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Regional Outlook

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PREFACE

For two decades, diplomats, security specialists, journalists, business people, professionals, and other readers, both in Southeast Asia and outside the region, have relied on ISEAS' annual *Regional Outlook: Southeast Asia*. They have come to value its timely and well-informed appraisals of the trends, figures, and developments likely to have the greatest impact in the near-term future.

While featuring a fresh new cover design, this twentieth edition of *Regional Outlook* carries on the tradition of previous editions of the book. It offers a unique resource to readers who require rigorous understanding of leading trends in Southeast Asia. Its coverage includes both insight-rich sections on the political and economic outlooks for each of the ten Association of Southeast Asian Nations (ASEAN) member states and a number of specially commissioned thematic sections. Topics treated in those thematic sections include ongoing regional initiatives on the South China Sea, the increasing integration of the Greater Mekong Sub-region with China, the implications of the inclusion of the United States in the East Asia Summit, levels of trust in state institutions among Southeast Asians, food security in Timor-Leste, the significance of second tier cities in Southeast Asia, APEC's prospects during this year and the years ahead, "smart cities" in Southeast Asia, challenges for the Malaysian economy and the New Economic Model, and the contribution of integrated resorts to the Singapore economy.

The book's sections on what lies ahead on the political front for each of the ten members of ASEAN during 2011 and 2012 highlight the importance of the consequences of recent or imminent political transitions in the Philippines, in Myanmar, and in Vietnam. They consider the very different sorts of challenges confronting the governments of Singapore and Thailand as they look towards elections in the near future. Contrasting the confusion that prevails in Malaysian politics with the stability achieved in Brunei, Cambodia, and Laos, they suggest the implications of these

countries' circumstances for developments in the years just ahead. Finally, the section on Southeast Asia's largest country makes clear that trends in parliamentary rule, sub-national government, and religious affairs will have great bearing on Indonesia's immediate future. Taken together, these sections on the political outlook in the ten ASEAN member states emphasize the need for observers of Southeast Asian affairs to balance an awareness of complex domestic developments with attention to the broad regional movements highlighted in the thematic sections of this year's *Regional Outlook*.

On the economic front, Southeast Asia's rapid recovery has been aided by improvements in the external demand. Having contracted for most of 2009, exports posted a strong recovery in the first half of 2010. Direct investment and portfolio flows have also returned to the region. Stock markets have rallied, and the surge in capital inflows has caused regional currencies to appreciate; in some cases, sharply in relation to the U.S. dollar. The Southeast Asian upswing is also exerting inflationary pressures. Looking ahead, exports and economic growth in the region are likely to moderate in 2011 and 2012. Policymakers in the region, for the moment though, face the challenge of managing economies to prevent overheating in some sectors.

Regional Outlook: Southeast Asia 2011–2012 collects in one volume the forward-looking analyses of a team of knowledgeable specialists. I wish to thank each of the scholars who have contributed to this year's stimulating edition of the book. ISEAS is proud to be able to share their perspectives with a broad readership. I also wish to thank editors Michael Montesano and Lee Poh Onn for commissioning these contributions and Stephen Logan of the ISEAS Publications Unit for ensuring the timely publication of the volume. The sharp focus and original insight for which *Regional Outlook* is known owe much to contributors' willingness to draw in their analyses on their own well-informed and time-tested views. These also represent the personal views of contributors, rather than those of the governments and institutions with which they are affiliated.

K. Kesavapany
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8 December 2011

INTRODUCTION

To forecast even the short-term future of a region as diverse and as subject to external influences as Southeast Asia is rash. But to fail to be aware of emerging trends and likely developments in the region is scarcely less foolhardy. Equally important is attentiveness to the interaction of developments at the national and regional levels in Southeast Asia. That interaction will determine the future of the region.

In the realm of regional politics and security, no trend or development looms as large to observers looking ahead towards 2011 and 2012 as the progress of the "great game" set in motion by the increasing power and assertiveness of the People's Republic of China (PRC). This game spans all of eastern Asia. It has implications for the Indian Ocean. But it is in Southeast Asia that the PRC's growing ambitions and increasing military capabilities have begun to have the greatest consequences. States both within and outside the region have adopted a range of postures in reaction to those ambitions and capabilities. The result has been a climate of deep uncertainty about the extant regional security order.

On one level, the PRC's ever more intense interest in the region challenges the viability of ASEAN's longstanding vision of Southeast Asian security. Beijing's expansive understanding of its national interests seems difficult to reconcile with that vision, which has consistently downplayed such assertiveness in the interest of the gradual construction of a regional community.

On another level, the policies of a range of other external actors have also long shaped the regional political and security environments. American, Japanese, Australian, and, increasingly, Indian and South Korean approaches to Southeast Asia bear as much examination as do Chinese undertakings.

Nowhere have challenges to ASEAN's approach to regional security proved more apparent than in the South China Sea. While ASEAN and the PRC agreed on a Declaration of Conduct in the South China Sea in 2002, the failure in the intervening years both to implement the terms of that declaration and to arrive at a more formal and effective Code of Conduct may symbolize the obsolescence of the Association's approach to regional security. Today, it is difficult to avoid concluding that many years of easy-going inaction on the South China Sea are coming back to haunt not only those of ASEAN's member states with claims to territorial waters there but also the grouping as a whole.

American Secretary of State Hillary Clinton took advantage of the July 2010 meeting of the ASEAN Regional Forum in Hanoi to call attention to the need for a concerted, multilateral approach to countering Beijing's increasingly forceful assertions of its unilateral rights in areas of the South China Sea claimed by various of its Southeast Asian neighbours. American naval power has long underpinned ASEAN's approach to regional security. Clinton's call was thus little more than an open affirmation of the status quo that ASEAN had long favoured. But events soon made clear that a number of ASEAN member states were uncomfortable with direct American involvement in the settlement of disputes over the South China Sea.

These developments come in the context of trends with unmistakable importance to the future of the region. One is the clear sense of Indonesia's and Vietnam's rise in regional stature. This rise comes at the apparent expense of Thailand and Malaysia, two countries whose persistent domestic political difficulties and lack of clear national economic strategies have begun to have an impact on their regional standing. A second is the ever greater integration with China of those parts of Southeast Asia lying within the so-called Greater Mekong Sub-region. This integration takes the form of trade and investment, of road and rail links, and of flows of electric power and of fossil fuels. It exemplifies a third, more general trend: the remarkable dynamism that, particularly in contrast to the United States, the PRC has brought to the full range of its engagement with Southeast Asia. It remains to

be seen whether Washington's rather small-bore and often symbolic initiatives in Southeast Asia since the inauguration of President Barack Obama will appreciably counter this trend.

The significance of developments and trends at the regional level notwithstanding, their role in determining the course of this "game" will depend above all on their interaction with domestic developments and trends in each of the countries of Southeast Asia. Relative to citizens of the countries of East Asia, Southeast Asians retain great trust in their governments and in state institutions. At the same time, younger and better-educated Southeast Asians demonstrate less such trust than their older, less well educated compatriots. Indications thus suggest that bonds between state and society face important tests across the region in the years just ahead.

For example, Indonesia's snowballing successes during the past decade have nevertheless left it with several serious challenges to confront. These challenges include the troubling confluence of money and power exemplified in the presidential aspirations of Golkar party chairman and tycoon Aburizal Bakrie, the continued ineffectiveness of the national parliament, questions about the quality of governance at the sub-national level, weak civilian control of the armed forces, and the alarming spectacle of increasing religious intolerance. As Indonesians again think of their country as a rising power, in terms that recall the global ambitions of their founding president, Sukarno, the need to address these challenges will only grow.

The manner in which Vietnam will address its own challenges will become clear early in 2011, with the results of the imminent National Congress of the Communist Party of Vietnam (CPV). In choosing its new General Secretary, the CPV will put the country on a path either of stability and reinforcement of the status quo or of reform and removal of some of the constraints holding the country's economy back. Should the Party opt for that latter path, the National Assembly elections due in the first half of the year will assume real significance. For they will choose the members of a body well positioned to support the cause of reform through its increasingly evident effectiveness in scrutinizing the policies of Vietnam's executive.

In a number of Indonesia's and Vietnam's important ASEAN partners and neighbours, well-established social compacts are under some pressure. Thais are due to go to the polls by the end of 2011. But a range of concerns lead many to wonder whether those polls will take place and whether their results will be respected. These concerns include the spectre of renewed political violence, popular anger over social and legal "double standards" and over the role of the courts in perpetuating those double standards, and accusations of efforts to undermine the Thai monarchy. The very modest progress of the reconciliation plan advanced by the government of Prime Minister Abhisit Vejjajiva does nothing to alleviate these concerns. In Malaysia, an unreformed United Malays National Organisation (UMNO) has struggled, even under the leadership of the impressive Prime Minister Najib Razak, to confront threats to multiracialism and the very real risk of economic decline. The weakness of its Malaysian Chinese Association and Malaysian Indian Congress coalition partners does not make UMNO's task any easier. Singapore's rising cost of living and increasing social differentiation will be the backdrop to elections due by early 2012. It remains unclear how prominently the emergence of "a new Chinese ground" in Singaporean society and such issues as immigration, housing, healthcare, and education will figure in the electoral campaign.

The Philippines and Myanmar both began political transitions in 2010. Benigno "Noynoy" Aquino III, son of the late President Corazon Cojuangco Aquino and the slain Senator Benigno "Ninoy" Aquino Jr, took office as Philippine head of state in June. The years ahead will test his and his country's ability to address the socio-economic and political problems of the Philippines' large southern island of Mindanao, endemic corruption, and the need for economic reforms. The second President Aquino benefits from an image of virtue, in marked contrast to the membership of the fractious Philippine Congress on which he will depend for the passage of legislation. Myanmar's controversial 7 November 2010 elections chose members of the upper and lower houses of its national parliament and of fourteen newly established regional and state

parliaments. The Union Solidarity and Development Party, a creature of the ruling State Peace and Development Council, won majorities in all sixteen of these bodies. Following two decades of stalemate under naked military rule, the introduction of a range of new offices and institutions of government to Myanmar may bring new dynamics to the country's politics, including intra-military politics. The release of Aung San Suu Kyi from house arrest six days after Myanmar's November polls only enhances the potential for meaningful change in the country. International public opinion has come increasingly to favour serious modification of the economic sanctions imposed on Myanmar; Aung San Suu Kyi may play a leading role in hastening that development.

Cambodia's Hun Sen government continues to make a great success of deft cooptation of some of its political opponents and thoroughgoing marginalization of others. At the same time, political ties between Phnom Penh and Beijing — while perhaps not yet so intimate as those linking Bangkok and Beijing — continue to develop. The growth of those ties coincides with a rising Chinese economic profile in Cambodia. Chinese influence is also substantial in Laos, where it coexists with and perhaps complements the networks of political patronage through which the ruling Lao People's Democratic Party continues to operate. As in neighbouring Vietnam, members of Laos' National Assembly have shown signs of increasing independence in their scrutiny of the government. But the high-stakes nature of conflicts over access to resources — relating above all to dam construction and the granting of large land concessions — makes Laos' patronage politics particularly insidious. What resources are to Laos, food is to Timor-Leste, where concerns over the cost of living and the politics of rice exports have become central to national affairs. In Brunei, pressing challenges lie in the areas of human capital development and economic diversification, issues of concern to every country in Southeast Asia. In fact, in matters of governance and opposition politics, struggles over access to resources, and food security too, the region's larger countries and their smaller neighbours face many common challenges.

Economic recovery in Southeast Asia is mainly driven by resurgent exports in the various sectors, increases in domestic demand due to a better economic environment, and the firming up of labour markets and higher wages. For Brunei Darussalam, real GDP is expected to be in positive territory in 2011 and 2012. This is because of the earnings from the oil and gas sector, continuing development of Brunei's ecotourism industry, rising exports from the completed methanol plant project, and the continuing development of the Sungai Liang Industrial Park project. Since the beginning of 2010, the Cambodian economy has begun to show signs of recovery, aided by buoyant exports and tourism receipts, and sustained growth in agricultural production. The global financial crisis highlighted Cambodia's vulnerability to external shocks and the need for the country to diversify and reduce its reliance on a narrow range of commodities and export markets in order to reduce its vulnerability.

Despite a stronger direct investment outlook, consumption continues to be the backbone of the Indonesian economy for the next two years. The balance of trade should continue to be favourable to the country but exports may expand only moderately from 2011 because of fragile demand from its traditional trading partners and the strong Indonesian currency. Inflationary pressures are expected to rise further with the return of stronger demand and escalating commodity prices in the global market. In the Lao PDR, the resource sector remains the main source of growth for the country. A number of mining and hydropower projects have been carried out and have contributed to economic growth in the country. These projects are expected to contribute to growth during the forecast periods of 2011 and 2012. Challenges however remain for the country to continue to delicately manage its economy in spite of high capital inflows, managing its external debts, continuing to enforce monetary and fiscal discipline, and improving the business climate for the private sector.

In Malaysia, the current account surplus is expected to remain at a high level and to underpin its external balance fundamentals. Recovery in export demand will sustain a modest rebound in manufacturing

while services and construction will benefit from the strengthening of domestic demand, especially from private consumption and investment. The services sector will not only constitute the largest part of the economy in the coming years but will also be the most dynamic in the country. For Myanmar, growth is expected to be supported by foreign investment in new gas fields and the construction of the oil and gas pipeline to China. Agriculture production remains favourable, especially rice. The rising private consumption in the years ahead will also fuel growth. Inflation is forecast to rise due to rising costs of imported goods and fuel.

As in the past, growth in domestic output in the Philippines will continue to be driven by private consumption. Current efforts under the Aquino administration to focus on social services and infrastructure will increase disposable income that will enhance private spending. Despite a slowdown in global trade in 2011, the exports of goods and services will remain an important source of growth for the country. In Singapore, economic growth for 2010 is forecast to be 15 per cent. The manufacturing sector contributed to the country's robust growth performance. In addition, the tourism sector was given a huge boost in 2010 when Singapore's two integrated resort were officially opened. GDP is projected to grow between 4.3 per cent and 5.3 per cent in 2011 and around 5 per cent in 2012.

The Thai economy is estimated to grow by 7 per cent in 2010, from a contraction of 2.2 per cent in 2009. This is attributed to the rebound in exports which account for more than 60 per cent of the Thai GDP. In 2011 and 2012, growth rates will moderate to about 4–4.5 per cent, given the slow recovery of its major trading partners. Inflation is projected to rise to 4–4.2 per cent per year due to an upward trend in the minimum wage, rising agricultural prices, and higher retail prices. One of the main engines driving Vietnam's economic growth has been its robust integration into the world economy. Looking ahead, Vietnam is expected to continue to enjoy its strategic strengths of location, political stability, and

human capital to promote economic development in the country. The government is also expected to continue its efforts to improve the business environment and to provide more attractive incentives to promote foreign and domestic investment in the country.

Michael J. Montesano
Lee Poh Onn
Editors

9 December 2010