

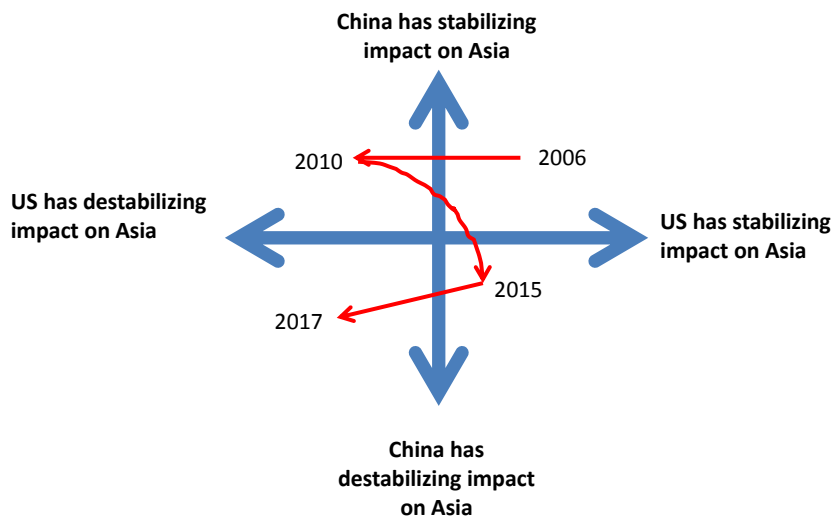
# ASIAN INTELLIGENCE

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## US and China Policies Threaten Asia



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## REGIONAL OVERVIEW

### *A worrisome turn in US foreign policy*

As the US election campaign progresses and the state primary results come in, it is becoming apparent that something new is afoot. Pressures are building in the US for a fundamental shift in foreign policy – in a way that might seem appealing to many Americans in the short term but is almost certain to have destabilizing fallout globally. The graph on the cover of this report is based on two driving forces shaping Asia. One is China; the other is the US. With China's economy slowing and its foreign policy becoming more aggressive, the shift in US foreign policy could push Asia in the direction of much greater instability.

That shift is comprised of several parts. First is a move toward greater trade protectionism by Washington. Gone are the days when the US championed free trade. Both Democrats and Republicans are favoring more protectionist policies.

Second is an increased desire to avoid foreign entanglements in which US troops are on the ground in other countries fighting and dying for causes that do not directly threaten the US.

Third is a reduced level of concern for the kind of foreign governments that exist around the world and their tactics for holding onto power and managing their populations, provided those governments do not directly threaten the US. Closely related to this is a greater appreciation by the American public that a regime change for the sake of regime change need not produce a government that is better for the US.

Fourth is a desire to review what many Americans consider to be unbalanced alliances that put too high a potential burden on the US. The imbalances can be economic – allies that Americans perceive do not pay their share of the US defense umbrella and take advantage of their relationship to run huge trade surpluses with the US. They can also be in terms of personal commitment – like alliances in which the US is supposed to put its soldiers' lives

on the line when the allies themselves are reluctant to do so.

This Regional Overview looks at changes that could be happening in the US, while the country entries that follow look at the unsettling implications for these countries if the US actually changes foreign policy course to a new kind of "America First" guiding philosophy. A swing in this direction might only be limited, but the implications for the world if it is really embraced by the US public and the government it elects would be profoundly disturbing. Signs are emerging that need to be recognized, studied and factored into strategic thinking.

Some trends are already evident that should give Asia cause for serious concern no matter what the outcome of the next presidential election. First, the US is turning more protectionist. The Trans-Pacific Partnership pact launched by the US is not an exercise in trade liberalization. It is an attempt to raise standards on trade, investment, intellectual property, labor rights and other matters so that those standards are aligned to what the US thinks is appropriate. In other words, the TPP is an exercise that from the start puts more of the onus on foreign countries and companies to change than on the US and US companies, giving the US firms an advantage at least initially. By excluding China, the TPP is also a policy of containment against Asia's largest economy, and is considered as much by Beijing.

The TPP still has to secure the approval of the US Congress, but it is telling of the future direction of US trade policy that virtually all candidates running for the presidency have criticized the TPP for not doing enough to help US companies and workers. In other words, they favor even greater protectionism. Opposition to the TPP ranges from Democratic candidate Bernie Sanders' claims that the pact is "job killing" to Ted Cruz's claims that the TPP is a bad deal for US companies. Hillary Clinton has reversed her position on the TPP and is now against it too, arguing it does not do enough to help US workers, while Donald Trump calls the TPP a "horrible deal." The fact that every candidate from every party does not support the TPP on the grounds that it does not do enough to help the US is a clear sign of the shift toward protectionism in which the US is drifting. Future measures could include new

tariffs and sanctions against surplus countries like China, Japan and Mexico, measures to offset the advantages of countries that have significantly lower labor costs than the US, and discriminatory treatment of all imports whose production does not meet other standards set unilaterally by the US, be it with respect to labor rights, environmental protection, or some other arbitrary criteria that US companies or labor argue tilts the playing field against them.

While a move toward greater protectionism is worrying enough, there are also other new foreign policy themes emerging. A new spin on “America First” is resonating with a large part of the electorate, including in states like South Carolina, Florida and Hawaii where the military forms a large part of the economy and population. The new theme is that the military should stay strong but the government should do more to avoid foreign entanglements. This means not sending troops into hotspots like Syria, Iraq and Libya and also reviewing existing alliances so countries are more responsible for their own defense and, when they do use the US defense umbrella, they pay more for it.

The implication is that the US could become a much less reliable ally and existing agreements, be they for trade or defense matters, will all be up for re-evaluation. On the one hand, some of the rhetoric makes it sound like the US would take faster direct military intervention against countries or groups that directly threaten the US. For example, it might be more willing to launch a preemptive missile strike against North Korea if Pyongyang actually “tested” a missile capable of carrying a nuclear bearing load in the direction of the US or it might bomb Chinese-occupied islets in the South China Sea if the PLA on or near these islands were to fire on a US Navy ship. On the other hand, the US would be unwilling to send troops to settle other countries’ conflicts, including allies like Japan, Taiwan and the Philippines. Their argument is that these alliances are not reciprocal and therefore are unbalanced.

Causes like democracy and human rights are no longer put on a pedestal to be defended or nurtured. Donald Trump has even struck a sympathetic chord with part of the population by advocating such practices as religious discrimination and torture. His rivals and the majority of the US

public did not share these extreme views, but the propagation of values like democracy and human rights might not drive US foreign policy in the future the way it has in the past, particularly if the US public does not see how the foreign instances where these violations take place threaten the interests of the US. The US would also be less eager to press for a regime change simply because it disagrees with another government’s philosophy or tactics. It will not mind providing limited support to those who are victims of controversial regimes, but it will be up to these victims to do the actual fighting.

If the US were to adopt such a policy shift, the results would force all countries, from Europe to Asia, to make major adjustments. It would open the door for China to test the boundaries of the US commitments from the Indian Ocean to the Korean peninsula. It would guarantee that governments like those of Japan and India adopt much more aggressive military profiles. It would cause close US allies like Singapore and the Philippines to review their own vulnerabilities and make appropriate adjustments. It could cause governments like those in Indonesia and Malaysia to be faced with much more threatening domestic movements in which religious dogma is a bigger bone of contention.

Since the weakening of national security support would probably be accompanied by a major intensification of trade friction with the US, countries like Japan and Korea would find themselves in unprecedented positions where almost all assumptions on which they have built their foreign policies since the end of World War II and the Korea War would have to be reviewed.

In the US, the fight for foreign policy is no longer a three-way fight between neo-conservatives, liberals, and realists. Leading thinkers from all three of these camps are worried about the type of foreign policy Donald Trump is sketching out. However, by singling out Mr. Trump for criticism, they are missing the bigger issue of an apparent sea change in US public opinion. Even if Mr. Trump falters in his campaign to the White House, the fact that his foreign policy ideas and those of Bernie Sanders have both resonated with such a large voter base (together, they are winning 40% or more of all votes cast and are winning the majority of white, male voters) is a

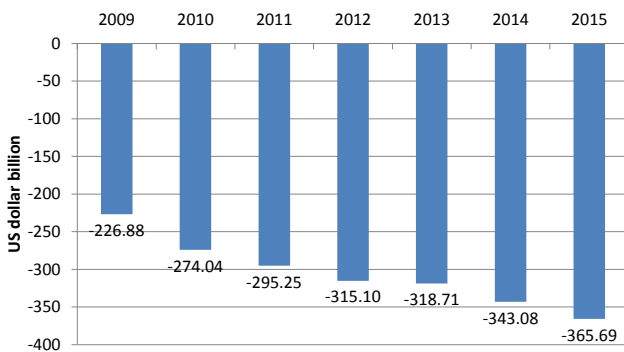
strong indication that a large part of the US population is not aligned with the foreign policy thinking of the establishments of either the Republican or Democratic parties. The consensus

that once existed on many aspects of foreign policy no longer exists, and the new themes resonating with the public will shape US foreign policy going forward, regardless of whoever wins in November.

## CHINA

### Comment

#### The US Trade Deficit with China



Source: US Census Bureau

stimulate exports in the near term, the bigger this risk.

Even if Beijing were to increase its exports, reducing its stockpiles of steel, cotton and materials and goods, this does not mean raw material prices would come under upward pressure again. Beijing's export success, to the extent that it takes place, would be at the expense of foreign producers, who are forced to meet the extra competition by holding the line on their own prices. The total volume of goods sold would not increase much, which is why there would not be much upward pressure on input prices, but China would be exporting not just its goods but also its manufacturing problems to other countries.

While the US seems to be heading in the direction of adopting a tougher trade line vis-à-vis China, the shift in voter sentiments in the US makes it even less likely that the next government in Washington, whatever its make-up, would be willing to engage China over territorial disputes in the South China Sea or to come to the defense of Taiwan if Beijing were to become more aggressive in pushing for a change in the current cross-Strait's status quo. And if Washington were to push allies like Japan and Korea to assume more of the financial burden of their defense even while it chides those governments for their own trade practices, Beijing might feel it has more room in which to pursue more aggressive foreign policies vs. these countries too.

At the very least, Beijing would be able to make an argument to its domestic population that China's own economic problems are the fault of the US containment policy rather than mismanagement by the Chinese government. For this reason alone, a more confrontational relationship with the US might suit China's leaders just fine. If they feel they are powerless to avoid being a target for US trade protectionists and the US is also viewed as being less reliable by other countries in the region, it would make it easier for China to present itself as an alternative, even as it steps up pressure on these neighbors in other ways to accept Beijing's dominant position within the region.

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## HONG KONG

### Comments

There was a time in the years running up to Hong Kong's 1997 transition when Washington cared about Hong Kong's political status. However, that concern has faded with time. If Beijing were to assert more direct control over Hong Kong and unilaterally modify the "one-country, two-system" formula that is supposed to apply to the SAR, it is very doubtful that Washington would do more than voice its concern. It would not adopt any punitive measures or treat people from Hong Kong as potential political refugees. The only change in policy would probably be that if Washington decides for other reasons to raise tariffs on imports from China or to apply sanctions that affect Chinese companies, it would not even pause to consider whether Hong Kong should be excluded from any punitive action; it would not be. It would be considered to be an integral part of China, just as it was when Washington refused to invite Hong Kong to join the Trans-Pacific Partnership pact in its own right.

The main factor that is likely to constrain Beijing in how it interferes in Hong Kong in the future has nothing to do with the US but with Taiwan. It does not want Hong Kong to become a symbol that energizes a Taiwan independence movement or motivates the island to stay as separate from the Mainland as possible. The preference for Beijing would be to use Hong Kong as an example of why Taiwan does not have to fear China but can look forward to profiting the more it engages with the Mainland.

The problem for Beijing is that the timing is wrong. Taiwan has a new DPP-led government that Beijing still hasn't figured how best to approach, and Hong Kong is entering a stretch where China is unhappy with political undercurrents. At the end of the day, Beijing will do what it thinks is in its best interests, which probably means giving more business to Hong Kong in the form of Chinese IPOs and bond business while narrowing the space of political expression in the SAR. Recently there have even been indications that Beijing is starting to by-pass those local Hong Kong leaders who are solidly in Beijing's camp and are supposed to act as a bridge between the SAR and Beijing. Such indications include the way Beijing handled the problem of Hong Kong booksellers dealing with publications banned on the Mainland (Beijing bypassed Hong Kong institutions entirely and kept local political leaders in the dark) to the seating arrangements for Hong Kong delegates at the recent National People's Congress. Beijing's actions might be destabilizing from a Hong Kong perspective, but they are designed to preserve stability and control from Beijing's perspective.

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## INDIA

### Comments

India is probably more at risk to developments in China than it is to ones in the US. China's policies around the region will be increasingly challenging for New Delhi. It has to worry about Beijing's efforts to project its military power into the Indian Ocean and to develop port facilities in countries like Pakistan. India is not looking so much at the US as a counterbalance to China as it is to using its own muscle – for example, by giving support to Vietnam's military and offering other types of support to Mauritius and Sri Lanka. The more that the US refuses to take on such a balancing role, if such a scenario actually happens, the more India is likely to play such a direct role itself – not just in Southeast and South Asia but also in parts of Central Asia and Africa.

Indian manufacturers are also likely to feel threatened by China's attempts to boost its exports. This could affect their competitive position in India, hurt India's trade balance, and also interfere with India's ability to grow as an exporter, particularly in products like steel and cotton-based goods that China might try to dump on the world market.

In theory, India should be hurt by the rise in US protectionism and anti-immigrant sentiments. In practice, however, India does not have a lopsided trade surplus with the US and is not accused of taking manufacturing jobs away from the US (backroom service jobs are another matter, but so far none of the US presidential candidates have focused on business process outsourcing industries as a concern that needs to be addressed). Moreover, there is not a flood of illegal immigrants from India to the US. India is a major provider of highly skilled immigrants to the US, who go through official channels to fill high-paying jobs in medicine, IT, and business. They are not taking such jobs because they are less expensive than indigenous labor but because there is a dire shortage of such skills in the US. Even the most extreme anti-immigrant candidates like Donald Trump have had to retreat on their positions when they were asked to respond to the problem of importing skilled labor critical to the operations of America's most dynamic companies.

Consequently, India is somewhat sheltered from adverse foreign policy trends in the US. It is not a target of US trade protectionists the way countries like China and Mexico are. It will be excluded from the anti-immigrant movement and help to define how the door to immigration into the US is likely to remain open. It does not have a lopsided alliance relationship with the US. India is paying for its own defense and is not covered by the US defense umbrella. It is not asking for the US to play a moderating role in contentious foreign policy relationships with such countries as Pakistan and China. India has the capability of looking out for its own best interests – sometimes in ways that the US would not approve, such as by developing its own nuclear weapons capabilities or in developing closer economic relations with countries like Iran and Russia.

However, what a movement into the bottom left quadrant of the scenario grid on the cover of this report does imply is that India would probably want to accelerate most of the policies it is currently adopting. These include building closer relations with Southeast Asia and South Asian neighbors, often in ways that position India as a preferred alternative to China or as a potential counterbalance to China. It guarantees that India will have to keep spending heavily on defense. It also probably means that while the government will want to keep developing India's own manufacturing capabilities, it will retain a strong protectionist bias that focuses on the local market and local ownership, and also favors poor countries not being held to the same IPR and other standards as the US would like to see.

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## INDONESIA

### Comments

Because of its penchant for neutrality, Indonesia does not want to become involved in a confrontation between China and the US. It does not have any formal territorial differences with China, and while it is happy to have the US Navy plying the waters of the South China Sea in order to keep the sea lanes open, it leaves it to countries like Singapore, Vietnam and the Philippines to voice support for this presence. However, if China were to increase its own military presence in the South China Sea, while the US makes it clear that it is not about to become involved in territorial claims in the region, pressure would grow on Indonesia to assume more of a leadership role of its own that at times might put it at odds with China.

However, the biggest impact on Indonesia from a shift in US foreign policy that more openly shuns engaging US troops in foreign conflicts would be potential fallout from the Middle East. Indonesia is already the country in Southeast Asia that is most vulnerable to a return of nationals who are fighting with ISIS. If there is a switch in US foreign policy that reduces the willingness of the US to become involved in conflicts in countries like Libya, Syria and Iraq and reduces the zeal with which the US champions ideals like democracy and human rights, Indonesia would have to face much stronger winds of change in the Islamic world on its own. As groups in the Middle East square off against each other, it is anyone's guess which ideas will be ascendant and which groups will ultimately prevail. More Indonesians are likely to become involved in the fighting and they will ultimately be

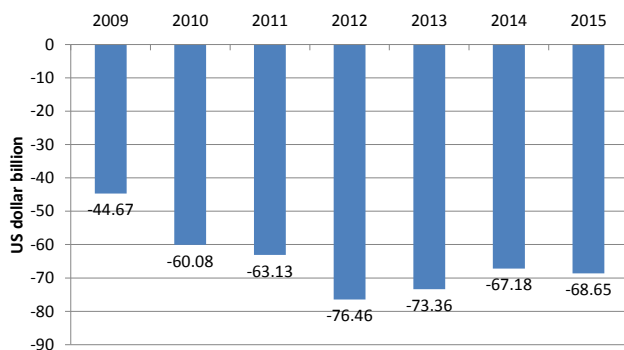
returning home, where the clash of ideas is likely to continue.

At the same time, populations in the Middle East and countries like Bangladesh and Myanmar that are victims of war and discrimination will swell the outflow of refugees. Many of these are already heading for Indonesia as a stopping off point on their way to Australia. If the US were to remove itself from the equation of countries accepting such refugees and Europe buckles under the weight of the refugees it is getting, Australia almost certainly would be viewed as an even more attractive haven. Of course, Australia might try to clamp down on such inflows even harder than it is already doing, but this would only further strain relations with Indonesia and place more of the burden on Indonesia to deal with the refugee problem. The results would be social, political and diplomatic strains for Indonesia that quite possibly cause the authorities there to adopt more isolationist policies of their own, even while they have to deal with the internal social strains caused by clashing interpretations of religious dogma between different parts of the population.

## JAPAN

### Comments

#### The US Trade Deficit with Japan



Source: US Census Bureau

consistently runs a large trade deficit with Japan. The magnitude of that deficit is not growing fast but it is large, and Japan has had a conscious policy in recent years of causing its currency to depreciate against the US dollar. This will be enough to ensure that the next US government takes a more critical look at US-Japan trade relations.

However, the biggest risk is that a shift to an “America First” policy could weaken the US defense commitment to Japan not just in terms of footing the financial cost but also in terms of commitment of personnel and responsibility for carrying out certain types of military maneuvers. If Tokyo were forced to deal with higher national security risks due to its inability to count on the US to defend it against external threats, the government would have to invest much more heavily in its own military. This could actually stimulate the economy, but it would add to the national debt and greatly increase that risk of at least isolated military incidents in the defense of territory also claimed by countries like China and South Korea. The worst possible scenario would be if China were actually to do something to restrict the movement of international shipping in the sea-lanes of the South China Sea. Japan quite simply could not let that happen. For this reason alone, China is unlikely to go that far.

Of course, it is possible, that China, Japan and Korea might set aside their differences and come together in some form of Northeast Asian alliance. However, it is much more likely that the three countries will allow

their historical animosities to resurface in ways that prevent cooperation and highlight suspicions, nationalism, and confrontation. This will be especially the case since China will not want to see a resolution of tensions on the Korean peninsula that result in a reunification of North and South Korea, since that would put a nuclear power on its own doorstep with the potential to challenge Beijing. Instead, China would prefer to keep the peninsula divided and the North's belligerence directed towards the US. Interesting, under this scenario, the US would be less concerned with North Korea exporting its weapons technology to other countries, since Washington would be pulling back from such engagements globally.

Japan would have to be more concerned about securing its own supply lines, which implies it would not only become more aggressive in trying to invest in countries like Indonesia, Australia, Malaysia and Myanmar but also with Russia. These countries, in turn, would try to keep on the good side of both Japan and China, a motivation that could be a great force for stability going forward.

However, ultimately the issue would be how Beijing and Tokyo can learn to share the same stage. This is a possibility. They will face many common challenges like the threat of global warming and other environmental issues, a desire not to become involved with the Islamic wars affecting many other parts of the world, and the need to resist attempts by the US to penalize them on the grounds of unfair trading practices and currency manipulation. It would also be in their common interests to approach jointly problems like alternative energy development so they are not competing for the same limited supply sources. However, there is also a possibility that Tokyo and Beijing will try to contain the other in ways where each party (or perhaps just one) tries to dominate the stage at the other's expense. This would leave Northeast Asia a much riskier region. Legacy issues would continue to interfere with the trust that would be needed for real cooperation, and the individual governments might be so insecure domestically in a world moving away from free trade toward protectionism that nationalism is used even more than now as a way to rally local populations around a common enemy.

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## **MALAYSIA**

### **Comments**

Much of our analysis for Indonesia also holds true for Malaysia. Although Malaysia would probably have an increased refugee problem, it would probably not be as bad as Indonesia's, and it would be one-step further removed from potential conflicts with Australia than would its neighbor.

Malaysia already has fairly good commercial and diplomatic relationships with China and Japan and would stand to profit more if these two countries can cooperate than if they were to spar off against each other. Malaysia's territorial dispute with China might intensify in this scenario, but the downside here would be more than offset by what Malaysia stands to gain from selling goods and commodities to China and from participating in various programs associated with the AIIB and the New Silk Road initiative.

Malaysia's membership of the Trans-Pacific Partnership would become less important in this scenario, since the US, in its desire for greater protectionism, might have second thoughts about the pact itself. Since the opportunities for doing business with the US would be more limited, Malaysia would have to focus more on other markets like China, Japan, Korea, other ASEAN countries and India.

The big threat for Malaysia from a shift in US foreign policy toward protectionism, non-engagement in disputes that don't directly threaten the US, and a hands-off policy toward regime change is that the domestic political situation in Malaysia could become more unstable. As in the case of Indonesia, Malaysia would be unsettled by the fight for supremacy and conflicting ideas in the Islamic world. Different Islamic groups are battling not just for political supremacy but also for the morale high ground. The issue is not a defense of a



system like democracy or a monarchy but of different interpretations of religious dogma and how it should be applied. However, Indonesia has no counterpart of Malaysia's UMNO, the leadership of which has a firm grip on the levers of political and economic power and yet has disenfranchised a large portion of the Malay community, which has joined the opposition, and now has alienated even factions of UMNO that are not part of this inside group. Malaysians from other ethnic groups are feeling even more marginalized than usual. The conditions might not exist for the kind of instability that is currently tearing Syria apart, but Malaysia's social system is more fragile than it looks, and it would not take much for different groups in the country to start having ethical questions that challenge the current political status quo.

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## PHILIPPINES

### Comments

The Philippine government has bet heavily that its alliance with the US will help it defend its interests in the region. If it becomes clear that Washington is not there as a backstop, the Philippines is probably the first country that China will pick on to demonstrate its sovereignty claims. That is because the Philippines cannot mount a credible military defense the way, say, Vietnam could. China would be much freer to dictate the terms by which it manages these territorial claims. For example, it could have a military presence on these islands but not interfere at all with sea or air traffic going through or over this territory. It might even allow Philippine fishing boats to operate alongside Chinese trawlers in the waters surrounding the Chinese-controlled islets. China could try to use its actions rather than its words to show it can be a good neighbor, provided the countries respect its dominant position.

The Philippines is not a major exporter of manufactured products but it does depend heavily on the US as a market for what it does export, so a move toward greater protectionism in the US would hurt the Philippines. However, the bigger impact could be on remittances of Filipinos working abroad, particularly in the Middle East. To the extent that US intervention in the Middle East has helped to maintain peaceful conditions in some countries like Saudi Arabia, the UAE and Kuwait, it has created jobs for Filipinos in this part of the world, but if the conditions in the Middle East become more unsettled and unrest spreads, it could limit employment growth in this region and make conditions much more dangerous for Filipinos who are working there.

It would also be more difficult for the Philippines to deal with its domestic insurgency problems. The US might have second thoughts about basing troops in the Philippines or sending advisors with Philippine troops to help fight insurgents in the South. It would be happy to sell weapons and equipment to the Philippines, but financial constraints would limit what the Philippines could buy, and if the US were to become more isolationist, it also would probably be less generous in its foreign aid and assistance.

In other words, the Philippines would have to stand more on its own. It would look more to Japan and Korea for assistance and would probably look for ways to make ASEAN a more useful organization for Manila's purposes. However, its options would be more limited, and it might have to make more compromises than it would like in order to deal with the reality of having neighbors like China.

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## SINGAPORE

### Comments

The bottom left quadrant of our scenario grid is bad for Singapore. It has attached its star to free trade and globalization, but the world would be moving in the direction of greater protectionism. The US would not be

there as a stabilizing influence in the waters around Singapore. Political conditions in Indonesia and Malaysia could become much more unstable. There is even a risk that tax changes in the US designed to get US multinationals to repatriate their foreign profits back to the US could cause many companies to scale back the size of their Singapore offices and the types of business they do there.

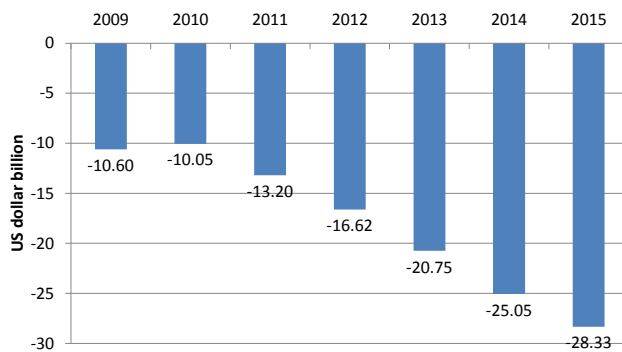
The bottom left quadrant is not the worst of all worlds for Singapore. That would require the US and China actually being at war with each other or locked in a new Cold War. However, that does not define the fourth quadrant, which is driven by domestic politics in both China and the US, with Washington turning more protectionist and less willing to become involved with foreign entanglements. If China leaves the US alone, the US will leave China alone. But that would still leave Singapore in a situation in which China's influence in the Asian region is greater and Singapore would have to adjust to this reality.

Singapore's competitive position vs. Hong Kong in this scenario would be more starkly defined than it is today. Hong Kong would be the preferred base for business that involves China's commercial interactions with the rest of the world, while Singapore would be the preferred back for international business in which China is a secondary consideration. In some ways, it could find that it is in more direct competition with cities like Dubai, particularly when it comes to legal system support and certain kinds of financial services. The key to the success of both cities will be to preserve social and political stability at a time when conditions in many neighboring countries could become more unstable. In one sense, this neighboring instability is the biggest threat they will face, but in another sense this same instability will be what helps to generate the growth of business and defines the opportunity for Singapore.

## SOUTH KOREA

### Comments

The Growing US Trade Deficit with South Korea



Source: US Census Bureau

Currently, US-Korean relations are moving closer due to the drawing power of both the Trans-Pacific Partnership pact and the need to deal with the common threat posed by North Korea. However, the alliance could come under new strains if Washington responds to pressures for a foreign policy shift that is more protectionist and isolationist.

Any future government in Washington will treat North Korea as a direct threat as long as Pyongyang treats it like an enemy and threatens to develop nuclear weapons that could be launched on missiles capable of reaching the US mainland. However, the US is not as motivated by reunification of the two Koreas as South Korea is, and it is

possible that Washington might decide in the future that the South needs to do more to carry the burden of its own defense. It is even possible that Washington might conclude going forward that China's position on North Korea is to perpetuate the status quo in order to prevent political changes that turn the peninsula into a greater direct threat to the Mainland. Washington might decide that the best way to contain North Korea is to step back from the front line of the fight or at least to reduce the exposure of its own troops because Beijing would have a stronger self-interest take the lead in managing the threat. Washington would place more emphasis on its own

defense against a direct attack from North Korea, leaving it more up to China and to South Korea to pay for and worry about aspects of the threat that relate directly to them.

Seoul and Washington could also differ even more in the future over Japan’s beefing up its own military and assuming a greater role for its own defense. Although Washington would prefer that Seoul and Tokyo remain allies, the US could become even less willing than it is now to interfere in any territorial disputes these governments might have with each other.

At this point, the above change in US national security policy regarding the North Korean threat is not imminent. However, it is possible that the US could change its view on how best to deal with the North Korea threat, and that a shift toward an “America First” policy that places less importance on current alliances could result in new stains in US-South Korean relations. Moreover, the attraction of dealing with a common national security threat could also be weakened by a clash of South Korean economic nationalism with greater US protectionism. The Obama Government might like to point to the US-Korean free trade agreement as one of its bigger successes and as “a model for trade agreements for the rest of the region, and underscores the U.S. commitment to, and engagement in, the Asia-Pacific region.” However, this is not a view shared by all presidential candidates. Donald Trump, for example, called the FTA with Korea “something that only a moron would sign.”

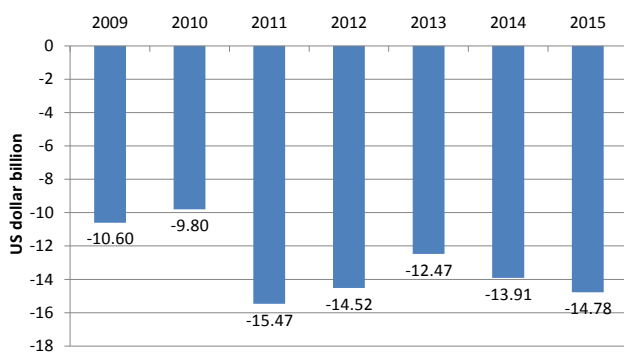
The emergence of greater protectionism in the US could end the current trend toward reduced trade barriers between South Korea and the US. First of all, a large and vocal segment of the Korean population is against opening the Korean market and adopting the reforms demanded in the TPP. From the US perspective, Korea is a prime example of a country that is taking advantage of the accommodating trade policies of the US without really offering reciprocal treatment. It is debatable whether or not this view is correct, but those in the US who would like to single Korea out for more discriminatory treatment for “unfair trade practices” will point to the trend in the trade imbalance as proof of their assertion. According to US figures, Korea has one of the largest trade surpluses with the US of any country in Asia – and the amount of the surplus has been growing rapidly. Last year alone it jumped more than 13% to US\$28.3 billion.

## TAIWAN

### Comments

#### The US Trade Deficit with Taiwan

(shifted on to China’s books)



Source: US Census Bureau

Even though Taiwan’s trade surplus with the US is much smaller than is South Korea’s and the trend of this surplus has not been rising as rapidly, Taiwan is even more vulnerable to a rise in US protectionism than is Korea. That is because Taiwan is producing most of its exports to the US from factories in China, and the surplus now shows up in China’s trade accounts, not the island’s. While Korea at least has the framework of its free-trade agreement with the US to act as an obstacle to protectionist forces in the US, neither China nor Taiwan has any such framework. Since the US trade deficit with China is the largest of any country and China is also increasingly viewed as a threat to US national security, it will be in the cross-hairs of the US protectionist movement,

which will not discriminate between Mainland-owned factories and those owned there by Taiwanese and other foreign investors. About the only force arguing China's case in the US will be those US companies that have major production facilities in China themselves – many of which are producing goods for export back to the US. However, those same companies are also likely to be a target of US protectionists, so it is likely that the influence of such multinationals on US foreign policies will diminish going forward in the “America First” scenario.

The US defense relationship with Taiwan is already more in line with what more isolationist forces in the US would like to see applied to other countries. In theory, the United States' support for Taiwan is defined by the Taiwan Relations Act. The US has not committed any troops on the ground and is unlikely to. It has helped Taiwan defend itself by selling weapons and technology, but this is not in the form of aid and is not a drain on the US fiscal accounts. Taiwan pays for the arms it buys from the US. Just last December, the US government announced a US\$1.8-billion arms sale to Taiwan that would send high-profile defense items such as warships and surface-to-air missiles to help bolster the small island nation's military.

The Chinese government, which has long known about the sale since it was approved more than a year ago, has consistently voiced concerns about Taiwan's purchase of US arms. The US has responded by having certain limitations on the level of technology it will sell to Taiwan, but Washington has not really worried about Beijing's objections. Its bigger concern has been that Taiwan, under the former KMT government, was starting to drag its heels on arms purchases, causing the impression that it was not investing enough in its own defense. This type of impatience is likely to continue going forward.

Now that Taiwan has changed governments and the DPP is in power, the US will be watching closely to see if island's new leadership turns more or less aggressive in buying arms from the US. If it becomes more aggressive, Taiwan's friends in Washington would probably lobby hard to avoid having the island become a victim of a more isolationist US foreign policy (if only because it is a way to contain China and make money in the process without really risking the lives of US troops). However, if the DPP scales back its purchases of more advanced defense systems from the US, its lobbying power in the US would diminish considerably and Beijing could be more confident that there would be limits to the extent that the US would intervene on Taiwan's behalf that might make China willing to become more aggressive in its cross-Strait reunification tactics.

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## THAILAND

### Comments

Since China and the United States are the two biggest buyers of Thai exports, any impediments to that trade would be a serious setback for the economy, which still depends heavily on exports for growth. Earnings from the export of merchandise and services are equivalent to 70% of Thailand's GDP. Risks of possible trade protection measures by the US and of increased cut-throat trading by the Chinese have arisen at a time when Thai exporters are battling fierce headwinds. Exports are running below last year's depressed level when they fell more than 8% and they have been contracting even more since the New Year.

If in fact the US and China are going to become tougher on trade most of Thailand's manufacturing industry will be hardest hit, though there are some less vulnerable sectors, principally the automotive, electronics and petrochemicals industries.

Thailand is not likely to be a specific government target for US protectionist measures but some important export sectors, particularly seafood products, could be damaged by boycotts imposed by governments and foreign importers. Flagrant breaches of international marine laws by Thai fishing fleets and their employment of slave labor have seen the cancellation of purchases of Thai seafood products by importers in

Europe and North America. More exports will be lost unless the Thais show that they are now respecting international fishing laws and correcting human rights abuses in the industry. The products of some other Thai industries, notably garment manufacturing and gold and other mineral mining continue to be at risk of boycotts because of disregard for labor and environmental laws.

Despite Washington's continuing condemnation of the army coup two years ago, political events have had little impact on Thai-US trade. However, Thailand still has little chance of concluding its long-delayed free trade agreement with the US while it is without an elected government. The governor of the Thai Central Bank recently reported that Thai exports to the US were poised to increase and that shipments of vehicle parts, electronic parts and appliances had recently expanded and that their growth was likely to continue. That positive situation will continue while the ruling junta maintains peace and order but there is a risk it would not prevail if the junta's enforcement of their new constitution caused an outbreak of violent civil unrest.

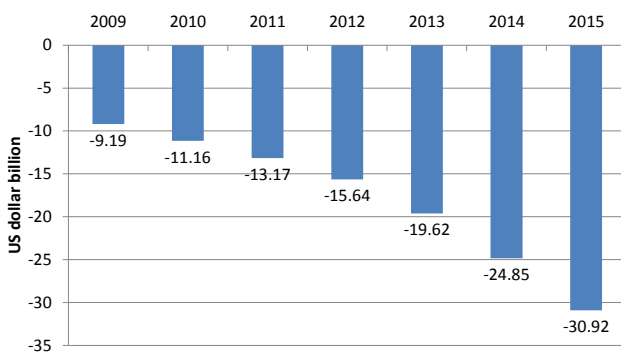
In recent years as much as 15% of total Thai exports were going to China and lesser proportions to the other two major markets, the US and Japan. Shipments to China began to slip three years ago with the onset of its economic slowdown. Food and other agricultural products, rubber, computers and parts, auto parts, plastics and paper and jewelry have been among the big export items. At the same time as Thai exports to China were declining, Chinese exports, pushed aggressively and cheapened by a currency devaluation, began cutting into Thai sales to the same markets. That trend has strengthened recently.

The Thai steel industry has already felt the power of aggressive Chinese trading. The biggest company, Sahaviriya Steel, was forced by heavy losses to shut its steel mill in the north of England last year because it could not compete with cheap steel imports from China. The company and government authorities accused the Chinese of dumping steel below production costs. Later, Sahaviriya went into bankruptcy owing US\$1.4 billion to Thai banks, the biggest default on the banks since Thailand's financial crisis in the late 1990s.

## VIETNAM

### Comments

#### The US Trade Deficit with Vietnam



Source: US Census Bureau

Vietnam would like to have the US military stay engaged in the region to counterbalance China's growing power, but Hanoi is not counting on such a commitment. It knows the US would not come to its aid militarily if Vietnam were to become involved in a dispute with China. For this reason, it will continue to invest heavily in its own military capabilities, and while it could not defeat China in a conflict, it would be such a formidable opponent that China will have second thoughts about allowing disputes it has with Vietnam from escalating. After all, Vietnam doesn't have to win a war with China. It just has to make China look vulnerable and fallible so China's leadership is embarrassed enough to weaken its position at home.

Vietnam does need to worry about a rise in protectionism in the US. The country has been invited to join the TPP as a founding member, but it is currently not even close to complying with the standards demanded of

TPP members. Therefore a future US government could use Vietnam's failure to meeting these commitments as an excuse for raising taxes or launching other punitive actions.

Hanoi's lobbying power in the US is weak. Moreover, while its success in growing its exports to the US has been a major factor behind Vietnam's strong economic growth, the growing dependency on the US market is also a major vulnerability. As the graph here indicates, the US trade deficit with Vietnam has grown even more rapidly than its imbalances with other countries in recent years, and while Vietnam might still be an emerging market, last year the size of the US deficit with the country was more than double that of Taiwan and 9% larger than Korea's. Consequently, while Vietnam might not yet have been mentioned as a potential target for unfair trading practices the way China, Korea and Mexico have been, it is probably only a matter of time before it is. Vietnamese seafood, garment and textile, footwear and furniture exporters are especially vulnerable.

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## EXCHANGE RATES

<i>Currency</i>	<i>3/11/16</i>
Chinese renminbi	6.4961
Hong Kong dollar	7.7596
Indian rupee	66.9363
Indonesia rupiah	13,000
Japanese yen	113.84
Malaysian ringgit	4.0719
Philippine peso	46.4450
Singapore dollar	1.3732
South Korean won	1,188.10
Taiwan dollar	32.64
Thai baht	35.040
Vietnamese dong	22,271

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

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