald Trump abruptly pulled the US out of the Trans-Pacific Partnership Pact, Japan filled the vacuum and held the pact together minus the US. Governments like those in Vietnam and India see fewer downside risks from moving closer to Japan than to the US. At the same time, almost every ASEAN country looks to Japan more than the US as

a source of investment, while its trade and aid levels are also substantial. China's growth as a market for other Asian countries was starting to eclipse Japan's ability to play that role, but the recent slowdown in China's economy has weakened its overall ability to be the primary driver of other Asian economies compared with pre-pandemic days. This could be temporary, but for the time being, it gives Japan extra-economic leverage it can use to raise its profile in Asia.

However, as big as Japan's economic role is in Asia and as much as Prime Minister Kishida might be trying to act as Washington's key ally in the region, playing almost a surrogate role for the US in many countries, the reality of Japan's ability to project power in ways that counter China's influence in the region has been limited. Tokyo's attempts to be a US surrogate have increased, but the results are not particularly noticeable. This was perhaps best reflected in a recent survey by Singapore's ISEAS – Yusof Ishak Institute, which canvassed 1,677 respondents from various backgrounds, including government and academia. Only 2.6% of the respondents picked Japan as Southeast Asia's most influential economic power, down from 4.1% in last year's survey. Three-quarters picked China. Four in 10 surveyed said their lack of confidence in Japan stemmed from a belief that Japan does not have the capacity or political will for global leadership. Nearly three in 10 said Japan was distracted by domestic affairs and relations with China, South Korea, and Taiwan.

Based on survey results like this, it is debatable that there has been an upward movement along the vertical axis in the scenario graph presented here that depicts recent trends in Japan's influence over the rest of Asia. It is not an effective surrogate for the US and does not seem to influence China's behavior in the region nearly as much as the US. On the one hand, Japan's limited ability to project military power due to constitutional requirements makes it less of an immediate military threat to other countries. On the other hand, it also limits Japan's ability to form effective security alliances with smaller Asian countries or even supply them with all the weapons and defense systems they want. Japan's economic power is formidable, but it does not bring the growth potential to the table that China did before the pandemic and could again if Beijing can successfully recover. Still, the Kishida government is making a more substantial effort than its predecessor to raise Japan's regional profile. The closer coordination it is adopting with the US could give their common agenda in Asia the extra punch it needs to justify movement up the vertical axis. However, any progress so far has been limited.

MALAYSIA

Comments

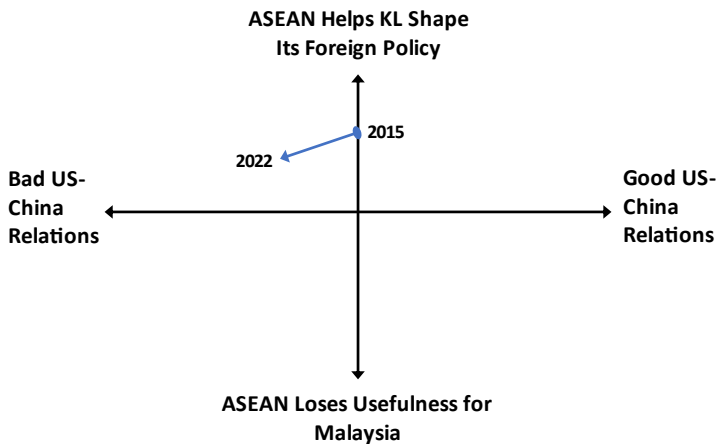
It is tempting to use the same vertical axis for Malaysia that we used for Indonesia. Both countries have a Muslim majority that dominates the political system and an ethnic Chinese minority that controls a disproportionate share of the country's business and wealth. Religious and ethnic prejudices figure prominently in politics. However, those biases have not extended to Malaysia's relations with Mainland China for several decades. Such biases are kept out of the government-to-government relationship. For this reason, it is not a variable that qualifies as a driving force that will shape Malaysia in the years ahead.

Previous, the current, and future Malaysian governments are likely to push economic engagement with China, which means trade and investment will likely remain robust. This does not mean there are no contentious issues or Malaysian leaders will always refrain from publicly criticizing China. However, differences like outstanding territorial disputes and China's efforts to help the former government headed by Najib Razak cover up the 1MDB corruption scandal are handled quietly to protect the stability of the overall relationship.

Malaysia's more significant concern is how it can best manage its overall foreign policies to the country's maximum benefit. Indonesia's size means it carries a lot of weight in negotiating with other countries, including the major powers like China and the US. In contrast, Malaysia is much smaller and in a weaker position to push

its foreign policy agenda on its own. For this reason, it has been one of the most active members of ASEAN since the group’s founding in 1967 – at the height of the Cold War between the US and the former USSR and when the Vietnam War was at its peak. Malaysia used its influence to align its foreign policy priorities with ASEAN’s. This gave Malaysia more leverage in international negotiations, and it has played a central role in guiding ASEAN through the post-Cold War period to the world that exists today, in which “neutrality” has assumed an entirely different meaning and China’s role as an economic power is far larger than when ASEAN started.

A Question of How Relevant Can ASEAN Remain



On the one hand, Malaysia has used ASEAN to engage with China and the US. KL would like to see the group continue to favor policies promoting engagement with the US and China. Since other ASEAN members like Thailand and Cambodia are against having ASEAN assume a group position for negotiating with China on territorial disputes, Malaysia has supported this position and, instead, has been content to conduct quiet bilateral negotiations with China to deal with territorial differences. However, the more China presses its claims, as it has been doing recently, the more difficult it could be for Malaysia to keep these differences in the background.

Moreover, China may keep pressuring Indonesia on conflicting territorial claims (something it has not done until recently). This could force Jakarta to join in the debate over Beijing’s dotted-line South China Sea claims, something it has not had to do yet, which would also spotlight Indonesia’s long-standing territorial disputes with Malaysia. The more these conflicting intra-regional territorial claims divide the ASEAN members themselves, the more difficult it could be to stay effective as a group in adopting a common front on other issues. The existing divisions mean ASEAN is unlikely to ever evolve into a group promoting regional security.

Malaysia has also shared China’s dislike for the West’s focus on democracy and human rights and found solidarity based on collectivist “Asian values” compared to individualistic Western ones. ASEAN has been a good vehicle for promoting those “values.” However, Russia’s invasion of Ukraine and China’s support for Russia’s position put “human rights” and “sovereignty” issues in a different light. ASEAN members like Singapore have already spoken out on this issue. So have other Asian countries like Japan and Korea.

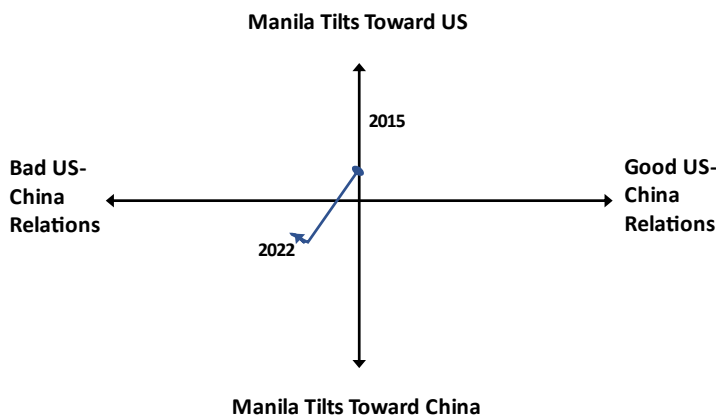
The divide is now less between societies that stress individual rights vs. those that favor collective responsibilities. More attention is being paid to how far a more powerful government can go to force its will on a smaller country and how should such a bully be treated. If ASEAN cannot pull together and adopt a united front on issues vital to some but not all members, the group’s relevance would be diminished further, pushing Malaysia down the vertical axis, perhaps to the lower half of this axis. This would leave Malaysia much weaker in implementing its foreign policy interests. If movement continues to the left along the horizontal axis, it will be more vulnerable to China’s influence.

PHILIPPINES

Comments

Before Rodrigo Duterte was elected president in 2016, the Philippines was an ally of the US and had a frosty relationship with China. The latter was dominated by territorial disputes in which the Chinese military was seizing control of islets and fishing waters also claimed by the Philippines. However, after Mr. Duterte won the election, he gave the US the cold shoulder and announced that his government would subsequently try to seek a closer relationship with China. He did not give up the Philippines' sovereignty claims to territory also claimed by China, but he dismissed the Permanent Court of Arbitration's historic ruling in favor of the Philippines against Beijing's claims and tried to put the disputes on the back burner, choosing instead to emphasize his desire to boost Philippine exports to China and Mainland investment in the Philippines, particularly in physical infrastructure projects.

Misdirections in Manila's Foreign Policy Plans



He maintained this tilt toward China until almost the end of his term in office. In the past year, he has shown a willingness to engage more with the US and be more aggressive with China over the rival territorial claims. This is why we put a small hook upward in the line in our vertical axis of the graph showing the trend of Philippine relations with China and the US since 2015.

The Philippines has just changed government. Ferdinand Marcos, Jr. has replaced Mr. Duterte as president, while his daughter, Sara Duterte, has won the vice presidency. Indications are that Mr. Marcos will not make radical domestic or foreign policy changes. However, he will likely try

to strike a better balance in Philippine policies toward the US and China while keeping equal distance from both. The main difference in his approach to China is likely to focus on territorial claims, while the main difference in his approach to the US will be his efforts to get more benefits for the Philippines from the relationship. For example, like its predecessor, the Marcos government will likely press for a review of the Mutual Defense Treaty with the US. But if Marcos's government does launch a review process, it will probably be to improve Manila's benefits within the alliance rather than trying to find ways to terminate it like Mr. Duterte wanted to do.

Infrastructure development will be a core part of Marcos' agenda. Mr. Marcos has inherited a large budget deficit. This means a driving force behind his foreign policy will be to attract the foreign help he needs to push ahead with expensive domestic infrastructure projects. For this reason, he will try to maintain good relations with China. Still, Beijing has already failed to deliver as much as the Philippines had hoped – and it had five years of relative prosperity when its Belt and Road Initiative was being pushed hard to do so. Now the Mainland economy has slowed sharply; its B&R initiative has stalled; China's contribution to growth in other countries in the region is much less than before the pandemic. The US might be able to take up some of this slack, but it is more likely that Mr. Marcos will turn to other sources like Japan, South Korea, and Australia. Therefore, it is likely that the most significant change in his foreign policy compared with the Duterte administration will be the way he tries to reorient it more to other Asian Pacific countries other than China. This probably also means strengthening linkages with other like-minded states in the ASEAN group. The problem, however, is that the Philippines does not have much leverage, while groups like ASEAN are in danger of losing influence too.

SINGAPORE

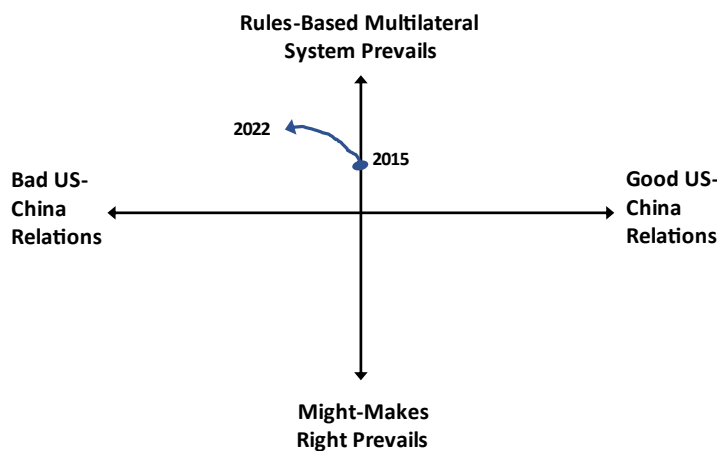
Comments

The world in which Singapore has navigated to achieve one of the highest standards of living anywhere has always been a mix of rules-based systems and anything-goes opportunism. Singapore has excelled in both types of systems, while its open economy and ability to bridge cultures have facilitated close ties to both east and west. However, the main reasons for its evolution into an international business center have been those attributes it brings to the table that support a rules-based multilateral order. It has a consistent regulatory environment. It participates in most multilateral agreements that raise the bar on standards and practices. It has negotiated numerous multilateral and bilateral agreements that facilitate trade in goods and services. It has also signed many investment guarantee agreements that reduce uncertainties and risks for companies undertaking cross-border direct investments. It has a sound judicial system with the credibility needed to make Singapore a center for international arbitration.

We could go on with this list, but it is also important to note that Singapore has also prospered by taking advantage of situations where no rules exist or are so weakly enforced that companies and professional offices in Singapore have profited by helping those exploiting such systems to hide and protect gains made elsewhere. The list of such activities ranges from serving as an investment site for well-placed individuals in neighboring countries like Indonesia and Myanmar who have tried to hide unreported income (often obtained through corrupt activities) by placing it in real estate and investment accounts in Singapore to multinational giants that have taken advantage of tax incentives offered by Singapore to avoid paying taxes in other countries where they have actually earned the profits.

The government has been moving Singapore away from facilitating more marginal or controversial lines of business toward businesses that comply with a rules-based multilateral order. This has made good sense since, until recently, that was the direction in which the world was headed. The government has recognized that it is to the island's advantage as an international business center to be seen as benchmarking against other countries' best practices rather than being an outlier profiting from marginal activities. This is reflected in the

What Kind of Global System Will Singapore Have to Compete In?



high levels of intellectual property protection it offers, the high standards it maintains for such issues as labor and environmental protection, and its no-nonsense approach toward local corruption and increasingly toward incidents where companies or banks based in Singapore are caught facilitating corruption in other countries. The way the government arrested individuals in Singapore who helped the people behind Malaysia's 1MDB scandal is one example of Singapore's embrace of a rules-based system of capitalism.

A more recent example is the government's willingness to modify its system of tax incentives to ensure Singapore

is compliant with the latest tax reform engineered by the OECD and agreed to by more than 130 jurisdictions last year to establish a global minimum tax of 15% on large multinational businesses. According to the government's calculations, the tax deal will affect about 1,800 multinationals in the Republic.

One reason the world has been moving closer to a rules-based system of capitalism is that China has been bringing its system into compliance with such bodies as the World Trade Organization. This meant the US and China had been competing increasingly according to a mutually agreed set of standards. It would help explain why Singapore's movement up the vertical axis in our graph was pronounced during the past 40 years since Deng Xiaoping introduced market economics to the Mainland and started to raise China's profile in prominent international organizations that set the rules and standards of behavior. When the US and China agreed on these matters, it was easy for Singapore to agree.

However, Singapore's position is becoming more complicated now that the US and China are starting to disagree on a rules-based international order. Instead, Singapore is being put more frequently in an awkward position. For example, Singapore was quick to join the US in condemning Russia's invasion of Ukraine for being a blatant violation of another country's sovereignty and violating accepted international practices. Singapore's government also supported the US-backed sanctions against Russia, but not all companies in Singapore complied immediately. Alexsong Pte Ltd., a Singapore-based telecom electronics wholesaler, was one of the first companies sanctioned by the US Treasury Department for allegedly facilitating transactions between Mainland Chinese suppliers and Russian buyers.

The more that the US and China adopt positions at odds with each other, the more difficult it will be for Singapore to strike the right balance that satisfies both parties and does not violate the "standards" of either. It would be nice if Singapore had the luxury to simply follow its own high standards like the government did when it immediately spoke out against Russia's invasion of Ukraine, but it is so small that its priority has to be its own survival and what is best for Singapore. So far, the direction of movement is still up the vertical axis, but it is tapering off. It could turn downwards if the current rules-based system of globalization is replaced by one that is more of a free-for-all in which the Big Powers, namely, China and the US, insist on different standards and rules and, rather than negotiate with other countries to accept these rules too, use their power to force compliance from other countries. It would be much more difficult for Singapore to prosper in this kind of might-makes-right world.

Indeed, the problem for Singapore is even more complex than for most countries in Asia, considering that its state-linked investment firms have such considerable exposure outside of Singapore in areas of the world where the influence of China and the US differs. The returns on these investments would also be vulnerable to discrimination and other risks that would intensify in a world where Beijing and Washington are applying pressure for different types of behavior.

SOUTH KOREA

Comments

South Korea's new government under President Yoon Suk-yeol is moving fast to strengthen the country's alliance with the US, and President Biden is reciprocating in kind. His first stop on his recent trip to Asia was Seoul, where he met with Mr. Yoon and agreed to align their policies more closely on several issues.

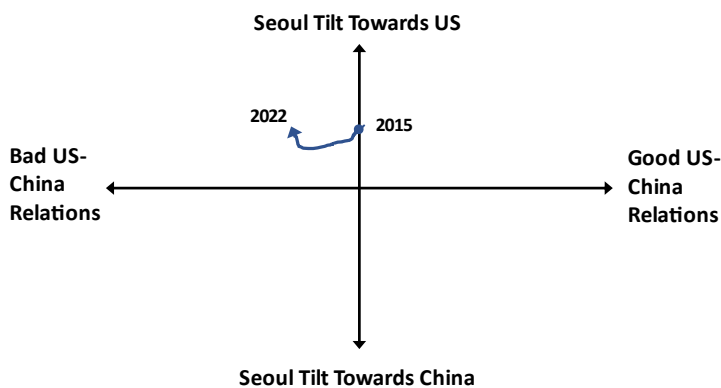
First and foremost is their approach toward North Korea. Previously, under the former South Korean government headed by Moon Jae-in, the South tried to keep the door open to a dialogue with the North. At the same time, Washington had moved away from former President Donald Trump's initial willingness to hold face-

to-face meetings with the North Korean leader to one where his administration paid little attention to the North. Now, both presidents are coordinated in their approach to limit any engagement with the North until Pyongyang takes the first concrete steps toward disarmament, an action Kim Jong-un shows no inclination to do.

President Yoon is also trying to smooth out the South’s relations with Japan enough so the tripartite alliance between Japan, the South, and the US can be more effective. There is also likely to be more of an economic angle to this alliance. Mr. Biden has not shown any desire yet to rejoin the Trans-Pacific Pact that Donald Trump abandoned shortly after assuming office. Still, Washington does not want to leave China alone as an initiator of regional trade alliances. Consequently, Mr. Biden and Mr. Yoon agreed to launch a new vehicle called The Indo-Pacific Economic Framework (IPEF), which will initially at least exclude China but will eventually include other economies in the region like Japan, Australia, New Zealand, and Singapore.

Mr. Yoon is still unwilling to be as supportive of the US as other countries like Japan and Australia are in formally mentioning China as a threat. Still, the South and the US will be raising their level of military cooperation to deter North Korea. Moreover, while Mr. Yoon is vocal in his commitment to upholding “liberal free democracy and the market economy,” he has been unwilling to be as openly sympathetic to Taiwan’s position and willingness to support the island in the face of an invasion by Chinese forces as have the US and Japan.

Seoul’s New Government Moves Closer to US



However, as we try to indicate in the vertical axis in our scenario grid for South Korea, there has been movement in recent times away from China (i.e., towards the US). This is not just because the US is moving to strengthen its alliance with the South. It is also because of China’s actions in supporting Russia in Ukraine and flexing its muscles over territorial waters also claimed by other countries, including Korea. This has contributed to a significant increase in distrust of China by average Koreans. The South is now more willing than before to collaborate with the Quad group, even though the main thing uniting these four-member countries is their shared recognition of China as a significant security threat.

The Yoon government's official line – and almost certainly hope – is that there is a way forward for the South to have a smooth working relationship with China and the US. Seoul’s efforts are still focused on striking this delicate balance. However, Seoul’s position is less ambiguous than before. If push comes to shove, it will side with Washington.



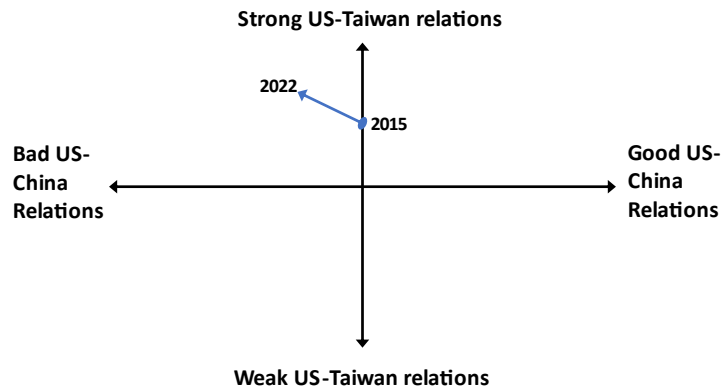
TAIWAN

Comments

The strength of US-Taiwan relations is almost directly inverse to the strength of US-China relations. To be sure, the issue of Taiwan’s autonomy does not dictate Washington’s foreign policy toward Mainland China, but it is one of the most critical factors influencing that relationship. The more that Beijing uses verbal threats and

displays of military power to assert its claims of sovereignty over the island and show its determination to regain control as soon as possible, the more that US-China relations come under strain. China's provocative behavior has also caused Washington to respond in kind, including weapons sales and visits of high-level US officials, to show US determination to support Taiwan if it were to come under attack.

Risks Grow that the Status Quo Might Not Hold



As we try to show in the graph here, that trend has been almost a straight line for the past seven years, with the magnitude of the deterioration in US-China relations matched by a similar improvement in the displays of US support for Taiwan. A few of the more recent signposts include:

1. Since early this year, the Biden administration has consulted on Taiwan more with other countries, including Australia, Japan, the UK, and Germany. The aim is to boost cooperation with allies and raise awareness about what the Biden administration regards as Beijing's increasingly threatening behavior toward

Taiwan. In the wake of Russia's invasion of Ukraine, the message the US is trying to send out is that other liberal democracies need to ensure that democracies like Taiwan can defend themselves.

2. The US State Department approved a US\$95-million missile support deal with Taiwan last April. This was the third arms deal with Taiwan since President Biden took office in 2021. China's foreign ministry quickly responded that the arms sales would seriously damage China-US relations and stability in the Taiwan Strait.
3. Later that month, a six-member bipartisan delegation, led by US Sen. Lindsey Graham (R, S.C.) and Senate Foreign Relations Committee Chairman Robert Menendez (D, N.J.) flew to Taiwan, met with Taiwan's senior leaders, where they referred to Taiwan as "a country of global significance," warned against any attempts by Beijing to change the status quo across the Taiwan Strait with military action, and condemned China for what they are doing all over the world, signaling out its support for Russia's invasion of Ukraine. Beijing responded by ratcheting up its military activity around Taiwan and condemned the visit as external interference in support of Taiwanese separatists.
4. In late May, President Biden went the furthest yet in reducing ambiguity that might be left regarding US policy toward Taiwan by saying the US would intervene militarily if China invaded Taiwan. He made this statement in Tokyo while standing beside Japanese Prime Minister Fumio Kishida. Beijing's response was immediate and blunt: China "has no room for compromise and concession" on core concerns like Taiwan and "will take firm action to safeguard its sovereignty and security interests."
5. Although the Biden administration decided against including Taiwan as a founding member of the newly proposed "Indo-Pacific Economic Framework" partly because some Southeast Asian countries were concerned about antagonizing China, a few days later, he did order the US Trade Representative Office to negotiate a new pact with Taipei to promote bilateral trade on areas such as digital trade, clean energy, and labor rights. At the same time, the US Commerce Department is to launch a separate dialogue with Taiwan addressing export controls of sensitive technologies like semiconductors to ensure there is no interruption in the supply of chips from Taiwan to the US.

6. President Dr. Tsai Ing-wen's administration has welcomed the extra support Taiwan is getting from the US. Moreover, the opposition KMT has just finished a trip by its chair, Eric Chu, to Washington to ensure that US support will not be confined only to the DPP. The implication is that when it comes to securing US support for Taiwan's autonomy from the Mainland, there will be little risk of change if the KMT were to win the next elections. The implication is that just as US attitudes against China have hardened, the KMT recognizes it needs to adopt a less accommodating stance vs. the Mainland too. Its policy of engagement was costing it too many votes at home.

While the positions of both Beijing and the US toward Taiwan seem to be hardening, little has changed regarding Taiwan's international status. It remains relatively isolated diplomatically but has considerable flexibility (and success) in pursuing its economic interests. What remains to be seen is whether the tough talk by Beijing and Washington has increased the risk of a violent conflict taking place in the near term or if the posturing, for all its aggressiveness, is just a way to preserve the status quo. It is tempting to think that the status quo will hold if only because it has for so long, but that is not very convincing in today's troubled global environment. The more Taiwan moves into the top left quadrant of the scenario grid, the higher the risk that it could have destabilizing global implications if the status quo does change.

THAILAND

Comments

Thailand is exceptional in managing its relations with China and the US. There are a lot of discussions about which way the government is tilting at any given time. Still, the Kingdom has a long history of balancing its relations with both major powers.

Thailand has achieved this delicate balance so well that it is one of the few places where the US and Chinese militaries have cooperated recently with local forces in military exercises. Last March, Thailand hosted its annual Cobra Gold exercises. Admittedly, they were scaled down in response to the COVID threat. However, the training still brought together US and Thai troops and forces from 20 other countries. At the same time, China, India, and Australia joined in a humanitarian and civic assistance capacity (they have been doing so since 2014). Apart from these joint exercises, Thailand also participates in drills with China.

It is possible to have a vertical axis in the scenario grid for Thailand that measures the extent the country tilts toward China or the US. The direction in recent years has been toward China rather than the US. However, the magnitude of the movement would not be very great, and it would still be located close to the mid-point of this axis. The odds are that there is where Thailand will remain, even if relations between the US and China continue to deteriorate.

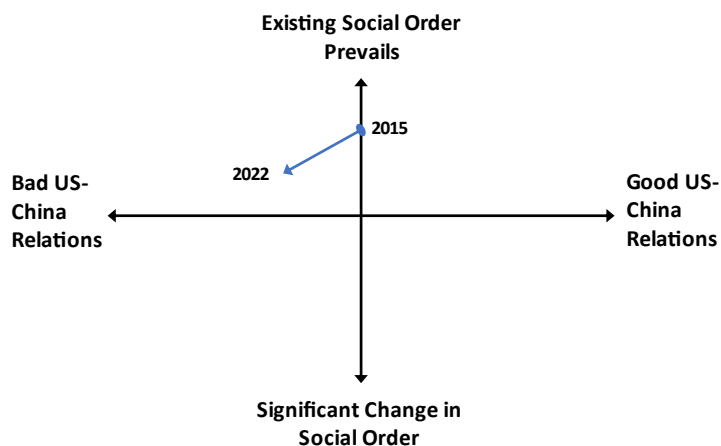
Since the pandemic, Bangkok has probably done more to improve relations with Tokyo than with Beijing or Washington. This has been encouraged by Japan, whose new prime minister, Fumio Kishida, traveled to Bangkok and met with Thai Prime Minister Prayut Chan-o-cha to bolster bilateral defense and economic cooperation. New Japanese tech investments in Thailand have also strengthened the orientation toward Japan. For example, Murata Manufacturing, the world's largest capacity maker and an iPhone supplier, announced earlier this year that it will open a new plant in Thailand in late 2024, in part of the company's strategy to cut its dependence on China amid the growing US-China rivalry.

ASEAN is probably the organization that matters the most to the Kingdom. Since Thailand does not have any border disputes with China like several other ASEAN countries do, it has been one of the members that have been most reluctant to allow the group to be used as a vehicle for the aggrieved members to use as a common

platform to support their claims against China. This has suited Beijing just fine, and Thailand is getting rewarded for this position by enjoying more trade with and investment from China. However, other than not wanting to be drawn into the territorial disputes with China, Thailand would like to use ASEAN to support its foreign policy priorities of trying to nurture cooperative, balanced relations with both China and the US and supporting the Kingdom’s overall penchant for neutrality. Historically, Thailand had bent with the wind when necessary (such as during World War II). Still, its top priority has been to protect the country’s sovereignty and independence from foreign interference, regardless of whether Thailand’s government is elected or put together by the military.

A deterioration in US-China relations would complicate Thailand’s foreign policy, but the Kingdom might also benefit from such a trend. Because of the strength of its underlying relationship with China, Thailand would continue to enjoy good access to China’s market for its agricultural products. Chinese tourists will also feel comfortable visiting the country, and Mainland companies would probably be big direct investors in Thailand. However, these would probably not be at the expense of Thailand’s economic links with the US and other countries. There are already examples, as noted above in the case of Murata Manufacturing, of companies from Japan, South Korea, and other countries shifting manufacturing to Thailand from China to reduce supply chain risks and potential problems from a further deterioration in US-China relations. This investment shift should continue and result in more Thai exports to the US and markets other than China.

Questions Surrounding Systemic Stability



Therefore, the big question for Thailand is whether it can maintain the domestic stability needed to keep existing foreign investors in the country and attract new ones. A more appropriate vertical axis for Thailand measures domestic socio-political stability. The government has already shown that it can experience coups and elections confined to the traditional group of major players (military leaders, politicians, royalists, and business elite) and maintain an attractive environment for foreign investors and industries like tourism. The remaining question is whether or not a more profound change in the system could be more destabilizing.

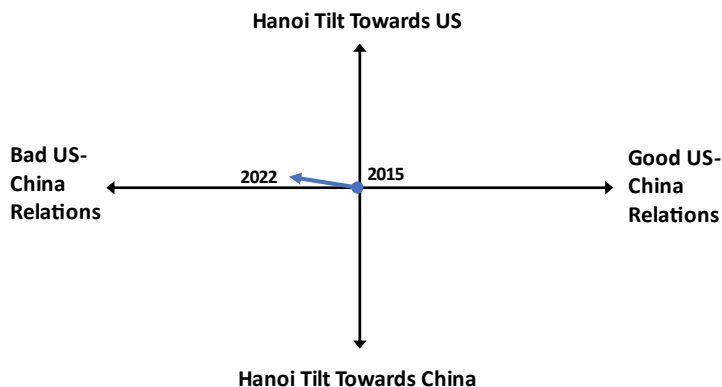
Such a change is possible. The most immediate one surrounds the role of the monarchy and its ability to be a force that promotes social order or destabilizes it. In years past, there was little debate on this issue. The role of the monarchy as a stabilizing force was an assumption that was widely held. However, in recent years that has changed. Solid evidence of this change is the mushrooming number of arrests of dissidents on the grounds of lèse-majesté. The new king is a much more controversial figure than his father. It is valid to question whether the institution of the monarchy is as stabilizing today as it was in years past or if the resistance of the monarchy to any reform is so divisive that it upsets the social order to the point where investors perceive risks to be too high, and tourists are put off by social instability. Thailand is far from such a point yet, but movement along this axis has been downward in recent years, and the trend could continue.

VIETNAM

Comments

Vietnam has a balanced diplomacy. It is not biased toward either the US or China. Consequently, the directional line in the scenario grid is almost an overlay of the line describing the direction of US-China relations shown in Graph 3 in the Regional Overview of this report. There has been little movement up or down the vertical axis. It is still located very close to the middle, reflecting the balance Hanoi is trying to maintain.

Hanoi Tries to Strike a Balance



Still, the line is not the same as in Graph 3 in the Regional Overview. It started in 2015 in the center of the crosshairs, where the two axes intersect. However, there has been a slight upward movement along the vertical axis since then, indicating a modest tilt toward the US and away from China.

While Hanoi has not done anything directly with the US to change the status of the bilateral relationship, it has been moving closer to countries that are major allies of the US and share with Washington a desire to counter China's growing military and economic clout in the region. For example, in May, Japanese Foreign Minister Yoshimasa Hayashi met with Deputy

Vietnamese Prime Minister Pham Binh Minh in Tokyo, where they vowed to confront security threats in Indo-Pacific. Although they did not say so, they had China's maritime assertiveness in mind. Tokyo is engaged in territorial disputes with Beijing in the East China Sea, while Hanoi is in similar territorial disputes with Beijing in the South China Sea.

Considering that this declaration to work together in dealing with security threats came only a few days after Japan and the US adopted a more confrontation stance toward China, the implication might not be that Hanoi is tilting more toward the US as much as it is tilting away from China.

However, Hanoi is not about to make an open break with China. The two countries are too important as trading partners. They both favor their communist political systems over liberal democratic systems and do not share the same antipathy toward Russia as the US. The trajectory of Vietnam-China bilateral relations is unlikely to change in 2022. Hanoi and Beijing are trying to cooperate in other areas despite tensions over disputed territories. China wants to be able to invest more in Vietnam to circumvent the rules of origin criteria under the Regional Comprehensive Economic Partnership (RCEP). This year's focus is on drawing up detailed measures related to land border management and structured cooperation between different ministries.

In contrast, no such initiatives are planned with the US. So far, the Biden administration has failed to get any agreement from Hanoi to elevate the US-Vietnam relationship to a "strategic partnership." Hanoi is determined to proceed with caution to limit as much as possible its tensions with China. Vietnam has refused to condemn Russia's invasion of Ukraine, has abstained from all UN votes on the issue, and is unlikely to support sanctions targeting Moscow.

As in most countries, the COVID-19 pandemic caused Vietnam's actual revenues last year to far short of what was originally expected. Revenues totaled an estimated VND 1,320 trillion (US\$57 billion) in 2020, which was almost 13% less than the government originally targeted and 14% less than revenues recorded in 2019. However, unlike most other countries, Vietnam's budget spending also fell short of original plans. It totaled VND 1,680 trillion (US\$72.47 billion) in 2020, 3.5% less than the original Budget estimate. That said, considering that in normal years, actual government spending falls short of the amount budgeted by a much larger degree, last year's spending was actually a big increase from previous years. For example, in 2019, actual government expenditures were only 80.6% of the amount budgeted.

The National Assembly approved the 2021 state Budget last November. In 2021, total spending is seen at VND 1,687.0 trillion (roughly US\$73 billion), which is a slight increase from last year's actual spending but 3.4% less than last year original budget target, with the government postponing a salary hike for public sector workers and aiming to reduce payrolls in a bid to save costs.

Revenue is projected at VND 1,343.3 trillion, which would be 11.7% less than last year's original budget forecast and 1.7% higher than the actual level of revenues last year. This would leave a fiscal deficit of VND 343.67 trillion (US\$14.82 billion) for the year, equivalent to 4% of GDP, down from an estimated deficit of 4.99% – 5.59% in 2020. The government is set to borrow VND 608.56 trillion (US\$26.3 billion).

While 2020 was an atypical year for Vietnam's fiscal results insofar as expenditures came much closer to reaching the amount budgeted at the start of this year, 2021 is likely to see a return to the pattern in which the government does not spend nearly as much as it has budgeted. If so, the actual deficit for 2021 could be much less than the shortfall now being projected. This will be even more the case if revenues exceed current projections, which is very likely. This could generate greater foreign investor optimism toward Vietnam, helping the economy to gain more momentum and kicking the government's new five-year plan off to a good start. The plan calls for private companies to account for more than half of the economy by 2025, up from 42% now, and to almost double per-capita GDP to between US\$4,700 and US\$5,000 by 2025 from US\$2,750 at the end of 2020.

In short, there are a lot of notable differences between the US and Vietnam. So far, both Washington and Vietnam seem willing to address these differences quietly. Still, more than Vietnam, the US appears to be publicly emphasizing the progress that is being made in the relationship. Indeed, its strategy seems to be almost the same as China's in this sense. Hanoi does not seem to see the need to over-emphasize the positive features of its relations with the two major powers and is trying to maintain a certain distance from both.

EXCHANGE RATES

<i>Currency</i>	<i>6/10/22</i>
Chinese renminbi	6.7089
Hong Kong dollar	7.8498
Indian rupee	78.15515
Indonesia rupiah	14,553
Japanese yen	134.42
Malaysian ringgit	4.4020
Philippine peso	53.0900
Singapore dollar	1.3877
South Korean won	1,279.50
Taiwan dollar	29.66
Thai baht	34.730
Vietnamese dong	23,182

Commercial middle rate expressed in terms of US\$1.