



SINGAPORE INSTITUTE  
OF INTERNATIONAL AFFAIRS

12<sup>TH</sup>   
ASEAN  
& ASIA  
FORUM

# THE SINO-AMERICAN CONFLICT AND ASEAN:

*Surviving, Transforming, Succeeding*

Special Report

Aug 2019

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# I. Introduction

“When elephants fight, it is the grass that suffers.” The old proverb rings true as countries within the Association of Southeast Asia Nations (ASEAN) have to reckon with two superpowers clashing on the global arena. The trade war between the US and China is causing stock markets and investment flows to falter. But the conflict goes deeper than just trade. Battle lines have been drawn in technology, education, intellectual property, infrastructure and maritime behaviour. The effect has been widespread as multinationals rethink strategies, countries feel pressured to take sides, and growth forecasts begin to get downgraded. As of August 2019, when this report was being written, developments were still unfolding at a rapid pace. However, it is clear that the US-China conflict has deep roots, and is likely to be long-lasting.

The challenge is for ASEAN to remain united amid the fragmentation of a rules based international order. It is a breakdown of a system that used to facilitate an era of globalisation that encouraged the free movement of goods, services, capital and people. It is the recognition that other countries, apart from the US and China, need to work together to help strengthen a weakening global trading system. Complex global supply chains are already being unravelled, which may bring some benefits to Southeast Asia, albeit short-lived ones. This report highlights how ASEAN centrality and collective leadership can act as a bulwark against the long-term negative effects of the Sino-US conflict.



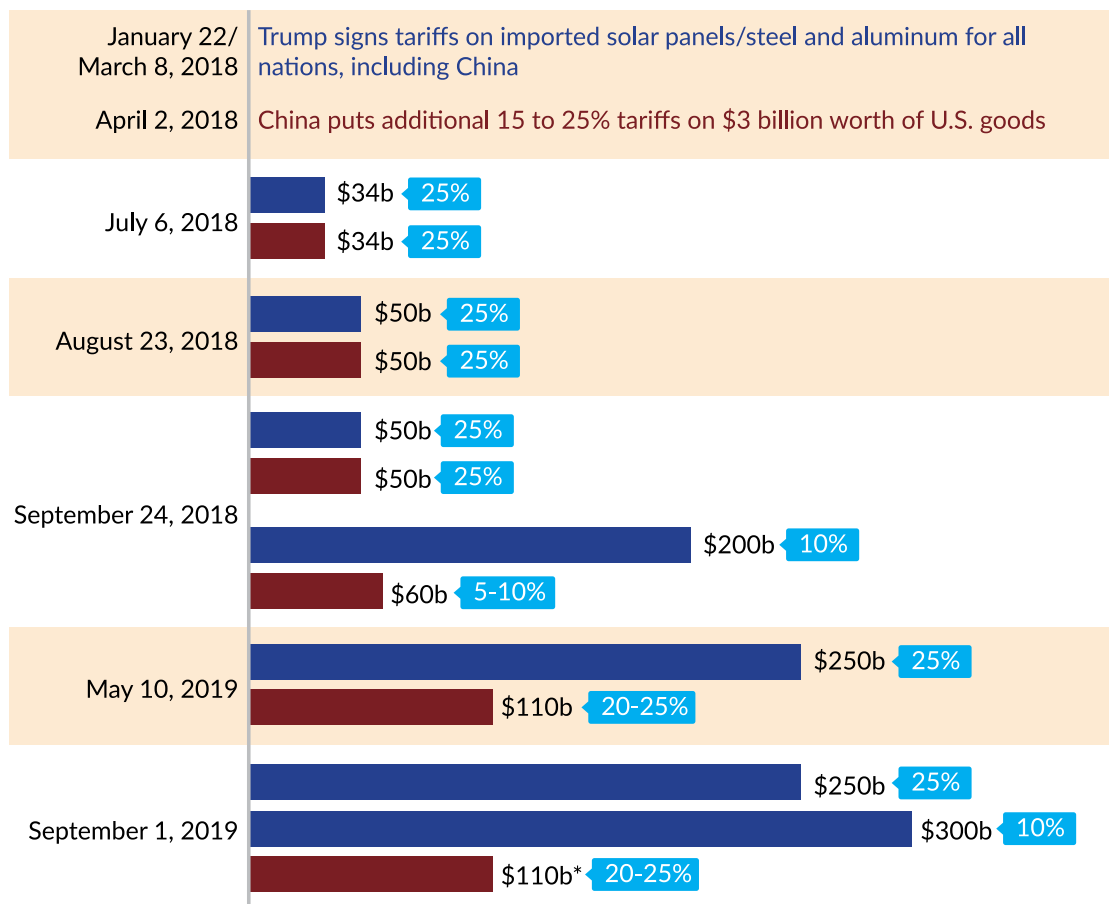
# II. Sino-US Tensions: Bracing for Protracted Pain

In 2018, the US imposed three rounds of tariffs on more than US\$250 billion worth of Chinese goods, following an investigation into Chinese trade policies in 2017. China responded with tariffs ranging from 5% to 25% on US\$110 billion of US products. In May 2019, the US increased tariffs on US\$200 billion of Chinese goods from 10% to 25%. China retaliated with further tariffs on US\$60 billion of US products.

During the G20 Summit in Osaka, US President Donald Trump announced that he and Chinese President Xi Jinping had agreed to a “truce” as bilateral trade talks resumed. However, the peace was soon shattered by Trump’s announcement of a 10% tariff on an additional US\$300 billion of goods, scheduled to take effect on 1 September 2019. The People’s Bank of China (PBOC) allowed the yuan to weaken past the threshold of 7 yuan to a dollar, the US Treasury Department labelled China a currency manipulator, and Beijing halted new purchases of US agricultural products.

## The Tarrif Timeline

■ U.S. tariff action ■ Chinese tariff action ■ Tariff rate



\* Further retaliation expected  
Source: The International Business Times (IBT)

# Fallout from the Trade War

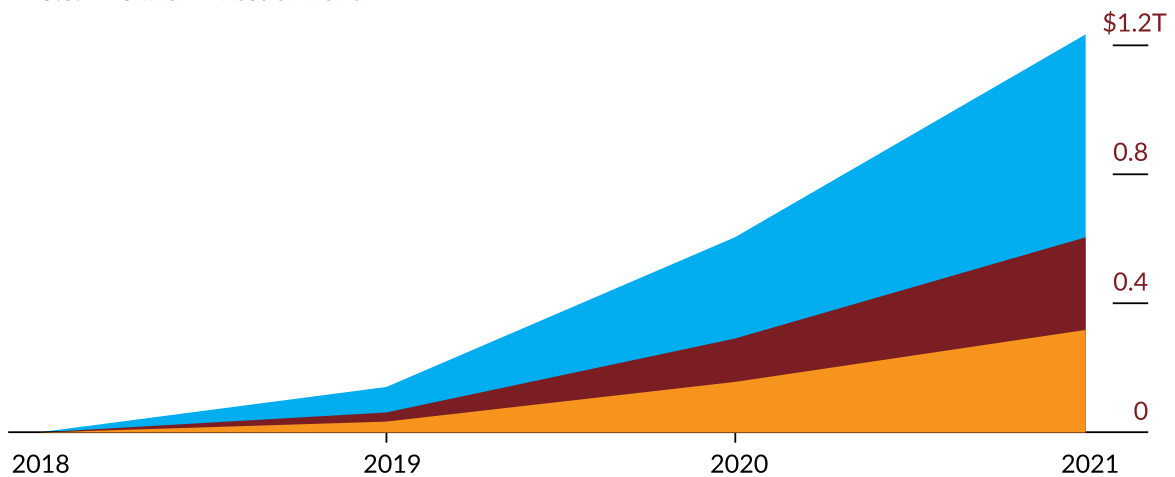
Bloomberg Economics estimates that if the trade war persists, it could reduce global GDP by US\$1.2 trillion by the end of 2021. This would not constitute a global recession, but it would push global growth to its lowest level since the 2008 financial crisis.<sup>1</sup>

Similarly, the World Bank Group expects global growth in 2019 to slow to 2.6% due to weaker trade and investment. Emerging market and developing economy growth is

expected to be constrained by economic uncertainty and concerns over a further escalation of trade tensions. Growth in East Asia and the Pacific is expected to remain above the global average, but will still slow – falling from 6.3% in 2018 to 5.9% in 2019 and 2020. If these numbers materialise, it would be the first time since the 1997-1998 Asian financial crisis that growth in the region drops below 6%.<sup>2</sup>

## Forecast of Cumulative World GDP Lost Due to Trade War

■ U.S. ■ China ■ Rest of world



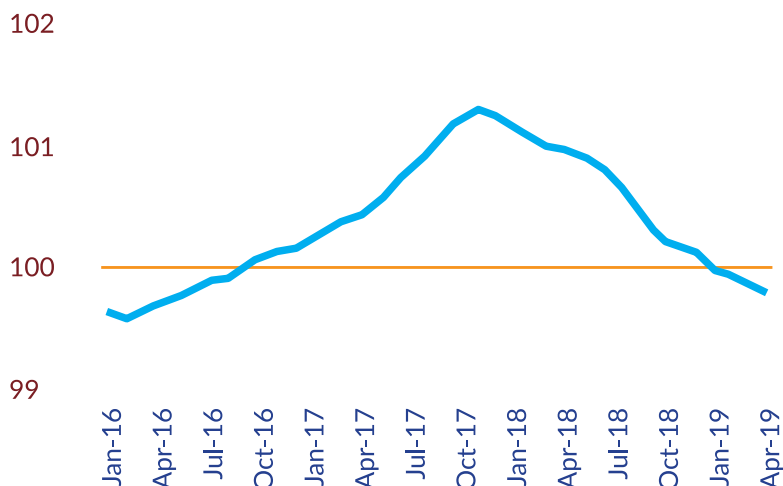
Source: NiGEM, Bloomberg Economics  
Note: Forecasts are as of the end of each year.

Sino-American trade frictions are already affecting business and consumer sentiment. A Thomson Reuters/INSEAD survey in June 2019 found that confidence among Asian companies had fallen to the lowest since 2008, due to uncertainty over the trade war, Brexit and the slowing

Chinese economy. OECD data from April 2019 on business confidence across the major advanced and emerging economies reflects a corresponding picture at the global level.<sup>3</sup>

## Global Business Confidence

Index, 100=2000-18



Source: Organisation for Economic Co-operation and Development. World Bank.

# Decoupling in More Ways Than One



Although some characterise the present trade frictions as wholly attributable to Mr Trump and his Republican administration, there is bi-partisan support within the US for the Trump administration's characterisation of China, with China increasingly seen as the primary opponent of the US.

The Indo-Pacific Strategy Report launched in June 2019 by Acting Defense Secretary Patrick Shanahan at the Shangri-La Dialogue in Singapore explicitly frames American policy in the context of geopolitical rivalry and countering Chinese dominance. The report claims China "seeks to reorder the region to its advantage", and notes China's "use of espionage and theft for economic advantage, as well as diversion of acquired technology to the military" as a "source of economic and national security risk to all of China's trading partners".<sup>4</sup>

The current narrative in American discourse is that the US gave China a good-faith period to reform and liberalise, such as with its entry into the World Trade Organisation (WTO) in 2001. But in the American view, rather than integrate into the international order, China has instead expanded its power and is challenging American interests. Attitudes were already beginning to shift under President Barack Obama, who said that China was "both an adversary, but also a potential partner".<sup>5</sup> As such, many Americans now feel that the US must take a tough stance against China.

In this context, it is likely that tensions between the US and China will be deep, broad, and prolonged – not merely a trade war, but a conflict on multiple levels. While Mr Trump is up for re-election in 2020, even a Democrat victory at the polls may not reverse current US policy vis-à-vis China.

# III. Silver Linings with Caveats for Southeast Asia

ASEAN has become a major theatre for the Sino-US conflict to play out. On one hand, some Southeast Asian nations can look forward to expanding their factory floors, as companies begin to shift production out of China in order to avoid US tariffs. Existing investment trends in the region will likely continue despite China's slowing economy, with the Belt and Road Initiative (BRI) supporting enhancements to connectivity. On the other hand, the "trade deficit story" could become ASEAN's problem, inviting scrutiny from the US Trade Department. There is also the risk of low quality and low value manufacturing being 'dumped' into developing countries. ASEAN economies can and should position themselves to reap the influx of manufacturing capacity – but they would do well to take heed of the dangers that lurk in the background.

## Out of China into ASEAN?

Companies have been on edge amid ongoing trade negotiations between China and the US. Some observers are calling the last 12 months of talks and tariffs as "just the first sentence of the first chapter" of a new superpower rivalry.<sup>6</sup> There is also the concern of further escalation, including measures such as trade blacklists.

In response, manufacturing and export companies are considering their options. A survey by the American Chambers of Commerce in China and Shanghai in May 2019 found that slightly more than 40 percent of its members had relocated outside of China, or were considering making such a move.<sup>7</sup> Chinese companies are looking to

countries such as Thailand, whose Board of Investment announced that the number of relocation applications from Chinese businesses increased threefold in 2019. Japanese companies have also looked increasingly to ASEAN, with its Foreign Ministry reporting that Southeast Asia now hosts more Japanese workers than any other region.<sup>8</sup>

The implications of these shifts for ASEAN represent a silver lining in this period of uncertainty. Aside from Vietnam, countries such as Indonesia, Malaysia and Thailand can or have leveraged their respective advantages to attract investments.

Table 3.1 – Recent FDI Stats in Select ASEAN Economies

Country	Approved FDI Influx (Jan-Mar 2019)	Effective Period and Change from 2018	Top 3 Sources of Capital	Targeted Sector(s)
Vietnam	<b>\$16.74 billion*</b> <small>*Jan - May 2019</small>	+69.1% from H1 2018	Hong Kong, South Korea, Singapore	Manufacturing and Processing
Indonesia	<b>\$7.62 billion</b>	-0.9% from Q1 2018	Singapore, China, Japan	Logistics, Utilities, Construction
Malaysia	<b>\$7.07 billion</b>	+73.4% from Q1 2018	US, China, Singapore	Manufacturing (High Tech)
Thailand	<b>\$4.37 billion</b>	+76.7% from Q1 2018	China, Japan, Hong Kong	Manufacturing (Machinery, Electronics)
Myanmar	<b>\$1.07 billion</b>	+14.4% from Q1 2018	Singapore, China, Thailand	Manufacturing, Logistics, Real Estate

While China has been a favoured manufacturing hub for decades, rising wages, rentals and cumbersome red tape have eroded its allure. Manufacturers have also been seeking to diversify their manufacturing chains. For instance, Japanese companies shifted their focus from China to Vietnam and Thailand in the 2010s. It is also

noteworthy that fellow Asian economies often occupy the top places on their FDI charts, with Singapore featuring in the top three investors for four of the five economies. In turn, these ASEAN economies have been attractive for a number of reasons.

Table 3.2 – Minimum Wage and Economic Statistics

Country	Minimum Wage as of 2019 (US\$/Month) <sup>16</sup>	Average (US\$/Month)	GDP Growth Rate (2019, ADB)	Human Capital Index Ranking (2018)	Ease of Doing Business Ranking (2018)
China	145.00 – 352.00	248.50	6.50%	46	46
Thailand	284.00 – 304.00	290.00	4.10%	65	27
Malaysia	222.09 – 265.54	243.82	4.70%	55	15
Philippines	145.00 – 280.00	212.50	6.70%	84	124
Indonesia	110.00 – 260.00	185.00	5.20%	87	73
Cambodia	182.00	182.00	7.00%	100	138
Vietnam	125.00 – 180.00	152.50	6.80%	48	69
Lao PDR	132.00	132.00	7.00%	111	154
Myanmar	91.00	91.00	7.00%	107	171
Singapore	-	-	2.90%	1	2
Brunei	-	-	2.00%	-	55

- **Lower Labour Costs** – Labour costs in China have risen over the years, varying from US\$145 per month in certain areas of Guangxi to US\$352 per month in Shanghai. As table 3.2 shows, labour costs of ASEAN economies are generally lower, despite Thailand having a higher minimum wage on average.

- **Comparable Levels of Economic Growth** – While China's growth rate has outperformed, ASEAN economies are close behind. The Asian Development Bank (ADB) predicted that the region will grow by 5.2% in 2019, close to China's predicted growth rate of 6.5%.

- **A Vibrant Workforce** – ASEAN is a populous region, with more than 100 million people estimated to have joined the workforce over the past two decades. Some ASEAN economies are ranked highly on the World Bank's human capital index, which measures the human capital a child born today will likely acquire by age 18. Vietnam is ranked #48 of 157, only two places behind China.

- **Ease of Doing Business** – Singapore, Thailand and Malaysia are ranked higher on the ease of doing business index than China, while Vietnam and Indonesia are not far behind. Further, the development of the ASEAN Economic Community (AEC) could also improve cross-border value chains by deepening regional economic integration, and increase the attractiveness of manufacturing clusters in the region. Singapore in particular has positioned itself as a hub for deeper integration in the region, and stands poised to benefit from greater investment flows.



# Caveats for ASEAN and The Wider Consequences of the Trade War

Despite this attractiveness, the benefits of the trade war for ASEAN are limited. Not all supply chains can be nimbly relocated out of China due to logistical demands. Multinational companies based in the US are now mindful of political imperatives, and are factoring their responsibilities to their home bases into their investment decisions. In addition, ASEAN economies face a range of short, medium and long term risks as the trade war develops.

- **Short Term Risks – Attracting Unwanted Attention from Superpowers**

Vietnam in particular can be a bellwether for the region. The economy was predicted by a Nomura Holdings report in June to be the biggest beneficiary of the trade war, which could potentially boost its gross domestic product (GDP) by up to 7.9% for Q1 2019. Yet, the White House has expressed disgruntlement with this trend, with President Donald Trump describing Vietnam as “the single worst abuser of everybody” during a Fox Business Network interview in June. He was tight-lipped about the possibility of tariffs on Vietnam. Vietnam was also added to the currency manipulator watch list alongside Singapore and Malaysia in May, based on its trade balance with the US, overall trade surplus and the frequency of its interventions in currency markets. Vietnam’s experiences highlight that ASEAN economies are not shielded from the fallout of US-China tensions, and cannot ignore the political context of the trade war while pursuing economic benefits.

- **Medium Term Risks – Slowdown in the Chinese Economy and its Ripple Effects on ASEAN’s Growth**

China’s economy is showing signs of a slowdown, with two major manufacturing data sets (the Caixin Purchasing Manufacturers’ Index and the official manufacturers’ index) falling due to weaker demand in June 2019.<sup>9</sup> Weakness in the region’s biggest economy would have dire consequences for ASEAN countries, many of whom count China as their biggest trading partner. A July 2019 survey by the Japan Centre for Economic Research and Nikkei revised the growth forecasts for the five richest ASEAN countries and India to 4.3%, making it the fourth consecutive decrease since September 2018. While US-China tensions featured prominently among the surveyed countries, the possibility of a China slowdown was also among the most cited risks.

- **Long Term Risks – Deepening of Differences in Manufacturing Competitiveness**

ASEAN economies require significant investments in training, infrastructure development and other needs to develop their industrial base, and prepare their economy for the advantages of Industry 4.0. Yet, the influx of investments into ASEAN manufacturing could serve to deepen this existing rift. While Vietnam and Malaysia have managed to attract investments into high-tech industries such as photovoltaic cells, investments into countries such as Myanmar have centred on low value, high-production industries. Left unchecked, a multi-speed model of production could be entrenched by deep differences in manufacturing competitiveness.

- **Long Term Risks – Fragmentation Amid a Larger Tech Cold War**

The move by the US to place Chinese phone manufacturing titan, Huawei, on an export blacklist on 16 May 2019, was to some a replay of the blacklisting of telecoms company ZTE in 2018. While the ban has since been lifted, there are concerns that the blacklist is part of a larger technological cold war as the US tries to preserve its lead in related industries. Rather than being guided by commercial decisions, tech developments would become beholden to national agendas. In turn, it could create a fragmented landscape of standards by massively disrupting global technology supply chains.

The implications of such a tech cold war are severe for ASEAN economies. Companies embedded in Chinese supply chains, such as Singapore’s Flextronics, would face disruptions to their operations. All companies that do business with Chinese and American tech firms may have to contend with two sets of standards, complicating their business models and driving up costs. Governments would be forced into another balancing act between the US and China, in which formerly mundane economic choices acquire an extra dimension of geopolitical significance.

# IV. How Can ASEAN Strengthen a Weaker Global Trading System?

While there are domestic measures that ASEAN economies can take to ensure they fully benefit from supply chain shifts, an escalation of US-China tensions remains a worrying possibility. Any flare-up would not only threaten ASEAN's prosperity, but also its security and future. Taking steps at the regional level to protect ASEAN against the fallout of such an escalation is therefore just as important as domestic efforts to reap the benefits of supply chain shifts.

## 1. A Strong Base – Pursue Deeper Integration within ASEAN

ASEAN integration has been a part of the grouping's raison d'être since its inception, and achievements such as the ASEAN Trade in Goods Agreement (ATIGA), which eliminated 99.65% of tariff lines between six ASEAN countries, are laudable. The full implementation of the AEC Blueprint 2025, which seeks deeper and broader integration, is also welcome. Yet, current trade ties leave much to be desired. From 2000 to 2017, the proportion of intra-regional flows in ASEAN's total trade in goods only grew from 22.6% to 23.5%. Intra-regional FDI flows also languish at 19.4% of overall flows.<sup>10</sup> In order to better defend against global economic uncertainty, more intra-regional integration is necessary.

Such integration could be tied to drivers such as E-Commerce. The digital economy is shaping up to be a new engine of regional growth, with a 2018 Google-Temasek study predicting that it will exceed US\$200

billion in valuation by 2025. However, ASEAN's economies remain divided in their approach to issues such as data privacy. While Malaysia's Personal Data Protection Act is in force, Indonesia, Myanmar and Thailand do not have specific laws to safeguard data privacy. Instead, elements of data privacy are referenced in existing laws, such as Myanmar's law on "Protecting the Privacy and Security of Citizens".<sup>11</sup> To harmonise these various standards, the ASEAN E-Commerce Agreement of 2018 was a valuable starting point, and should be expanded upon.

Another issue that bears addressing is the elimination of non-tariff barriers. As of 2018, customs surcharges were active on 2,683 tariff lines, while technical measures and product requirements involved more than 975 tariff lines. More work should be done to lower these barriers as well.



## 2. Open for Business – Trade Agreements and Supporting the Regional Order

Beyond its borders, ASEAN has also signed a series of free trade agreements (FTAs) with external partners such as China (with bilateral trade of US\$514.8 billion in 2017) and Japan (bilateral trade of US\$217.9 billion in 2017). Further, ASEAN countries are in the midst of negotiating the Regional Comprehensive Economic Partnership (RCEP) with six non-ASEAN partners. These agreements underscore ASEAN's commitment to actively working with external partners.

RCEP might include countries with whom ASEAN has signed FTAs. Yet, ASEAN stands to gain economically from these pending deals. The Brookings Institution estimates that RCEP will boost global real incomes by US\$286 billion per year once the agreement is fully in place by 2030, while absolute gains from the signing of the CPTPP would

be roughly half as large.<sup>12</sup> On a strategic level, there are intangible benefits for ASEAN as well. The conclusion of trade deals would reaffirm the grouping's commitment to the rules-based global trading system, and help to mitigate global economic uncertainty.

The challenges are daunting. The CPTPP suffered a critical blow when President Trump pulled the US out of the deal in 2017, citing concerns about preserving American jobs. To date, only four of the 10 ASEAN economies have signed up for the partnership. Similarly, only seven of RCEP's 18 proposed chapters have been finalised after 26 rounds of talks, with key parties such as India holding out for better terms. All eyes will be on the ASEAN summit in November, where it is hoped that the RCEP negotiations will finally be concluded.

Table 4.1 – ASEAN's Pending FTAs

FTA Name	Countries Involved	Bilateral Trade in Goods, 2017	FDI Inflows to ASEAN, 2017
ASEAN-EU Free Trade Agreement	EU (28) + ASEAN (10)	US\$257.4 billion	US\$25.4 billion
ASEAN-Canada Free Trade Agreement	ASEAN (10) + Canada	US\$13.2 billion	US\$1.0 billion

FTA Name	Countries Involved	Combined GDP, 2018 <sup>24</sup>
Regional Comprehensive Economic Partnership (RCEP)	ASEAN (10) + China + Japan + Republic of Korea + Australia + New Zealand + India	US\$27.6 trillion
Comprehensive and Progressive Trans-Pacific Partnership (CPTPP)	ASEAN (4: Singapore, Malaysia, Vietnam, Brunei) + Australia + Canada + Japan + Mexico + New Zealand + Peru + Chile	US\$11.0 trillion

### 3. Collective Thought Leadership – Smoothing Rough Edges on the Indo-Pacific and BRI

ASEAN should also seek to play an active role in shaping the narrative of the region. Rather than reinforcing the frameworks that define the region, such efforts would entail promoting a more cooperative atmosphere by reframing initiatives to be more palatable to both superpowers.

The recent announcement of the ASEAN Outlook on the Indo-Pacific, following a year-long campaign by Indonesia, is an example of this. To ASEAN, the Indo-Pacific was led by four liberal democracies (the US, Japan, Australia and India), and mentions of the need for “good governance” and “fundamental rights and liberties” in US speeches left observers concerned that it would be an exclusive club for like-minded polities. The strategy appeared to target China, a crucial partner for many ASEAN economies. Moreover, and despite assurances by US officials that ASEAN is at the centre of the Indo-Pacific, there was uncertainty over the role that ASEAN would play in this vision.

The resulting outlook can thus be seen as a response to these concerns. While it was vague on issues such as operationalisation, and omitted direct mentions of issues such as the South China Sea, the Outlook was a useful starting point for translating the Indo-Pacific concept into a workable, agreeable plan for the region.

Another opportunity for ASEAN to demonstrate leadership would be via the Belt and Road Initiative (BRI). While an important source of financing for countries with high infrastructure demand, critics such as the US have often highlighted how BRI deals are opaque and exclusive, and question the benefits they bring to national economies. Debt issues in particular have attracted criticism. ASEAN was a source of international attention on this issue in 2018, as observers noted that Malaysia and Myanmar sought to renegotiate the prices of the East Coast Rail Link (ECRL) and Kyaukpyu Port respectively. These were taken as evidence of a pushback against Beijing.

In response to these concerns, Chinese leaders offered the right assurances. A Debt Sustainability Framework for BRI participants was announced during the 2019 Belt and Road Forum, and lauded by International Monetary Fund Managing Director Christine Lagarde as a “significant move in the right direction”. However, China should not be alone in deciding the future of the BRI. ASEAN, too, can show that BRI participants can be partners to China, and not merely puppets.

**i. Successfully Engaging China** – ASEAN governments’ engagement of Chinese developers on issues such as project costs could provide a model for the rest of the world.

Malaysia managed to bargain the cost of the ECRL from US\$16.0 billion to US\$10.7 billion and increase the local labour participation rate from 30% to 40%. Myanmar also managed to scale down the cost of the Kyaukpyu port project from US\$7.2 billion to US\$1.3 billion for the first stage.

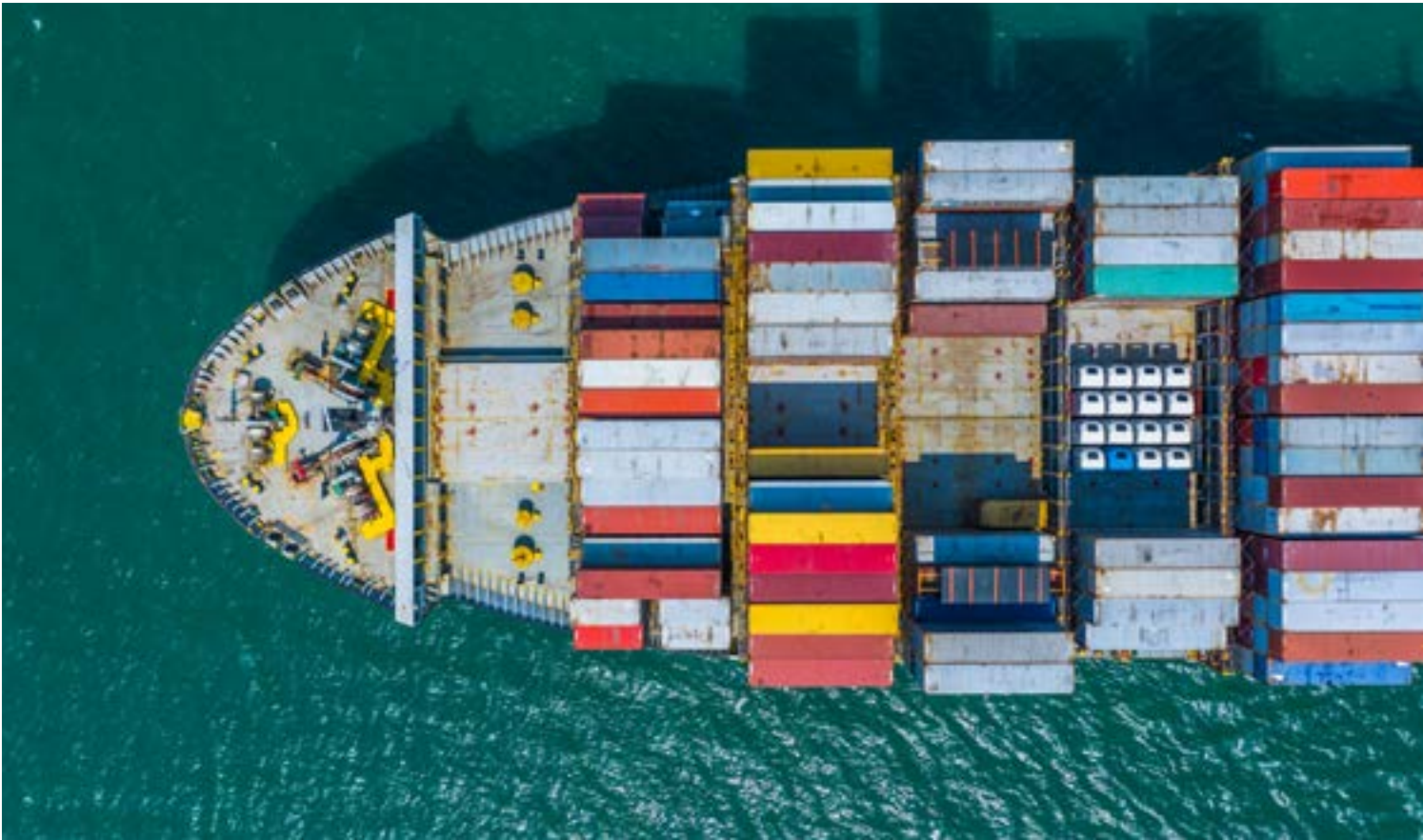
**ii. Ensuring Standards** – ASEAN governments could engage Beijing and partners such as multilateral development banks (MDBs) to arrive at a common understanding on sustainability criteria, and fast-track projects that comply with acceptable standards\*. Existing platforms that already vouch for green standards, such as the BRI International Green Development Coalition, should be promoted and enhanced.

Indonesia ensures that domestic infrastructure proposals account for environmental safety, use local workers, add value to the local economy and offer tech transfers to local industries.

**iii. Matchmaking Western Firms and Institutions with Chinese Counterparts** – ASEAN economies could offer matchmaking platforms for foreign firms to participate in regional BRI projects.

Singapore is well-positioned to fulfil such a role in ASEAN. First, the Singapore government launched Infrastructure Asia in 2018 to match-make firms and catalyse project development. Singapore also enjoys close cooperation with key regional players, having signed memoranda of understanding (MOUs) to promote infrastructure development and investment in Asia with the US (March 2019<sup>13</sup>) and China (April 2018, updated April 2019<sup>14</sup>).

# V. What Next?



The effects of the Sino-US trade war will continue to rumble throughout the global economy. The issues run much deeper than just trade surpluses and deficits. Fragmentation is occurring on a global scale and is affecting decisions on infrastructure investment and technological networks. ASEAN countries may feel the pressure to side with one great power over another, even though its leaders will keep trying to remain neutral.

The impact on ASEAN is particularly salient. ASEAN's geographical position and growth potential has not been lost on greater powers. This is why the Indo-Pacific theatre has drawn the interest of countries far and near. Already there are signs that benefits from the trade war will be short-lived. There are questions about whether Vietnam can manage the current of influx of investment without overheating. And with China and the US as ASEAN's top two trading partners, any intention from each great power to hurt its counterpart will have knock-on effects on ASEAN's economies.

A sense of urgency is now needed for ASEAN to anchor itself on its original principles and act as a gravitational force to draw in the broken pieces shattered from great power rivalry. Rather than being forced to pick a side, ASEAN countries should instead stake out their own position.

ASEAN centrality will be key and will require policymakers to communicate, strengthen ties and have a shared understanding of fixing the rules based order. Collective leadership will entail ASEAN working with middle powers, to help mitigate the negative consequences of a weaker global trading system. Hubs for investment, integration and infrastructure development, such as Singapore, are uniquely positioned to support such efforts even amid challenging economic pressures.

Another challenge is for ASEAN to conclude discussions on deals that have been bandied about for far too long. The goal post to finalise the Regional Comprehensive Economic Partnership (RCEP) agreement needs to stop shifting. Practical measures need to accompany the current skeletal structure of the 'ASEAN Outlook on the Indo Pacific'. The South China Sea Code of Conduct needs to see the light of day.

The above approaches are unlikely to resolve all the risks associated with the trade war. However, they would help to reinforce ASEAN's economic and strategic stability, and allow it to better weather the ongoing storm. Such issues will be the test of resilience for ASEAN centrality and could provide the momentum to create solid, actionable policies.

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