Southeast Asia 2035: A Realized Economic Promise?

A Wikistrat crowdsourced simulation

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Southeast Asia’s economies outperformed those of other regions during the Global Financial Crisis of 2008-2009, and recent projections point to continued strong growth. Today, as production costs are increasing in China, multinational firms look to Southeast Asia for its lower cost of production, its growing middle class and its rising education levels.

In addition, during the past decade, the Association of Southeast Asian Nations (ASEAN) and individual countries in the region have forged stronger economic ties with Europe, North America and the BRICS (Brazil, Russia, India, China and South Africa) via trade agreements and investment treaties. Intraregional and sub-regional trade networks are also flourishing: Singaporean, Malaysian and Thai firms are going international and ASEAN is taking steps toward creating a single market (à la the EU) with free movement of goods, capital and people.

Notwithstanding these positive economic developments, as well as the region’s relative political stability, some dark clouds are gathering on the horizon. As income levels rise, so do wages, thereby undercutting Southeast Asia’s low-cost advantage. Squeezed in between other low-wage economies and advanced high-income ones, the region could stagnate unless it pushes its way to high-income status with innovation, advanced technology and high-skilled labor. In other words, the question is: Will Southeast Asia overcome what the World Bank calls the “middle-income trap” (languish within a range of per capita yearly income of about $1,000 to $12,000, measured in 2010 U.S. dollars) that sees many other developing countries failing to rise to the next level of economic development?

There are other challenges for Southeast Asia that don’t directly involve economics. These include: major trade agreements such as the Trans-Pacific Partnership (TPP), promoted by the United States; China’s Regional Comprehensive Economic Partnership (RCEP); the vast potential of oil and gas resources within or outside disputed waters in the South China Sea; the American “pivot” to Asia; China and Japan’s rising nationalism; global geopolitical rivalry; water scarcity and climate change.

**ABOUT WIKISTRAT**

*Wikistrat is the world’s first crowdsourced consultancy. It leverages a global network of subject-matter experts via a patent-pending “Collaborative Competition” methodology to provide a variety of analytic services. Wikistrat conducts scenario generation, policy planning, risk assessment and red-teaming exercises on a real-time, interactive online platform.*
In July 2014, Wikistrat conducted an online, crowdsourced simulation in which its analysts were asked to identify which of these factors, or combinations of factors, will contribute to Southeast Asia’s economic success (or lack thereof) over the next twenty years. Analysts generated two sets of distinct scenario pathways to answer these questions. First, they proposed competing scenarios for individual countries in Southeast Asia, identifying the main drivers of their growth or stagnation between now and 2035, taking into account political and social changes that might affect their economic restructuring. Next, analysts provided descriptions of the economic relations (e.g., ties and barriers) in the region.

Fifty-nine Wikistrat analysts collaborated to develop more than fifty competing scenarios. This report summarizes their findings.
This report organizes the dozens of scenarios that were generated in the simulation into four “Master Narratives,” linking together various scenarios into larger storylines. These Master Narratives are articulated around two axes:

1. To what extent will the region integrate successfully so as to maximize each country’s comparative advantage and hone its unique selling points?

2. To what extent will the region restructure its socioeconomic and political makeup to rise above the middle income trap?

Against these two axes, the following four Master Narratives emerge.

In this matrix, variables at the left and bottom are considered less desirable than those at the right and top. A lack of integration is taken to be undesirable, as it would prevent countries from maximizing their comparative advantages, as is enduring middle-income status for Southeast Asia. Master Narrative I, “Sweatshops,” should therefore be considered the worst-case outcome for the region by the year 2035. Master Narratives II and III, “Processing Zone” and “The Joneses,” should be considered mixed-case outcomes – and, ideally, stepping stones to the best-case outcome for the region as represented in Master Narrative IV, “Country Club.”

A Master Narrative (MN) consists of a distinct grouping of individual scenarios that form an alternative future. Scenarios are plausible storylines whose primary purpose is to describe how the major relevant variables in any trend or series of events can come together to produce a distinct pathway through a perceived “crisis” and then toward an exit point that can be characterized as the subsequent “new normal.”
This Master Narrative is marked by the following characteristics: natural disasters, inability to restructure inert existing economies, lack of progress toward better governance and social equity, as well as tense and potentially explosive regional politics. These combine to plunge the whole region into isolated “sweatshops” struggling to stay above water or ensnared ever more deeply in the institutionalized middle-income trap.

The brutal implementation of Islamic law in Brunei makes the country a much tougher place to live in, especially for women. In Thailand, the looming royal succession ushers in great instability, with the aged, highly respected king set to be replaced by an immensely unpopular crown prince. Political rivalry and open fighting (often literally) between opposing factions reverts the country to an unfortunate cycle of revolving doors turned by military coups rather than the ballot box. Myanmar, despite Aung San Suu Kyi’s best efforts, falls back on authoritarianism and cronyism. Vietnam’s vibrant economy gives vested interests a bigger enticing pie. The “Golden Triangle” is awash with narcotics as drugs find huge markets generated by an upper middle class surging worldwide. Singapore is losing its shine as its dominant People’s Action Party (PAP) is becoming unpopular in a more divided society with marginalized migrant workers.

By far the largest storm ravaging the region is China’s unravelling economy. The much-hyped “China Miracle” has turned into a nightmare. Growth rates have slowed to 3 percent. This proves inadequate to generate sufficient jobs to absorb the rural masses migrating to the cities. A modified One Child Policy fails to deliver more new blood. Most people are wary of the future. The lack of sufficient political checks and balances sees corruption rearing its ugly head all over the country. Rising inequalities and social tension feed into surging aspirations for political reform from a civil society of 200 million university graduates. Decades of environmental degradation have resulted in a crisis point as water scarcity and pollution accentuate social discontent. Uprisings in the ethnically tense Tibet and Xinjiang provinces are becoming more regular – and more deadly. The Uighurs in Xinjiang, in particular, are drawing strength from a worldwide Islamic resurgence.

For political diversion, the military resorts to even more assertive actions to fortify China’s vast claims of territorial sovereignty in the East and South China Seas. As a result, the United States deploys more military assets in the region, including nuclear-armed battle groups. More joint military exercises with U.S. allies are conducted near China’s borders as an unspoken warning to Beijing. As China’s relations with its Southeast Asian neighbors worsen, it moves more production to South America – partly to be closer to the North American market. This results in much less trade flowing through countries near the Malacca Strait. A new Kra Canal in Thailand further compounds the problems of trade diversion for these countries.

Meanwhile, for lack of synergy, the Southern Philippines fail to take off as part of the much-vaulted BIMP-EAGA (Brunei, Indonesia, Malaysia and Philippines – East Asia Growth Area) economic area.

Climate change delivers the coup de grâce. Waters in the Mekong Delta begin to run dry while the ecology of river flows (on which much of Mekong’s agrarian livelihood depends) is massively disrupted by reckless upstream dam-building in China.
While the region struggles to escape the middle-income trap, it manages to integrate extremely well. This is driven by the mutual affinity of Asian cultures and decades of shared prosperity in an increasingly globalized production and supply chain. Today, a “flat world” has seen capital-intensive countries outsource manufacturing and other processes around the globe wherever the cost-and-benefit calculus is most competitive. As a result, **China** has emerged as the world’s central production hub, with Southeast Asian countries acting as suppliers of resources, materials and components.

By 2035, however, this calculus has changed. China has become the world’s largest economy, moving into higher-value-added manufacturing, services and domestic consumption. Not only costs have risen significantly – China is no longer interested in labor-intensive mass production as the country wants to upgrade, innovate or buy into the world’s commanding heights of technology, creativity and global brands.

Taking advantage of this tectonic change, with a more skilled labor force and more investment-favorable policies, Southeast Asia integrates itself into an alternative “factory of the world,” able to comply with international quality standards and build an economy of scale comparable to China’s.

Regional and bilateral trade agreements within ASEAN are boosted by what the TPP and RCEP can offer. As China moves toward more quality than quantity, a great decanting process takes place. Processes where China has become non-cost-competitive migrate elsewhere within the region (which still has the world’s leading infrastructure for supply and production chains). Six of the world’s busiest container ports are still located in China. Moreover, as China’s consumption growth drives global consumer demand, it becomes the final product destination – which Southeast Asian countries are well-positioned to take advantage of.

Consequently, a new regional division of labor emerges. Helped by a new Kra Canal, **Thailand** becomes a manufacturing hub for mid-priced goods. More labor-intensive processes migrate to **Laos** and **Cambodia**. Malaysia and Indonesia cater for goods and services with inputs sourced from the Middle East and other Arab and Islamic countries. **Singapore** expands its role as a predominant “ASEAN-plus” financial and service hub. The whole region looks like a Pearl River Delta redux, despite national boundaries and diverse socioeconomic communities. Nevertheless, absent transformational socioeconomic restructuring, the region remains trapped as a processing zone, albeit of global proportions, far removed from the vision of a rich men’s club.
Under a new president, Indonesia becomes the first Muslim democracy with relative racial harmony — embracing its long-established Chinese community — and creating a $1 trillion economy rich in commodities and middle-class consumption. Increasingly self-confident, however, it feels less inclined to piggyback weaker neighbors.

Similarly, Thailand is basking in splendid isolation, even as its politics have become more inclusive. Relying on its proximity to and friendly relations with China, it benefits hugely from the production it outsources. While a new Kra Canal through Thailand’s narrowest isthmus helps China’s trade and energy flows bypass the geopolitical choke point of the Malacca Strait, this is at the expense of Singapore and Malaysia. To compensate for this economic loss, Singapore hones its uniqueness as a global hub for tax avoidance. State-of-the-art bonded warehouses at Changi International Airport see expensive artwork and jewelry change hands tax-free with an encrypted telephone call.

Elsewhere in the region, East Timor becomes an oasis of wealth as oil and gas production propels its economy — which this island country succeeds in balancing with agriculture, fisheries and tourism. Myanmar’s economy and society have been totally transformed under President Aung Sun Suu Kyi. Foreign investment is pouring in to take a stake in the new-found economic dynamism. Hong Kong is thriving merely as a conduit for China-centric trade and financial flows.

But all these growing economies fail to scale up to reap greater regional and global opportunities. The TPP is yet to embrace a larger share of the region as Indonesia, Malaysia and some smaller Southeast Asian countries continue to resist demands for immediate liberalization of their service sectors and politically-sensitive industries. The United States is also becoming less proactive in pushing the TPP after the Trans-Atlantic Trade and Investment Partnership with the European Union is concluded and China becomes a closer strategic partner to confront an expansionist Russia.

China’s RCEP, meanwhile, looks irrelevant, as Southeast Asian countries are ready to sell to each other (and to China) whatever they want. ASEAN+3 gets stalled by worsening relations between China and Japan. Tensions between these two countries nearly flare up in all-out war, if not for behind-the-scenes mediation by the United States. China is nevertheless redoubling the deployment of oil rigs in disputed waters with the Philippines and Vietnam. This worsens the divisiveness in the ASEAN community on how to confront China. Nor are things quieter in the Taiwan Strait. A new anti-Beijing and pro-independence Taiwan government has just been elected to power, this time openly allying itself with Japan, China’s nemesis.

Individual component economies of BIMP-EAGA continue to prosper with their natural resource endowments but fail to integrate into a meaningful sub-regional network. To a smaller extent, East Timor also finds itself living on borrowed time. When the oil revenue dries up, it will find it has largely misspent and in, some cases, misappropriated the funds. In sum, while certain economies prosper, the region as a whole looks rather like a mixed and divided neighborhood.
Taking full advantage of ASEAN+1 (China), +2 (adding Korea) and +3 (adding Japan) as well as the TPP and the RCEP, Southeast Asia is able to achieve the best of all worlds. Thanks to robust leadership ushering in economic restructuring and better governance, countries have left their corruption-infested eras behind. Rising out of the middle-income trap, their true potential is unleashed. The whole region becomes fully integrated and excels as a competitive regional “factory of the world,” absorbing processes decanted from China due to rising costs. National institutions are being perfected – embracing democracy, clean government and inclusive, open society. Regional manpower resources are upgraded and integrated (through curriculum coordination). E-commerce partnerships with Chinese investors and businesses are giving the region’s vibrant consumer market a further boost. This is supported by sub-regional networks (such as BIMP-EAGA) which are blessed with bio-diverse and energy resources.

Meanwhile, a born-again Indonesia links up with economies in the Indian Ocean. Muslim businesses find a vibrant home in the Malaysia-Indonesia nexus, which turns into a global hub for Islamic finance. Acting as a vanguard for the U.S.’s Asia “pivot,” Vietnam upgrades its economy through increased transfers of American technology. Taiwan’s economy is revitalized by embracing the Cross-Strait Service Trade Agreement with China, thanks to much better cross-strait relations following two more decades of economic integration. Cooperation in exploiting massive resources in the South China Sea is a real game-changer, involving the world’s oil majors, as territorial claimant countries sweep disputes under the carpet to cooperate.

Following universal suffrage in 2017, Hong Kong overcomes sociopolitical tensions and is able to hone the Special Administrative Region’s unique strengths as the world’s freest economy at the heart of a Hong Kong – Shenzhen-Guangzhou megapolis. This becomes the world’s largest mega-region of 120 million people linked by high-speed rail and integrated processes.

As China’s economy becomes the largest in the world, most countries across the globe have it as their largest trading partner. The Chinese currency, which is now fully convertible on the capital account, forms part of many nations’ reserve currency portfolio along with the U.S. dollar. RMB-denominated trade settlements and financial instruments flourish, consolidating Hong Kong’s unique position as the world’s financial center of choice for RMB-based financial services. The ASEAN-China Free Trade Area, established in January 2010, has ensured that Southeast Asia continues to benefit from China’s explosive growth.

Thanks to gradually-introduced economic and social reforms, China has become a more open, liberal, equitable and rule-based society, playing an active role in the global commons as a benign and responsible stakeholder. Its dam-building in the upper reaches of the Mekong has been satisfactorily managed with advanced computer technology in close partnership with downstream nations, while Mekong Delta economies become much more closely linked with China through high-speed rail. In the wake of national socioeconomic/political restructuring and smarter cooperative synergies, the whole of Southeast Asia has transformed into an upper-middle-class economic region, anchoring the vision for an “Asian Century.”
China looms large in the region. By 2035, it has become the world’s largest economy and the largest trading partner for all the Southeast Asian countries. However, in the face of a multitude of critical domestic and external challenges, how China will pan out during this trajectory matters hugely for the region – for better or for worse.

1. Every Southeast Asian country has its own cross to bear, including corruption, vested interests and want of political inclusiveness. How to restructure and upgrade their economic makeup, hone higher skills and comparative advantages, develop better governance and integrate both regionally and globally will determine each country’s ability to overcome the middle-income trap.

2. Powerful and interlocking regional trade initiatives are vital drivers in a complicated regional "spaghetti bowl." How Southeast Asia is able to have the best of all worlds requires a great deal of diplomatic sagacity and nimbleness, reaping the economic benefits without being caught up in problematic regional rivalries.

3. The U.S. Asia “pivot” is viewed in China as containment in all but name. The deployment of more American military assets, closer joint defense mechanisms and military exercises with allies on China’s doorsteps are unlikely to put China’s mind at ease. This is concomitant with China’s increasingly assertive stance over territorial claims in the East and South China Seas. Japan’s rearmament risks throwing a spanner in the works. Changing Taiwanese politics threaten renewed tensions over the Taiwan Strait. Regional turbulence is on the rise, as a classic “security dilemma” is playing out. The jury is still out on whether the “Thucydides Trap” ensnaring an existing superpower and its rising challenger can be avoided.

4. The East and South China Seas promise to be a cornucopia of rich resources. In an energy-hungry world, they are set to become a game-changer if areas outside territorial disputes prove viable for cooperative exploitation among Southeast Asian partners and the world’s oil majors. The impact could become tectonic if mutual trust manages to sweep disputes under the carpet for large-scale win-win cooperation between rival territorial claimants.

5. The world is witnessing a revival of Islamic culture and businesses. As the largest secular Islamic countries in the region, Malaysia and Indonesia are well-positioned to become a regional, if not a global hub, for Islamic finance.

6. Last but not least, Southeast Asian agrarian economies are susceptible to ravages of climate change, including rising sea levels and adverse water flows in the Mekong Delta. Water scarcity is compounded by unilateral dam-building by countries upstream. Water conflicts and climate chaos are likely to define regional economies and geopolitics.
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This report is based on the collaborative effort of 59 Wikistrat analysts held in July 2014.

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