

The Outlook for U.S. Business in South and Southeast Asia in 2017 and Beyond

By Ambassador Robert Blake

Thank you for this opportunity to address this distinguished audience and to escape the Washington bubble and dysfunction. With a new Administration in office, Washington if anything has become even more focused on its self-importance. After two days in LA, I hear rumors of plans to secede. If so, I may apply for citizenship!

I was asked to discuss the outlook for US business in South and SE Asia this year and beyond. I will break this down in four:

- First to discuss the bright medium to long-term future for this region
- Second to address the challenges now facing the region
- Third to focus on the outlook for the two largest economies in this region, India and Indonesia, and
- Fourth to offer some advice going forward.

Bright future:

Virtually every study of medium and long term growth trends points to the regions of South and SE Asia becoming increasingly important sources of growth in the global economy. This is due to:

- Their favorable demographic profile at a time when most of the rest of world, including Europe, Japan and China are facing diminishing population and labor force growth;
- strong sustained GDP growth rates; and
- relatively strong geo-political stability.

Let's dig a little deeper:

A recent PriceWaterhouseCoopers study of the world by 2050 details the likely shake-up of the world's economic leaders. By 2050:

- India will have overtaken the US as the world's second largest economy in PPP terms after China; and Indonesia will have risen to fourth place.
- The Philippines and Vietnam will make the fastest moves up the global rankings to become respectively the 19th and 20th largest economies in the world.

Challenges and Uncertainties

Belying these rosy projections is a growing list of uncertainties and challenges:

- US itself: many in the region are worried about a possible confrontational US policy regarding China, which they do not want to see. The upcoming visit to Mar a Lago by President Xi will be very important.
- China: China itself is another point of uncertainty. The US National Intelligence Council's most recent examination of global trends released this January noted that China is the most likely to grow in economic importance, but it also faces growing political uncertainty caused by slowing growth, a shrinking labor force, and President Xi's concentration of power.
- The same NIC study predicts that the region's many territorial and maritime disputes are unlikely to be resolved in the next five years, keeping

tensions simmering and complicating the maturing of conflict-resolution mechanisms such as the Association of Southeast Asian Nations (ASEAN).

- Many ASEAN nations are concerned about the militarization of islands in the SCS. What is China's strategic purpose? Do they intend to try to establish an ADIZ or control shipping?
 - Indonesians wonder whether they will see more aggressive efforts by the Chinese Coast Guard to protect illegal Chinese fishing in Indonesian waters.
- Another big concern for the region is that President Trump's America First policies and Brexit are contributing to a sea change in how the world views globalization and free trade.
- Multilateral trade agreements such as the Trans Pacific Partnership are now in question as the focus in the United States shifts to negotiating bilateral trade accords, and reducing the often substantial trade deficits the U.S. has with many countries.
- After more than 70 years of trade liberalization, momentum has slowed. The World Trade Organization has noted that the proportion of international trade of global GDP has stopped growing in the last decade.
- Resurgent nationalism in many Asian countries has led to sentiments against foreign companies and pressures from many Asian nations to establish more localization requirements for foreign investors.

· And with certain exceptions such as Singapore, many South and SE Asian nations face the challenge of ensuring their young populations receive the higher education and vocational training they need to diversify away from low-technology agriculture and commodity exports to higher wage digitally-enabled services and industries, even as artificial intelligence and robotics threaten new disruption in the next 5-10 years.

So, yes, the South and SE Asian regions face many short term uncertainties, but the experiences of India and Indonesia give us hope for the future not only of the people of these two countries, but also for the wider region given the increasing importance of these two countries to global growth.

India

India, under the leadership of Prime Minister Narendra Modi, has doubled down on reforms that most observers predict will bring India's growth rate to 8% by 2019. These include his recent demonetization drive that helped to crack down on black money in the Indian economy and move more transactions into the formal and taxed economy; and the long awaited implementation of a Goods and Services Tax expected to begin in July that will replace India's tangle of local and state taxes with a single tax.

Modi boldly decided to cast recent State assembly elections in February as a referendum on demonetization. In India's gargantuan state of Uttar Pradesh with 200 million people, an alliance led by Modi took a stunning 325 of 403 seats in the state assembly. Modi's BJP party is also poised to form governments in as many as three other states. The landslide victory in Uttar Pradesh cements Prime Minister Modi's reputation as India's only credible national political leader as India looks ahead to the 2019 national elections.

Modi is proceeding now with reforms that could keep growth at a sustained high level for years to come. Perhaps the biggest game changer may be the acceleration of the digitization of India by connecting India's 600,000 villages to fiber-optic lines and rolling out the Aadhaar system, which has given 1 billion Indians thus far a unique identification number that is verifiable by fingerprint or optical scan.

Aadhaar is helping reduce fraud and corruption in government welfare schemes, but will also have other far reaching impacts on the 600 million Indians who live on less than \$2 a day. As the legendary Indian tech giant Nandan Nilekani has explained, having an Aadhaar number will make it easier to open bank accounts, get SIM cards for mobile phones and buy insurance.

These reforms complement a healthy race to the top by India's states. Where innovation was once confined to cities such as Bangalore and

Hyderabad, today one sees progress all over India. Bhubaneswar in the eastern State of Orissa, for example, recently was named the number one smart city in India. The State of Madhya Pradesh quietly has become a major agricultural producer, while Rajasthan also is making a strong play for the most wired state in India.

India's reforms will further spur the growth of India's middle class. According to Ernst & Young, India's middle class will reach 200 million five years from now, and then accelerate quickly, reaching 475 million by 2030. All of this is good news for U.S. business. After years of stagnation, bilateral trade has increased fivefold since 2003 to \$107 billion, 500 US companies have offices in India, and Indian investors are playing an increasingly important role here in America.

With the new Administration in Washington, the outlook is bright for continued progress and partnerships. In recent years, India has moved to open its e-commerce, retail, defense and other sectors to complement robust opportunities US companies had in aviation, clean energy and many consumer sectors. Defense Secretary Mattis in his confirmation hearing hailed the progress and promise of increased defense trade with India as a result of the Defense Technology and Trade Initiative. Prime Minister Modi's strong electoral performance positions him to continue opening the Indian market, which will offer US companies some of the brightest opportunities anywhere.

Indonesia:

Let me now turn to another pole of growth in the 21st century, Indonesia. The world's largest Muslim-majority democracy, Indonesia is a G-20 country with a near trillion dollar economy with growth rates that have averaged between 5 and 6% for the last decade.

Just as important it has good prospects for the foreseeable future because half of its population is under 30; and its middle class of 75 million people is projected by most to double in the next ten years. It is also the largest, most influential country in Association of SE Asian Nations (ASEAN).

Today the 10 ASEAN countries have a \$2.5 trillion economy, and a population of 625 million. In January 2016 they formed the ASEAN Economic Community that is now one of the largest markets in the world.

President Jokowi has sought to raise Indonesia's growth rates to reduce poverty and inequality. He has undertaken major efforts to improve Indonesia's infrastructure, to better integrate the poorer islands of Eastern Indonesia with the main island of Java, and to expand internet access to boost the digital economy.

These efforts are bearing fruit. Moody's recently upgraded its investment outlook from stable to positive. Indonesia is expected to have one of the fastest growing e-commerce markets in the world. A recent Temasek and Google study projected that the number of Indonesian internet users should

increase from 92 million in 2015 to 215 million by 2020, while the total e-commerce market is expected to reach \$48 billion by 2025.

Recent huge rallies to protest allegedly blasphemous remarks by the city's Chinese Christian governor, popularly known as "Ahok," have led many to question whether Indonesia faces greater extremism.

My own view is that while Indonesia undeniably has become more conservative, that trend should not be mistaken for greater support for violent extremism. Five characteristics differentiate Indonesia from countries facing more significant terrorist challenges:

- First it has a **strong democracy** that gives Muslims and other Indonesians the opportunity to express their grievances peacefully through the media, NGOs and their own political parties.
- Second, the growing **Indonesian economy** has generated jobs and opportunity for young people so you do not have large groups of young unemployed and disaffected people like one sees in the Middle East.
- Third, the Government made a real effort to promote ethnic and religious tolerance.

- Fourth, despite widespread corruption in Indonesia, President Jokowi has prioritized reducing corruption and is considered personally honest.
- Last, since the Bali bombings of 2002 the Government made a serious effort to upgrade its counter-terrorism capabilities, and arrested or killed hundreds of terrorists, while improving its human rights record.

What Advice Can I Offer?

· In markets such as India and Indonesia, US businesses still face many obstacles so investors must be patient, because both countries are committed to improving the ease of doing business.

Second, have good local partners who can help navigate the local often opaque bureaucracy.

· Third, consider ways to localize production and highlight the local jobs you create.

· Fourth, remember that with growing nationalism and increasingly vocal democracies, Ministers and other decision-makers in India and Indonesia must be seen as strongly defending national interests. So economic reforms or decisions in investment disputes that benefit foreign investors are unlikely in the year before national elections.

- Remember also that the US Embassies and Consulates have superb American and local staff whose business is your business so do seek their counsel and help if you run into problems. They in turn can help ensure your issues are plugged into government-to-government dialogues that the State and Commerce Departments and the US Trade Representative have with their counterparts. In the Trump White House, we may see the White House itself and the Commerce Department taking on wider roles in trade negotiations.

- Last, hire plenty of consultants!