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**REGIONAL
OUTLOOK
Southeast Asia
2010–2011**

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**Southeast Asia
2010–2011**



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PREFACE

This nineteenth annual edition of *Regional Outlook* continues the tradition of the series in reviewing the political and economic trends likely to inform developments in Southeast Asia in the near-term future. With its brief and accessible, but rigorous and well-informed, analyses of the region, it is a unique resource for readers interested in ASEAN and its member states and also in the wider region. The target readership is broad: businesspeople, professionals, diplomats, security specialists and others who follow Southeast Asian affairs. Stakeholders in those affairs all over the world have long recognized the value of the *Regional Outlook* series, and constituted its loyal readership. The *Regional Outlook* also includes some specially commissioned thematic contributions. Thus it examines this year the state of the maritime sector, recent initiatives to deepen and broaden relations between Southeast Asia and South Korea, harnessing carbon markets in Southeast Asia, and the nature and implications of a renewed interest in nuclear power in the region.

The heart of *Regional Outlook* nevertheless remains the sections looking ahead to what 2010 and 2011 may have in store for Southeast Asia and for ASEAN. On the political front, highlights this year include the encouraging implications of the successful 2009 Indonesian elections, the consolidation in Malaysia both of the premiership of Najib Abdul Razak and of a newly competitive two-coalition political order, and Myanmar's progress towards elections next year. Less encouraging have been Thailand's continued lack of success in bringing peace to its far South, its tensions with Cambodia, and the continuing spectre of political violence in the southern Philippines. The successful APEC summit held in Singapore in November 2009 affirmed both Southeast Asia's centrality to an international economic order defined

by prosperity through trade, and the region's success in building partnerships with both China and the USA in order to further global economic integration.

On the economic front, unlike the sharp dip in growth in several Southeast Asian countries in 2009, the next two years will see many regional economies recovering gradually, with East Asia, India and Southeast Asia expected to perform best. However, the need to resolve various imbalances remains to be addressed. The region now faces the need to rethink present economic policies and to depart from relying mainly on exports to drive growth. The key may lie in continuing the push for economic integration while maintaining trade openness. The prevailing state of the U.S. economy, the continuing rise of China and India, and oil prices will prove crucial for all countries.

The editors of *Regional Outlook: Southeast Asia 2010–2011*, Michael Montesano and Lee Poh Onn, have assembled a distinguished team of talented experts to contribute to this volume. They have asked these contributors to incorporate their own views into their sections. Thus these views do not represent the views of the institutions or governments with which the contributors are affiliated. I wish to thank these experts for the keen focus and original insight of their contributions. We also owe our thanks to Rahilah Yusuf of the ISEAS Publications Unit for ensuring the volume's timely appearance.

K. Kesavapany

Director

Institute of Southeast Asian Studies

10 December 2009

INTRODUCTION

It has grown common in recent decades to hear veteran journalists in Southeast Asia bemoan their editors' nearly exclusive interest in economic stories. These veterans chafe at the past quarter-century's focus on the region's successful economies, impressive rates of growth and maturing financial markets. They lament the passing of the era during which the region's absorbing political stories and the crises that typically defined those stories commanded most of their time and attention.

Thankfully, "politics" and "crisis" have long stopped serving as synonyms in Southeast Asia. Equally happily, the region's record of economic success looks likely to stretch into the future, important challenges notwithstanding. But, as Southeast Asia arrives at the end of the first decade of the twenty-first century, fundamental political questions have again become as central to developments in the region as during the three or four decades after 1945.

In many respects, there is reason to welcome the renewed centrality of politics in Southeast Asia. It points, first, to the region's success in putting the turmoil occasioned by the 1997 Asian Financial Crisis behind it, once and for all. Second, in some parts of the region at least, it may prefigure the ability of increasingly open, self-confident and competitive domestic political systems — rather than only technocratic-authoritarian dispensations — effectively to address issues of difficulty and moment without violence, instability or crisis. Among these issues, the promotion of sustained economic growth and the pursuit of social equity, regional integration and the threat of terrorism, human rights and freedom of expression, decisions about food and energy policy and the region's accommodation with an increasingly wealthy and assertive People's Republic of China (PRC) all rank high.

No case exemplifies the enhanced ability of an open domestic political system to confront these challenges so clearly as that of Southeast Asia's largest nation-state, the Republic of Indonesia. Its successful 2009 legislative and presidential elections have affirmed the promise initially dashed in its first decade of independence and later betrayed by the long New Order dictatorship of General Soeharto. That promise reflected a conviction that Indonesia's vast diversity, scale and ideological pluralism could prove fertile ground for a liberal and progressive political order. In Malaysia, too, the emergence of what may well prove an enduring pattern of electoral competition between two well-matched coalitions of parties bespeaks a return to the country's less claustrophobic politics of the years before National Operations Council rule during 1969–71. This trend is particularly evident at the state level.

The Singapore government's announcement during 2009 of measures to guarantee a larger number of non-*People's Action Party* members of parliament, the broadening of the membership of its *Public Service Commission* (a body empowered to shape the country's future bureaucratic, military and political elite), the process of eventually identifying the ruling party's "fourth-generation" candidate for prime minister and the growing vitality of at least two of its opposition parties may give politics in the country a rather different flavour in the years ahead. It is unclear whether or not one can view the continued efforts of the Sultan of Brunei to energize his government and people in a similar light.

While as yet neither liberal nor competitive, the domestic politics of both Laos and Cambodia has evolved to meet the increasing complexity of those countries' economies and societies. In this regard, they demonstrate certain similarities to their much larger Indochinese neighbour, Vietnam. An optimist might find in the run-up to that last country's 2011 Party Congress encouraging signs of a rigid political system working to adapt itself to a decade of dramatic social and economic change. As 2009 drew to a close, Hanoi's efforts to manage the potentially Sinophobic turn in currents of grass-roots Vietnamese nationalism during a time of economic insecurity have shed much

light on this process of adaptation. Vietnam's apparent dependence on Chinese resources for the support of its shambolic state-owned enterprise sector give this matter some gravity.

Thailand's confrontation with its own pressing need for political adaptation has given rise to the deepest confusion to characterize its basic political and social orders for many decades. Students of its efforts to grapple with fundamental, even existential, questions find themselves deeply troubled and also reminded of its pre-1980 past. Extreme division has coincided with — and is in some measure due to — the approaching end of a reign that has redefined without necessarily reinstitutionalizing the country's monarchy. Foreign embassies in Bangkok report to their governments a variety of astonishingly contradictory scenarios for the transition to the next reign. In the meantime, political and social division has empowered illiberal forces to the point at which neither resolution of the crisis by means of early elections nor the sweetness and light of "national reconciliation" can be considered serious possibilities for the country.

Both Myanmar and the Philippines are due to hold elections during 2010. A dwindling number of observers believe that polls in the former — the first under its controversial new constitution — will fail to take place. But the polls' likelihood has already given rise to accelerated efforts to rationalize — by force if need be — Yangon's relations with the armed "cease-fire" groups on its ethnically complex frontiers and to mounting concern with economic conditions on the Irrawaddy Delta, almost two years after Cyclone Nargis, and in the Burman heartland of Upper Myanmar. Further, the possibility of elections and uncertainty over the nature of the political order to which they will give rise has left the large, active, fractious post-1988 exile movement in a position of growing awkwardness. In the Philippines, the grisly massacre in late November 2009 of more than four dozen people in Maguindanao Province has focused attention on outgoing president Gloria Macapagal Arroyo's dexterous use of provincial power in creating the strongest Philippine presidency since those of Manuel Quezon and Ferdinand Marcos. The hopes of Filipino liberals have congealed in support of the candidacy of the only son of the late Benigno Aquino, Jr., and the

latter's recently deceased widow, former president Corazon Cojuangco Aquino. But the real stakes in the coming elections and thereafter may not involve the integrity dear to those liberals so much as the nature of presidential power in the Philippine Republic's troubled political order. Arroyo's decision to run for a seat in the House of Representatives from her father's native province of Pampanga and the resultant likelihood of a former president sitting in the lower chamber can only complicate efforts to stabilize and liberalize that order.

At the regional level, the member states of the Association of Southeast Asian Nations (ASEAN) look forward to Vietnam's assumption of its chairmanship after a year during which the domestic troubles facing the Thai government of Abhisit Vejjajiva left it struggling to bring effective leadership to the organization. ASEAN diplomats believe that Hanoi is determined to present a marked contrast to Bangkok's weak performance. Questions of leadership notwithstanding, ASEAN continues to pursue an agenda of increasing integration in the realms of security, economics and cultural affairs. That agenda must, however, face up to such realities as bitter Thai-Cambodian tensions in defiance of putative norms of neighbourly ties among ASEAN member states. It must also accommodate Indonesia's rediscovery of founding president Sukarno's determination to act in foreign affairs on a broad global — rather than merely a narrow regional — stage; in this respect, Southeast Asia's largest country is joining its fellow ASEAN member state Singapore.

The United States' decision to accede to ASEAN's Treaty of Amity and Cooperation and President Barack Obama's brief "summit" with ASEAN leaders on the sidelines of November's Asia-Pacific Economic Cooperation (APEC) gathering in Singapore helped put paid during 2009 to what were always rather self-indulgent regional complaints that Washington had been ignoring Asia. Southeast Asia must nevertheless show greater ingenuity than heretofore in building the dynamic, substantive ties with Washington that the region needs in order to balance China's political and economic clout in the latter's "near abroad". ASEAN's aspirations to achieve consensus in matters of security continue to founder on questions relating to the South China

Sea; Beijing's claims and attitudes lie at the centre of those questions. Encouragingly, however, there are indications that the new Japanese government of Prime Minister Hatoyama Yukio will follow the lead of the South Korean government of President Lee Myung-Bak in revivifying the Northeast Asian democracies' partnership with Southeast Asia.

Inter-regional, intra-Asian partnership will also merit close observation as Southeast Asia navigates its near-term economic future. The scale of the global financial crisis of 2008 and of the broader economic crisis that followed in 2009 had no precedent since the Great Depression of the 1930s. Major global economies faced challenges of such magnitude as to provoke fear of systemic melt-down. Governments around the world implemented concerted plans to shore up their economies through massive stimulus packages and efforts to ensure that their banking systems remained sound. These efforts included guaranteeing banks' local- and foreign-currency deposits. The crisis defied theorizing — common in 2008 — about the "decoupling" of the Asian and American economies.

Indeed, America's financial crisis confronted Southeast Asia with its most difficult economic challenge since the 1997 Asian Financial Crisis. While the region's financial systems have remained relatively robust during this most recent period of turbulence, the crisis nevertheless made itself felt through declines in external demand. These declines hit many countries' real sectors hard. Nevertheless, some of the region's economies began to display "green shoots" of growth from as early as the second half of 2009. Industrial production has recovered in these economies, with stock markets in the region also on the uptrend. From a global perspective, the relatively small and historically open economies of ASEAN, hardest hit at the onset of the crisis in 2008, numbered among the fastest to recover by mid-2009. A gradual improvement in international economic conditions and the external trade environment helped account for this early recovery.

The outlook looks better for Brunei in 2010 and 2011 than in the immediate past. Oil prices are forecast to increase. Brunei's budding ecotourism sector and the continuing development of the Sungai Liang Industrial Park are likely to emerge as positive drivers of long-term

growth. Real GDP growth is expected to return to positive territory, but below 2 per cent. Macroeconomic conditions in the country remain favourable, with inflation under control. In Cambodia, the global recovery in 2010 is expected to bolster GDP growth in the next two years. Construction activity in the country suffered from a sharp decline in foreign direct investment — above all from Korea — in 2009. Tourist arrivals from the United States and Europe also dropped significantly during the year. With world demand returning, garment exports from the country are expected to recover, although competition from China will continue to pose a serious challenge to Cambodia's clothing sector.

Indonesia weathered the global slump of 2008 and 2009 remarkably well. It maintained the third highest GDP growth rate among Group of Twenty (G-20) economies — lower only than China's and India's. The country's large domestic market and its relatively low openness to trade shielded its economy from the global turmoil. Rising commodity and oil prices will work in the country's favour in 2010 and 2011. Indonesia must, however, take steps to overhaul its infrastructure; that overhaul will be fundamental to any prospect of high rates of economic growth over the longer term. In Laos, too, the impact of the global crisis was minimal. The country enjoyed a growth rate of about 7 per cent in 2009. The resources sector and increasing government expenditure were the main sources of economic expansion. Growth is expected to be about 8 per cent in each of the next two years, with the development of the hydropower and mining sectors serving as the principal drivers. Inflation and exchange rates are also expected to be stable in the medium term.

Myanmar's economic performance in 2009 was weak; it is, however, expected to pick up from 2010 onwards. The agricultural sector remains an important source of growth. Its significance will persist. Myanmar also has ambitions to profit from its neighbours' booming future demand for electricity. It plans to construct five dams on the Salween River over the next few years. China, India and Thailand remain important trading and investment partners for the country. They will continue in that role in 2010 and 2011. For Malaysia, 2009 brought change in

the country's political and economic leadership, as Prime Minister Datuk Seri Najib Abdul Razak assumed the helm on 3 April 2009 and formed a new National Economic Advisory Council (NEAC). That body is expected to articulate a fresh economic paradigm for Malaysia, intended to spur growth in the years to come. Challenges remain, but there are positive signs on the economic horizon. These signs include the continuing development of Iskandar Malaysia in Johor, a special economic zone designed to tap investments from around the region and across the globe. The improving external environment ought to bring further good news for the Malaysian economy in the two years ahead.

In the Philippines, macroeconomic conditions are expected to improve modestly in 2010. The country's electronics sector will benefit from the recovery in global demand and the restocking of inventories in global electronics markets. Rising government expenditure in 2010 is also expected to contribute strongly to growth, and the service sector will continue to underpin the steady expansion of domestic output. However, 2010 will be a crucial year for the Philippines as it prepares for a presidential election and the resulting administrative transition. Singapore's recovery in the third quarter of 2009 was largely led by the manufacturing sector. The country's economy has finally bottomed out. Barring any repeat crisis in 2010, it should achieve modest rates of growth in 2010 and 2011. Singapore's growth rate will continue to hinge on external factors, with the manufacturing, construction and electronics sectors playing important roles. Inflation is expected to increase only slightly during the period of forecast.

Economic recovery in Thailand will also hinge on external factors, especially the ongoing recovery of its major trading partners. Inflation is expected at only 2 to 3 per cent in the two years ahead, with expansionary fiscal policies and exports driving growth into positive territory from 2010 onwards. Vietnam must progressively transform its investment-led growth into productivity-led growth in the years to come, if the country is to remain globally competitive and to extend the record of growth enjoyed in recent years. Vietnam's economy proved resilient during the global crisis because of Hanoi's swift responses

and prudent measures. Signs point clearly to better times to come, with improved circumstances due not least to more favourable global economic conditions.

While Southeast Asia will continue to navigate uncertain economic currents as 2010 begins, many positive developments have appeared on the horizon. Barring another crisis, growth rates in the region — while perhaps modest during a time of global economic recovery — look set to follow an upward trend. Across the region, the implications of that trend for the distribution of the fruits of growth and for elite and popular sentiment will serve as the backdrop to the political developments of the near-term future. The trend will also continue both to reflect and to shape historically trade-dependent Southeast Asia's interactions with the rest of the world.

Michael J. Montesano
Lee Poh Onn
Editors

10 December 2009