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Singapore | 17 Mar 2015

The Significance of the 2015 U.S. State of the Union Address for Southeast Asia

*By Tang Siew Mun and Sanchita Basu Das**

EXECUTIVE SUMMARY

- President Barack Obama delivered the State of the Union Address on 20 January 2015 outlining his Administration's plans and priorities for the year. Among them, four issues that should be closely watched by Southeast Asian nations are the state of the US economy, the Trans Pacific Partnership Agreement (TPPA), reshoring activities and the stability of the alliance structure in the region.
- The US economy is cautiously regaining its economic footing and is recording lower unemployment rates, as well as cheaper oil and gas prices. While a recovering US economy will counterbalance a softening Chinese economy, the increase in household disposable income will stimulate demand for imports. These have implications for Southeast Asian economies, including additional incentive for ASEAN states like Brunei, Malaysia, Singapore and Vietnam to win over sceptics and galvanise domestic support for the TPPA.
- The knock-on effect of the reshoring activities may be muted if ASEAN suppliers remain connected to the supply chain that now bypasses China and is rerouted directly to firms in the US. If done on a large scale, reshoring have the potential to realign the region's trade flows by strengthening ASEAN-US economic and trade relations.

- From a strategic perspective, the reshoring exercise coupled with the direct linking between Southeast Asian suppliers and US manufacturers will lessen ASEAN's dependency on China.
- “Modernizing” alliance structures is a pragmatic approach to move beyond the confines left by the Cold War. This phenomenon is mainly limited to Japan, South Korea and Australia.
- In Southeast Asia, tending to political relations is as important as exploring new modalities of cooperation and modernizing alliances. Unless the US moves quickly to repair its political relations with Thailand, it risks alienating one of its closest allies in the region.

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INTRODUCTION

The State of the Union Address by the US president is one of the major highlights in the American political calendar. The President delivered the Address on 20 January 2015 to a joint sitting of the House of Representatives and Senate and laid out the Administration's plans and priorities for the current year. This year's Address was keenly watched as it came in the wake heavy losses suffered by the Democratic Party in the mid-term elections, which saw the president's party losing control of the Senate. Already facing a hostile Congress and with his term of office expiring in two years' time, President Barack Obama is considered by many to be a political lame duck. Undeterred by the electoral setbacks, however, Obama pledged to continue his job of governing the country. As a global power, US policies and actions have as much impact in the US as it does around the world.

This article provides an analysis of how some of the proposed plans and ideas in the address will impact Southeast Asia. Specifically, it touches on the state of the US economy, the Trans Pacific Partnership Agreement (TPPA), reshoring activities and the stability of alliance structure in the region.

AMERICA HAS REGAINED ITS ECONOMIC FOOTING

The President delivered what *US Today*, *New York Times* and *Washington Times*¹ considered a rosy picture of the economy. He proclaimed that the US economy "is growing and creating jobs at a faster pace since 1999. Our unemployment rate is now lower than it was before the financial crisis." There is to be sure a renewed sense of confidence born out of the strong economic numbers. Indeed, the US recorded a GDP growth rate of 5 per cent and 2.6 percent quarter-on-quarter in the third and fourth quarters of 2014 respectively (Figure 1). For the whole year of 2014, US economic growth, though subdued in nature, is reflected in positive contributions from personal consumption expenditures² and gross private domestic investment. But signs for worry remain. While a dull world economy and the stronger US dollar dampened the demand for US exports, imports rose briskly as foreign goods became cheaper³ (Table 1).

¹ <http://www.straitstimes.com/news/business/economy/story/chinas-gdp-growth-slows-74-2014-20150120>

<http://www.usatoday.com/story/news/politics/2013/02/13/state-of-the-union-obama-fact-check/1915781/>

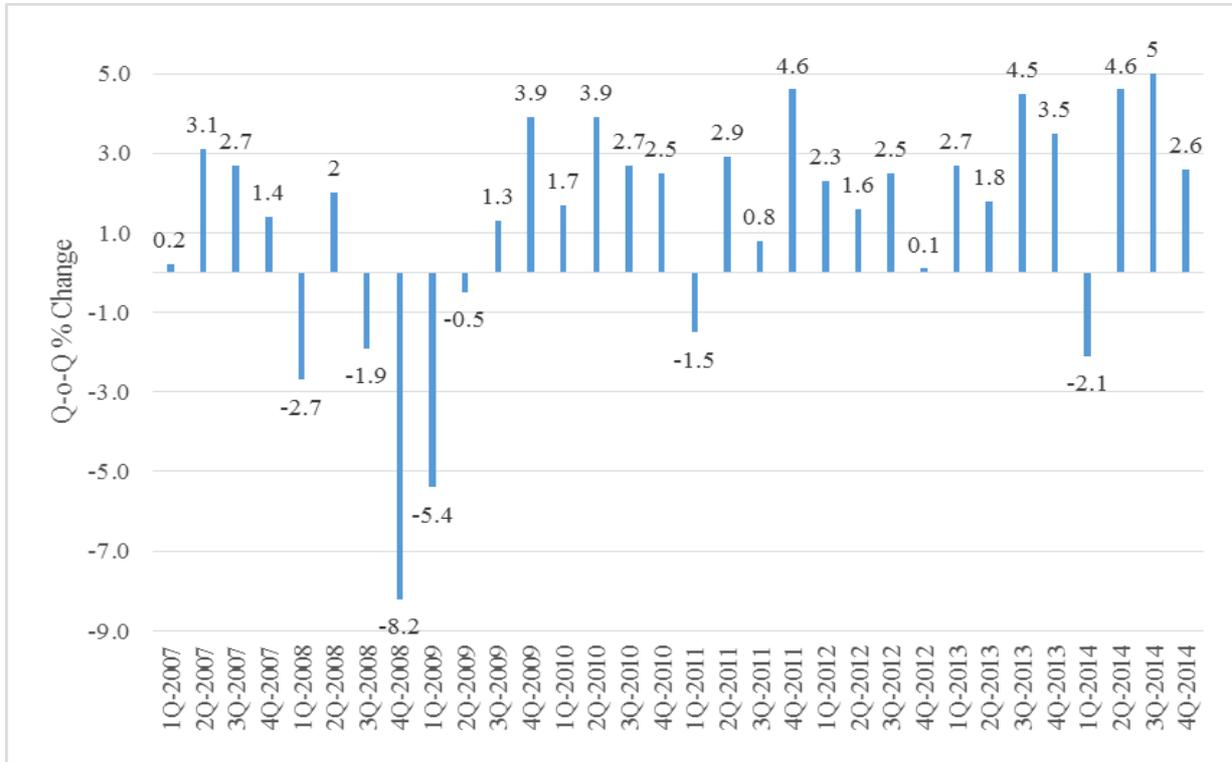
<http://www.washingtontimes.com/news/2014/jan/28/president-obama-uses-rosy-math-his-state-union-mat/?page=all#!>

http://www.nytimes.com/2011/01/26/us/politics/26speech.html?pagewanted=all&_r=0

² Amid signs of rising consumer confidence, the growth of personal consumption expenditure in the fourth quarter is 4.3% q-o-q, which is the biggest increase in almost nine years. The sense of optimism is backed up by a surge in hiring and a slide in gasoline prices.

³ As of mid-December, the U.S. dollar index was trading around 88.825, the highest level since March 2009.

Figure 1: Percentage Change in Real GDP (Quarter-on-Quarter; SAAR)



Source: Authors' compilation from the Bureau of Economic Analysis, US Department of Commerce

**Table 1: Percentage Change in Real GDP and its Key Components
(Quarter-on-Quarter; SAAR)**

Quarters	2012				2013				2014			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product	2.3	1.6	2.5	0.1	2.7	1.8	4.5	3.5	-2.1	4.6	5	2.6
Personal consumption expenditures	2.8	1.3	1.9	1.9	3.6	1.8	2	3.7	1.2	2.5	3.2	4.3
Gross private domestic investment	6.9	5.8	1.6	-5.3	7.6	6.9	16.8	3.8	-6.9	19	7.2	7.4
Exports	1.3	4.8	2.1	1.5	-0.8	6.3	5.1	10	-9.2	11	4.5	2.8
Imports	1.7	4	-0.6	-3.5	-0.3	8.5	0.6	1.3	2.2	11	-0.9	8.9
Government consumption expenditures and gross investment	-2.7	-0.4	2.7	-6	-3.9	0.2	0.2	-3.8	-0.8	1.7	4.4	-2.2

Source: Authors' compilation from US Department of Commerce, Bureau of Economic Analysis

The US unemployment rate dropped to 5.6 per cent by end-2014 from a high of 9.9 per cent in end-2009 and 7.9 per cent in end-2012. But higher employment has yet to translate into higher earnings.⁴ In his Address, Obama also referenced the shale gas revolution and the plummeting oil price and remarked that “thanks to lower gas prices and higher fuel standards, the typical family this year should save \$750 at the pump.” Indeed, it is a net positive when the US underwent a structural change from a net importer to a major energy producer of oil and gas. While the drop in prices is hurting the oil industry, it has significantly lowered business-operating costs in the US and these savings add to the disposable income of US consumers. Higher demand for consumer goods will spur exports from Southeast Asia.

The implications of the US economic rebound for Southeast Asian economies is more pronounced especially when the Chinese economy is slowing down to around a 7-7.5 per cent growth rate, firmly marking an end to the high growth rate era of the 1990s and early 2000⁵. Southeast Asia as a whole is still dependent on the US market for exports and foreign direct investment (FDI) (Table 2). For some countries, such as Cambodia, the Philippines and Vietnam, the US is a key market that absorbs more than 14 per cent of their total exports. Only Brunei, Myanmar and Singapore have a negative trade balance with the US. More

⁴ Hiring Booms, but Soft Wages Linger, Jeffrey Sparshott, 9 Jan 2015 (<http://www.wsj.com/articles/u-s-adds-252-000-jobs-unemployment-falls-to-5-6-1420810489>)

⁵ The Chinese economy grew by 7.7 per cent in 2013 and another 7.4 per cent in 2014 compared to an average of 10.7% during 1991-1999 and 10.3% during 2000-2010 (IMF, World Economic Outlook Database, October 2014).

importantly, the US invests more in Southeast Asia than it does in China and India combined. US FDI to Southeast Asia in 2012 was US\$190 billion compared to US\$51.4 billion and US\$28.4 billion for China and India respectively. A rebounding economy may spur more US trade and investment to Southeast Asia.

Table 2: Trade and Investment Linkages between USA and Southeast Asia, 2013

	Exports to USA (US\$ million)	Imports from USA (US\$ million)	Trade Balance (US\$ million)	Share in country's total exports	Share in country's total imports	USA FDI in ASEAN countries (stock) (US\$ billion), 2012
Brunei	16	614	-598	0.2	7.2	0.116
Cambodia	2,079	1,111	968	22.5	12.1	0.054
Indonesia	15,741	9,082	6,659	8.6	4.9	13.5
Laos	28	27	1	0.7	0.4	--
Malaysia	18,474	16,186	2,287	8.1	7.9	15.0
Myanmar	27	160	-133	0.3	0.8	0.001
Philippines	7,832	7,358	475	14.5	10.8	4.6
Singapore	24,063	38,872	-14,809	5.8	10.4	138.6
Thailand	22,644	3,311	19,333	10.1	5.6	16.9
Vietnam	23,869	5,232	18,637	18.8	4.1	1.1
ASEAN	114,773	81,954	32,820	9.1	7.7	189.9

Source: Office of the US Trade Representative, CEIC Database; (<https://ustr.gov/countries-regions/southeast-asia-pacific/burma>)

In addition, a stronger US economy will also provide additional incentive for ASEAN states like Brunei, Malaysia, Singapore and Vietnam who are negotiating with the US to conclude the TPPA to win over sceptics and galvanise domestic support for the trade pact.

FAST-TRACK AUTHORITY FOR CONCLUDING THE TPPA

The TPPA is one of the centrepieces of the Obama Administration's rebalancing strategy. The "gold-standard" free trade agreement serves to consolidate US linkages with the region, and provides Brunei, Malaysia, Singapore and Vietnam with preferential access to the US market. Although interest remains strong among the 12 negotiating parties, there is a

noticeable lack of progress. Questions abound if the Obama administration could carry the final negotiated document through ratification by the Senate, especially now that the upper house is controlled by the Republican Party. In this regard, the president's request for trade promotion authority (TPA) – more popularly known as fast-track authority – takes on added importance and is thus a reassuring sign that the Obama Administration remains committed to the TPPA.

The TPA – which last expired on 30 June 2007 – will provide a needed sense of assurance to negotiating parties and allow them to make politically difficult concessions in the knowledge that there is a high probability that the agreed deal will get Congress' nod. Trade economists like Jagdish Bhagwati, considers TPA a pre-requisite for US trade negotiation and notes that other countries would be reluctant to take up trade agreements with the US, especially when Congress can unilaterally amend an FTA.⁶

Obama faces stronger opposition from his own ranks than from the Republicans. Senate Finance Committee Chairman, Orin Hatch (R-Utah) and House Ways and Means Chairman Paul Ryan (R-Wis) have signalled their support for trade promotion authority,⁷ while on the other side of the political aisle, vocal Democratic voices, among them Senator Elisabeth Warren (D-Mass) and Representative Rosa DeLauro (D-Conn) are determined to undermine support for the measure. Sen. Warren argues that “trade agreements were among the poor choices that left America's middle class in a deep hole.”

The US bargaining position would be weakened and the negotiating parties forced to take their chances with the Congress unpacking the agreed terms, if skeptics in the Democratic wing are successful in defeating the trade promotion authority bill that is expected to be introduced in Congress in March, at the earliest. The negotiating parties will not relish the thought of experiencing South Korea's harrowing experience of concluding the US-Korea Free Trade Agreement without fast-track authority. This is a disconcerting thought for countries like Malaysia where the political leadership has staked its political fortunes on the TPPA.

The strategic value of the TPPA for the US is immense. If concluded, it will increase the number of ASEAN states that it has an FTA with from one (Singapore) to four. Viewed from the region, enhanced economic ties will help boost the regional economy by diversifying its linkages and strengthening its trade ties with the US.

The TPPA is as much a trade agreement as it is a test of American credibility and diplomatic standing in East Asia. Should it fail to be realised, it will be yet another missed opportunity for the US to upgrade its relations with Asian partners. With two-way trade valued at US\$127 billion in 2014,⁸ the ASEAN-4 negotiating parties will be keenly watching the fast-track authority bill make its way through Congress.

⁶ Bhagwati: US Must Rethink Doha Demands, Interview with Jagdish N . Bhagwati on February 9 2007, Council on Foreign Relations (<http://www.cfr.org/india/bhagwati-us-must-rethink-doha-demands/p12592>)

⁷ <http://thehill.com/policy/finance/230028-hatch-says-trade-promotion-authority-a-necessity>

⁸ <https://www.census.gov/foreign-trade/balance/c5590.html>

RESHORING AND RE-ALIGNMENT OF TPPA

“Reshoring” or reverse outsourcing, is a growing phenomenon in the US as it is seen as a harbinger for better employment prospects for American workers. Obama threw his support behind reshoring to tackle unemployment woes: “More than half of manufacturing executives have said they are actively looking at bringing jobs back from China. Let’s give them one more reason to get it done.” While the numbers of American firms that have implemented reshoring policies remain low – about 100 – the trend of relocating from China to the US is gathering traction. Some of the firms that have “reshored” include General Electronics, Caterpillar, Google and Lenovo.⁹

One key reason for reducing US manufacturing exposure in China is the rise in wages there. According to the International Labour Organisation’s Global Wage Report 2014/15¹⁰, real wages in the Asia rose by an average of 5.8 per cent for the period between 2011 and 2013. This is significantly higher than the global average of 1.8 per cent for the corresponding period (Table 3).

Table 3: Cumulative Real Wage Growth (Index: 1999=100)

	2005	2010	2011	2012	2013
World	113.0	125.8	127.0 (1.0)	129.8 (2.2)	132.4 (2.0)
Developed Economies	103.3	106.5	106.0 (-0.5)	106.0 (0.0)	106.3 (0.3)
Asia	149.8	205.7	216.7 (5.4)	229.6 (5.9)	243.3 (6.0)
East Asia	165.2	245.4	261.6 (6.6)	281.7 (7.7)	301.8 (7.1)
Southeast Asia and the Pacific	124.8	136.6	139.9 (2.4)	145.1 (3.7)	152.8 (5.3)
South Asia	114.4	147.9	152.8 (3.3)	155.1 (1.5)	158.8 (2.4)

Note: the figures in the bracket gives the % year-on-year growth rate

Source: International Labour Organization: Global Wage Database 2014/2015

Rising wages are also compounded by labour issues, which in turn add to production costs. US and other foreign firms have encountered incidences of labour unrest, and these disturbances often end with a negotiated wage increase. For example, after the Zhongshan strikes in 2010, Honda gave its Chinese workers a 47 per cent pay rise. Foxconn Technology Group – a subcontractor for Apple and other big technology firms – doubled pay at its factory in Shenzhen after a series of suicides. Apart from these, other production costs, including

⁹ *The Economist*, <http://www.economist.com/news/special-report/21569570-growing-number-american-companies-are-moving-their-manufacturing-back-united>

¹⁰http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-bangkok/documents/publication/wcms_325219.pdf

rentals, electricity tariff, corporate income tax, have also been rising in the Chinese economy.¹¹ As a result, China is losing its lustre as a haven for low production costs.

Reshoring will impact Southeast Asia in two ways. In the first instance, just as US firms are reassessing their economic model in China, they are likely to do the same with their operations in the Southeast Asian region. This is because Southeast Asian economies, especially the more developed ones, are also experiencing the same pressure of increase in their wage structure, a factor that will chip away their competitiveness vis-à-vis other developing economies such as India and Sri Lanka. Nevertheless, with the advent of the ASEAN Economic Community (AEC) involving some 635 million people, multinationals will be attracted by cost efficiencies, as well as by economies of scale and scope. According to Tholons – a Services Globalization and Investment Advisory firm – “Southeast Asia’s maturing ‘Outsourcing Brand’, improving macro-economic environment and expanding domestic markets continue to draw the attention of large service providers into the region, resulting in the upward movement of key Southeast Asian service delivery locations.”¹²

Second, Southeast Asian economies are intrinsically linked with China and the effect of the scaling down of US manufacturing in the world’s second largest economy will reverberate throughout the region. However, the knock-on effect may be muted if ASEAN suppliers remain connected to the supply chain that now bypasses China and is rerouted directly to firms in the US. The strategic impact of reshoring extends beyond economics and trade. If done on a large scale, reshoring have the potential to realign the region’s trade flows by strengthening ASEAN-US economic and trade relations. The region’s trade with the US will then be reflected in their bilateral trade statistics, instead of showing up on Chinese ledgers. Strategically, the reshoring exercise coupled with the direct linking between Southeast Asian suppliers and US manufacturers will also lessen ASEAN’s dependency on China.

At its present scale and intensity, reshoring is not expected to have a significant impact on Southeast Asian economies. Currently, the larger impact on the region is coming from the reaping of benefits from production cost increases in China as more US firms turn to low-cost Southeast Asian countries like Indonesia, Vietnam and Thailand as an alternative FDI destination to China. Nevertheless, it is important to keep track if reshoring is to snowball into a larger trend.

REPAIRING CRACKS IN THE ALLIANCE SYSTEM

The US President focused the bulk of the international affairs component of the Address on pressing strategic issues such as stopping the ISIL advance in Syria and Iraq, the US withdrawal from Afghanistan and the Ukrainian crisis. With reference to the “Asia-Pacific,” Obama called for “modernizing alliances while making sure that other nations play by the rules, in how they trade, how they resolve maritime disputes, and how they participate in meeting common international challenges like non-proliferation and disaster relief.” The

¹¹ Deloitte University Press (2013), ‘Manufacturing Beyond China’, Business Trends

¹² Tholons 2013 Top 100 Outsourcing Destinations Report

http://www.tholons.com/TholonsTop100/pdf/Tholons%20Top%20100%202013_Rankings%20and%20Report%20Overview.pdf

singular mention of “Asia-Pacific” in the 6,718-word Address is a testament to the relative stability of the region compared to other parts of the world.

Obama’s advocacy of “modernizing” alliances is not a new position but is one that still ruffles a few feathers in Beijing as China sees the US-led hub-and-spokes security alliances as a Cold War relic aimed at China. If the US-Japan security alliance is any indication, the US has indeed been successful in breathing new life into Cold War security structures. The fact remains that the US provides the indispensable common good of regional security. Without the US security umbrella, countries like Japan and South Korea would embark on an arms build-up that would have a destabilizing effect on the region.

“Modernizing” alliance structures is a pragmatic approach to move beyond the confines of the Cold War. The most significant revitalization of US strategic ties in the Asia-Pacific is however largely confined to Japan, South Korea and Australia. The US rotational deployment of its Marines in Darwin is one of the more important strategic developments that have a direct bearing on Southeast Asian security. Darwin’s geographical proximity to the region effectively provides the US with a forward deployed option that can be used to project limited force into Southeast Asia. Updating the alliances also reinforces the balance of power in the region and reaffirms US commitment to regional security. The picture is, however, different in Southeast Asia.

The US military footprint in Southeast Asia is clearly less visible today. It withdrew from the Philippines in 1991 and has now adopted a “places not bases” approach to forge security partnerships throughout the region. Nevertheless, the US has maintained a strong strategic presence in the region through various modalities. For example, the US concluded the Enhanced Defence Cooperation Agreement (EDCA) with the Philippines in April 2014 that allows the US greater access to Philippines military bases. It has also maintained a strong and durable partnership with Singapore, culminating in the Strategic Framework Agreement for a Closer Cooperation Partnership in Defence and Security (SFA) signed in 2005. US military relations with Malaysia have also improved and became more visible in the last few years.

But its relations with Thailand are more challenging today. In the wake of the military coup in Bangkok, there is a noticeable cooling of strategic ties between Bangkok and Washington. Speaking at a public seminar at Bangkok’s Chulalongkorn University, US Assistant Secretary of State, Daniel Russel made some comments that were critical of the coup, which had the effect of widening the diplomatic spat between the two long-time allies. Deputy Foreign Minister Don Pramudwinai responded by saying that Russel had “caused wounds to Thais.”¹³

A prominent Thai political analyst, Kavi Chongkittavorn, lamented that “left unattended by the major Western powers following the May 22 coup, Thailand and China have quickly strengthened their relations – especially in longstanding defence cooperation.”¹⁴

¹³ “US statement ‘wounded’ Thailand, Deputy Foreign Minister says,” 28 January 2015, *The Nation* <http://www.nationmultimedia.com/politics/US-statement-wounded-Thailand-Deputy-Foreign-Minis-30252836.html>

¹⁴ “Thai-China ties destined for new level of strategic significance,” 3 November 2014, *The Nation* <http://www.nationmultimedia.com/opinion/Thai-China-ties-destined-for-new-level-of-strategi-30246792.html>

Concomitantly, the US continues to underline its support for parliamentary rule by limiting its participation in this year's Cobra Gold exercise to 3,600 troops, down from 4,300 the year before.

More than anything, the floundering US-Thai relations point to the importance of nurturing political relationships. In a region that has the luxury of not having to deal with an immediate external security threat, strategic relations and military partnerships are guided by political exigencies and interests. Malaysia is a case in point. The much improved political relations between Kuala Lumpur and Washington have allowed for more open and visible security cooperation, which is manifested in Malaysia's participation in the Cobra Gold military exercise, among others. By the same token, the fractured political relationship between Bangkok and Washington has taken a toll on the bilateral military relationship.

CONCLUSION

The US is an important partner for ASEAN and has provided the common good of regional security for almost 70 years. This is a dynamic relationship that has been preserved through difficult times and that has seen many more bright moments. The TPPA has the potential to elevate US ties with Brunei, Malaysia, Singapore and Vietnam while providing a strong economic boost for the 12 negotiating parties. It is for these reasons that the passage of the trade promotion authority bill is closely watched.

In the meantime, reports of the US recovery from the 2007 financial crisis could not have come at a more opportune time as the region pins its hopes on US growth to compensate for the slowdown of the Chinese economy. The US recovery story will dampen fears of losses associated with "reshoring." The downside to reshoring for Southeast Asian economies will be negligible if the relocation is limited to US investments in China. In fact, it may even be a fortuitous outcome for Southeast Asia as reshoring provides the opportunity for firms to supply directly to US manufacturers and assemblers, instead of feeding into Chinese assembly lines. On the whole, these developments contribute to the rebalancing strategy and the strengthening of US relations with the region. The only blemish are the deteriorating US relations with Thailand, which underscores the point that military relations often take the cue from politics.

ISEAS Perspective is published electronically by the Institute of Southeast Asian Studies, Singapore.

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