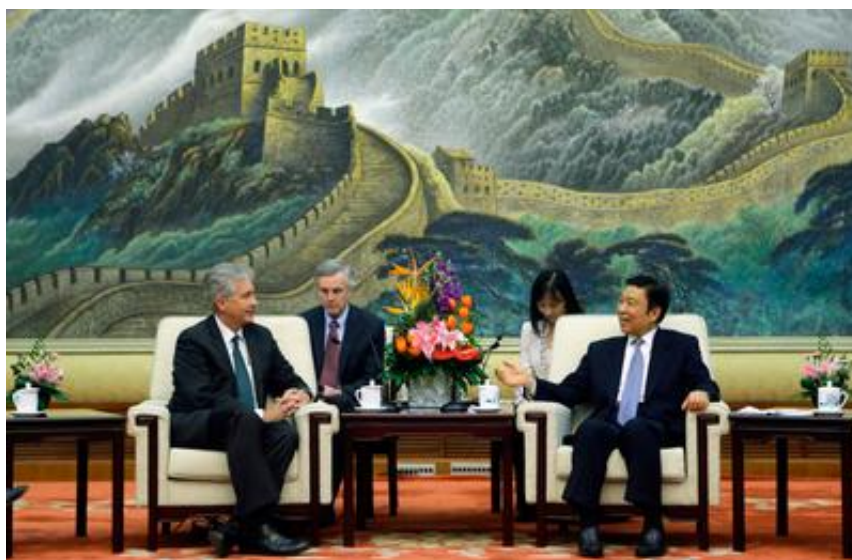


Ten trends that will shape Asia in 2014

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A fraught 2014 lies ahead for Asia. Political risks will rise, security tensions will increase and scepticism will continue to grow about whether major Asian governments are sufficiently committed to growth-conducive reforms. Ten trends will shape this more volatile Asia over the next 12 months and beyond.



First, the good news: Asia's relationship to the world economy is changing in dramatic, and positive, ways. For decades, G7 countries beat a path to Asia's door — buying Asian exports and investing heavily in Asian economies. But Asia has become a major factor in the advanced economies' own growth stories. And where others have long consumed goods from Asia, it is Asians who are now investing and consuming more from overseas. Take the United States: Asians are now major consumers of American corn and soybeans (for their animal feed), pork (for their tables), and natural gas (for their power plants). Increasingly, they are buying stakes in US companies and resources too.

But here's the bad news: the central strategic challenge in Asia today is the collision between economics and security. The same countries that are trading, investing and growing together are beset by security tensions and dysfunctional diplomatic relationships. A central factor is China. Bluntly put, Beijing's long-term strategic intentions inspire deep anxieties. So, as a hedge against China's growing strategic weight, many Asian countries are deepening defence and political coordination with the United States and each other. China has become the top trade partner for many of Asia's major economies. Yet, economic interdependence alone cannot serve as a conflict-mitigating mechanism.

These tensions are likely to play out in the global commons as well. Beijing's November

declaration of an [air defence identification zone](#) ^[1] in the East China Sea has raised broader questions about how competing sovereignty claims in Asia may touch public goods and the global commons — airspace, cyberspace and the high seas. Beijing and Washington in particular seem to be talking past each other — China talks mostly about [sovereign rights and claims](#) ^[2]; the United States talks largely about [international rights and customs](#) ^[3]. Disputes will intensify over rights of passage, freedom of navigation, and diverging interpretations of customary international law.

With a competitive eye on China, expect Tokyo to further reinvigorate its Asian diplomacy in 2014. Just one year into his tenure, Prime Minister Shinzo Abe has travelled Asia relentlessly, courted India and [pledged US\\$20 billion](#) ^[4] in new aid and loans to Southeast Asia. Tokyo has a long history of vigorous [pan-Asian diplomacy](#) ^[5]. But Abe's effort takes on special resonance in the face of intensifying strategic wariness between Tokyo and Beijing. Tokyo will look to expand its toolkit, leveraging project finance, trade, aid, people-to-people exchanges and even security cooperation. How deeply this resonates in Southeast Asian countries, which have long sought to foster balance between Beijing and Tokyo, will be especially telling of whether Abe is getting traction in his effort to use China as a foil to boost Tokyo's ties in Asia.

The December execution of Jang Song-thaek, the uncle of North Korean leader Kim Jong-un, and the ongoing purge of [his patronage network](#) ^[6] have raised underlying questions about the stability of the regime—a risk that will grow in 2014. Pyongyang has a penchant for provocations that, if acted upon, would pose tough choices for everyone in Northeast Asia. China has shown scant appetite for coercing North Korea, while Seoul and Washington have bet that Chinese leverage could limit Pyongyang's behaviour. Meanwhile, the ghosts of history have bedevilled US efforts to encourage security collaboration between South Korea and Japan. China's rise looms in the background, but Seoul has been careful not to lean too far toward Tokyo. And if a more volatile North Korea can't bring these two US allies together for security coordination and contingency planning, what will?

Meanwhile, Washington, for its part, must make choices in 2014 that will test traditional US roles in Asia. In recent years, the US role as Asia's principal security provider has been reinforced, but Washington's allies in particular will be anxiously watching to see how it reverses the debilitating effects of sequestration on its defence posture and whether it makes long-range investments in new capabilities. As its economic weight shrinks in relative terms, it is unclear whether the US role is sustainable without a significantly increased American economic profile to balance its enhanced security profile.

One test will be to show the kind of leadership that helps bring global and regional trade agreements to conclusion. Indeed, a raft of regional preferential trade agreements now also competes for attention in Asia. These include the US-backed Trans-Pacific Partnership (TPP) and the pan-Asian Regional Comprehensive Economic Partnership (RCEP), which does not include the United States. Many see the TPP and the RCEP as competitive. And in recent years some in Beijing have looked warily at the TPP, viewing it as part of a US containment strategy. But things may change in 2014, as China has begun to take an interest in the TPP. This does not mean that competition between models will evaporate overnight. For one, the gap between TPP requirements and China's domestic arrangements is huge. But if the TPP is concluded in

2014, it will set a new competitive standard in Asia.

China's reform efforts have become more vigorous because its growth model has begun to run out of steam. Beijing ends 2013 having adopted a [sweeping economic reform agenda](#)^[7] that includes new commitments to financial liberalisation, the repair of China's social safety net, protections for rural property rights and greater reliance on market forces. But reforms that aim to give the market a more decisive role cannot succeed unless the state begins to shed some of the functions that have made it a pervasive force in the economy. Chinese leaders have declared war on 'vested interests' that, they say, are obstructing market reforms. Yet the biggest vested interest in the Chinese economy is the state itself, which plays an outsized role in areas, like price controls, that would be better left to the market. The biggest changes will likely come through a move toward market-based prices and steps to begin liberalising deposit interest rates. The biggest struggles, meanwhile, will be over restrictions on internal migration and the subsidies provided to state-owned firms.

Antsy global investors and angry domestic voters will push and pull a number of Asian governments in competing directions in 2014. In India, tax, insurance and land acquisition reforms have stalled, investor confidence has sunk, and a pending national election seems unlikely to yield any scenario conducive to bolder initiatives. Tokyo confronts scepticism that the prime minister's economic agenda can deliver a [long-term growth strategy](#)^[8] that will return Japan to sustained economic health. Investor confidence will be tested in Thailand, where political conflict continues, and Indonesia, where slowing growth has been managed primarily through monetary policy, not policy reforms. In Malaysia, the government's popularity has taken a hit as it cuts subsidies, hikes tariffs and moves to introduce new consumption taxes to address its fiscal deficit.

New economic and strategic pressures will also emerge in continental Asia in 2014. Landlocked Central Asian economies will be tested amid the US withdrawal from Afghanistan, new Chinese investment and infrastructure initiatives, Russia's efforts to extend its preferential customs union, and Iran's uncertain trajectory. To date, enthusiasm for economic cooperation has been far greater outside the region than among Central Asian states themselves. Yet cooperation is important because [these landlocked economies](#)^[9] rely on surrounding powers for the transit of goods and resources. And pressure is increasing on Central Asian governments to deliver more enduring economic gains.

For two decades, Asia has defied the gloomy predictions of those who believed that its future would resemble Europe's conflict-ridden past. But Asian countries have managed throughout the post-Cold War period to grow and prosper together while keeping their disputes in check. The question is how long that positive trajectory will last. Posing tough new tests to this effort to construct a shared future, the year to come will prove a trying one for Asia.

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