

# U.S. Department of State

## Diplomacy in Action

### U.S. Relations With the Philippines

Bilateral Relations Fact Sheet

**BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS**

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#### **U.S.-PHILIPPINES RELATIONS**

The United States recognized the Philippines as an independent state and established diplomatic relations with it in 1946. Except for the 1942-45 Japanese occupation during World War II, the Philippines had been under U.S. administration since the end of the Spanish-American War in 1898.

U.S.-Philippine relations are based on strong historical and cultural links and a shared commitment to democracy and human rights. The United States has designated the Philippines as a Major Non-NATO Ally, and there are close and abiding security ties between the two nations. The Manila Declaration signed in 2011 reaffirmed the 1951 U.S.-Philippines Mutual Defense Treaty as the foundation for a robust, balanced, and responsive security partnership. The U.S.-Philippine Bilateral Strategic Dialogue advances discussion and cooperation on bilateral, regional, and global issues. There is also a focus on economic, commercial, and people-to-people ties. There are an estimated four million U.S. citizens of Philippine ancestry in the United States, and more than 220,000 U.S. citizens in the Philippines, including a large presence of United States veterans. An estimated 650,000 U.S. citizens visit the Philippines each year. Many people-to-people programs exist between the United States and the Philippines, including Fulbright, International Visitor Leadership Program, and the Kenney-Lugar Youth Exchange and Study program.

Manila is home to the only VA benefits office and healthcare clinic outside the United States, and the American Cemetery in Manila is the largest American military cemetery outside the United States.

#### **U.S. Assistance to Philippines**

The U.S. government's goal in the Philippines is to partner with the country to become a stable and prosperous nation. The 2011 Partnership for Growth Statement of Principles reinforced a shared interest in promoting inclusive and sustainable economic growth in the Philippines. U.S. assistance to the Philippines fosters broad-based economic growth; improves the health and education of Filipinos; promotes peace and security; advances democratic values, good governance, and human rights; and strengthens regional and global partnerships. Department of State, Department of Defense, and the U.S. Agency for International Development (USAID) programs in conflict-affected areas of Mindanao aim to strengthen the foundation for peace and stability in the area. U.S. assistance, including from the Millennium Challenge Corporation, seeks to intensify cooperation through a whole-of-government approach, using a wide range of assistance and other foreign policy tools. The United States has had a Peace Corps program in the Philippines for over 50 years.

Over the last decade, disaster relief and recovery has also become an increasingly important area of assistance to the Philippines. The United States has provided over \$143 million in assistance to date to the people of the Philippines in relief and recovery efforts after Typhoon Haiyan/Yolanda devastated the country in 2013. The United States continues to support long-term reconstruction and rebuilding efforts, and has contributed \$26.4 million to support ongoing humanitarian relief in Marawi.

### **Bilateral Economic Relations**

The United States and the Philippines have a strong trade and investment relationship, with over \$27 billion in goods and services traded (2016). The United States is one of the largest foreign investors in the Philippines, and is the Philippines' third-largest trading partner.

Key imports from the Philippines are semiconductor devices and computer peripherals, automobile parts, electric machinery, textiles and garments, wheat and animal feeds, coconut oil, and information technology/business process outsourcing services. Key U.S. exports to the Philippines are machinery, cereals, raw and semi-processed materials for the manufacture of semiconductors, electronics, and transport equipment. The two countries have a bilateral Trade and Investment Framework Agreement, signed in 1989, and a tax treaty.

### **Philippines's Membership in International Organizations**

The Philippines and the United States belong to a many of the same international organizations, including the United Nations, ASEAN Regional Forum, Asia-Pacific Economic Cooperation (APEC) forum, International Monetary Fund, World Bank, and World Trade Organization. The Philippines is also an observer to the Organization of American States. The Philippines served as chair and host of ASEAN for 2017.

### **Bilateral Representation**

The U.S. Ambassador to the Philippines is Sung Y. Kim; other principal embassy officials are listed in the Department's Key Officers List.

The Philippines maintains an embassy in the United States at 1600 Massachusetts Avenue NW, Washington, DC 20036 (tel. 202-467-9300).



Boundary representations are not necessarily authoritative.

## BACKGROUND

### Land and Climate

Combined, the more than 7,500 islands of the Philippines are about the size of Italy or the U.S. state of Arizona, but the islands are spread over a much larger territory. Most of the population lives on 11 main islands, of which Luzon and Mindanao are the largest. Many islands are mountainous, and there is potential for volcanic and earthquake activity throughout the country. More than one-fourth of the country's fertile soil is under cultivation. About 26 percent of the land is covered with forests (down from 40 percent a decade ago). Located in the southern Philippines, the Tubbataha Reefs Natural Park, which is a UNESCO World Heritage site, is home to about 360 types of coral, 600 species of fish, and 100 species of birds.

The climate is generally tropical and humid. The Luzon highlands, near Baguio, have a mild climate with low humidity. The rainy season extends from June to October. Typhoons are likely from June to November, but they may occur during any season because the Philippines is in the typhoon belt.

### History

#### Early Kingdoms

Negritos and Indons were already living on other islands when Malay peoples migrated from Borneo to Panay Island in the 13th century. Malay fiefdoms spread throughout the islands, including Luzon, and were often at war with one another. Muslim missionaries gained a presence in the 14th

and 15th centuries among Malays who had spread south to the island of Mindanao.

#### Spanish Colonization

Ferdinand Magellan encountered the warring fiefdoms of the north and the Islamic society of the south in 1521, marking the islands' first Western contact. Magellan claimed the entire area for Spain. China, Japan, and other countries tried to conquer the Philippines, but Spain maintained control for nearly four hundred years.

#### Philippine Revolution

José Rizal, writer and patriot, helped inspire a revolt against Spain in 1896. Spain lost a war to the United States and turned the Philippines (not a part of the original conflict) over to U.S. control in 1899. Preferring self-rule, the Filipinos, led by Emilio Aguinaldo (the first president of the First Philippine Republic), tried to repulse U.S. troops. Internal strife continued until 1901, when U.S. control formally began. Japan invaded the Philippines in 1941 and remained until U.S. forces returned near the end of World War II.

On 4 July 1946, the Philippines became an independent republic, but the United States maintained a military presence until 1992. Through the 1960s, unrest over inequality between landowners and tenant farmers threatened government stability and inspired revolutionary movements that remained active well into the 1990s. In 1972, President Ferdinand Marcos declared martial law and ruled by decree, effectively controlling all opposition until 1986. Corruption increased and the standard of living for the poor remained low.

#### Elections

The peaceful People's Power Revolution drove Marcos from power in 1986. His elected rival, Corazon Aquino, took office

and implemented reforms of the government and the economy. She did not run for reelection in 1992, but elections were peaceful and democratic. Aquino's successor, Fidel V. Ramos, inherited a weak and inefficient system during a time when the country was plagued by natural disasters. However, his success at meeting these challenges allowed candidates loyal to him to win majorities in both houses of Congress in 1995. Ramos negotiated a 1996 peace agreement with the Muslim separatist Moro National Liberation Front (MNLF), ending 26 years of conflict; however, fighting with other splinter separatist groups continues.

Elections in 1998 brought Joseph Estrada (a former action star) to the presidency, but charges of corruption forced him to relinquish his position to the vice president, Gloria Arroyo, in January 2001. Arroyo was reelected in May 2004 and withstood the opposition's attempt to impeach her on charges of corruption and electoral fraud in 2005. Other challenges that faced her administration included a lackluster economy, hostage crises, natural disasters, and separatist and religious violence. Arroyo was succeeded in mid-2010 by Benigno Aquino, son of former president Corazon Aquino (who died just prior to the election).

#### **Natural Disasters**

The Philippines is vulnerable to tropical storms and has been struck by several large natural disasters in the past few years. In late 2011, a typhoon struck the southern Philippines. Flooding and mudslides resulted in the deaths of over 1,200 people, and waterborne illnesses threatened the health of survivors. In early 2012, a 6.8-magnitude earthquake struck near Cebu City, resulting in more than 20 deaths. Typhoon Haiyan (locally known as Yolanda) swept through the Philippines in 2013 and is the strongest storm to ever be recorded. Millions of Filipinos were displaced, and several thousand people died. International aid efforts provided many Filipinos with food, clothing, shelter, and health care, but there was difficulty in getting aid to many rural areas.

#### **Recent Events and Trends**

- **Presidential election:** In May 2016, Filipinos elected Rodrigo Duterte as president; he was sworn into office in June. Duterte has been in politics for many years and has served as a mayor twice and as a congressman. He is known for his tough stance on crime and says he plans to bring back the death penalty.
- **War on drugs:** In October 2017, President Duterte ordered police to end all operations in fighting the Philippines' illegal drug problem and to leave responsibility solely to the Philippine Drug Enforcement Agency (PDEA). Since 2016, President Duterte's war on drugs, which mainly targets poor drug dealers and users in Manila's slums, has left tens of thousands of people dead. Human-rights groups condemn this campaign, as they consider many of the casualties the result of government-endorsed extrajudicial killings.
- **Autonomy referendum:** In January 2019, millions of Filipinos voted for a law that would grant greater autonomy to the Muslim-majority parts of Mindanao. The referendum was part of a larger peace deal between the government and the Moro Islamic Liberation Front. Years of conflict between Moro rebels and the government have resulted in the deaths of thousands and the displacement of millions of Filipinos.

## THE PEOPLE

### **Population**

Filipinos are predominantly of Malay and Spanish descent. Further divisions formed along linguistic, geographic, and religious lines. The largest group is the Tagalog (28 percent), followed by the Cebuano (13 percent), Ilocano (9 percent), and Bisaya (8 percent). A few tribes of indigenous descendants of pre-Malay peoples still live in the Philippines. The Aetas live around Mount Pinatubo, while Negritos inhabit the uplands of islands around the Sulu Sea. The Igorot and Ifugao of the Cordillera Mountains, in northern Luzon, are known for their stunning two-thousand-year-old rice terraces in Banaue.

### **Language**

English and Filipino (referred to as *Tagalog*) are official languages. English is the main language of business, government, and higher education; it is also the language of instruction for some schools and of math and science in all schools. Tagalog is a dialect that originated on Luzon. Many ethnic groups that speak one of more than 70 other languages or dialects were hesitant to adopt Filipino when it was introduced in the 1960s because it was based on Tagalog. But it is now a primary language for daily communication between speakers of different dialects. In Luzon, spoken English is heavily laced with Tagalog words in informal conversation. Speaking in a dialect that someone present might not understand is considered rude. However, some groups speak only their own dialect; this is particularly true in the Visayan region, where Cebuano dominates.

### **Religion**

The Philippines is a predominantly Christian nation. About 81 percent of the population belongs to the Roman Catholic Church, 2 percent belongs to the Philippine Independent (or Aglipayan) Church, and 10 percent belongs to various other Christian churches. Five percent is Muslim. Muslim Moros live mainly on southern islands, particularly Mindanao. Violent clashes between Christians and Muslims can occur. In remote areas, people are still heavily influenced by traditional beliefs, worshipping a variety of gods. A number of Buddhists also live in the Philippines.

### **General Attitudes**

The influence of Chinese, Malayan, Spanish, and U.S. cultures is evident in Filipino society. Individualism is considered less important than the family. Bringing shame to individuals reflects on their family and is avoided at all costs. Interdependence is considered more important than independence. Although generally casual and fun loving, Filipinos tend to be sensitive people and consider maintaining smooth social relationships to be more important than expressing personal views or delivering bad or unwanted news. To avoid hurting or displeasing others, most Filipinos may use a third party to deliver bad news or might say "maybe" when they mean "no." "Yes" can mean "maybe."

Confrontation is usually avoided. Frankness can signify a lack of culture. In general, Filipinos have a relaxed view of time (sometimes referred to as "Filipino time") and may not always begin meetings or appointments promptly.

Accepting a favor obliges a Filipino to repay with a greater favor, although never with money. Filipinos often show admiration by imitation. Innovation, change, and competition are sometimes considered risky since they could result in failure. Changing social or religious habits may be regarded as ingratitude to parents. Fatalism is common—success may be attributed to fate rather than ability or effort. The Latin concept of *machismo* (proving one's manliness or superiority) is evident in the Philippines; the ideal man is a macho man. Men often make comments about women passing by on the street, and although such comments are often ignored, they can be distracting to some women.

### Personal Appearance

Proper appearance for an event is important; being over- or underdressed can be a cause for embarrassment. To avoid this, appropriate dress is often discussed prior to an event. Filipino formal clothing for men includes a *barong*, a white or pastel-colored embroidered shirt that hangs over the pants. Women wear a *terno*, a full-length dress with a scoop neckline and flat, oversized "butterfly" sleeves. Manual laborers wear pants and long-sleeved T-shirts, often with a shirt wrapped around their heads to avoid getting sunburned on the head and neck. Farmers likewise wear long-sleeved shirts and pants to protect themselves from the sun. Some office workers wear long pants and a collared shirt; others may be required to wear corporate dress. Others wear denim jeans, business casual attire, or Western-style suits. Flip-flops are common footwear in casual situations.

Women (including Muslim women) generally wear Western-style dresses or skirts with blouses; they may also wear jeans and T-shirts. Government employees wear uniforms, although not necessarily every day; the uniform's style identifies the agency. Teachers have a different uniform for each day of the workweek. Ethnic minorities in highland villages and on outlying islands sometimes wear traditional clothing. A fair complexion is considered the sign of someone who does not have to labor in the fields and is therefore considered more beautiful or desirable than a darker complexion.

## CUSTOMS AND COURTESIES

### Greetings

Initial greetings are usually friendly and informal. Handshakes are typical, but verbal greetings are acceptable alone. Some men may hold a handshake longer than normal, which is usually a sign of respect. To show additional respect or enthusiasm, one places the free hand on top of a handshake or uses it to pat the other person's shoulder. Between women or between men and women, a *beso-beso* (kiss to each cheek) is common. Common informal Tagalog greetings include *Saan ka pupunta?* (Where are you going?) and *Saan ka galing?* (Where have you been?). A typical response is *Diyari*

*lang* (There, only). *Kumusta ka na?* (How are you doing?) is more formal. *Anong balita?* (What's new?) and *Ayos ba tayo 'dyan?* (Is everything all right?) are used among friends. Just as common are *Hi* and *Good morning*.

Young people show respect to adults by addressing them with a proper title. If a professional title (doctor, manager, chief) is not appropriate, then *Sir*, *Ma'am*, or a familial title based on the age difference and relationship of the speakers is used. Young adults commonly address strangers of roughly their age as *ate* (older sister) or *kuya* (older brother). Older adult strangers are often referred to as *manang* (old lady) or *manong* (old man). The elderly might be called *lola* (grandmother) or *lolo* (grandfather). When speaking to the elderly or out of respect, Filipinos commonly use *po* (a marker used to show respect) and *opo* (polite form of "yes") in their speech. Similar titles exist in most dialects. Those equal in age and status usually address each other by first name or nickname. If individuals have a professional title, however, even peers may address them by that title to acknowledge their achievement or status.

### Gestures

Hand movement is not excessive in conversation, but Filipinos do use various hand and body gestures to communicate. Raising the eyebrows can mean "hello" or "yes." To beckon, one waves all fingers with the palm facing down. A quick head nod can mean "I don't know." Filipinos often point by puckering the lips. A shoulder shrug with open palms facing up means *Bahala na*, a common expression meaning "Accept what comes and bear it with hope and patience." A widely opened mouth means "I don't understand."

Men normally offer bus seats to the elderly or handicapped. Younger people, especially rural Catholics, "bless" an elder (particularly godparents) by bringing the elder's hand to their forehead. Women commonly walk arm in arm or hand in hand, and men may put an arm around each other's shoulders, but displays of affection between men and women, especially in rural areas, are considered inappropriate. It is increasingly more common for youth in urban areas to publicly show affection.

### Visiting

Filipinos, especially those from the *barrios* (small villages or suburbs), enjoy visiting often. Rural visits are often unannounced, but urban visits are less frequent and more planned. Guests do not typically take gifts, since the visit itself is considered a gift. However, a guest who has been away for a long time or visits from a foreign province or abroad is expected to bring a small *pasalubong* (inexpensive gift) to the family.

Guests are treated with great hospitality and offered the host's best amenities. They are typically offered something to drink. Common drinks initially offered during a visit include water, juice, and soda. Alcoholic drinks may be offered after a guest has stayed for a while. Food is also typically served, except during very short visits. Guests can decline refreshments, but hosts insist until the guests decline several times. The woman of the house is referred to as *Maybahay*, as



Mrs., or (if on familiar terms with the host) with *Aling-* prefixed to her given name.

Although socializing in the home is the most popular leisure activity, Filipinos also enjoy meeting in public places, where drinking is often a primary activity. Urban neighborhoods often have a central park where schoolchildren can practice dance or other presentations. Youth like to socialize in malls or clubs. Villages nearly always have a plaza where political events, dances, meetings, and socializing occur and where basketball can be played nearby.

## Eating

Filipinos usually eat three meals a day, with at least two snack periods (*merienda*) between meals. Rural Filipino families usually eat all meals together. Urban families eat weekday breakfast and dinner, as well as most weekend meals, together. Spoons and forks are the most common utensils. Typically, one pushes food onto the spoon with the back of the fork. Diners may use their hands in large rural gatherings, a practice that is less common in urban areas. Guests typically are seated nearest the head of the home and are always served first. No one eats until after the guests have had a bite or two. Likewise, no one leaves the table until everyone has finished eating. Guests show their appreciation by eating heartily. Refusing any food is considered impolite, except for health reasons. Tipping is not practiced in restaurants, except at finer dining establishments, which include the tip in a service charge.

## LIFESTYLE

### Family

#### Structure

The extended family is the basic social unit, and more than two generations often live together in the same household. The average rural family has about three children; urban families tend to be smaller. Family ties remain strong, even after children are grown and married.

People support financially needy relatives (immediate or extended) when necessary. Many Filipinos work overseas to earn money for education costs or medical expenses of the extended family at home. Recipients of such aid are expected to return help when possible or necessary. Individuals may sacrifice much to help provide family members (especially children) with a better life. Within the country, people may help find employment or opportunities for relatives.

#### Parents and Children

When one or both parents work overseas, children are frequently left in the care of a grandparent or other mature family members. The primary responsibility of most children is to complete their education, but some families expect their children to work to help support the family. Some children continue to live with their parents, even after marriage. Both parents discipline their children, and children take advice from their mothers very seriously. Adult children are expected to support their parents, and some married children may live with elderly or infirm parents.

Families with parents employed overseas can suffer strains

on their relationships, as parents have limited interaction with their children. Single-parent families as a result of unwed pregnancy or separation are increasingly common. Most single-parent families are headed by women.

#### Gender Roles

As fathers, men are responsible for major family decisions, but women also play significant roles in the family. Most women work outside the home, even working overseas. Rural women work alongside men in the rice fields. In addition to being co-providers, women are also expected to take care of the children and manage the household and family finances. Some wealthy and dual-income families hire a nanny or a maid.

Modernization has led women to play a greater role in society. More women are able to complete advanced education and develop careers, and they are less likely to conform to traditional roles. Educated and experienced women tend to be competitive for jobs. Filipino women hold business and industry positions and have held high office in government, including the presidency. Several feminist groups have organized to help secure women's rights and promote women's issues such as single parenthood. Despite the institution of the Anti-Violence Against Women Act, domestic violence against women and children continues to be a major problem. Female desk officers are assigned at every police station to assure female victims that reports of crime or abuse will not be ignored.

## Housing

### Rural

In rural areas, families consider the changing weather conditions when choosing building materials. Typical rural housing is the *nipa* hut, a bamboo structure with a roof of dried palm fronds. These homes usually consist of one main room and one or two bedrooms. Rural families may rely on outhouses and outdoor kitchens, sometimes called "dirty kitchens," because they are often used for cooking dishes that have strong odors or that produce a lot of smoke.

The *sala* (living room) is a home's focal point, where the family spends most of its time. Other rooms include the *cucina* (kitchen), bathroom, and two to four bedrooms. It is common for siblings to share rooms. For big families, the living room may also be turned into a sleeping space at night. Common fixtures in rural homes include a radio, charcoal stove, and paraffin lamp.

### Urban

The designs of most houses in urban areas have a mix of traditional and Western influence—for example, using materials like bamboo with wide windows and expensive wooden furniture. Homes are built of wood or concrete and have concrete foundations. Common types of housing include single-family houses, row housing (cheap, one-storey buildings in villages), and more recently, townhouses, condominiums, and apartment buildings. The wealthy live in large homes with modern architecture and design, often located in private developments. Homes in and around Manila, especially near the city center, are expensive and tend to be smaller than those in outlying provinces.

Apartments typically have one or two bedrooms, while

houses may have two to four bedrooms. Urban kitchens usually have a stove, a sink, and electricity. The water supply in urban areas may be indoor plumbing, while in rural areas it may be a communal tap. Most urban families have a television, radio, stove, telephone, and refrigerator. These appliances are often considered status symbols, an indication that the family has achieved prosperity.

#### **Ownership**

Most Filipinos consider housing an investment, and the ability to afford a house is a sign of success. The government offers subsidized housing for the poor, and there is a growing trend in rent-to-own townhouses (two-storey buildings found in cities) and condominiums for the emerging middle class. Housing loans are available, though typically only middle-class families and above can take advantage of them. Urban newlywed couples usually rent a studio-type apartment, while families with children may rent houses.

Due to urban migration, an increasing number of families squat illegally in private or government-owned lots. Poor families also set up shanties beside railroad tracks, under bridges, or along river banks. Shantytowns are cramped and lack basic facilities like plumbing and waste removal. Government programs seek to relocate the squatters to provide them with legal property and decrease the ecological toll squatting has on waterways.

### **Dating and Marriage**

#### **Dating and Courtship**

Urban dating usually begins in the early teens. Young people often socialize through school activities like dances and acquaintance parties (a party of peers hosted by a youth organization to acquaint youth with each other). They also meet friends through social networking sites and chat rooms. Youth tend to date in groups and may socialize at malls or organize out-of-town trips over weekends or on vacations. In urban areas, speed dating and blind dates (through acquaintances or, increasingly, online matchmaking sites) have increased in popularity. Dancing, singing karaoke, eating at restaurants, and going to movies are also popular dating activities.

In rural areas, dating habits vary according to religion and tradition. Casual dating is not common. In some rural areas, the tradition of *harana* is still practiced. *Harana* is a courting ritual wherein a boy stands outside the house of a girl who he intends to court and sings folk love songs. When the girl hears him, she expresses her interest by looking out from her window. With her parents' permission, the boy may be invited in to chat and eat light snacks.

#### **Engagement**

*Pamanhikan*, a visit of the suitor and his family to the family of his prospective bride, traditionally started the engagement process. The man and his family brought gifts and food to persuade the girl's family to accept the suitor. When the family accepted the offer of marriage, both families began preparations for marriage. More commonly today, especially in urban areas, *pamanhikan* is a formality where the parents of the couple begin talking about wedding preparations; the engagement may have already happened.

#### **Marriage in Society**

Most Filipinos value marriage as an important institution, and legal rights such as property ownership and health benefits are legally guaranteed to married people. Common-law marriages are acceptable if the family cannot afford a wedding, but rights like healthcare benefits extend only to the children. Same-sex marriage is illegal in the Philippines. It is common for Filipino women to marry foreigners; many men come from the United States, Australia, and, increasingly, the Middle East and South Korea. Although the legal marriage age is 18, some Filipino women marry younger. As education levels among women have increased, the average marrying age has also increased. Most Filipinos marry before they are 30 years old.

#### **Weddings**

A traditional Filipino church wedding is often elaborate and costly. In the past, the groom's family paid for the wedding, but it is more common for families to share expenses. Some families save for months or years to afford a wedding. Most couples choose a traditional religious wedding, but some opt for a simple civil wedding performed by a government official. The families plan the wedding together. In urban areas, couples may also hire wedding planners to help with preparations. In rural areas, couples are assisted in wedding preparations by their immediate relatives and friends. Catholic wedding ceremonies are held on church premises, but other religions may hold the ceremony in an outdoor setting or hotel function rooms. Grooms often wear a *barong* (a lightweight, embroidered shirt, similar to a dress shirt) made of pineapple or banana fiber. Brides usually wear a white gown with a veil, chosen by the bride. Couples are also expected to buy gowns and suits for the bridal party.

At the reception, which usually follows the wedding ceremony, parents and close friends deliver speeches and the couple cuts the wedding cake and makes toasts. The bride and groom dance a waltz while guests pin money to the clothes of the couple to wish them prosperity in their marriage. Generally, guests bring practical gifts such as household appliances, but in recent years, money is also a common gift.

#### **Divorce**

Divorce does not exist in the Philippines, except for limited cases involving Muslims. Legally, marriages must be ended with an annulment; however, the cost and extended time frame of annulments make them difficult to obtain for most Filipinos. Separation is the alternative for those who cannot afford annulment.

### **Life Cycle**

#### **Birth**

Family members visit a relative within a few days after she gives birth. Catholic parents plan the baptism of their baby, through which the child will become a member of the parents' faith. Parents choose close friends and relatives to serve as godparents, who will assist the parents in raising the child, be involved in the personal development and discipline of the child, and act as the child's guardian in the case of the parent's death. After the ceremony, a reception follows where family and guests share a meal together. Baptisms can be expensive events (since they are a private mass service), and several families may plan a baptism together. Parents

celebrate their children's first and seventh birthdays as significant birthdays and invite friends and family for a party. Other birthdays are celebrated within the immediate family.

#### **Milestones**

The legal and voting age is 18, but while legally adults, most young Filipinos remain dependent on their parents. No formal rite of passage exists for boys, though high school and college graduations are much-celebrated achievements. Filipino parents feel obligated to finance their children's entire education, and children usually must finish tertiary education before they are given independence in major life choices. Most children are between 20 and 21 years old and have graduated college when they start being more independent. In rural areas, some teenagers as young as 16 are required to work to help support the family.

Wealthy families may throw a party when a young woman turns 18 to mark her transition to adulthood. The party includes 18 waltzes, which the birthday girl dances with different partners, beginning with the father, followed by brothers and cousins, and ending with male friends.

#### **Death**

In keeping with religious traditions, most Filipino families choose to bury their dead. Families with relatives buried in a cemetery are required to pay fees to maintain the grave. If a family fails to pay the fee, the remains will be removed from the cemetery. In recent years, however, cremation has become more popular. Families can rent a place to hold a wake, or they can arrange the wake at home. The wake usually lasts three to five days, during which religious services are held each night. Relatives and friends visit to express their sympathy and condolences and offer flowers or money. The body is never left alone during this time; family members take turns holding overnight vigils.

On the last night of the wake, close relatives and friends are expected to visit and spend the night with the deceased. The family usually requests a priest or religious leader to bless the body of their dead relative before it is buried or cremated. Family members may lead a procession to the cemetery on foot (in rural areas) or in cars (in urban areas). Additional prayer services are held at the home of the family of the deceased over the next 40 days. On All Souls' Day (2 November) and on anniversaries of the death, families visit the cemetery and leave the person's favorite dish or drink as an offering at the grave site.

#### **Diet**

Rice, the main staple food, is prepared in a variety of ways and is often included in desserts. *Suman*, a sweet rice cake, is a popular dish. Fish, the primary source of protein, is accompanied by vegetables and tropical fruits. A typical meal might consist of boiled rice, fried fish, and a vegetable, with fruit for dessert. Fruit is also often eaten for breakfast. Pork, beef, and chicken are favorite meats. Seafood is common at restaurants and resorts. Popular for large celebrations is the *lechon*, a stuffed pig roasted over a charcoal fire. Meats are often roasted and served on skewers. *Kare-kare* is a stew of meats and vegetables served in a peanut sauce. *Adobo* is a stew of chicken and pork in garlic, soy sauce, and vinegar. Garlic is a common spice. Street vendors sell *balot*, a

fertilized duck egg with an embryo. A favorite snack is *halo-halo*, made from sweetened beans, milk, and fruits served in colorful layers with crushed ice. *Pulutan* is a deep-fried snack (like pork rinds, but it may also be made of goat or dog meat) often served with beer.

#### **Recreation**

##### **Sports**

Basketball is the most popular sport. People often gather for professional, intercollegiate, and local basketball games. Most towns have basketball courts, where young men play. Basketball classes for boys as young as primary school age are offered during summer break. Occasionally, basketball games are held between city *barangays* (districts). Other favorite sports include badminton, boxing, and only very recently, soccer. Recent successes by the national soccer team, known as the Azkals, have made it an increasingly popular spectator and participant sport.

##### **Leisure**

Filipinos love to entertain, and most have free time to do so during weekends or holidays. Singing karaoke is a popular activity when friends or families get together. At home, they watch TV and play chess or card games. In big cities, people often spend time in malls to window shop, eat, watch movies, or hang out at coffee shops. Young people enjoy using the internet for social networking and playing video games. Women spend their free time visiting friends or enjoying TV shows and movies. Men enjoy playing billiards and watching cockfights with friends.

Relatives and friends enjoy celebrating occasions like birthdays, graduations, and homecomings. In rural areas, town feasts celebrate the town's patron saint. These feasts are characterized by elaborate preparations and additional events sponsored by the local government, such as parades, talent contests, and fairs in the town plaza.

##### **Vacation**

During the summer season (March–June), families and groups of friends plan trips to the beach. Many people take advantage of inexpensive airfare to many destinations within the country. Visiting relatives is a very common activity.

#### **The Arts**

Government patronage revived interest in traditional Filipino arts in recent years. Concerts featuring modern, classical, and folk music are well attended. Native instruments include drums, gongs, woodwinds (such as the flute), and the *kutyapi* (a two-stringed lute). Western cultures, especially Spanish and U.S., have also greatly influenced Filipino music.

Folk dances vary according to region. The *Tinikling* is the national dance. While dancing between bamboo poles, performers mimic the quick actions of *tikling* birds (herons). Dances share the stories of the Spanish conquest, festivals, harvest, and courtship. Filipino crafts include wood carvings, marble sculpture, pottery, and weaving. Folklore, myths, and legends are still passed down orally in the more remote regions. While they vary by religion and region, they generally focus on nature, Filipino history, and daily life.

#### **Holidays**



Filipinos celebrate several national holidays and dozens of local *fiestas*, which are events for recreation and visiting family. Public holidays include New Year's Day (1 January), Easter Sunday, Day of Valor (also known as Bataan Day, 9 April), Labor Day (1 May), Independence Day (12 June), National Heroes Day (last Monday in August), All Saints' Day (1 November), Bonifacio Day (30 November), Christmas (25 December), and Rizal Day (30 December).

#### *New Year's*

New Year's celebrations are an extension of Christmas festivities, and Christmas decorations generally stay up until after the first week of January. Families get together on New Year's Eve and enjoy food as they wait for the clock to strike 12. Men spend their time at the parties chatting with friends and drinking, women prepare food and gifts, and children play. Everyone watches a fireworks display at midnight. Fireworks displays, traditionally thought to banish the bad spirits of the previous year, are held in parks and town plazas. New Year's Eve parties, often featuring musical performances, are held in major cities in the country.

#### *Lent*

Lent (a period of fasting for Catholics) extends from Ash Wednesday (46 days before Easter Sunday) to Easter Sunday. Most people are given Maundy Thursday (the Thursday preceding Easter Sunday) through Easter Sunday off from work. During Lent, devout Catholics refrain from eating meat and doing physically strenuous activities. Many religious traditions are followed during Lent such as *Visita Iglesia* (visiting seven churches while performing Catholic rituals) and *Pabasa* (chanting biblical passages). A few towns reenact scenes from the events leading up to the crucifixion of Jesus Christ. On Easter Sunday, people attend Mass and afterward enjoy a special meal served for lunch or dinner. People might also take advantage of this time to travel or relax at home.

#### *Christmas*

Christmas is the most celebrated holiday. The Christmas season extends through 6 January (Three Kings Day) and is a time of family reunions and great merriment. Most Filipinos working overseas come home during this season, and people commonly visit their hometowns to attend family or school reunions. People begin decorating for Christmas and listening to Christmas music as early as September. Families in both urban and rural settings buy and decorate artificial Christmas trees. Although Christmas shopping begins early in urban areas, it is limited in rural areas, as people tend to limit their gift giving, preferring instead to simply spend time with family and neighbors. Christmas parties are organized at work and school, and friends usually have lunch or dinner parties in the weeks before Christmas.

Catholics attend a series of Christmas masses called *Simbang Gabi*. From 16 December to Christmas Eve, a mass is held at dawn each morning. Many Catholics believe that if one faithfully attends *Simbang Gabi*, a wish will be granted. From the beginning of *Simbang Gabi* until Christmas Eve, children in many areas go door to door singing carols and receiving money and sweets. On Christmas Eve, urban families gather to exchange gifts and enjoy a large feast featuring pork, beef stew, casseroles, and traditional desserts like *leche flan* (caramel custard) and coconut salad. Rural

Filipinos also enjoy a large meal, but exchanging gifts is less common. On Christmas, people light fireworks to celebrate. Windows, doors, and drawers are opened to let out the bad spirits and welcome the good. For luck, many people hang 13 ripe, round fruits around their doorway, wear clothes with circular (which symbolizes eternity) prints, and carry money in their pockets.

## SOCIETY

### Government

#### *Structure*

The Philippines is a presidential republic comprised of 80 provinces. Each province is divided into *barangays* ("districts," similar to counties), which are made of several *barrios* (small villages or suburbs). The national government is led by a president, who serves as head of state and head of government. A vice president is elected on a separate ballot. The legislature, the bicameral Congress, consists of a 297-seat House of Representatives and a 24-seat Senate.

The president and vice president are directly elected to six-year terms, senators to six-year terms, and representatives to three-year terms. Most government offices are in Quezon City, the former capital, named for the country's first president, Manuel Quezon. The Philippines is a member of the Association of Southeast Asian Nations (ASEAN).

#### *Political Landscape*

Many political parties function in the Philippines, and alliances shift often. The ruling party is the Liberal Party (LP), which leads a coalition that holds the most seats in Congress. The political landscape is controlled by several wealthy families. Most elections are won by individuals with strong family ties in politics, widespread fame, and large private funds. Corruption is widespread throughout all levels of government.

#### *Government and the People*

The government respects and provides for constitutional rights like freedom of expression, speech, religion, and assembly. Civic activism through demonstrations and organized rallies is common but requires a permit. The voting age is 15 for *Sangguniang Kabataan* (youth council) elections and 18 for national elections.

### Economy

After years of economic reforms and political stability, the Philippines has experienced strong and rapid economic growth. The economy is dominated by services (making up about 59 percent of the gross domestic product, or GDP) and relies on remittances, or money sent home from Filipinos working abroad. The Philippines is also a major center for outsourcing businesses that serve mainly U.S. companies. Agriculture employs 27 percent of the labor force. Cycles of drought and flooding can seriously hamper production. Important crops include rice, corn, coconut, sugarcane, abaca, and tobacco. In addition to agricultural products, the country exports electronics, clothing, minerals, and chemicals. Income distribution is fairly unequal; a little more than a quarter of the population lives below the poverty line. The economy

faces many additional challenges, including corruption, underemployment, the emigration of highly skilled and educated Filipinos, and underdeveloped infrastructure. The currency is the Philippine *peso* (PHP).

### Transportation and Communications

Many Filipinos in the middle class own cars, but others rely on public transportation. Metro Manila has numerous modes of public transportation, including buses, taxis, and *jeepneys*. A *jeepney* is an elaborately decorated minibus built on the frame of an old U.S. military jeep. They travel on relatively fixed routes and stop when waved at from the sidewalk. They carry 10 to 20 passengers for a low fare; passengers tap or pound on the roof when they want to stop. Traffic is heavy and driving habits aggressive. Rural transportation is less developed, often employing animals, bicycles, motorcycles, or *motorelas* (a motorcycle version of the *jeepney*). In addition to a domestic airline, ferries and *banca* (local outrigger) boats provide interisland transportation.

Although the communications system is generally good, service is not extensive in rural regions and between islands. Middle-class homes have phones if service is available in the area. Cellular phones are increasingly popular. The constitution guarantees freedom of speech and expression. Though journalists and newspapers cover an array of topics with relative freedom, violence against journalists is common. Most print media outlets are privately owned and reflect the views of their owners. Internet access is not restricted, but a new cybercrime prevention law, which is intended to defend users against identity theft, child pornography, and spam, may potentially limit online freedom of expression through its new libel provisions. Libel is a criminal offense in the Philippines and is punishable by long prison sentences. Television and radio stations are numerous. Social media is popular and available to all.

### Education

#### Structure

Education is highly valued in the Philippines and is compulsory for 13 years, but attendance is not enforced. Primary school begins at age six or seven and lasts six years, but young children can attend kindergarten at age five and preschool before that. Some schools offer a seventh year of primary school. The school year runs from June to March. Students start secondary school at age 12 or 13 and attend for four years. While the majority of children enroll in primary school, secondary school enrollment is much lower. Plans are underway to implement a program, called K+12, that will modify the current educational system by adding two more years of secondary school.

Public education is free. A variety of private schools exist for those who can afford the tuition. Most students go to public schools, but some middle- and upper-class families enroll their children in private institutions, which generally offer better quality education. The majority of private schools in the country are run by religious organizations.

#### Access

The education system faces a variety of challenges. In recent years, the government has struggled to fund education for the

growing population. Ongoing problems include a lack of teachers, classrooms, and facilities, especially in rural areas. Students sometimes attend classes in three daily shifts to compensate for a lack of facilities and materials. Some families cannot afford the extra costs, including school uniforms, transportation, and food allowance, which contributes to the number of elementary school and secondary school drop outs. Recent educational reform has attempted to address these challenges; however, it is expected to take several years for all changes to take effect.

#### School Life

School uniforms are worn by almost all students in both public and private schools. Classes are taught in English and Filipino. Proficiency tests are given at the end of sixth grade and the second year of high school to assess the students' skills in English, Filipino, mathematics, science, and social studies. Secondary school includes one year of civic volunteering, including military training, teaching in public schools, or cleaning the *barangays* (districts).

#### Higher Education

A senior high school student who wishes to enter a certain college or university has to take the admissions test administered by the school. Some universities require the applicant to pass an interview as part of the admissions procedures. Prominent universities located in Metro Manila include University of the Philippines, Ateneo de Manila University, De La Salle University, and University of Santo Tomas. Some colleges and universities require their students to wear uniforms. Vocational training at private institutions is an option for students who do not enter university. Commonly studied vocations include nursing, culinary arts, and hospitality and restaurant management.

### Health

Overall, medical service in Manila is good. Rural areas usually have a health unit, but it may lack supplies. A universal health insurance program is paid for mostly through taxes and other government funds. The government also sponsors free vaccinations for children. Poverty, poor sanitation, and superstition (particularly the use of folk remedies in place of medical care) still contribute to a high infant mortality rate. Pollution and conditions in slums, especially in Manila, are serious health hazards.

## AT A GLANCE

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**Country and Development Data**

Capital	Manila
Population	105,893,381 (rank=13)
Area (sq. mi.)	115,831 (rank=72)
Area (sq. km.)	300,000
Human Development Index	111 of 188 countries
Gender Inequality Index	97 of 188 countries
GDP (PPP) per capita	\$8,400
Adult Literacy	96% (male); 97% (female)
Infant Mortality	21 per 1,000 births
Life Expectancy	66 (male); 73 (female)
Currency	Philippine Peso

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# Philippines profile - Timeline

- 9 January 2018

## A chronology of key events:

**1542** - Spanish expedition claims the islands and names them the Philippines after the heir to the Spanish throne.



US troops in the Spanish-American War, which ended over 350 years of Spanish rule in the Philippines

**1896** - Civil and armed campaign for independence from Spanish rule begins.

**1898** - Revolutionary forces under Emilio Aguinaldo proclaim independence.

**1898** December - During brief Spanish-American War, US Navy destroys Spanish fleet in Manila Bay. Spain cedes Philippines to US, which proclaims military rule.

**1899** - Revolutionaries refuse to recognise US takeover, proclaim First Philippine Republic with General Aguinaldo as president, launch armed struggle against US forces known as Philippine-American War.

**1901** - Emilio Aguinaldo captured.

**1902** - Philippine-American War formally ends as US civil government replaces military rule. Some independence forces fight on until defeat of Moro resistance in south in 1913.

## Mount Mayon



Mount Mayon volcano, with its near-perfect cone, is active

### **Living in the shadow of a volcano**

**1907** - Elected Philippine assembly inaugurated under US rule. **1916** - US government promises Philippines greater autonomy, leading to independence.

**1935** - A plebiscite approves establishment of Commonwealth of Philippines. Manuel Quezon is its first president. Philippines promised full independence within 10 years.

### **Invasion and occupation**

**1941** - Japan seizes Philippines.

**1944** - US forces retake islands.

**1946** - Islands granted full independence and renamed Republic of the Philippines.

**1947** - The US is awarded military bases on the islands.

**1951** - Peace treaty signed with Japan. The Philippines eventually receive \$800m in reparations payments.

**1965** - Ferdinand Marcos becomes president.

## **Ex-president Ferdinand Marcos**

---



Marcos amassed an estimated \$10bn fortune

- Born in 1917
- Became president in 1965
- Fled the country in 1986
- Died in Hawaii in 1989

### **Manila awarded Marcos millions**

### **1986: Filipino coup leaders tell Marcos to go**

**1969** - Marcos re-elected amidst allegations of electoral fraud. Supports US policy in Vietnam. Muslim separatists in south begin guerrilla war.

### **Martial law**

**1972** - Marcos declares martial law. Parliament suspended, opposition politicians arrested, censorship imposed.

**1973** - New constitution gives Marcos absolute powers.

**1977** - Opposition leader Benigno Aquino sentenced to death, but Marcos delays execution.

**1980** - Aquino allowed to travel to US for medical treatment.

**1981** - Martial law lifted. Marcos wins presidential elections.

**1983** - Aquino returns to Philippines, but is shot dead as he leaves plane amid suspicions of official military involvement.

### **"People power"**

**1986** - Presidential elections see Marcos opposed by Aquino's widow Corazon. Marcos declares himself the winner, but Aquino disputes result. Mass protests, dubbed "people power", in Manila see military abandon Marcos, who flees to Hawaii. New government says Marcos looted billions of dollars during his rule.

**1989** December - US jets assist Philippine government forces suppress attempted coup.

## Fallen hero

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### **Profile: Joseph Estrada**

**1990** - Military officials convicted of murder of Benigno Aquino.

**1991** - US abandons Clark Air Base after volcanic eruption smothers it with ash.

**1992** - Aquino's defence minister Fidel Ramos wins presidency. US closes Subic Bay Naval Station.

**1996** - Peace agreement reached with Muslim separatist group, Moro National Liberation Front. Another group, Moro Islamic Liberation Front (MILF), fights on.

**1998** - Former film star Joseph Estrada elected president.

**2000 November** - Impeachment proceedings start against President Estrada on allegations of corruption, betrayal of public trust, and violation of the constitution.

### **Estrada tried**

**2001 January** - Suspension of impeachment causes mass street protests. Military withdraws support and President Estrada stands down. Vice-President Gloria Arroyo sworn in as president.

**2001 March** - MILF declares ceasefire, says ready to hold talks with government.

**2001 April** - Joseph Estrada is charged with plundering more than \$80m from state funds while in office. Eventually found guilty and jailed for life. although he wins pardon.

## Conflict in the south Philippines

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### **Guide to the Philippines conflict**

**2002 January** - US and Filipino armies hold joint counter-terror exercises take place near stronghold of Al-Qaeda-linked Abu Sayyaf group.

**2002** October - Series of deadly bomb blasts on Manila bus and three locations in Zamboanga city blamed on Islamist militants.

**2003** February - Ceasefire between MILF and government breaks down. Planned talks called off in May after rebel attack on Mindanao kills 30 people.

**2003** July - Government signs another ceasefire with MILF ahead of planned talks in Malaysia.

Army mutiny in Manila as some 300 soldiers seize shopping centre, but surrender peacefully following negotiations.

**2004** February - Peace talks between government and Maoist rebel New People's Army start in Norway, but are called off by the rebels in August.

**2004** June - Gloria Arroyo wins May's presidential elections.

### **Arroyo under pressure**

**2005** January - Heavy fighting between troops and MILF rebels breaks July 2003 ceasefire.



Despite impressive economic growth, millions of Filipinos still live in poverty

**2005** April- Breakthrough achieved on contentious issue of ancestral land achieved at peace talks in Malaysia between government and MILF rebels.

**2005** June - Influential Cardinal Jaime Sin, who led the two peaceful revolts that toppled Presidents Marcos and Estrada, dies aged 76.

**2006** February - More than 1,000 people are killed by a mudslide which engulfs a village on the central island of Leyte.

President Arroyo declares a week-long state of emergency after the army says it has foiled a planned coup.

## **Political killings**

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2007: students in Quezon city stage a mock massacre in protest against political killings

- Report implicated military in deaths of hundreds of activists

**Philippines army is 'in denial'**

2007 January - Death of Abu Sayyaf leader Khaddafy Janjalani in 2006 confirmed.

2007 February - Government report accuses military of being behind the killings of hundreds of mainly left-wing activists since 2001.

2007 November - Renegade soldiers make failed coup bid at luxury hotel in Manila after breaking out of court where they were standing trial for failed 2003 mutiny.

**Rebel peace accords**

2008 July-August - Government negotiators say they have reached an agreement with MILF rebels on the expansion of a Muslim autonomous region in the south. Deal collapses after Christian communities raise objections and renewed fighting on the southern island of Mindanao leaves at least 30 people dead.

2008 December - Norwegian-brokered peace talks with Maoist guerrillas of the New People's Army (NPA) break down; NPA attacks army patrol on Mindanao.

2009 September - Army announces capture of leading MILF figure Camarudin Hadji Ali.

2009 November - An attack on group of people travelling to file election nomination papers on Mindanao leaves 57 dead. Victims' relatives blame the rival Ampatuan clan.

2009 December - Peace talks between Manila and MILF resume in Malaysia, after breaking down 16 months ago.

**Mindanao massacre**



The 2009 massacre of 57 people on Mindanao shocked the Philippines

**The rise of the Ampatuans**

**Philippine massacre exposes political underworld**

**2010** February - The army captures Abu Sayyaf leader Mujibar Alih Amon, suspected of a kidnapping raid on a Malaysian resort in 2000 and the killing of Christian missionaries in 2001.

Prosecutors charge 196 more people with murder over the Maguindanao massacre in November, including Andal Ampatuan Snr, a former provincial governor and ally of President Arroyo.

**Benigno Aquino elected**

**2010** June - Benigno "Noynoy" Aquino becomes president.

**2010** September - Andal Ampatuan junior, a member of the powerful Ampatuan clan, goes on trial on charges of organising the Maguindanao mass killings.

**2011** February - Manila and Maoist NPA agree to work towards a peace deal by 2012 at talks in Oslo, their first negotiations since the previous round broke down in 2004. Troops arrested prominent NPA member Tirso Alcantara the previous month.

**2012** May - Philippines and Chinese naval vessels confront one another off the Scarborough Shoal reef in the South China Sea. Both countries claim the reef, which may have significant reserves of oil and gas.

**2012** October - The government signs a framework peace plan with the Muslim rebel Moro Islamic Liberation Front, ending a 40-year conflict that has cost an estimated 120,000 lives.

**2012** December - Parliament defies the Catholic Church to vote for state-funded contraception, approving a bill that has been debated for 13 years.

**2013** February - Armed followers of a self-proclaimed sultan invade Sabah state on Malaysian Borneo, sparking several days of fighting with Malaysian forces. More than 60 people are killed.

**2013** May - Major diplomatic row erupts between Taiwan and the Philippines after Filipino coastguards kill a Taiwanese fisherman in disputed waters.

**2013** September - Stand-off between the army and rebel remnants of Moro National Liberation Front in southern city of Zamboanga prompts 75,000 residents to flee.

**2013** November - Typhoon Haiyan sweeps across central areas of the country leaving devastation and thousands of dead in its wake. A major international aid effort is organised to help more than four million people affected.

**2014** March - The MILF rebel group signs a peace deal with the government that brings an end to one of Asia's longest and deadliest conflicts.

**2014** April - Supreme Court approves a birth control law, which requires government health centres to distribute free contraceptives. The bill marks a defeat for the Catholic Church, which campaigned strongly against it.

**2015** January - Forty-four police commandos are killed in clashes with Muslim rebels on the southern island of Mindanao, the largest loss of life for the security forces in recent memory.

**2015** March - Hundreds of Muslim rebels in the southern Philippines register to vote in 2016 elections under peace deal designed to end four decades of conflict.

**2016** June - Populist former mayor Rodrigo Duterte elected president, announces hard-line crackdown on drugs and suggests he might pivot from the US to China.



Government troops fought Islamic State-inspired militants on the island of Mindanao in 2017

**2016 June** - The so-called Islamic State (IS) group acknowledges its operations in the Philippines in an official video, having recognised Isnilon Hapilon, an Abu Sayyaf leader, as "emir" there.

**2016 July** - Government welcomes the ruling in a case it brought before an international tribunal which concluded that China's claim to much of the resources in the South China Sea had no legal basis.

**2017 May** - Martial law imposed on the island of Mindanao after fighting erupts between security forces and Islamic State-linked militants of the Maute group and Isnilon Hapilon.

**2017 October** - Southern city of Marawai declared liberated from jihadist fighters who held it for almost five months.

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## Country Report

# Philippines

**Generated on September 17th 2019**

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"0 or 0.0" means nil or negligible; "n/a" means not available; "-" means not applicable

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# Briefing sheet

Editor: **John.marrett@eiu.com**

Forecast Closing Date: **August 18, 2019**

## Political and economic outlook

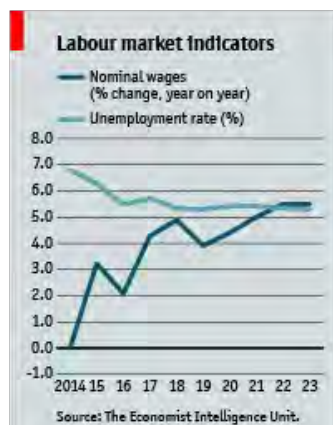
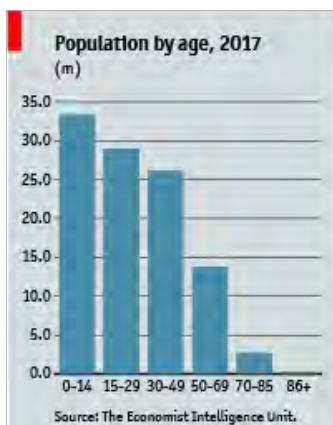
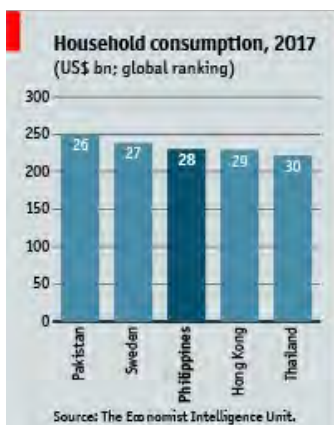
- The Economist Intelligence Unit expects Rodrigo Duterte, the president, to retain a strong grip on power even as his term approaches its end in 2022. The coalition that backs him will remain cohesive under the leadership of his daughter, Sara Duterte.
- Mr Duterte's efforts to deepen economic relations with China will bear fruit, despite the countries' unresolved territorial disputes in the South China Sea. However, domestic political considerations will limit the prospect of a full pro-China tilt.
- We expect the Bangko Sentral ng Pilipinas (BSP, the central bank) to loosen monetary policy further in 2019-20 in response to easing inflationary pressures and lacklustre levels of private investment. Policy tightening will resume in 2021-23.
- The economy will grow by an average of 5.6% a year in 2019-23, slower than the average rate of 6.4% recorded in 2014-18. The slowdown will be driven in large part by weaker investment and export growth in the early part of the forecast period.
- The peso will appreciate modestly against the US dollar in 2019. This trend will reverse in 2020 with a widening of the current-account deficit. The peso will weaken further in 2021-22 ahead of the presidential election due in 2022.
- The Philippines will record a current-account deficit in 2019-22 before returning to surplus in 2023. This is largely due to the wide shortfall on the trade account, which will not be adequately offset by surpluses elsewhere. The deficit will average 2.1% of GDP in 2019-22.

### Key indicators

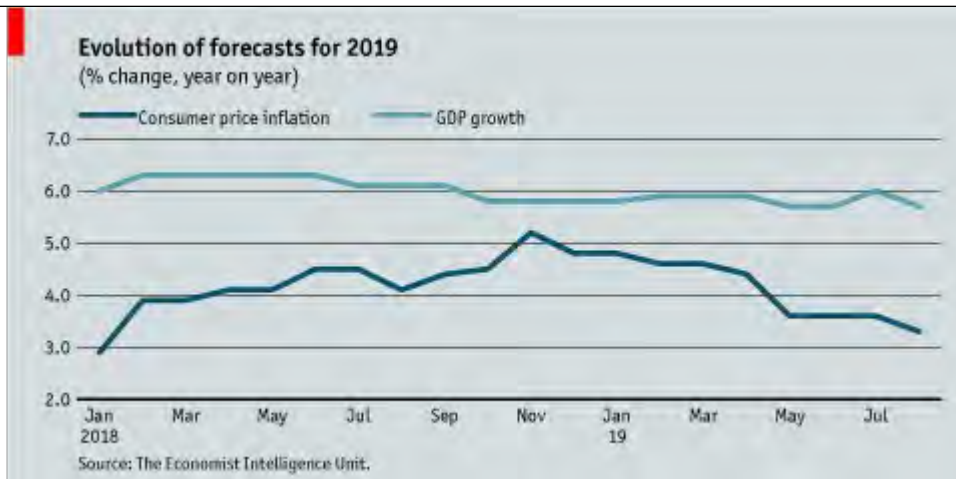
	2018 <sup>a</sup>	2019 <sup>b</sup>	2020 <sup>b</sup>	2021 <sup>b</sup>	2022 <sup>b</sup>	2023 <sup>b</sup>
Real GDP growth (%) <sup>c</sup>	6.2	5.7	5.2	5.8	5.8	5.7
Consumer price inflation (av; %)	5.3	3.3	3.1	4.1	4.6	4.7
Government balance (% of GDP)	-3.2	-2.5	-2.7	-2.3	-2.5	-2.3
Current-account balance (% of GDP)	-2.4	-2.1	-2.6	-2.1	-1.6	0.1
Money market rate (av; %) <sup>d</sup>	3.6	4.5	1.9	2.5	3.5	3.6
Unemployment rate (%)	5.3 <sup>e</sup>	5.3	5.4	5.4	5.3	5.3
Exchange rate P:US\$ (av)	52.66	52.10	53.36	53.74	54.36	54.07

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit forecasts. <sup>c</sup> Includes statistical discrepancy. Seasonally adjusted. <sup>d</sup> Average. <sup>e</sup> Economist Intelligence Unit estimates.

## Market opportunities







### Key changes since July 11th

- Softening inflation and a slump in investment will incline the BSP to cut its policy interest rate once more, in October 2019, after having already reduced rates twice this year. We had previously believed that it would cut rates only twice in 2019.
- We have revised down our forecast for government consumption growth in 2019, from 9.5% to 8.4%, on account of weaker than expected second-quarter data.
- Private industrial investment has fallen below our expectations in recent months, as companies turn dovish in their outlook for external demand. Accordingly, we have revised down our real gross fixed investment growth forecast for 2019, from 9% to 3.9%.
- We have adjusted our forecast for exports of goods and services (on a national-accounts basis) on the back of weak data for the second quarter of 2019. We now expect exports to grow by 4.2%, compared with 5.5% previously.
- The above changes have resulted in a headline growth forecast of 5.7% for 2019, down from 6% before. Similarly, related effects have led to a downward adjustment to the 2020 forecast, from 5.3% to 5.2%.

### The month ahead

- **September 5th—Consumer prices (August):** Consumer price inflation slowed to 2.4% year on year in July, from a peak of 4.4% in January of this year. The data will give an indication of whether robust private consumption growth can counter the disinflationary effect of falling commodity prices.

### Major risks to our forecast

Scenarios, Q2 2019	Probability	Impact	Intensity
The Philippines loses GSP plus privileges due to human rights	Very high	Moderate	15
Payment crisis is triggered from a collapse of the peso	Moderate	Very high	15
Tax collection is stepped up	High	Moderate	12
Extreme weather sets back infrastructure development	Moderate	High	12
Militants attack Manila	Moderate	High	12

Note. Scenarios and scores are taken from our Risk Briefing product. Risk scenarios are potential developments that might substantially change the business operating environment over the coming two years. Risk intensity is a product of probability and impact, on a 25-point scale.

Source: The Economist Intelligence Unit.

## Outlook for 2019-23

### Political stability

The Economist Intelligence Unit expects the president, Rodrigo Duterte, to complete his constitutionally mandated single six-year term in 2022. Mr Duterte's position has strengthened in the legislature following the mid-term elections that were held in May. In particular, the coalition of parties that support him, known as Hugpong ng Pagbabago (or Faction for Change) managed to gain a supermajority in the Senate (the upper house of Congress). This will help the president to push through his policy agenda more swiftly during the remainder of his term.

The administration's main legislative priority for 2019-22 will be to push through revisions to the 1987 constitution in order to install a federal form of government. Charter change has long been a hot-button issue in the Philippines, and previous efforts by three other presidents were all unsuccessful. Mr Duterte's proposed revisions are the most ambitious of the attempts made so far. The proposals call for significant institutional overhaul, including the abolition of the vice-president's office, the ombudsman and the Judicial Bar Council. Another amendment being considered is to the Bill of Rights for citizens, which has raised concerns about potential infringement of freedom of speech. Although such proposals will continue to face lengthy debate in Congress, the risk of prolonged deadlock of the legislative process has lessened following the mid-term elections.

As Mr Duterte (born in 1945) is the oldest person ever elected to the Philippine presidency, his poor health has become an emerging concern. The constitution states that, although non-serious illnesses do not need to be declared publicly, serious ones do, and if the president requires regular treatment he may need to resign from his duties. Given Mr Duterte's reluctance to stand down from the presidency, as he does not believe that the vice-president, Leni Robredo, is up to the task, he may choose to disguise the true state of his health during the remainder of his term. Ms Robredo is a member of the opposition Liberal Party (LP) and opposes many of the president's policies.

In December 2018 martial law in the southern Mindanao region was extended by Congress for the second time, up to end-2019. The move underscores Mr Duterte's preferred hardline approach in dealing with the long-running insurgencies in this part of the Philippines. The government is fighting on two main fronts: against communist insurgents and Islamist militants. Although the declaration of martial law in Mindanao helped government forces to retake the city of Marawi, following the heavy fighting that broke out there between the army and Islamist militants in 2017, the prospects for long-term peace in Mindanao remain bleak.

Nevertheless, some positive steps have been taken towards lasting peace in the majority-Muslim part of Mindanao. In mid-2018 the president signed a revised draft of the Bangsamoro Basic Law (BBL), which was devised under the previous government to provide greater autonomy for the area. The BBL was welcomed by the public, as evidenced by the peaceful nature of the plebiscite held on it in January. Although this sets up a good legislative framework for the region, its implementation will be slow.

## Election watch

Mid-term elections for all 297 seats in the House of Representatives (the lower house) and 12 out of 24 seats in the Senate were held in May. The next political contest in the Philippines will be the general and presidential elections, which are scheduled for May 2022. As presidents are constitutionally mandated to serve a single term, Mr Duterte will be prohibited from seeking a second term. However, the coalition backing him is likely to remain united under the leadership of his daughter, Sara Duterte (who is currently the mayor of Davao City and a potential contender for the presidency). This will help to prevent the president from becoming a lame duck as 2022 approaches.

In addition to Ms Duterte, other potential presidential candidates within Mr Duterte's camp will include the children of the former dictator, Ferdinand Marcos (in office 1965-86)—Imee Marcos and Bongbong Marcos—both of whom are keen to revive their family's political influence. By contrast, presidential hopefuls from the opposition, which could include Ms Robredo and Manuel Roxas, a senior politician who ran for the LP, will find it challenging to rebuild their support base. Results from the mid-terms suggest that a majority of the electorate continue to view the LP as an elitist party with an urban focus.

## International relations

Mr Duterte will strive to improve ties with China, despite a long-running territorial dispute with that country over the South China Sea. Mr Duterte has set aside a sweeping verdict in favour of the Philippines issued by the Permanent Court of Arbitration in The Hague (Netherlands) in 2016, which dealt a serious blow to China's efforts to win international legitimacy for its claims. Instead, Mr Duterte has pushed to resolve the issue bilaterally—a path that China has long preferred. Mr Duterte's pro-China policy is not popular among the general public, and periodic clashes between Chinese and local vessels in waters claimed by the Philippines will continue to fuel antagonism towards China in the next few years. However, the threat to the president's position stemming from this issue is low. In fact, Mr Duterte has threatened to jail any dissenters towards his foreign policy.

We expect that economic ties with China will continue to improve as the South China Sea dispute becomes less of a priority in the government's considerations. A resolution of the territorial dispute—either bilaterally or multilaterally, with the other claimant countries—is unlikely in 2019-23, however. Anti-China sentiment among the public will prevent the administration from pursuing a full pro-China tilt.

Ties between the Philippines and the US have warmed under the current US president, Donald Trump. This is because Mr Trump has been highly complimentary towards Mr Duterte's anti-drug campaign, despite international criticism elsewhere over potential human rights infringements. The US has historically been the archipelago's strongest ally among Western nations. The two countries have long-standing economic, social and military ties: the US is home to the largest Filipino diaspora population, and pro-US public sentiment is strong in the Philippines. The close security ties between the two countries, which the Philippine military establishment strongly wants to uphold, will remain anchored by the Enhanced Defence Co-operation Agreement, a ten-year bilateral pact that was signed in 2014.

## Policy trends

The generally capricious decision-making of the president and his administration will continue to raise risks for businesses throughout the rest of his term, especially given the populist nature of many of Mr Duterte's policies. For example, the president signed an executive order in May 2018 that imposed tighter regulations on short-term employment contracts. This was a watering-down of his campaign promise in 2016 to abolish such contracts. Nevertheless, amid mounting concerns about worsening business sentiment, he reversed track and vetoed legislation tightening controls on short-term contracts in July 2019. We believe that the president's stronger position after the May mid-term elections will mean that in the period to 2022 he will put less priority on his populist promises and more on measures to boost the economy.

The government anticipates that its ambitious spending plans will be financed in part by its planned tax reforms. The first set of reforms, passed in December 2017, reduced the personal income tax burden for many low-to-middle-income earners, but the benefits were partially offset by an increase in indirect tax rates on a host of goods, such as petroleum products and sugary drinks. The second set of reforms will create short-term headaches for specific industries. Although the government envisages reducing the corporate income tax rate, it wants to offset any losses in revenue through a simultaneous reduction in tax incentives for the private sector. The administration is likely eventually to secure approval from the Senate for its tax proposals, although the cuts in incentives may be trimmed.

The poor state of infrastructure remains one of the main impediments to doing business in the Philippines, and the government is planning to address these gaps through Duterteconomics, a large-scale infrastructure spending initiative. Progress on this, however, will continue to be hampered by widespread corruption, a lethargic bureaucracy, gaps in funding and uncertainty about the effectiveness of the administration's preferred public-private partnership (PPP) structure, which sees the government taking the lead on construction projects before opening the bidding for operations and maintenance activities.

## Fiscal policy

We expect the fiscal deficit, as a proportion of GDP, to remain below the government's 3% ceiling throughout the forecast period. However, we do not forecast major improvements on the fiscal front and expect the Philippines to record budget deficits throughout 2019-23. A delay in the passage of the 2019 budget will mean that spending will slow for the year as a whole. We therefore expect the fiscal deficit to narrow from 3.2% of GDP in 2018 to 2.5% in 2019.

We expect that tax reforms will help to bolster revenue in the short term, but the additional funds raised will be redistributed to the government's ambitious infrastructure programme and social welfare schemes. Spending on education and the police will also be a priority for the government. The reconstruction of Marawi will create additional budgetary pressures in the near term: the government has allocated P20bn (US\$390m) for reconstruction. The distribution of these funds began in 2018 and will be complete by end-2019.

We assume that the government will make gradual progress on its infrastructure programme. However, the authorities typically underspend in the face of bureaucratic obstacles in the construction sector. As a consequence, actual public investment will remain consistently below budgeted outlays. Another downside risk to our budget deficit forecasts is the possibility that the government will overextend itself in other spending areas; chief among these will be its efforts to deal with security matters in Mindanao. Towards the end of the forecast period, election-related spending will put further pressure on the fiscal accounts.

## Monetary policy

We expect the Bangko Sentral ng Pilipinas (BSP, the central bank) to maintain a dovish monetary policy stance in 2019-20. The shift in the direction of policy will be supported by a general easing in consumer price inflation in this period compared with 2018. In line with our view, the BSP cut its policy interest rate by 25 basis points in May and by the same amount in August. We expect an additional cut following the central bank's October 2019 monetary policy meeting.

Looking ahead, we believe that the BSP will sanction a further 25-basis-point rate reduction in the second quarter of 2020, amid softening inflation, owing largely to weakening commodity prices. Inflationary pressures will start to build in 2021-23 as global commodity prices rise and domestic demand remains healthy. At this stage, the BSP will look to raise its benchmark interest rate incrementally.

## International assumptions

	2018	2019	2020	2021	2022	2023
<b>Economic activity (%)</b>						
US GDP	2.9	2.2	1.7	1.8	2.0	1.7
OECD GDP	2.2	1.6	1.6	1.8	2.0	1.8
EU28 GDP	1.8	1.2	1.4	1.6	1.7	1.6
World GDP	2.9	2.4	2.5	2.8	2.9	2.8
World trade	4.4	3.1	3.5	3.8	3.9	4.0
<b>World prices (%)</b>						
US CPI	2.4	2.0	1.4	2.2	2.1	1.8
OECD CPI	2.5	2.3	1.9	2.1	2.1	2.1
EU28 CPI	1.4	1.1	1.3	1.4	1.5	1.5
Manufactures (measured in US\$)	5.1	1.0	3.0	3.8	3.2	3.3
Oil (Brent; US\$/b)	71.1	67.7	62.0	67.0	73.2	75.0
Non-oil commodities (measured in US\$)	1.8	-4.7	4.0	3.5	1.4	0.7
<b>Financial variables</b>						
US\$ 3-month commercial paper rate (%)	2.0	2.4	1.7	1.7	2.2	2.5
¥ 3-month money market rate (av; %)	0.1	0.0	0.1	0.2	0.2	0.3
¥:US\$	110.4	109.9	108.8	104.8	100.5	96.1
US\$:€	1.18	1.13	1.18	1.21	1.24	1.24
P:US\$	52.7	52.1	53.4	53.7	54.4	54.1

## Economic growth

Real GDP growth will average 5.6% a year in 2019–23, compared with 6.4% in 2014–18. During the forecast period, investment spending will expand by 6.4% a year on average—much slower than the average growth of 14.8% recorded in 2014–18. This partly reflects investors' nervousness about the administration's policies and a weaker global economic outlook in the early part of the forecast period. Indeed, we have made downward revisions to our fixed investment and trade growth forecasts for 2019 on the basis of second-quarter data that indicated a strong slowdown in industry. Nevertheless, the government's ambitious infrastructure drive (largely funded by public expenditure) will help to put a floor under growth this year and in the medium term.

Private consumption will remain the key driver of economic growth. In 2019 the impact of policy interest-rate cuts on private consumption will not be felt until the end of the year. A short-lived softening of inflation, owing to weaker global commodity prices, will boost real private consumption in 2020. However, there is a risk that inflows of remittances, which underpin household spending, will also slow in 2020, as real GDP growth in the US economy (a key market for Filipino workers) eases. On the whole, we expect private consumption growth to average 6.2% annually in 2019–23. We expect government consumption growth to average 8.8% a year over the same period, underpinned by populist spending policies under successive governments.

Sustained growth in domestic demand will underpin import growth for much of the forecast period, albeit with a notable slump in demand in 2019 owing to weaker private investment. Accordingly, we expect real imports of goods and services to increase by an annual average of 7.7% in 2019–23. We expect growth in exports of goods and services to decelerate in 2019–20 owing to the slowdown in trade flows on the back of US-China trade tensions. The slowdown will also reflect the lacklustre performance of business-process outsourcing (BPO), which is threatened by advances in AI technology and changing patterns of demand in the US (the sector's main market). Growth in exports will average 4.7% a year in 2019–20, before recovering to 7.7% in 2021–23 as global demand strengthens.

### Economic growth

%	2018 <sup>a</sup>	2019 <sup>b</sup>	2020 <sup>b</sup>	2021 <sup>b</sup>	2022 <sup>b</sup>	2023 <sup>b</sup>
GDP	6.2	5.7	5.2	5.8	5.8	5.7
Private consumption <sup>c</sup>	5.6	5.8	5.9	6.2	6.8	6.3
Government consumption <sup>c</sup>	13.2	8.4	10.2	8.0	8.5	8.9
Gross fixed investment <sup>c</sup>	13.1	3.9	6.8	7.7	7.0	6.5
Exports of goods & services <sup>c</sup>	13.4	4.2	5.1	8.3	7.6	7.2
Imports of goods & services <sup>c</sup>	15.8	5.1	7.4	8.7	9.2	8.3
Domestic demand <sup>c</sup>	8.4	5.4	7.3	6.3	7.1	6.6
Agriculture	0.9	0.5	3.0	3.5	3.8	3.5
Industry	6.7	6.5	5.7	7.0	6.7	7.1
Services	6.8	5.9	5.2	5.3	5.6	5.1

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit forecasts. <sup>c</sup> Seasonally adjusted.

## Inflation

Inflationary pressures eased in the first half of 2019, driven partly by improved food supply. We therefore expect consumer price inflation to average 3.3% in 2019 as a whole, significantly weaker than the average increase of 5.2% in 2018. Our forecast assumes a pick-up in food prices in the second half of this year, resulting from the adverse impact on agricultural goods of the El Niño weather pattern. However, weakness in global oil prices will help to offset these seasonal factors and ensure that inflation weakens further in 2020. An anticipated increase in global oil prices in 2021–23 will raise inflationary pressure. This, along with other structural factors—including high capacity utilisation and a relatively tight labour market—will push up domestic prices at a faster pace towards the end of the forecast period.



## Exchange rates

The peso will appreciate modestly in 2019 after its sharp depreciation against the US dollar in 2017-18, when demand for the US currency surged. However, it will remain vulnerable owing to the wide current-account deficit and the BSP continuing to ease monetary policy. From 2020 the peso will depreciate against the US dollar as external headwinds gather strength. A slowdown in China will weigh on trade prospects, driving the current-account deficit. Moreover, investors' caution will rise as the Philippines prepares for general and presidential elections in 2022. We expect the peso to start to strengthen in the second half of 2022, and for this trend to persist in 2023.

## External sector

The current account will remain in the red in 2019-22, driven by a widening of the trade deficit. In the early part of the forecast period, growth in merchandise exports will be sluggish due to a global trade slowdown exacerbated by the US-China trade war. Notably, however, a slump in demand for capital goods will undermine import growth in 2019, leading to a narrowing current-account deficit in that year. From 2021 onwards a recovery in export growth, facilitated by the more competitive exchange rate and the migration of export-oriented manufacturing from China, will be sufficient to cause some narrowing of the trade deficit.

Throughout the forecast period, the Philippines will record surpluses on the services account, as well as on the primary and secondary income balances. The surplus on the services account will continue to rise as the tourism industry remains buoyant. The secondary income account will remain in the black as a result of substantial remittance inflows. Overall, we expect the current account to record a deficit equivalent to 2.1% of GDP a year on average in 2019-22, and then a small surplus of 0.1% of GDP in 2023.

## Forecast summary

### Forecast summary

(% unless otherwise indicated)

	2018 <sup>a</sup>	2019 <sup>b</sup>	2020 <sup>b</sup>	2021 <sup>b</sup>	2022 <sup>b</sup>	2023 <sup>b</sup>
Real GDP growth	6.2	5.7	5.2	5.8	5.8	5.7
Gross agricultural production growth	0.9	0.5	3.0	3.5	3.8	3.5
Unemployment rate (av)	5.3 <sup>c</sup>	5.3	5.4	5.4	5.3	5.3
Consumer price inflation (av)	5.3	3.3	3.1	4.1	4.6	4.7
91-day Treasury-bill rate	3.6	4.5	1.9	2.5	3.5	3.6
Government balance (% of GDP)	-3.2	-2.5	-2.7	-2.3	-2.5	-2.3
Exports of goods fob (US\$ bn)	51.7	48.6	49.7	57.5	66.1	77.4
Imports of goods fob (US\$ bn)	100.7	101.5	105.6	113.9	124.8	133.8
Current-account balance (US\$ bn)	-7.9	-7.6	-10.2	-8.8	-7.4	0.3
Current-account balance (% of GDP)	-2.4	-2.1	-2.6	-2.1	-1.6	0.1
External debt (year-end; US\$ bn)	78.6 <sup>c</sup>	79.6	81.6	85.5	89.5	93.1
Exchange rate P:US\$ (av)	52.66	52.10	53.36	53.74	54.36	54.07
Exchange rate P:US\$ (end-period)	52.72	52.73	53.55	54.05	54.22	53.93
Exchange rate P:¥100 (av)	47.69	47.41	49.07	51.30	54.11	56.28
Exchange rate P:€ (end-period)	60.37	60.38	64.26	66.21	67.50	67.41

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit forecasts. <sup>c</sup> Economist Intelligence Unit estimates.

## Quarterly forecasts

### Quarterly forecasts

	2018				2019				2020			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
<b>GDP</b>												
% change, quarter on quarter	1.3	1.5	1.6	1.7	0.6	1.4	2.2	1.5	1.0	1.1	1.1	0.9
% change, year on year	6.6	6.2	5.9	6.3	5.6	5.5	6.0	5.8	6.2	5.9	4.8	4.1
<b>Private consumption</b>												
% change, quarter on quarter	1.1	-	-	-	-	-	-	-	-	-	-	-
% change, year on year	5.7	5.9	5.5	5.2	6.2	5.5	-	-	-	-	-	-
<b>Government consumption</b>												
% change, quarter on quarter	1.7	-	-	-	-	-	-	-	-	-	-	-
% change, year on year	14.6	11.5	14.2	12.5	7.7	6.9	-	-	-	-	-	-
<b>Gross fixed investment</b>												
% change, quarter on quarter	-0.1	-	-	-	-	-	-	-	-	-	-	-
% change, year on year	8.5	18.8	16.4	8.8	6.6	-5.1	-	-	-	-	-	-
<b>Exports of goods &amp; services</b>												
% change, quarter on quarter	-0.6	-	-	-	-	-	-	-	-	-	-	-
% change, year on year	11.2	14.5	14.3	13.6	6.4	4.1	-	-	-	-	-	-
<b>Imports of goods &amp; services</b>												
% change, quarter on quarter	1.8	-	-	-	-	-	-	-	-	-	-	-
% change, year on year	11.6	20.2	19.5	12.2	9.1	-0.4	-	-	-	-	-	-
<b>Domestic demand</b>												
% change, quarter on quarter	1.3	-	-	-	-	-	-	-	-	-	-	-
% change, year on year	7.6	9.9	9.9	6.0	6.8	1.6	-	-	-	-	-	-
<b>Consumer prices</b>												
% change, quarter on quarter	1.8	1.4	1.7	0.8	-0.2	0.6	1.9	1.0	-1.1	1.5	2.3	0.4
% change, year on year	4.0	4.9	6.3	5.9	3.8	2.9	3.2	3.3	2.4	3.3	3.7	3.1
<b>Producer prices</b>												
% change, quarter on quarter	1.2	0.3	0.0	-0.9	4.4	-2.1	1.8	1.1	-0.1	0.0	1.0	1.0
% change, year on year	-0.1	1.0	1.2	0.7	3.8	1.3	3.0	5.1	0.6	2.7	1.9	1.8
<b>Exchange rate P:US\$</b>												
Average	51.45	52.45	53.55	53.20	52.36	52.06	51.68	52.30	51.58	52.88	54.48	54.50
End-period	52.21	53.52	54.25	52.72	52.78	51.36	51.99	52.73	52.23	53.68	54.49	53.55
<b>Interest rates (%; av)</b>												
Money market rate	2.7	3.4	3.3	5.1	5.6	6.2	3.9	2.4	2.5	1.8	1.7	1.6
Long-term bond yield	5.5	6.2	6.5	7.4	6.3	5.6	-	-	-	-	-	-

# Data and charts

## Annual data and forecast

	2014 <sup>a</sup>	2015 <sup>a</sup>	2016 <sup>a</sup>	2017 <sup>a</sup>	2018 <sup>a</sup>	2019 <sup>b</sup>	2020 <sup>b</sup>
<b>GDP</b>							
Nominal GDP (US\$ bn)	284.1	292.3	304.5	313.3	330.5	366.8	388.8
Nominal GDP (P bn)	12,613	13,302	14,461	15,791	17,405	19,110	20,745
Real GDP growth (%)	6.1	6.1	6.9	6.7	6.2	5.7	5.2
<b>Expenditure on GDP (% real change)</b>							
Private consumption	5.6	6.3	7.1	5.9	5.6	5.8	5.9
Government consumption	3.4	8.1	8.6	6.4	13.2	8.4	10.2
Gross fixed investment	7.2	16.8	26.3	9.4	13.1	3.9	6.8
Exports of goods & services	12.5	8.6	11.6	19.6	13.4	4.2	5.1
Imports of goods & services	10.0	14.7	20.2	18.1	15.8	5.1	7.4
<b>Origin of GDP (% real change)</b>							
Agriculture	1.7	0.1	-1.2	4.0	0.9	0.5	3.0
Industry	7.8	6.4	8.1	7.1	6.7	6.5	5.7
Services	6.0	6.9	7.5	6.8	6.8	5.9	5.2
<b>Population and income</b>							
Population (m)	100.5	102.1	103.7	105.2	106.7	108.1	109.6
GDP per head (US\$ at PPP)	6,919	7,302	7,774	8,332	8,924	9,488	10,038
<b>Fiscal indicators (% of GDP)</b>							
Central government revenue	15.1	15.9	15.2	15.7	16.4	15.3	15.0
Central government expenditure	15.7	16.8	17.6	17.9	19.6	17.8	17.7
Central government balance	-0.6	-0.9	-2.4	-2.2	-3.2	-2.5	-2.7
Public debt	45.5	44.8	42.1	42.1	41.9	41.2	41.2
<b>Prices and financial indicators</b>							
Exchange rate P:US\$ (av)	44.40	45.50	47.49	50.40	52.66	52.10	53.36
Exchange rate ¥:P (av)	2.38	2.66	2.29	2.22	2.10	2.11	2.04
Consumer prices (av; % change)	4.2	1.4	1.8	2.9	5.3	3.3	3.1
Producer prices (av; % change)	-0.9	-6.7	-4.8	-0.9	0.7	3.3	1.7
Stock of money M1 (% change)	13.3	15.2	15.1	15.7	9.5	5.9	9.0
Stock of money M2 (% change)	10.5	9.1	13.3	11.6	8.6	5.9	9.0
Money market interest rate (av; %)	1.2	1.8	1.5	2.1	3.6	4.5	1.9
<b>Current account (US\$ m)</b>							
Trade balance	-17,331	-23,309	-35,548	-40,215	-49,037	-52,872	-55,874
Goods: exports fob	49,823	43,197	42,734	51,814	51,673	48,587	49,699
Goods: imports fob	-67,155	-66,507	-78,282	-92,030	-100,710	-101,459	-105,573
Services balance	4,577	5,455	7,042	8,692	10,493	12,724	12,293
Primary income balance	728	1,857	2,580	3,225	3,844	4,534	3,743
Secondary income balance	22,782	23,262	24,728	26,152	26,820	27,969	29,681
Current-account balance	10,756	7,266	-1,200	-2,143	-7,879	-7,646	-10,157
<b>External debt (US\$ m)</b>							
Debt stock	77,434	76,448	73,014	73,080	78,592 <sup>c</sup>	79,592	81,637
Debt service paid	7,537	10,575	10,916	11,112	9,097 <sup>c</sup>	9,584	9,643
Principal repayments	4,477	7,410	7,772	8,226	6,636 <sup>c</sup>	6,837	7,108
Interest	3,060	3,165	3,143	2,885	2,461 <sup>c</sup>	2,748	2,535
<b>International reserves (US\$ m)</b>							
Total international reserves	79,541	80,667	80,692	81,565	79,193	84,149	82,516

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit forecasts. <sup>c</sup> Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

## Quarterly data

	2017		2018			2019		
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
<b>Government finance (P bn)</b>								
Revenue	625.1	671.7	619.8	790.7	701.0	738.7	687.7	859.8
Expenditure	683.7	809.2	772.0	831.6	886.2	918.7	778.0	812.2
Balance	-58.6	-137.6	-152.2	-40.8	-185.2	-180.0	-90.2	47.6
<b>Output</b>								
GDP at constant 2000 prices (P bn; seasonally adjusted)	2,188.5	2,217.4	2,246.6	2,280.5	2,317.9	2,357.3	2,372.5	2,405.5
GDP at constant 2000 prices (% change, year on year; seasonally adjusted)	7.0	6.7	6.6	6.2	5.9	6.3	5.6	5.5
Manufacturing index (2000=100)	138.6	153.4	152.2	152.4	145.1	150.6	140.4	134.9
Manufacturing index (% change, year on year)	10.7	11.2	12.3	14.5	4.7	-1.8	-7.8	-11.5
<b>Employment and prices</b>								
Employment ('000)	40,171	41,547	41,755	40,896	40,650	41,325	41,368	42,242
Employment (% change, year on year)	-1.9	-0.3	6.1	1.6	1.2	-0.5	-0.9	3.3
Unemployment rate (% of labour force)	5.6	5.0	5.3	5.5	5.4	5.1	5.2	5.1
Consumer prices (2006=100)	111.4	112.8	114.8	116.4	118.4	119.4	119.2	119.9
Consumer prices (% change, year on year)	2.7	3.1	4.0	4.9	6.3	5.9	3.8	2.9
Producer prices, manufacturing (2000=100)	132.7	132.2	133.8	134.2	134.3	133.0	138.8	135.9
Producer prices (% change, year on year)	-0.6	-0.3	-0.1	1.0	1.2	0.7	3.8	1.3
<b>Financial indicators</b>								
Exchange rate P:US\$ (av)	50.84	50.93	51.45	52.45	53.55	53.20	52.36	52.06
Exchange rate P:US\$ (end-period)	51.07	49.92	52.21	53.52	54.25	52.72	52.78	51.36
Deposit rate (av; %)	1.7	2.1	2.8	2.9	3.2	3.5	5.0	n/a
Lending rate (av; %)	5.7	5.7	5.6	5.9	6.2	6.8	7.1	n/a
M1 (end-period; P bn)	3,376.4	3,454.8	3,639.7	3,719.6	3,763.0	3,787.1	3,860.2	3,922.5
M1 (% change, year on year)	16.6	15.9	17.7	15.2	11.4	9.6	6.1	5.5
M2 (end-period; P bn)	9,840.2	9,920.2	10,423.9	10,557.4	10,775.8	10,780.4	10,924.8	11,082.1
M2 (% change, year on year)	14.6	11.9	14.1	11.2	9.5	8.7	4.8	5.0
Philippine Stock Exchange index (end-period; Jan 2nd 1985=100)	8,171.4	8,558.4	7,979.8	7,193.7	7,276.8	7,466.0	7,920.9	7,999.7
Philippine Stock Exchange index (% change, year on year)	7.1	25.1	9.1	-8.3	-10.9	-12.8	-0.7	11.2
<b>Foreign trade (US\$ m)</b>								
Exports fob	17,798	16,880	16,906	17,490	18,236	16,675	16,415	n/a
Imports fob	24,978	28,310	-26,387	-30,237	-31,479	-31,226	-27,646	n/a
Trade balance	-7,180	11,431	-9,481	-12,747	-13,244	-14,551	-11,232	n/a
<b>Balance of payments (US\$ m)</b>								
Merchandise trade balance fob-fob	-9,460	12,472	-10,561	-12,664	-12,480	-13,332	-12,388	n/a
Services balance	3,651	2,323	2,845	1,838	3,296	2,514	3,180	n/a
Primary income balance	725	856	798	714	1,017	1,315	1,351	n/a
Net transfer payments	6,519	6,822	6,583	6,604	6,531	7,102	6,642	n/a
Current-account balance	1,435	-2,471	-335	-3,508	-1,636	-2,401	-1,215	n/a
Reserves excl gold (end-period)	72,897	73,228	72,136	69,612	67,362	71,040	75,399	76,916

Sources: Bangko Sentral ng Pilipinas, Selected Economic Indicators; IMF, International Financial Statistics; Philippine Statistics Authority, Economic Indicators.

## Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>Exchange rate P:US\$ (av)</b>												
2017	49.74	49.96	50.28	49.86	49.86	49.85	50.64	50.87	51.01	51.34	51.04	50.39
2018	50.51	51.79	52.07	52.10	52.19	53.05	53.43	53.27	53.94	54.01	52.81	52.77

2019	52.47	52.19	52.41	52.11	52.26	51.80	51.14	n/a	n/a	n/a	n/a	n/a
<b>Exchange rate P:US\$ (end-period)</b>												
2017	49.81	50.27	50.19	49.70	49.87	50.47	50.58	51.17	51.07	51.80	50.37	49.92
2018	51.42	52.03	52.21	51.97	52.69	53.52	53.26	53.43	54.25	53.61	52.61	52.72
2019	52.35	52.01	52.78	52.11	52.26	51.36	51.01	n/a	n/a	n/a	n/a	n/a
<b>Real effective exchange rate (2000=100; CPI-based)</b>												
2017	93.52	92.71	91.96	92.20	92.02	91.19	89.36	87.93	87.45	87.94	88.45	89.31
2018	87.72	84.98	84.94	85.40	86.76	86.54	87.59	89.09	88.66	89.45	91.52	90.86
2019	90.13	90.40	90.04	90.48	90.89	91.12	n/a	n/a	n/a	n/a	n/a	n/a
<b>Central government revenue (P bn)</b>												
2017	200.3	151.8	180.2	235.9	228.3	179.8	194.6	230.4	200.1	205.1	243.5	223.1
2018	238.9	178.5	202.4	307.6	259.0	224.2	241.7	256.9	202.4	246.8	259.7	232.2
2019	256.7	202.1	228.9	308.7	317.2	233.9	n/a	n/a	n/a	n/a	n/a	n/a
<b>Central government expenditure (P bn)</b>												
2017	198.1	175.6	241.7	183.1	261.7	270.7	245.1	201.6	237.0	226.9	252.1	330.2
2018	228.7	230.2	313.1	261.2	291.9	278.5	328.1	259.5	298.6	306.6	298.8	313.3
2019	212.2	278.5	287.3	221.8	314.7	275.7	n/a	n/a	n/a	n/a	n/a	n/a
<b>Central government balance (P bn)</b>												
2017	2.2	-23.7	-61.5	52.8	-33.4	-90.9	-50.5	28.8	-36.9	-21.8	-8.6	-107.1
2018	10.2	-51.7	-110.7	46.3	-32.9	-54.3	-86.4	-2.6	-96.2	-59.9	-39.1	-81.0
2019	44.5	-76.4	-58.4	86.9	2.6	-41.8	n/a	n/a	n/a	n/a	n/a	n/a
<b>Money supply M1 (% change, year on year)</b>												
2017	15.1	15.1	14.8	14.5	14.6	16.0	16.0	18.1	16.7	17.7	17.2	15.7
2018	16.8	17.3	17.8	17.3	18.2	15.2	14.9	11.5	11.4	9.0	9.5	9.5
2019	7.0	6.9	6.1	6.1	5.0	5.5	n/a	n/a	n/a	n/a	n/a	n/a
<b>Money supply M2 (% change, year on year)</b>												
2017	12.3	12.5	11.8	11.4	11.5	13.3	13.7	15.4	14.6	14.9	13.9	11.6
2018	12.9	13.4	14.0	14.0	13.9	11.4	10.7	10.2	9.6	8.1	8.4	8.6
2019	7.0	5.9	4.7	5.6	5.1	5.1	n/a	n/a	n/a	n/a	n/a	n/a
<b>Deposit rate (av; %)</b>												
2017	1.7	1.7	2.1	1.7	1.9	1.7	1.8	1.7	1.8	1.8	2.0	2.6
2018	2.7	2.8	2.8	2.8	3.0	3.0	3.1	3.3	3.3	2.5	4.9	3.2
2019	4.5	5.3	5.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Lending rate (av; %)</b>												
2017	5.6	5.2	5.8	5.5	5.8	5.6	5.7	5.7	5.6	5.7	5.6	5.8
2018	5.7	5.4	5.8	5.7	6.0	5.9	6.2	6.2	6.1	6.6	6.6	7.0
2019	7.3	6.7	7.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>91-day Treasury bill rate (av; %)</b>												
2017	1.8	2.1	2.4	2.3	2.2	2.1	2.2	2.2	2.1	2.0	2.1	n/a
2018	2.3	2.7	3.0	3.4	3.4	3.4	3.3	3.2	3.3	4.8	5.2	5.4
2019	5.4	5.6	5.7	5.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Philippine Stock Exchange index (end-period; Jan 2nd 1985=100)</b>												
2017	7,230	7,212	7,312	7,661	7,837	7,843	8,018	7,959	8,171	8,365	8,254	8,558
2018	8,764	8,475	7,980	7,819	7,497	7,194	7,672	7,856	7,277	7,140	7,368	7,466
2019	8,007	7,705	7,921	7,953	7,970	8,000	8,046	n/a	n/a	n/a	n/a	n/a
<b>Consumer prices (av; % change)</b>												
2017	2.6	3.2	3.3	3.2	3.0	2.7	2.5	2.7	3.0	3.1	3.1	3.1
2018	3.8	3.9	4.3	4.6	4.8	5.4	5.9	6.4	6.4	6.5	5.9	5.1
2019	4.4	3.8	3.3	3.0	3.2	2.6	2.4	n/a	n/a	n/a	n/a	n/a
<b>Producer prices (av; % change)</b>												
2017	-1.1	-1.3	-0.3	-1.6	-1.9	-1.9	-1.0	-0.4	-0.6	0.5	-0.6	-0.8
2018	0.0	0.1	-0.6	0.7	1.4	1.0	0.9	0.9	1.8	1.2	0.5	0.3
2019	3.7	3.1	4.5	1.9	0.9	1.0	n/a	n/a	n/a	n/a	n/a	n/a
<b>Total exports fob (US\$ m)</b>												
2017	5,597	5,156	6,003	5,587	5,988	5,704	5,834	5,979	5,986	5,913	5,583	5,384
2018	5,656	5,226	6,025	5,482	6,092	5,917	5,967	6,216	6,053	6,309	5,637	4,730
2019	5,279	5,222	5,914	5,536	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Total imports fob (US\$ m)</b>												
2017	8,420	7,216	8,576	7,591	9,067	7,743	7,553	9,240	8,185	9,019	9,395	9,896
2018	9,378	8,179	8,830	9,699	10,529	10,009	10,557	10,261	10,662	11,470	10,286	9,471
2019	9,721	8,412	9,514	9,915	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Trade balance fob-fob (US\$ m)</b>												
2017	-2,823	-2,060	-2,573	-2,004	-3,080	-2,039	-1,720	-3,261	-2,199	-3,107	-3,812	-4,512
2018	-3,722	-2,953	-2,806	-4,217	-4,437	-4,092	-4,590	-4,045	-4,609	-5,161	-4,649	-4,741

2019	-4,442	-3,190	-3,600	-4,379	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Foreign-exchange reserves excl gold (US\$ m)</b>												
2017	73,735	73,577	73,006	74,084	74,175	73,486	73,062	73,290	72,897	72,354	72,264	73,228
2018	72,723	72,124	72,136	71,361	71,006	69,612	68,934	70,312	67,362	66,847	67,906	71,040
2019	74,080	74,421	75,399	75,753	77,025	76,916	n/a	n/a	n/a	n/a	n/a	n/a

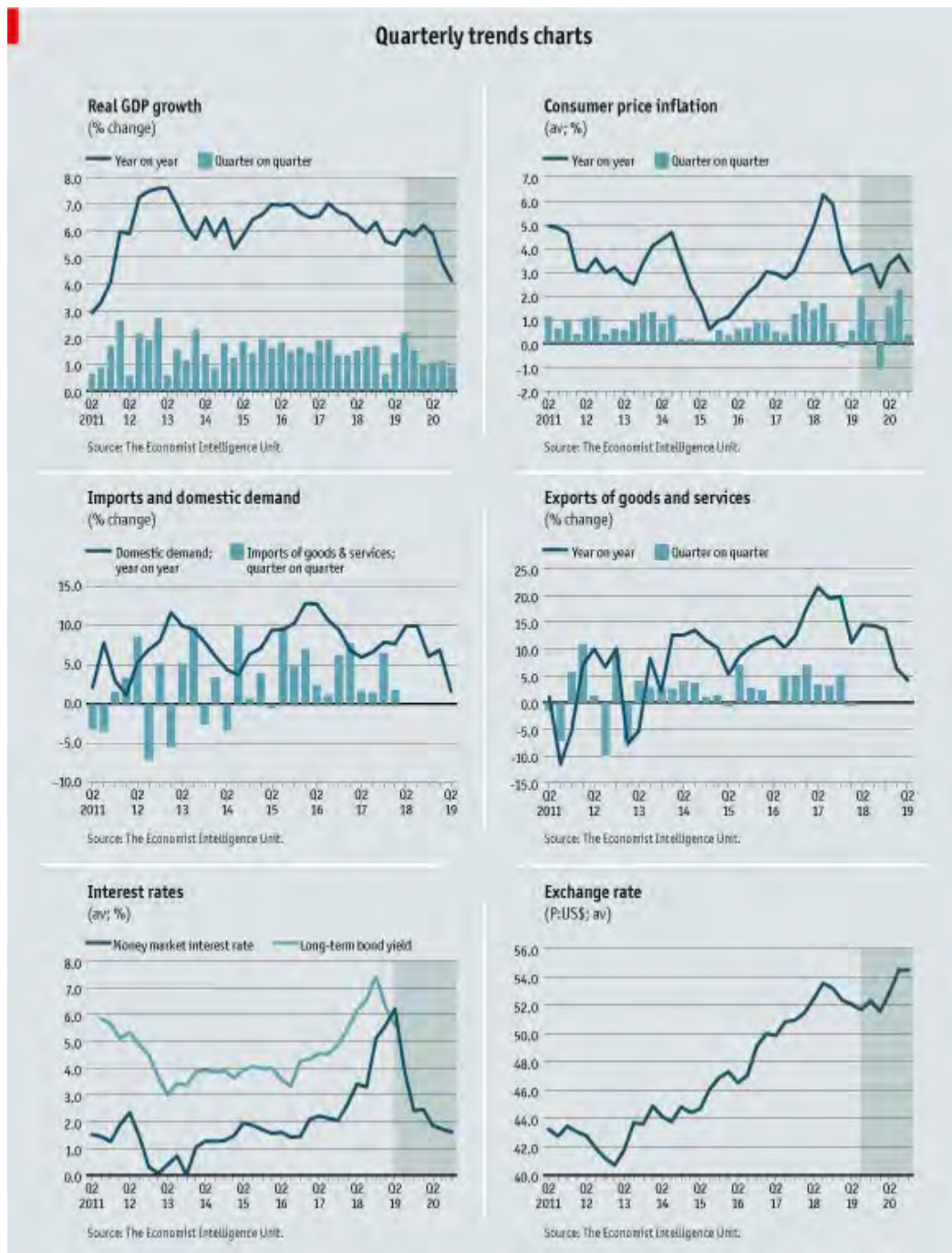
Sources: IMF, International Financial Statistics; Haver Analytics.

## Annual trends charts





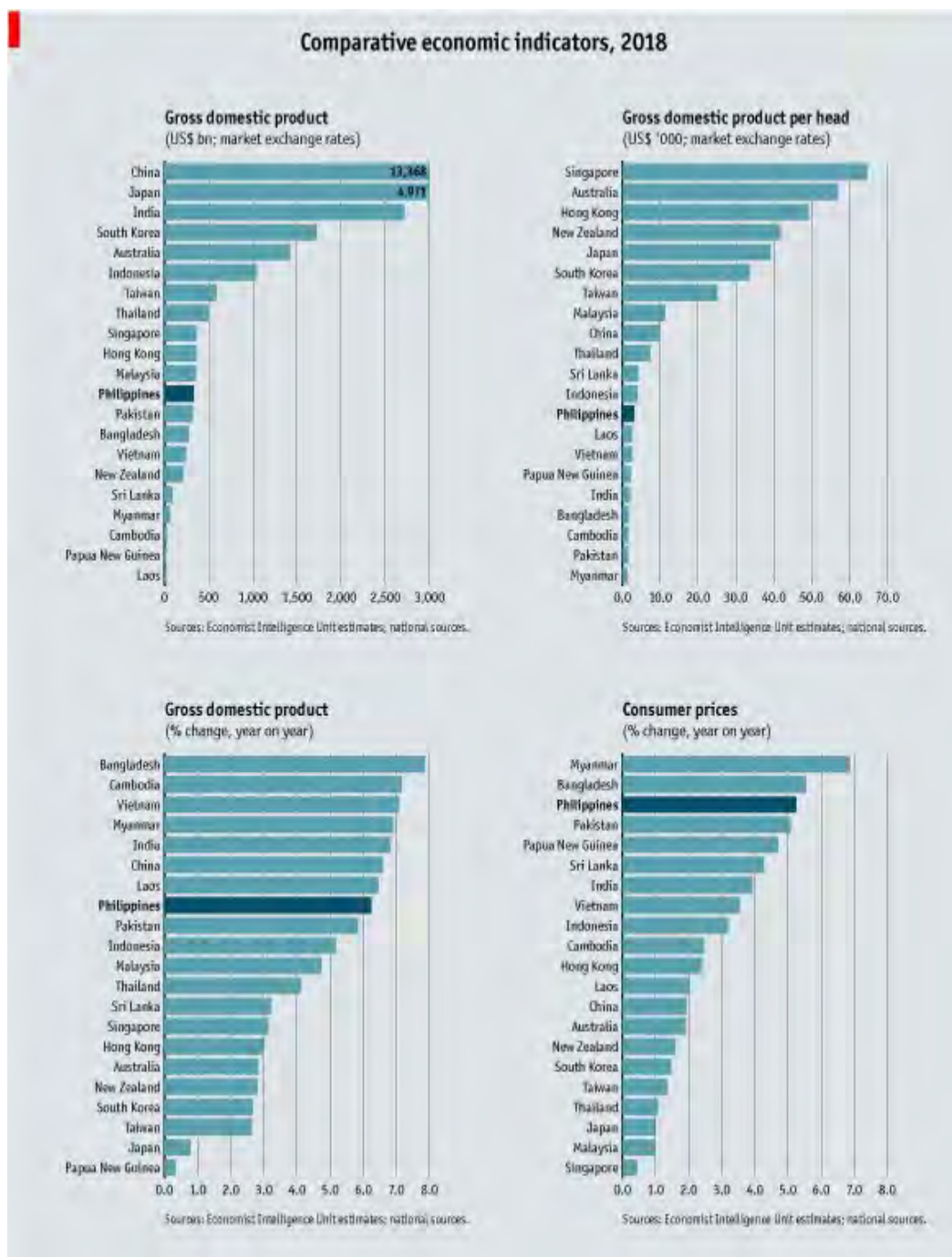
# Quarterly trends charts



# Monthly trends charts



# Comparative economic indicators



## Basic data

### Land area

300,179 sq km

### Population

106.7m (UN; 2018)

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## Main towns

Population in '000 (2015 census)

Metro Manila (National Capital Region, or NCR): 12,877

Quezon (NCR): 2,936

Manila (the capital; NCR): 1,780

Davao: 1,633

Caloocan (NCR): 1,584

Cebu: 923

Zamboanga: 862

Taguig (NCR): 805

Pasig (NCR): 755

Cagayan de Oro: 676

Parañaque (NCR): 666

Valenzuela (NCR): 620

General Santos: 594

Las Piñas (NCR): 589

Makati (NCR): 583

Bacolod: 562

## Climate

Tropical

## Weather in Manila (altitude 14 metres)

Hottest month, May, 24-34°C; coldest month, January, 21-30°C (average daily minimum and maximum); driest month, February, 13 mm average rainfall; wettest month, July, 432 mm average rainfall

## Languages

Filipino (Tagalog), English and Spanish; many local dialects

## Weights and measures

Metric system; also some local units

## Currency

Peso (P); P1 = 100 centavos. Average exchange rate in 2018: P52.7:US\$1

## Time

8 hours ahead of GMT

## Fiscal year

January-December

## Public holidays

January 1st (New Year); February 5th (Chinese New Year); February 25th (EDSA Revolution Day); April 9th (Valour Day); April 18th (Maundy Thursday); April 19th (Good Friday); April 20th (Black Saturday); May 1st (Labour Day); June 12th (Independence Day); August 21st (Ninoy Aquino Day); August 26th (National Heroes' Day); November 1st (All Saints' Day); November



30th (Bonifacio Day); December 24th/25th (Christmas); December 30th (Rizal Day); December 31st (New Year's Eve)



## Political structure

Official name

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Republic of the Philippines

## Form of state

Under the 1987 constitution, the government is based on a separation of powers between the executive presidency, a bicameral legislature and an independent judiciary

## The executive

The president, who is chief executive, head of state and commander-in-chief, serves no more than one six-year term and may approve bills passed by Congress (the legislature) or exercise a veto, which can be overridden by a two-thirds majority of Congress. Cabinet appointments are subject to approval by the Congressional Commission on Appointments

## Legislature

Congress consists of the Senate (the upper house, with 24 members at present) and the House of Representatives (the lower house, which currently has 297 members, of whom 80% are directly elected and 20% are selected from party lists). Senators are elected for six-year terms and representatives for three-year terms

## Legal system

Based on US common law; the 1987 constitution contains a Bill of Rights and provides for a judiciary with the Supreme Court at its apex

## National elections

Elections for half of the seats in the Senate and the entire House of Representatives took place in May 2019. Elections for the presidency, the House of Representatives and the other half of the Senate are due in 2022

## National government

In June 2016 Rodrigo Duterte was inaugurated as the 16th president of the Philippines after winning the election in May. The Liberal Party of the previous president, Benigno Aquino, remains the largest party in the House of Representatives

## Main political organisations

Liberal Party; Partido Demokratiko Pilipino-Lakas ng Bayan (PDP-Laban); Nationalist People's Coalition (NPC); Nacionalista Party; National Unity Party (NUP); United Nationalist Alliance (UNA); Lakas-Christian Muslim Democrats (Lakas-CMD); Laban ng Demokratikong Pilipino (LDP); Pwersa ng Masang Pilipino (PMP); Aksyon Demokratiko; Communist Party of the Philippines (CPP); Moro Islamic Liberation Front (MILF); Moro National Liberation Front (MNLF)

## Key ministers

President: Rodrigo Duterte

Vice-president: Leni Robredo

Agriculture: Manny Piñol

Defence: Delfin Lorenzana

Education: Leonar Briones

Energy: Alfonso Cusi

Environment & natural resources: Roy Cimatu

Finance: Carlos Dominguez

Foreign affairs: Alan Peter Cayetano

Health: Francisco Duque

Housing: Eduardo del Rosario



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Interior & local government: Eduardo Año

Justice: Vitaliano Aguirre

Public works & highways: Mark Villar

Trade & industry: Ramon Lopez

## **Central bank governor**

Benjamin Diokno

## Recent analysis

Generated on September 17th 2019

The following articles have been written in response to events occurring since our most recent forecast was released, and indicate how we expect these events to affect our next forecast.

## Politics

### Forecast updates

#### South China Sea row casts cloud over Duterte's China visit

September 2, 2019: International relations

### Event

On August 29th the president of the Philippines, Rodrigo Duterte, met his Chinese counterpart, Xi Jinping, in the Chinese capital, Beijing.

### Analysis

This was Mr Duterte's fifth official visit to China and his eighth meeting with Mr Xi as president. However, it was the first time that he raised with the Chinese a 2016 ruling by the Permanent Court of Arbitration (PCA) in favour of the Philippines over its maritime territorial dispute with China in the South China Sea. Domestically, Mr Duterte has faced pressure to take stronger stance on the issue after a Chinese ship struck and sank a Philippine fishing boat, abandoning its crew, on June 9th. In April the Philippines also filed two diplomatic protests over the presence of around 275 Chinese vessels around Philippine-occupied Thitu Island (known as Zhongye Island in China).

Mr Duterte was unable to gain any concessions from China. The two sides agreed to continue dialogue to resolve the issue peacefully and to finalise before 2022 a South China Sea code of conduct, which has been under review by China and ASEAN for many years. The two countries were also unable to finalise a deal on oil and gas exploration in the South China Sea, although they did set up a joint government steering committee and enterprise working group to further dialogue. We do not believe that either a code of conduct or an agreement on joint exploitation of hydrocarbon resources is likely to be agreed within the next five years.

Among the deals that were agreed during the meeting was a loan agreement to finance a feasibility study for the South Long Haul railway project. The project is part of both China's Belt and Road Initiative and the Philippine government's infrastructure spending plan.

For his part, Mr Xi called on the Philippines to ban online gambling. Although China has successfully pressured Cambodia to end online gambling, which it claims facilitates illegal money outflows, the Philippines has put up more resistance. It has suspended issuing new licences, but has balked at banning the sector entirely.

### Impact on the forecast

We maintain our call that economic ties between the Philippines and China will strengthen, despite their clashes in the South China Sea. We also retain our forecast that Mr Duterte's pro-China leanings, which run in contrast to broader popular opinion on China, will do his public support little harm.

## MILF rebels hand in guns

September 10, 2019: Political stability

### Event

Around 1,000 fighters from the Moro Islamic Liberation Front (MILF) handed over their weapons to independent foreign monitors on September 7th as part of a treaty ending the long-running separatist insurgency on Mindanao, the second-largest island in the Philippines.

### Analysis

Muslims account for a larger share of the overall population in Mindanao than elsewhere in the Philippines. The MILF fought for an independent Islamic state on the island for decades, in an insurgency that left around 150,000 people dead. The gradual decommissioning of the MILF is part of a peace agreement signed between the central government and the rebel group in 2014.

The start of the decommissioning process follows a plebiscite in January, which cleared the legal path for the creation by 2022 of a new autonomous region with expanded powers (known as the Bangsamoro Autonomous Region in Muslim Mindanao). The central government promised cash rewards, scholarships, health insurance and vocational training for retired fighters. Rebels facing insurgency-related criminal cases will be granted amnesty.

Mindanao suffers from a much higher poverty rate than the national average, which is partly the result of investors being deterred by insurgency-related violence. The central government hopes that by granting wide-reaching autonomy to the region, Mindanao will become more attractive for investment, especially in the energy sector, as it is home to large untapped reserves of oil and natural gas.

Immediately before the MILF began to hand in its weapons, a bomb exploded near a market in the region, suggesting that there will not be an abrupt end to the violence. Nevertheless, the president, Rodrigo Duterte, stated on September 9th that he would provide retired MILF fighters with new weapons if they work with the government to maintain peace in Mindanao.

### Impact on the forecast

The latest development supports our view that internal security will improve during the remainder of Mr Duterte's term; the next presidential election is scheduled for May 2022.

## The president signals a major concession to China

September 13, 2019: International relations

### Event

On September 10th the president, Rodrigo Duterte, said that his administration would ignore the 2016 ruling by the Permanent Court of Arbitration in The Hague (Netherlands) that invalidated China's territorial claims in the South China Sea, including in areas that the Philippines claims as its exclusive economic zone.

### Analysis

On the same day Mr Duterte stated that China will lead the exploration of natural resources in the area and grant the Philippines 60% of the resulting revenue. The president said that his Chinese counterpart, Xi Jinping, agreed to the 60:40 sharing formula at a recent bilateral meeting in the Chinese capital, Beijing. Mr Duterte has been arguing that the Philippines has neither the military means to enforce the ruling nor the financial means to shoulder exploration by itself. His latest statement follows the signing in November 2018 of a Memorandum of Understanding (MOU) for joint oil and gas development in the South China Sea.

Driven by strong domestic economic growth and an expanding population, the Philippines' energy consumption is increasing rapidly, while the country's largest gasfield, Malampaya, is being depleted. The Department of Energy reports that only around five oil wells were drilled each year between 2008 and 2018, compared with 903 in Indonesia and 594 in Thailand in the same period. Accordingly, a prompt start of joint Philippine-China oil and gas development under a 60:40 deal has a compelling economic rationale. Nevertheless, by ignoring the ruling of the international arbitration court, the administration in the Philippines is complicating its security relationship with the US—its traditional backer.

Vietnam, which is also at odds with China over territorial claims, has pursued a very different strategy from that of Mr Duterte. It received backing from the US government when Chinese state-owned survey vessels were accused of hampering exploration by Vietnamese and foreign (non-Chinese) companies in Vietnamese-claimed waters.

### Impact on the forecast

The Economist Intelligence Unit had previously believed that China and the Philippines would not embark upon joint exploitation of hydrocarbon resources in the South China Sea in the next five years. The event has prompted a change to our international assumptions, and we will also be reviewing our macroeconomic forecast in the light of the latest development.

# Economy

## Forecast updates

### Inflation drops below target range

September 10, 2019: Inflation

#### Event

Consumer price inflation decelerated to 1.7% year on year in August, from a rate of 2.4% in July, according to data published by the Philippine Statistics Authority.

#### Analysis

The August data marked the fourth consecutive month of deceleration and the slowest inflationary pace in 34 months. More importantly, the annual increase in consumer prices is below the target band of 2-4% set by the Bangko Sentral ng Pilipinas (BSP, the central bank).

Slowing food price inflation served as the main inflationary brake in August, with prices for food and non-alcoholic beverages rising by only 0.6% year on year, compared with 1.9% in July. Rice prices declined by a marked 5.2%, owing to reduced red tape for importation; this reading is politically important, given how elevated rice prices irritated low income earners in 2018.

Similarly, inflation in utility costs (including fuels) slowed to 1.8% in August, from 2.3% in July, owing to low global oil prices, which also contributed to a decline in the transportation category. Core inflation, which excludes volatile food- and energy-related categories, slowed to 2.9%, from 3.2% in July.

With the end of the typhoon season drawing near, there is a decreasing likelihood that adverse weather will depress agricultural yields. The diminishing risk suggests that inflation in food prices—which make up over a third of the overall index—is likely to remain contained in the months ahead. However, inflationary pressure is likely to build in the final months of 2019 as the government ratchets up public spending in the wake of the delayed passage of the general budget.

#### Impact on the forecast

Consumer prices have increased by an average of 3% year on year in the first eight months of 2019. However, the moderation in food price inflation was faster than we had anticipated. We will be making a downward revision to our 2019 forecast, which currently sees consumer prices increasing by an average of 3.3%. The data also reinforce our view that the BSP will cut its policy rate by another 25 basis points at its meeting on September 26th.

## Reserves maintain upward trend in August

September 10, 2019: External sector

### Event

Gross international reserves surged by US\$430m in August to US\$85.6bn, their highest level since September 2016.

### Analysis

Higher foreign-currency deposits and income from the offshore central-bank investments were the main drivers behind the increase in reserve levels in August, according to Bangko Sentral ng Pilipinas (BSP, the central bank). Gross international reserves now cover around eight months of imports of goods and services.

Reserve levels increased steadily during the first eight months of the year. This is in sharp contrast to the year-earlier period, when the central bank intervened in foreign-exchange markets to help to shore up the value of the peso against the US dollar, depressing the level of international reserves. The BSP has refrained from such intervention this year, primarily because the peso:US dollar exchange rate was range-bound in January-August. Indeed, the peso appreciated against the US dollar in July, following the decision by the Federal Reserve (the US central bank) to cut its policy interest rate by 25 basis points—the first move of this kind since December 2008.

The Economist Intelligence Unit expects the peso to appreciate by 1.1% against the US dollar on an annual average basis in 2019. Such a backdrop, coupled with increases in services and income receipts, augers well for a sustained increase in the overall level of international reserves in the months ahead.

### Impact on the forecast

The data were slightly stronger than expected. As a consequence, we will be making an upward revision to our year-end forecast for international reserves, which is currently US\$84.1bn (or 7.8 months of import cover).



## Trade deficit continues to narrow

September 16, 2019: External sector

### Event

The value of merchandise exports increased by 3.5% year on year in July, marking four consecutive months of gains. By contrast, imports decreased for a fourth consecutive month.

### Analysis

The latest trade data continue to point to a gradual pick-up in external demand, although the sustained decline in import values suggests a continued weakening in domestic demand. Import values have fallen in line with global energy prices, but the value of raw materials and intermediate goods recorded double-digit declines in the four months to July. Admittedly, the value of intermediate inputs for the export-oriented electronics industry has declined because of a drop in global prices, but the weakness also hints at a sustained drop in orders.

Among the various import categories, imports of iron and steel plunged by 35.8% year on year in July, while annual imports of industrial machinery slid by 1.5%, which point to bottlenecks in the government's infrastructure programme. According to the Department of Budget and Management, infrastructure and other capital outlays shrank by 11% year on year in July, attributable mainly to lower disbursements by the Department of Public Works and Highways.

Strengthening demand from Japan, China and the EU helped to lift overall export values in July. Shipments to the US increased by 8.9% year on year. In terms of goods categories, electronics—which make up over half of the total—increased by 2.9%, while agro-based products and mineral products both recorded double-digit gains.

Although the gap between total imports and exports remains wide, the country's trading position continued to improve in July. The goods trade deficit stood at US\$3.4bn, US\$623m less than in July 2018.

### Impact on the forecast

The export data are slightly stronger than we had anticipated. We will be adjusting our 2019 growth forecast for merchandise exports in the light of the latest trade data, to show a shallower contraction for the year as a whole.

## Analysis

### Is the "sick man of Asia" ailing again?

August 21, 2019

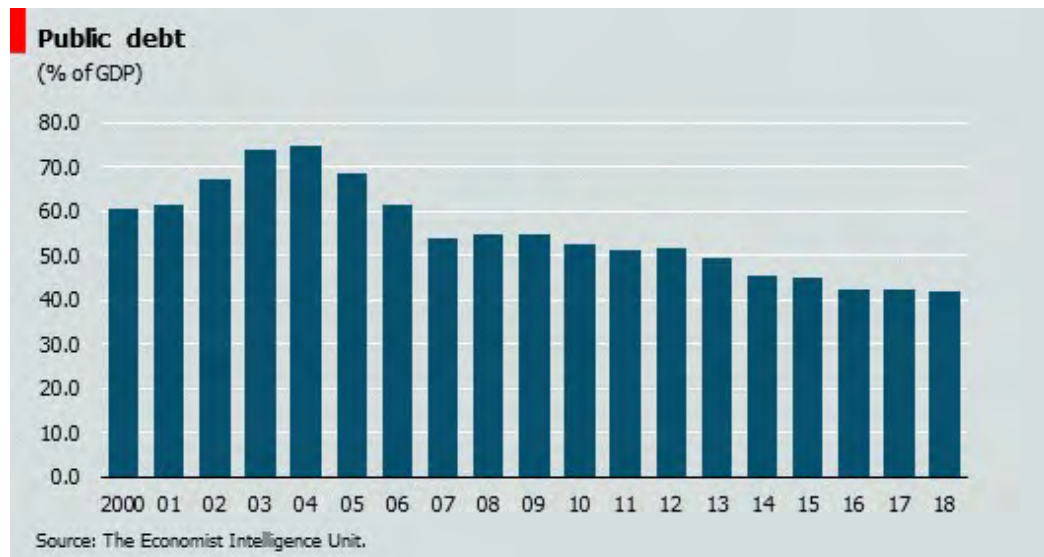
**In the second quarter of 2019, [real GDP](#) expanded by 5.5% year on year, representing the slowest pace of growth in four years. The weakening can be partly attributed to a slowdown in global commerce. Political factors have also played a role as the administration of the president, Rodrigo Duterte, fumbles through economic policymaking. However, the fundamentals still remain healthy, and so—although it is likely that sub-6% growth is now a new normal for the Philippines—the Economist Intelligence Unit believes that the economy will emerge largely unscathed from this slowdown.**

The Philippine economy is losing steam and slowing from the heady 6-7% growth it averaged in the mid-2000s. Its external balances are also struggling—in 2018 the country recorded the largest current-account deficit since the Asian financial crisis of 1997/98. This, combined with the country's weak currency, has raised speculation among observers and investors alike about whether the Philippines is regaining its status as the "sick man of Asia".

### Those days are gone

The Philippines acquired this controversial moniker in the late 1990s and early 2000s, when, along with weak growth, the country's economy was afflicted by corruption scandals at the highest level of political office. These resulted in the mismanagement of state funds and an untenable debt

burden—the public debt-to-GDP ratio peaked at 74.5% in 2004. It was the country's former president, Benigno Aquino (in office 2010-16), who finally managed to turn things around. He not only made efforts to crack down against corruption in government, but also reformed and strengthened economic institutions in order to match global best practices and standards. As a result, Mr Aquino was able to raise the Philippines' rank in the World Bank's Ease of Doing Business Index from 134th in 2010 to 99th in 2016. He also brought down the public debt levels from 51% of GDP in 2010 to 42.1% in 2016; a surplus on the country's current account was also consistently recorded throughout his term.



When Mr Duterte took charge in 2016, we had expected economic reform to take a back seat in comparison to Mr Aquino's stint. The country's rank in the Ease of Doing Business Index quickly slipped to 124th by the end of 2018, owing to the lack of any major reforms. It was ironic that two of the main reasons that Mr Duterte was elected in the first place were the rising income inequality and high levels of unemployment that had persisted under Mr Aquino. Mr Duterte campaigned on the basis of reducing elite capture in the economy and improving the distribution of wealth. But once in charge, it soon became clear that Mr Duterte did not have a clear plan to achieve this goal. Tax reforms that have been rolled out since he took office have been inflationary and have had a disproportionate effect on low-income households.

## Building blocks

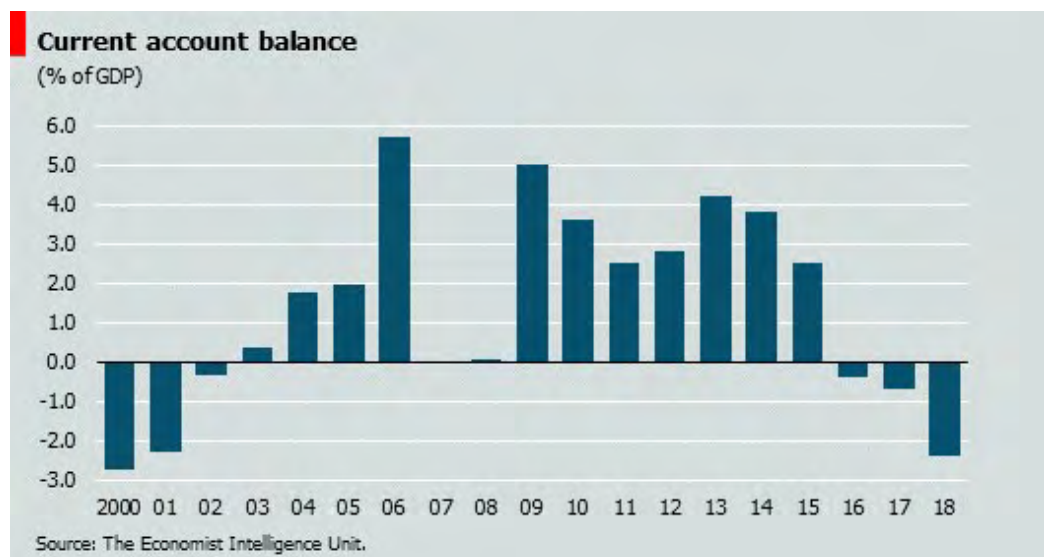
However, it would be unfair to imagine that Mr Duterte's administration is steering the Philippine economy back towards its "sick man" status. One of the key achievements of the current administration has been to boost public investment in infrastructure and improve general budgetary disbursement. Overall, the government has also been successful in lifting revenues and has thereby kept the fiscal deficit range-bound, while keeping public debt at a manageable level. In 2018 the Philippines recorded a budget deficit of 3.2% of GDP and public debt of 41.8%. Moreover, private investment has also remained healthy.

The administration hit a snag in 2019 after the budget for the year failed to secure legislative approval in time. As a result, public investments planned for the first half of the year have faced significant delays. The slowing impact of this was especially apparent in the growth figures for the second quarter of 2019, which showed that public construction investment contracted by 27.2% year on year. Overall capital formation contracted by a noteworthy 8.5% year on year; becoming the obvious dampener of growth in that quarter. We believe that this setback is not a permanent one, as a legislative majority for Mr Duterte's administration (achieved following the [mid-term elections](#) in May) will mean that future budgets will not face the same difficulties. Mr Duterte's single five-year term is due to expire in 2022, and he is determined to leave a legacy of infrastructure development that he hopes will be carried forward by his successor—someone from his own political camp.

## All is fair in trade wars

The same optimism cannot be applied to the country's external sector, however. The Philippines is

a major exporter of manpower to the rest of the world. Remittances from overseas Filipino workers play a major role in helping the archipelago to offset external liabilities. Notably, remittance inflows have weakened in recent years owing to structural changes that have taken place in the labour markets of the importing countries. For instance, many countries in the Middle East that have traditionally been large markets for Filipino workers have started to tighten rules on the hiring of overseas workers, in order to preserve economic opportunities for their own citizens. This slackening in remittances comes at a time when strong import demand in the Philippines (and weak exports) has significantly widened the trade balance and pushed the current-account balance into the red. This in turn has weighed on investor sentiment towards the local currency, the peso.



Prospects for trade will not improve significantly in the months ahead; remittances too will remain volatile. Nevertheless, the peso is supported by the country's still-significant foreign-exchange reserves. According to the latest data from the Bangko Sentral ng Pilipinas (BSP, the central bank), reserves stood at US\$8.2bn at the end of June—enough to cover seven months' worth of imports of goods and services. Meanwhile, domestic activity will remain bolstered by expansionary fiscal policy. The BSP will also continue to ease monetary policy in the months ahead. Most importantly, unlike in the 1990s, the Philippines now has enough institutional capacity to emerge from an economic slowdown fairly unscathed. All these factors will help the Philippines to shake off the "sick man" moniker.

## Renewables gain momentum in ASEAN

September 13, 2019

**South-east Asia has traditionally relied on fossil-fuel-fired power generation to drive its growth. The Economist Intelligence Unit estimates that combustible fuels accounted for 82% of total power generation in 2018 in the region's six largest economies. Yet there are signs that this may be changing. In the face of pressure to reduce carbon emissions—as well as a shift in the cost of producing electricity from renewable sources relative to coal—policymakers in some countries are reassessing power policies.**

Progress towards more sustainable energy strategies has varied substantially among the members of the Association of South-East Asian Nations (ASEAN). Although fossil fuels still dominate the energy mix in most of the grouping's economies, Singapore and Thailand have at least relied more on natural gas, which produces less carbon dioxide (CO<sub>2</sub>) when burned. By contrast, coal—often regarded as one of the dirtiest forms of fuel both in terms of CO<sub>2</sub> emissions and more toxic pollutants—continues to play a major role in many of the region's economies. We estimate that in 2018 coal-fired plants accounted for 31.3% of electricity generation in Vietnam, 42.5% in Malaysia, 45.4% in the Philippines and 52% in Indonesia.

ASEAN set a target in 2015 for renewables to account for 23% of the region's energy mix by 2025. This target stands out as being relatively modest by global standards, but it will be tough to meet. Even in power generation, which forms only part of the total energy mix, renewables accounted for just 17.6% of total generation in 2018 by our estimates. Nevertheless, some policymakers are

beginning to move more aggressively. For example, in his state of the nation address in July, the Philippine president, Rodrigo Duterte, called for the country to "fast-track the development of renewable energy sources and to reduce dependence on traditional energy sources such as coal".

## Turning on the waterworks

Hydropower currently dominates South-east Asia's renewable energy space, thanks largely to its reliability as a baseload power source. Not only do hydropower plant (HPP) projects provide a clean and stable source of power, they also serve as major infrastructure projects that can generate jobs, revenue for the state and clean water for drinking and farming. The build-out of hydropower within ASEAN continues; in particular, Laos plans to complete hydropower projects with a capacity of 1,950 MW in 2019, according to the Vietnam News Agency (Vietnam's state-owned news service).

However, hydropower also attracts much criticism. International Rivers, a non-governmental organisation (NGO), warned in April 2019 that plans to build 11 major HPP projects and 120 tributary dams along the Mekong River by 2040 pose a serious threat to the region's ecology, economy and food supplies. It projects that fish catches in Laos, Cambodia, Thailand and Vietnam will plunge. Partly for this reason, dams have tended to encounter considerable public opposition. Myanmar's Chinese-financed Myitsone Dam, for example, has repeatedly stoked public protests.

## Reaching for the sun

Vietnam boasts more than 18,000 MW of renewable power generation capacity, with the bulk of that coming from HPPs. The country generated an estimated 40% of its total power from hydro in 2018, according to our estimates. However, more recently, Vietnam has also seen a surge in photovoltaic (PV) installations. Installations ramped up ahead of the June 30th deadline, by which projects had to be completed to be eligible for a preferential feed-in tariff (FIT). Vietnam saw its total installed solar power capacity explode from less than 150 MW in mid-April to 4,460 MW by the end of June, according to the Vietnam Electricity Group (EVN, a state-owned power company). The government has now adjusted its FIT system, which is likely to slow the pace of solar capacity creation in the coming months.

Thailand has traditionally been the regional leader in solar, and remains committed to expanding installed solar capacity. It has more recently focused on the potential for floating solar installations, as well as rooftop generation. These elements form part of its target for renewables to make up 27% of generating capacity by 2037; this is laid out in the government's power development plan.

Other countries in ASEAN are also passing new solar milestones. Myanmar, for instance, opened its first commercial solar plant in June 2019, with a capacity of 170 MW, and the Asian Development Bank (ADB) in September announced that a solar power auction in Cambodia had set a record low for electricity prices in Asia, of US\$0.03877/kWh.

## Lagging behind

Plans for the development of solar and other renewables remain less well developed in Malaysia, Indonesia and (despite Mr Duterte's recent call) the Philippines. Indonesia and Malaysia sourced 12% and 15% of their total electricity output from renewable sources respectively in 2018, based on our estimates. Malaysia aims to raise this proportion to 20% by 2025, and Indonesia to 23% by 2025 and 31% by 2050. However, these figures look relatively modest compared with efforts elsewhere, and the two countries' governments do not appear to have committed wholeheartedly to shifting their energy mix.

Although in 2018 the Philippines generated 8.6% of its electricity from hydropower, and a further 12.5% from geothermal sources, according to our estimates, the share of renewables in the total generating mix is falling. The country's government is currently reviewing its National Renewable Energy Programme, which was introduced in 2011 to cover the 2012 to 2030 period. The original plan envisaged raising the country's renewable energy capacity from 5,438 MW in 2010 to 15,304 MW by 2030. The Department of Energy (DOE) has revealed that 7,000 MW of new capacity had been added by 2017. However, with other forms of generating capacity coming on stream at a faster pace, the share of renewables in total generation has fallen. The DOE is looking to nudge this share back up again using initiatives like Renewable Portfolio Standards, which

would require power distributors to source a proportion of their supply from renewable sources. With Mr Duterte apparently putting more focus on the issue, the prospect of a bolder commitment to renewables now looks more likely in the Philippines.

## The last coal holdout?

ASEAN's 2025 target for renewables is, for some members, only a starting point. The cost of renewable power projects has fallen dramatically in recent years, encouraging the likes of Vietnam and Thailand to put more emphasis on increasing renewable capacity, particularly for solar. Yet there remain obstacles to a region-wide shift in the energy mix. China's financing of coal-fired plants can make them an attractive option. China has committed funding for roughly 6 GW of coal-fired generation in Indonesia, 2.3 GW in the Philippines and 5.5 GW in Vietnam, according to a report published in January 2019 by the Institute for Energy Economics and Financial Analysis. Even more projects are at the proposal stage. By contrast, other countries are moving away from financing coal. In Japan—formerly one of the big financiers of coal-fired projects—many institutions are changing their stance. Nippon Life Insurance, for example, has decided to no longer extend loans for, or invest in, coal-fired power plants owing to environmental concerns.

State-controlled enterprises—in the power generation and distribution sectors and in the coal mining sector—can present powerful resistance to any shift towards renewables. This has been particularly evident in Indonesia. Geographic factors and the reach of existing electricity grid networks can present further challenges. Vietnam's grid, for example, is struggling to cope with the flood of solar projects that have been set up in recent months, which may leave some facing financial troubles. Yet the potential of relatively cheap renewable projects to supply far-flung, off-grid locations can also be attractive in some countries. Indonesia has introduced new regulations aimed at supplying more than 2,500 off-grid villages with solar power between 2019 and 2020.

The energy mix in south-east Asia will be important both for the region and for the world. We forecast that ASEAN's population will rise from 649m in 2018 to over 670m by 2023. The region's economy will be one of the fastest-growing in the world, with an average annual pace of expansion at 4.6% over this period. This means that its energy demand will rise rapidly. The current dependence on coal means that south-east Asia is likely to be a major contributor to global greenhouse-gas emissions over the next decade. If renewables, particularly solar and wind, are able to gain more of a foothold in the region, then that contribution—and the associated potential for more damaging forms of climate change—would be reduced. Given south-east Asia's vulnerability to the impact of climate change, that would be beneficial for the region's long-term development.

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## Asia Pacific

James J. Przystup and Phillip C. Saunders

*This chapter examines the strategic challenges the United States confronts in the Asia-Pacific region and argues that the United States should work with allies, partners, and multilateral organizations to build a rules-based regional order that includes China and advances U.S. national interests. This requires sustaining the U.S. rebalance to the Asia-Pacific and intensifying cooperation with other regional actors to shape China's choices. The chapter begins by reviewing the history of U.S. engagement with Asia and describing the range of important U.S. national interests located in the Asia-Pacific region or strongly influenced by developments there. It then reviews major trends shaping the region (including economic dynamism, China's rise, and the U.S. rebalance to Asia) and considers specific security challenges in Northeast Asia, the Korean Peninsula, the China-Taiwan relationship, and in the South China Sea. The authors argue that the United States needs to devote high-level attention to its alliances in Asia, to cooperation with new regional security partners, and to shaping the Asia-Pacific strategic and economic order in favorable directions. These actions will place the United States in a better position to shape China's strategic choices and integrate China within a rules-based regional and global order.*

America's engagement with Asia began before the United States existed. In February 1784, the ship *Empress of China* departed New York harbor, arriving in Macau in August of that year. The ship returned the following year with a cargo of Chinese goods that netted a \$30,000 profit. In Federalist Paper No. 4, John Jay referred to American commerce with China and India.

In 1835, before the United States touched the shores of the Pacific Ocean, the U.S. Navy East India Squadron was established. In 1844, China, in the Treaty of Wanghia, granted trading rights to the United States. Two years later, the United States attempted to negotiate a commercial treaty with Japan. The talks ended in failure, but a decade later



Commodore Matthew C. Perry concluded the Treaty of Kanagawa, opening Japan to American goods and providing protection for shipwrecked American sailors engaged in the China trade.

In the last half of the 19<sup>th</sup> century, U.S. commercial interests expanded rapidly. At the end of the century, U.S. interests expanded beyond trade. In the Treaty of Paris ending the Spanish-American War, Spain ceded the Philippines and Guam to the United States.

Expansion across the Pacific brought the United States into contact with the geopolitics of Asia, focused then on China and the efforts of the imperial powers (France, Germany, Great Britain, Italy, Japan, and Russia) to carve out spheres of influence and commercial privileges in the weakening Qing empire.

Over the past century, the United States has adopted multiple policy frameworks to protect and advance its national interests in the Asia-Pacific region. The Open Door policy toward China represented a unilateral U.S. initiative aimed at rejecting imperial spheres of influence and special privilege and advancing the principle of equality of commercial opportunity. The Open Door evolved into a multilateral framework for managing commercial competition in China. A second Open Door note, issued at the time of the Boxer Rebellion, appealed to the imperial powers to preserve China's territorial and administrative integrity.

President Theodore Roosevelt, playing balance-of-power politics, aligned the United States with Japan to check Russia's efforts to develop an exclusive sphere of influence in Northern China and Korea. Roosevelt's diplomatic intervention in the Treaty of Portsmouth brought the Russo-Japanese war to a close.

In 1920, at the Washington Conference, the United States worked to fashion a multilateral, cooperative framework to preserve China's territorial integrity and the postwar status quo in the Asia-Pacific region. Lacking any enforcement mechanism, the Washington Conference system failed to meet the challenges of rising Chinese nationalism, the great depression, and Japanese unilateralism.

From 1945 through the end of the Cold War and the Barack Obama administration's rebalance to the Asia-Pacific, the United States has relied on bilateral security treaties with Japan, the Republic of Korea (ROK), Australia, the Philippines, and Thailand to protect and advance its security interests. This bilateral "hub and spokes" framework has served as the region's informal security structure, underpinning its remarkable postwar reconstruction and present-day prosperity. Today, the hub-and-spokes framework is evolving to encompass trilateral cooperation among alliance partners and multilateral cooperation involving U.S. allies and strategic partners.

## Asia Pacific

The common principle underlying these various policy approaches is the concept of “access”: economic access to the markets of the region to pursue U.S. commercial interests; strategic and physical access to our allies to ensure confidence in U.S. security commitments; and political access to allow for the promotion of democracy and human rights.

At the same time, the United States has championed the evolution of a postwar liberal, open, rules-based international order allowing for the free flow of commerce and capital supported by the Bretton Woods institutions of the World Bank, International Monetary Fund, General Agreement on Tariffs and Trade, and its successor the World Trade Organization. At the same time, the United States has promoted efforts to support international stability and the peaceful resolution of disputes. This principled U.S. commitment has contributed significantly to the stability and prosperity of the Asia-Pacific region today.

### **U.S. National Interests in the Asia-Pacific Region**

The United States has a range of important national interests either located in the Asia-Pacific region or strongly influenced by developments there. These interests include:

- defense of the homeland, U.S. territories, and U.S. citizens
- maintenance of an open, rules-based international order, including resolution of disputes through peaceful means rather than coercion or the use of force
- access to the region and freedom of navigation in the maritime and air domains
- maintenance of a stable balance of power that supports regional stability and promotes economic prosperity joined with opposition to any power or group of powers that would deny U.S. access to the region or threaten U.S. interests
- strengthening U.S. alliance relationships and reinforcing U.S. commitment to security of its allies
- prevention of the proliferation of weapons of mass destruction and missile delivery systems

- promotion of global norms and values, such as human rights, democracy, and good governance.

### **Defining Trends in the Asia-Pacific Region**

The Asia-Pacific region is marked by important opportunities and challenges that require high-level attention. Economic dynamism is increasing the region's weight in world affairs and its importance to U.S. interests. China's rise is part of this positive story, but Beijing is also converting its astonishing economic growth into military power and diplomatic influence that are challenging the regional balance of power and threatening the stability of the existing order. The Obama administration has responded to regional opportunities and challenges via its rebalance to the Asia-Pacific, which sought to increase U.S. diplomatic, military, and economic engagement there. U.S. interests merit increased strategic attention and resources, but the next administration will need to decide how to sustain the rebalance and what adjustments are necessary given the changing global and regional strategic environment and the U.S. domestic political context.

### **Asia's Economic Dynamism**

In 2013, the Asia-Pacific region generated close to \$21 trillion in economic activity, over a quarter of the global economy. China and Japan stand as the world's second and third largest economies, while the 10 countries in the Association of Southeast Asian Nations (ASEAN) have a combined economic output of over \$2.3 trillion.<sup>1</sup> East Asia remains one of the fastest growing regions in the world, with an annual growth rate of 6.8 percent in 2014, accounting for about 40 percent of global growth.<sup>2</sup> This economic dynamism is increasing the region's overall strategic weight and importance to the U.S. economy.

In 2015, U.S. trade with Asia totaled more than \$1.5 trillion, growing from \$397 billion at the end of the Cold War and \$503 billion at the turn of the century.<sup>3</sup> In 2014, U.S. exports to the Asia-Pacific region represented 27.8 percent of total exports, while imports accounted for 37 percent of total imports. Capital goods, excluding automotive, led U.S. exports to the region, amounting to 26.3 percent, while consumer goods, excluding food and automotive, accounted for 32.2 percent of U.S. imports from the region. Meanwhile the U.S. direct investment position in the region amounted to \$738.8 billion, an increase of 6.1 percent over 2013.<sup>4</sup> The United States remains the single largest investor in the Asia-Pacific region.

## Asia Pacific

In 2012, 32 percent of export-related jobs in the United States were tied to the Asia-Pacific region, representing 1.2 million American jobs, an increase of more than 52 percent over 2002. In 2011, 68 percent of all congressional districts exported more than \$500 million to the region, with 39 states sending approximately 25 percent of their exports to the Asia-Pacific region.<sup>5</sup> Governor-led trade missions target the region's booming economies. Top U.S. trading partners include China (the second largest), Japan (fourth), and South Korea (sixth); if taken as a whole, ASEAN would be the fourth largest U.S. trading partner.<sup>6</sup>

### The Rise of China

China's rise is altering the strategic landscape of the region and challenging the existing regional order. In 1980, as Deng Xiaoping began to open China to the market, China had a \$200 billion economy; by 2014, its economy topped \$10 trillion. This remarkable transformation was achieved by adopting market-oriented economic reforms and opening China to foreign trade, investment, technology, and ideas. The result is a China that is firmly integrated into the regional and global economy. China is now more exposed to external economic developments; the 1998 Asian Financial Crisis and 2008 Great Recession both caused significant slowdowns in Chinese growth.<sup>7</sup> Conversely, China's economy is now big enough and integrated enough that its economic problems can move global trade patterns and U.S. stock markets.

Like other Asian countries, China's economic rise was enabled by an open international trading order and stability in the Asia-Pacific region underpinned by U.S. military power and the U.S. alliance system. A reasonably good working relationship with the United States remains critical for Chinese goals such as sustaining economic growth and maintaining regional stability, but the relationship has become more competitive and many Chinese elites believe that the United States seeks to subvert the Chinese political system and contain China's economic and military potential. As China has become more powerful, and has converted some of its economic gains into military power, it has become less comfortable with the U.S. alliance system and begun to seek more influence within the region and in the international system as a whole.

China's economic growth has reshaped regional trade and investment patterns and greatly increased Beijing's influence. China is now the number one export market for almost all countries within the region and has dramatically expanded its foreign investment across Asia. China has a free-trade agreement (FTA) with ASEAN and is currently pursuing both a China–Japan–South Korea FTA and a broader Regional Comprehensive Economic Partnership agreement. Chinese foreign aid and infrastructure

projects within Asia, some of which are now under the umbrella of Xi Jinping's "One Belt, One Road" initiative, are another source of influence. Beijing has mostly used its economic power as assurance measures and inducements to cooperate with China, but in recent years has become more willing to use more coercive economic measures to punish countries that displease it.<sup>8</sup>

Rapid economic growth has also supported modernization and expansion of the Chinese military, which has enjoyed double-digit budget increases for most of the last 20 years and now has the largest defense budget in the Asia-Pacific region (\$154 billion for 2016).<sup>9</sup> The People's Liberation Army has been modernizing its forces and developing the joint doctrine, training, and capabilities necessary to win "local wars under conditions of informationization."<sup>10</sup> This modernization effort gives priority to naval, air, and missile forces capable of projecting power beyond China's borders and places increasing emphasis on the maritime, space, and cyber domains. As part of its efforts to deter potential U.S. intervention in a Taiwan contingency, the People's Liberation Army has emphasized the development of antiaccess/area-denial capabilities that would raise the costs and risks for U.S. forces operating near China.<sup>11</sup> These capabilities threaten to put at risk the U.S. ability to access its allies, extend deterrence, and meet its regional security commitments. Expanded naval and coast guard capabilities have also supported more assertive Chinese efforts with respect to maritime territorial disputes in the East and South China seas.

Countries in Asia have been carefully monitoring China's rise and the potential for a strong China to dominate the region. Aggressive Chinese behavior toward Taiwan and in the South China Sea from 1994 to 1996 created regional alarm about a "China threat," but more restrained Chinese behavior and assurance measures adopted over the period from 1997 to 2008 helped ease regional concerns. During this period, Asian views largely shifted from regarding China as a potential threat to regarding China as an opportunity; this shift was widely interpreted as an indicator of the success of China's Asia policy.<sup>12</sup> Beginning in 2009, however, more assertive Chinese behavior on maritime territorial disputes and other issues dissipated much of the goodwill built by China's charm offensive and revived regional concerns about how a strong China might behave in the future.<sup>13</sup> These concerns are most acute for countries with maritime or land territorial disputes with China, such as India, Japan, Malaysia, the Philippines, and Vietnam. Chinese policymakers talk about the need to maintain the proper balance between the competing goals of defending Chinese sovereignty (*weiquan*) and maintaining regional stability (*weiwen*); under President Xi Jinping there has been more emphasis

on pursuing territorial claims and less concern about the negative impact on relations with China's neighbors.

In interviews conducted as part of the Institute for National Strategic Studies research project "The Rebalance Beyond 2016," analysts across the region described China's rise as "inexorable." Despite the significant economic and political challenges facing China, they were confident that China will, at worst, muddle through, if not succeed eventually. Looking ahead, interviewees defined a best-case China scenario as one in which the pace of change would slow, allowing countries of the region to adapt and, over time, engage and socialize China toward acceptance and support of the existing regional order. This will require sustained U.S. involvement and coordination with regional allies and partners. For the United States and the Asia-Pacific region, China's rise (and international reactions to that rise) will shape the contours of the international order in the century ahead.

While participating in the postwar Bretton Woods system and benefiting from a stable regional order underpinned by U.S. alliances, China has moved to advance a parallel set of institutions that mostly exclude the United States. These include the Shanghai Cooperation Organization; the initial proposal for an East Asian Summit that would have excluded the United States; and under President Xi, the Asian Infrastructure Investment Bank, the One Belt, One Road Eurasian trade initiative, the Regional Comprehensive Economic Partnership, and the "Asia for Asians" security concept, widely viewed as aimed at U.S. alliances and the U.S. security role in the region. Taken as a whole, China's growing power and willingness to use that power to try to alter regional security arrangements and support new institutions that advance Chinese interests and exclude the United States pose a significant challenge to U.S. interests in the Asia-Pacific.

### **The U.S. Rebalance to Asia**

Upon taking office in January 2009, Obama administration officials proclaimed a U.S. "return to Asia." This pronouncement was backed with more frequent travel to the region by senior officials and increased U.S. participation in regional multilateral meetings, culminating in the decision to sign the ASEAN Treaty of Amity and Cooperation and to participate in the East Asia Summit at the head-of-state level.

The strategic rebalance to Asia built on these actions to deepen and institutionalize U.S. commitment to the Asia-Pacific region. In announcing the rebalance in a November 17, 2011, address to the Australian Parliament, President Obama argued that "Our new focus on this region reflects a fundamental truth—the United States has been, and always

will be a Pacific nation. . . . Here we see the future.” The President noted that Asia is “the world’s fastest growing region,” “home to more than half of the global economy,” and critical to “creating jobs and opportunity for the American people.” He described the rebalance as “a deliberate and strategic decision” to increase the priority placed on Asia in U.S. policy.<sup>14</sup>

Then—Secretary of State Hillary Clinton elaborated on the rationale for the rebalance, arguing that “harnessing Asia’s growth and dynamism is central to American economic and strategic interests” and that the United States had an opportunity to help build “a more mature security and economic architecture to promote stability and prosperity.” Given the importance of the Asia-Pacific region, she argued that “a strategic turn to the region fits logically into our overall global effort to secure and sustain America’s global leadership.”<sup>15</sup>

While the main objective of the rebalance was to bring U.S. foreign policy commitments in line with U.S. interests, it also responded to China’s increasingly assertive regional policies, especially on maritime territorial disputes. Countries across the Asia-Pacific region urged Washington to play a more active role in regional economic, diplomatic, and security affairs in order to demonstrate U.S. commitment and help maintain regional stability in the face of a more powerful and more active China.

Obama administration officials have stressed that the rebalance includes diplomatic, economic, and military elements, all of which must be applied in a coordinated manner for maximum effect.<sup>16</sup> The diplomatic element has involved enhanced high-level diplomatic engagement, including frequent travel to the region by the President, Secretary of State, and Secretary of Defense. President Obama has participated regularly in Asia-Pacific Economic Cooperation (APEC) and East Asia Summit meetings; had periodic meetings with the leaders of U.S. allies Japan, South Korea, and Australia; and launched a new U.S.-ASEAN dialogue mechanism that included a summit with Southeast Asian leaders at Sunnyslands, California, in February 2016.

American allies and partners in the region have stressed U.S. economic engagement with Asia as a key means of demonstrating U.S. staying power. The Obama administration faced a number of practical and political obstacles in increasing U.S. trade and investment ties with the Asia-Pacific, especially in the context of the global financial crisis. The centerpiece of the administration’s efforts is the Trans-Pacific Partnership (TPP), as “an ambitious, next-generation Asia-Pacific trade agreement” including Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.<sup>17</sup> The TPP agreement was signed on February 4, 2016, but will not

take effect until all member countries have ratified the agreement. The Obama administration has not submitted the agreement to Congress for approval; once submitted, Congress will have 90 legislative days to approve or disapprove it. TPP is an example of “open regionalism,” meaning that other Asia-Pacific countries willing to meet TPP standards will eventually be able to join the agreement.

The military element of the rebalance includes both increased commitments of U.S. military forces to the Asia-Pacific region and enhanced military and security cooperation with a range of allies and partners. The Navy and Air Force both announced plans to devote 60 percent of overseas-based forces to the Asia-Pacific region, including deployments of advanced systems such as the Littoral Combat Ship and F-35 Joint Strike Fighter. The Army announced plans to align 70,000 troops to Asia missions, while the Marines announced plans for rotational deployments of 2,500 Marines to Australia. Secretary of Defense Ashton Carter described a three-part Department of Defense approach to the “next phase” of the rebalance that includes investing in future capabilities relevant to the Asia-Pacific security environment, fielding key capabilities in quantity, and adapting the U.S. defense posture to be “geographically distributed, operationally resilient, and politically sustainable.”<sup>18</sup> A significant part of the rebalance involves efforts to expand military cooperation with traditional allies such as Australia, Japan, and South Korea, while using exercises and dialogues to reach out to nontraditional partners such as India, Malaysia, and Vietnam.<sup>19</sup>

While the President’s remarks set out a comprehensive strategy toward the region, the initial public diplomacy rollout focused on the military aspects, unfortunately playing into the Chinese conceit that U.S. policy is aimed at containing China. Beijing has subsequently gone a step further, blaming the rebalance for increasing tensions in the region even though it was partly a response to regional concerns about increasing Chinese assertiveness.

### **Asia-Pacific Security Challenges**

Asia’s economic dynamism, China’s rising power, and the U.S. rebalance are broad trends that are having a major impact on the Asia-Pacific region as a whole. These trends co-exist with a number of specific security challenges in Northeast Asia, the Korean Peninsula, the China-Taiwan relationship, and the South China Sea, including unresolved territorial disputes, competition to secure natural resources, and freedom of navigation issues that present complex challenges to regional stability and security.



### Northeast Asia

Even 75 years after the end of World War II, tensions over the history of Japanese colonialism and aggression continue to complicate Tokyo's relations with Beijing and Seoul. The Japan-China relationship is also marked by conflicting territorial claims in the East China Sea, including disputes over possession of the Senkaku/Diaoyu Islands, an unresolved maritime boundary, and resource competition for fish, oil, and natural gas. Both China and Japan claim the islands (as does Taiwan) and tensions over them have flared periodically since the late 1970s.<sup>20</sup> The United States does not take a position on the sovereignty dispute but recognizes Japanese administrative control and has stated that the unpopulated islands are covered under the U.S.-Japan Security Treaty.

In September 2010, a Chinese fishing trawler operating within Japan's exclusive economic zone north of the Senkaku Islands collided with two Japanese coast guard ships. The ships pursued and boarded the trawler, taking into custody the captain and crew. Tokyo took the position that the coast guard's actions were correct, taking place in Japanese waters and based on Japanese law. Beijing's response was to call on Japan to refrain from taking "so-called law enforcement activities" in Chinese waters. To have accepted the legality of the coast guard's action would have been to compromise China's claim to sovereignty over the islands. The rapid deterioration of relations that followed, China's suspension of rare-earth metal exports to pressure the Japanese business community, widespread anti-Japanese demonstrations across China, and small-scale anti-Chinese protests in Japan all underscored the sensitive nature of the territorial issue.

Two years later, in September 2012, the Japanese government purchased ("nationalized") three of the five Senkaku islands from their private-sector owner. Widespread anti-Japanese demonstrations spread across China, and Beijing suspended all high-level political and diplomatic contacts. To assert its claims to the islands, China stepped up patrols of white-hulled paramilitary ships (now consolidated into the Chinese coast guard) into Japan's contiguous zone around the islands, establishing an almost daily presence in the area. Chinese ships also entered Japan's territorial waters in the Senkakus. By the end of 2013, Chinese coast guard ships had entered Japan's territorial waters in the Senkakus 256 times. Of the incursions, 68 took place in the period September–December 2012 and 188 in 2013.<sup>21</sup> In November 2013, China declared an Air Defense Identification Zone that extended over the Senkaku Islands. The following month the government of Prime Minister Shinzo Abe, in its national security strategy, defined Japan's security environment as "ever more severe."<sup>22</sup>

Japan and China also hold conflicting claims over the maritime boundary in the East China Sea. Japan claims a mid-line boundary in the East China Sea, while Beijing's claim is based on the continental shelf and extends beyond the mid-line to the Okinawa trough. In the context of this unresolved boundary, exploration for oil and natural gas has also served as a flashpoint. In June 2008, Japanese and Chinese diplomats reached agreement on the joint development of resources in the East China Sea; implementing details were left to follow-on talks, which have failed to resolve outstanding issues. In June 2013 China began the construction of large exploration platforms on the Chinese side of the mid-line boundary. Tokyo considered the Chinese action to be at odds with the 2008 agreement and an "attempt to change the status quo unilaterally." Beijing's response was to make clear that exploration was taking place within China's sovereign waters, that China and Japan have yet to reach agreement on the maritime boundary, and that China does not recognize Japan's unilateral boundary demarcation. The Japanese press reported that Prime Minister Abe has raised the issue twice with President Xi at the November 2014 and April 2015 meetings.

### North Korea

North Korea, as it has for decades, remains the most destabilizing element in the Asia-Pacific security environment. Pyongyang's growing nuclear and missile arsenal poses a direct threat to U.S. national security interests. Senior U.S. defense officials have stated that North Korea, within a decade, will be able to deploy intercontinental ballistic missiles capable of reaching U.S. territory in the Pacific and the homeland itself.<sup>23</sup>

North Korea's estimated 1.2 million-man conventional army also continues to pose a direct threat to the Republic of Korea, a treaty ally of the United States. North Korean provocations, such as the sinking of the ROK navy's warship *Cheonan*, in March 2010, the shelling of Yeonpyeong Island in November 2010, and the August 2015 incident at the demilitarized zone (DMZ), risk escalation into a wider conflict. Pyongyang remains committed to the unification of the Korean Peninsula on its terms.

Diplomatic efforts to address North Korea's nuclear program have a long history. Beginning in 1991, then–Undersecretary of State Arnold Kanter met with North Korean diplomats in New York and proposed the basic tradeoff that has marked diplomatic efforts since: abandonment of North Korea's plutonium-based nuclear program in exchange for an array of security guarantees and economic benefits. The initiative eventually played out into the 1994 Agreed Framework, which offered Pyongyang two light water reactors, a security guarantee, and moves toward normalized relations. Profound distrust on both sides gradually

unraveled the accord, which collapsed in 2002 when the George W. Bush administration discovered that Pyongyang was secretly pursuing uranium enrichment as an alternative path to the bomb.

In September 2003, China launched the Six Party Talks to reduce the risk of unilateral U.S. military action and to keep denuclearization of North Korea on the security agenda. The talks produced the September 19, 2005, agreement, yet another attempt at a grand bargain. The Six Party Talks collapsed in December 2008 when North Korea failed to produce details of its nuclear activities that would verify compliance with the agreement. Efforts to revive the Six Party Talks have proved unavailing.

In 2009 the Obama administration attempted to break the diplomatic deadlock, offering to extend an open hand to North Korea. North Korea answered with ballistic missile and nuclear weapon tests. Nevertheless, the administration continued to pursue a diplomatic opening to Pyongyang, which resulted in the February 29, 2012, Leap Day agreement, a mini-grand bargain in which the United States would provide food in return for North Korea's freezing of its missile and enrichment programs. Pyongyang responded with another ballistic missile test.

In 2012 the nuclear and missile programs were enshrined in North Korea's revised constitution. Today, under the leadership of thirty-something Kim Jong-un, North Korea is pursuing *byungjin*, a two-track policy aimed at sustaining its nuclear weapons and missile programs and simultaneously promoting economic growth—in short, guns *and* butter. Pyongyang has made very clear that it has no interest in surrendering its nuclear program, even for an economic windfall. Instead it seeks international recognition as a nuclear weapons state.

Uncertainties about the long-term life expectancy of the regime under Kim Jong-un, including the prospect of instability or regime collapse, raise daunting security challenges.<sup>24</sup> China might intervene to prop up a failing regime, prevent a refugee crisis from spilling over its borders, or secure North Korea's weapons of mass destruction. Similar conditions could prompt the ROK to cross the 38<sup>th</sup> parallel in an effort to unify the peninsula or the United States to intervene to secure North Korea's weapons of mass destruction. The prospects for strategic miscalculation in a fast-moving, dynamic environment are extremely high, especially given the absence of substantive dialogue between the United States and China about contingency responses.

### **China-Taiwan**

The political dispute between Mainland China and Taiwan remains an unresolved legacy of the Chinese civil war. The People's Republic of China

(PRC) claims Taiwan as an inherent part of Chinese territory. While pursuing a policy of unification through peaceful development, Beijing has refused to renounce the use of force if Taiwan should pursue *de jure* independence. Even as economic integration has deepened to the point where Mainland China is now Taiwan's number one export market and the main destination for Taiwan investment, political trends have continued to diverge.

On the mainland, the narrative of a “century of humiliation” at the hands of foreign powers makes Taiwan reunification a benchmark goal for Chinese nationalism and a domestic political third rail where top leaders have little room to compromise. Conversely, democratization and social changes on Taiwan have reduced the political dominance of the mainlanders who fled the Communist takeover in 1949 and produced a population with less sense of a Chinese identity and little desire for closer political relations with Mainland China, much less unification with a country led by a Communist government. Despite an increasing sense of an identity separate from the Mainland, the pragmatic population on Taiwan prefers to maintain the political status quo and avoid pro-independence actions that might provoke hostile PRC responses.

U.S. policy is based on three communiques signed with the People's Republic of China and the 1979 Taiwan Relations Act. U.S. policy recognizes the PRC government as the sole legal government of China, acknowledges the Chinese position that there is but one China and that Taiwan is part of China, and maintains cultural, commercial, and other unofficial relations with the people on Taiwan. At the same time, U.S. policymakers have clearly and consistently stated that the United States does not support Taiwan independence. The Taiwan Relations Act provides the legal basis for U.S. unofficial relations with Taiwan and enshrines a U.S. commitment to assist Taiwan in maintaining its defensive capability. It also states that peace and stability in the Western Pacific area “are in the political, security, and economic interests of the United States, and are matters of international concern” and that U.S. policy is to “maintain the capacity of the United States to resist any resort to force or other forms of coercion that would jeopardize the security, or the social or economic system, of the people on Taiwan.”

U.S. policy is focused on maintaining a framework within which the two sides of the strait can work out their political differences rather than on achieving specific outcomes. Accordingly, the United States insists on peaceful resolution of cross-strait differences, opposes unilateral changes to the status quo by either side, and encourages cross-strait dialogue to help advance a peaceful resolution. This approach has helped the United States cooperate with the PRC on a range of global, regional, and bilat-

eral economic and security issues while maintaining robust unofficial ties with the people on Taiwan. However, the growing imbalance in economic and military power between China and Taiwan poses challenges for the viability of this policy framework, especially as Chinese military modernization expands the coercive tools available to PRC leaders.

Contentious cross-strait relations improved considerably from 2008 to 2016 under Taiwan President Ma Ying-jeou, whose willingness to endorse the so-called 1992 consensus (which he interpreted as “one China, separate interpretations”) reduced tensions and permitted a major expansion of cross-strait economic ties, establishment of direct air and sea links, and the signing of 23 cross-strait agreements. Ma resisted pressure from Mainland China to engage in talks on political issues or to define Taiwan’s status more precisely. Although this period saw stability and a significant expansion in cross-strait contacts, many on Taiwan claimed that the economic benefits went largely to politically connected big businesses and that the Ma administration did not stand up enough for Taiwan’s interests.

Opposition Democratic Progressive Party candidate Tsai Ing-wen won a decisive victory in January 2016 elections; her party won control of the legislature for the first time and she took office as president on May 20, 2016. Mainland China is suspicious of Tsai because of her party’s pro-Taiwan independence stance and her service in former president Chen Shui-bian’s government, although she has pledged not to challenge the status quo and has made subtle policy adjustments to reassure Beijing that she will not take pro-independence actions that might disrupt stability.<sup>25</sup>

Nevertheless, Mainland China officials have insisted that Tsai explicitly acknowledge that Taiwan is part of China and endorse the 1992 consensus, a concession she is unwilling (and perhaps unable) to make. A March 2016 Center for Strategic and International Studies delegation to China and Taiwan concluded that China is deliberately setting the bar high because it wants Tsai’s term in office to be considered a failure. To that end Beijing has severed semi-official cross-strait dialogue mechanisms, reduced the flow of tourists to Taiwan, and may take additional actions to curtail Taiwan’s international space, including by inducing some of Taiwan’s 21 diplomatic allies to shift recognition to the PRC. Beijing’s strategy appears to be to blame Tsai for a downturn in cross-strait relations that damages Taiwan’s economy, and to hope that Taiwan voters choose a candidate committed to improving cross-strait relations in the 2020 election.

This all suggests that cross-strait relations will enter a period of greater turbulence with Beijing seeking to depict Tsai as challenging the status

quo by refusing to endorse the 1992 consensus and Tsai and her government looking to Washington for support in the face of increasing Chinese pressure. At the same time, Beijing knows that any attempt to resolve the Taiwan issue with force would have extremely high costs and risks (including the likelihood of U.S. military intervention) and would severely damage China's relations with the United States and other major countries in the region.

### South China Sea

In contrast to the East China Sea, competing territorial claims and maritime boundaries in the South China Sea involve multiple parties. The disputes center on three sets of overlapping claims. China, Taiwan, and Vietnam all claim the Paracel Islands, which China occupied in 1974 during the last days of the Republic of Vietnam. China, the Philippines, and Taiwan claim Scarborough Shoal, site of a 2012 dispute between Beijing and Manila. China, Taiwan, and Vietnam claim all the land features in the Spratly Islands, while Brunei, Malaysia, and the Philippines each claim a number of specific features. China has not clarified the exact nature or legal basis of its claim to land features and adjacent waters inside the "nine-dash line" that it inherited from the Republic of China. The nine-dash line overlaps with part of Indonesia's exclusive economic zone claim, including part of the Natuna natural gas field.

In 2002, the member states of ASEAN and China adopted the "Declaration on the Conduct of Parties in the South China Sea" to address conflicting claims. In the document, the parties:

- reaffirmed "their respect for and commitment to the freedom of navigation in and overflight above the South China Sea as provided for by the universally recognized principles of international law, including the 1982 UN [United Nations] Convention on the Law of the Sea"
- undertook "to resolve their territorial and jurisdictional disputes by peaceful means, without resorting to the threat of or use of force"
- undertook "to exercise self-restraint in the conduct of activities that would complicate or escalate disputes and affect peace and stability including, among others, refraining from . . . inhabiting . . . the presently uninhabited islands, reefs, shoals, cays, and other features and to handle their differences in a constructive manner."<sup>26</sup>

Finally, the parties reaffirmed that “the adoption of a code of conduct in the South China Sea would further promote peace and stability” and agreed “to work, on the basis of consensus, toward the eventual attainment of this objective.”

A binding code of conduct today stands as a distant vision, and much has transpired that is at odds with the spirit of the Declaration of Conduct. Claimants have used a variety of tactics to reinforce their claims, with a significant increase in activity since 2009.<sup>27</sup> Tactics to assert sovereignty include patrols by coast guard and naval forces, occupying land features, enforcing fishing regulations in disputed waters, oil and natural gas exploration, harassment of military ships and aircraft operating in disputed areas, and using legal means (such as the case the Philippines brought against China in the International Tribunal of the Law of the Sea). None of the claimants has clean hands, but China has been the most active in using military and paramilitary means to assert its claims, including by coercion of other claimants.<sup>28</sup> Since 2009 China has become more assertive in enforcing its claims, including harassment of U.S. military ships and aircraft operating legally in international waters or within China’s exclusive economic zone. In May 2014 China deployed an oil rig into waters in the Paracels claimed by Beijing and Hanoi, raising tensions and setting off collisions between Chinese and Vietnamese coast guard ships and virulent anti-Chinese demonstrations in Vietnam.

In 2013 China began land reclamation projects in the South China Sea on several low-tide elevations, geologic features that do not extend above water at high tide. China’s efforts at land reclamation were not unprecedented: Malaysia, the Philippines, Taiwan, and Vietnam have also engaged in such projects since the 1980s. The U.S. Department of Defense *Maritime Security Strategy* notes that, in the period from 2009 to 2014, Vietnam “was the most active claimant in terms of both outpost upgrades and land reclamation,” adding “approximately 60 acres of land at 7 of its outposts and [building] at least 4 new structures as part of its expansion efforts.”<sup>29</sup>

However, China’s land reclamation activities dwarf those of other claimants. By June 2015 China’s land reclamation projects totaled “more than 2,900 acres, or 17 times more land in 20 months than the other claimants combined over the past 40 years, accounting for approximately 95 percent of all reclaimed land in the Spratly Islands.” In comparison Vietnam had reclaimed “a total of approximately 80 acres, Malaysia, 70 acres; the Philippines 14 acres; and Taiwan, 8 acres.”<sup>30</sup> Beijing’s position remains that “China has indisputable sovereignty over the Nansha islands and their adjacent waters,” with “sovereignty and relevant rights . . . formed over the long course of history and upheld by successive Chinese



governments.”<sup>31</sup> In October 2015 President Xi pledged that China would not “militarize” the islands that it had constructed, but the exact nature of this commitment is vague and most observers expect China to use the airfields and port facilities that it is building for both military and civilian purposes.

U.S. policy has been to avoid taking sides in the sovereignty disputes, but to stress the importance of respect for international law and peaceful resolution of disputes without coercion. China’s successful use of incremental salami tactics to expand its effective control of disputed maritime territory in the South China Sea has brought this approach into question, as Beijing has been able to “work around” the United States to gradually expand its naval and coast guard presence and power projection capabilities while avoiding the use of lethal force. More recently, the United States has adjusted its policies to increase security assistance to help improve maritime domain awareness of U.S. allies and partners and has also reinvigorated its Freedom of Navigation program, which challenges excessive or illegitimate maritime claims.<sup>32</sup>

### **U.S. Policy Responses: Sustaining the Rebalance**

U.S. policies must take the broad trends of Asia’s economic dynamism, China’s rising power, and the U.S. rebalance into account even as they grapple with specific regional security challenges. We believe the correct strategy is to work with U.S. allies, partners, and multilateral organizations to build a rules-based regional order that includes China and advances U.S. national interests. This requires sustaining the U.S. rebalance to the Asia-Pacific and intensifying cooperation with other regional actors to shape China’s choices and make it pay a price for aggressive actions that violate international rules and norms.

For over a half century, the U.S. system of bilateral security alliances (with Australia, Japan, the Philippines, the Republic of Korea, and Thailand) has served as the informal security architecture of the Asia-Pacific region, underpinning stability and enhancing economic prosperity. Although most countries in the region share concerns about how China is using its power (and especially about its aggressive pursuit of its maritime territorial claims), they are reluctant to choose between China (a critical economic partner) and the United States or to participate in security cooperation aimed against China. Given the diversity of the region in terms of political culture and security interests, a formal alliance system such as the North Atlantic Treaty Organization has been widely recognized as impractical.

The best approach is to build on the existing bilateral alliance system by encouraging increased cooperation between U.S. allies, engaging other regional security partners, and shaping the evolution of regional organizations through active U.S. participation. U.S. policymakers must recognize China is a powerful country that is also attempting to reshape the regional order in directions favorable to its interests. An open, rules-based regional order that includes the United States will be more attractive to Asia-Pacific countries than Chinese-backed alternatives.

### **Strengthening Alliances**

To address the security challenges in 2017–2021 and beyond, a critical first step for the next administration is to focus on strengthening the bilateral alliance structure. This starts with the U.S.-Japan Alliance.

*Japan.* For over half a century, the alliance with Japan has served as the foundation of U.S. strategy toward the Asia-Pacific region and an integral element of U.S. global strategy. Elements of the Seventh Fleet based in Yokosuka, Japan, were among the first U.S. units to support coalition efforts in the Persian Gulf War in 1991 and Operation *Enduring Freedom* in 2001.

Under the government of Prime Minister Abe, Japan has taken steps to enhance security cooperation with the United States. In December 2013, the Abe government released Japan's first-ever national security strategy, which defined Japan as a "Proactive Contributor to Peace" in support of international stability and security. The document set out three objectives for Japan's security policy: to strengthen deterrence, to strengthen the Japan-U.S. Alliance, and to strengthen the rules-based international order. In July 2014 a decision by the Japanese government cabinet reinterpreted Japan's constitution to allow for the exercise of the right of collective self-defense.

In April 2015 the Obama administration and the Abe government released the Revised Guidelines for Defense Cooperation. The new guidelines aim to enhance U.S.-Japan Alliance cooperation by providing for an Alliance Coordination Mechanism; closer operational coordination; a whole-of-government, upgraded bilateral planning mechanism; seamless coordination of efforts "to ensure Japan's peace and security in all phases, from peacetime to contingencies"; and defense equipment and technology cooperation as well as cooperation in space and cyberspace. The limiting geographic reference to "Situations in Areas Surrounding Japan" in the 1997 guidelines was omitted, theoretically expanding the scope of alliance-based security cooperation.

Of increasing concern to Japan is the potential for “gray zone” activities, attempts to change the status quo by force or coercion such as China’s frequent incursions into Japan’s sovereign waters and air space that could cause “unexpected situations” and challenge the alliance in response. In April 2014 President Obama made clear that Article 5 of the alliance extends to the Senkaku Islands given Japan’s administrative control. To strengthen deterrence, it is critical for the new administration to be seen actively planning and exercising with Japan’s Self-Defense Forces to deal “seamlessly” with gray zone situations that could arise in the Senkaku Islands.

With respect to North Korea’s growing missile threat, Japanese strategists are concerned with the potential for “decoupling,” the result of a North Korea inclined to engage in provocations, confident that its nuclear arsenal would preclude a U.S. response. Japanese strategists are also concerned with the deterrence challenge posed by China at both the regional and strategic levels.

Implementation of the new defense guidelines, in particular the U.S. commitment “to extend deterrence to Japan through the full range of capabilities, including U.S. nuclear forces” and to continue forward deployment in the Asia-Pacific region will be critical to sustaining Japanese confidence in the alliance. Implementation of the guidelines will be a critical test both of the new administration’s commitment to the alliance and to the rebalance.

Across the region, the strength of the U.S.-Japan Alliance as well as the U.S. commitment to the defense of the Republic of Korea are widely perceived as a barometer of the U.S. security commitment to the Asia-Pacific region.

**The Republic of Korea.** For over 60 years, the U.S alliance with the Republic of Korea has succeeded in deterring North Korea from again attempting to unify the Korean Peninsula by force of arms. The resulting armed peace has allowed for a political evolution to take place in which the Korean people have transformed an authoritarian political system into a vibrant democracy, while allowing the native energies of the Korean people to flourish and develop a dynamic market economy with an international presence.

At the same time, the threat posed by North Korea to the security of the ROK and the broader international community remains. The sinking of the ROK navy corvette *Cheonan* in March 2010 and the shelling of Yeonpyeong Island in November 2010 and the August 2015 landmine incident at the DMZ underscore North Korea’s continuing hostility.

While North Korea's conventional capabilities have continued to degrade, the threat posed by its nuclear weapons and missiles is increasing at an accelerating pace. Since the September 19, 2005, Six Party Talks agreement on denuclearization, North Korea has conducted five nuclear tests (in October 2006, May 2009, February 2013, January 2016, and September 2016). The UN Security Council imposed sanctions after the first four tests and is currently considering additional sanctions. Meanwhile North Korea continues to develop and test a ballistic missile arsenal. In October 2014, U.S. Forces Korea (USFK) commander General Curtis Scaparrotti, USA, cautioned that North Korea may have developed a miniaturized nuclear warhead and mated the warhead to missiles capable of striking U.S. territory.

North Korea's evolving nuclear and missile capabilities raise issues related to deterrence and defense, affecting both the ROK and Japan.<sup>33</sup> Defense planners are concerned that "newly nuclear states often are more assertive at the conventional level because of their confidence in being able to deter a strong adversary response with their nuclear means."<sup>34</sup> To address this potential risk, the ROK and the United States reached agreement on a Counter-Provocation Plan in March 2013. The plan was employed during the August 2015 DMZ landmine incident. Updating the Counter-Provocation Plan to deal with the evolving threats posed by North Korea will be an important alliance management instrument for the new administration.

Enhancing missile defense will also be a critical alliance issue for the new administration. In July 2016 the United States and the ROK agreed to deploy the Terminal High Altitude Area Defense (THAAD) system to the ROK. The deployment will defend against North Korean missile attacks and open the door to the development of an interoperable U.S.-ROK-Japan multilayered missile defense system that would enhance defense and deterrence in Northeast Asia. China, however, has expressed concerns that the U.S. deployment of the THAAD system in South Korea could put China's nuclear deterrent at risk and aggravate tensions on the peninsula. In July 2014 President Xi Jinping reportedly told President Park Geun-hye that THAAD deployment on the peninsula "went against China's security interests."<sup>35</sup> After the deployment decision, China expressed "firm opposition" and has applied economic and diplomatic pressure on the ROK to reconsider. U.S. and ROK policymakers will need to stand firm in the face of Chinese pressure.

Meanwhile, efforts to implement the September 19, 2005, Six Party agreement on the denuclearization of North Korea remain on diplomatic life support. In April 2009 North Korea announced its withdrawal from

the Six Party Talks and subsequently made clear that its nuclear arsenal will not be used as a bargaining chip to secure economic benefits.

The next administration should take the long view with respect to North Korea—not all problems will be solvable within its term in office. An effective policy will aim to strengthen deterrence and defense of the ROK, maintain the external pressure of economic sanctions, and keep the door open to dialogue and diplomacy.

To deal with the possibility of instability or regime collapse, the next administration should work to closely coordinate U.S. and ROK objectives, endstates, and policy responses and, at the same time, make every effort to bring China into the conversation. To date China has considered such official-level discussion to be premature.

***The Philippines.*** In 1992, after the Philippine senate rejected an extension of the basing agreement, the United States closed Clark Air Base and the Subic Bay Naval Base and withdrew its military forces from the Philippines. U.S. military assistance resumed after 9/11, directed to support Manila's counterterrorism efforts in Mindanao and the southernmost islands.

As Philippine concerns about China have increased, Manila has become more willing to expand security cooperation. In 2011, the United States agreed to support programs aimed at enhancing its maritime security capabilities. In 2012, the Balikatan joint exercise took place off Palawan Island, near the contested Spratly Islands in the South China Sea. The United States also transferred two former Coast Guard ships to the Philippines. In 2014, Washington and Manila signed the Enhanced Defense Cooperation Agreement, aimed at “addressing short-term capability gaps, promoting long-term modernization, and helping maintain and develop additional maritime security, maritime domain awareness, and humanitarian assistance and disaster relief capabilities.”<sup>36</sup> During his visit to the Philippines in 2014, President Obama made clear that the U.S. commitment “to defend the Philippines is ironclad and the United States will keep that commitment because allies never stand alone.” Obama reiterated the “ironclad commitment” formulation during his 2015 visit to the Philippines. Despite new Philippine President Rodrigo Duterte's recent remarks questioning the value of security cooperation with the United States, U.S. policymakers should exercise patience and remain focused on the long-term interests of both countries.

### **Moving Beyond the Hub-and-Spokes Alliance System**

Since the turn of the century, the U.S. alliance structure has been evolving from the Cold War bilateral hub-and-spokes construct toward a

more open architecture that includes increased cooperation between U.S. allies and active efforts to engage other regional security partners. The United States has supported increased bilateral security cooperation between U.S. allies, most notably between Australia and Japan and Japan and the Philippines; trilateral cooperation among Australia, Japan, and the United States and among Japan, the ROK, and the United States; and quadrilateral engagement involving the Australia, India, Japan, and the United States. Exercises that began in the context of U.S. bilateral alliances have expanded to include a wide range of regional participants, including China (which participated in the 2014 and 2016 Rim of the Pacific exercises).

At the same time, the United States has developed Comprehensive Partnerships with Indonesia, Malaysia, and Vietnam and a Strategic Partnership with Singapore. Japan and Australia, both U.S. allies, have developed similar partnerships with Indonesia, Malaysia, Singapore, and Vietnam. These non-alliance partnerships help to enhance broad-based regional security cooperation and contribute to stability.

Australia, Japan, and the United States are focusing on maritime issues in Southeast Asia and the South China Sea, including maritime capacity-building, maritime domain awareness, joint training and exercising, and port calls. In 2013 the United States committed \$156 million (2014–2015) to support maritime capacity-building in Southeast Asia, including \$18 million to Vietnam.<sup>37</sup> In November 2015, the White House announced its intention to enhance capacity-building efforts by committing more than \$250 million over the 2015–2016 period, focused on Indonesia, Malaysia, the Philippines, and Vietnam.<sup>38</sup>

In November 2015 Japanese and Vietnamese ministers of defense agreed to strengthen defense cooperation, including joint maritime exercise and a 2016 port call at Cam Ranh Bay by Japan's Maritime Self-Defense Force. Earlier, in 2006, Japan, making strategic use of its Official Development Assistance program, sent three patrol boats to Indonesia and in 2012 transferred 10 Japanese Coast Guard ships to the Philippines. Similarly, Australia has used the Pacific Patrol Boat Program to donate aging Australian ships to South Pacific and Southeast Asian neighbors.

One of the most difficult regional security issues is maritime territorial disputes, which are sensitive domestic political issues (but not existential interests) for all the claimants. China's efforts to use military and paramilitary means to expand its effective control of disputed territories and waters pose a challenge to key U.S. interests and principles such as peaceful resolution of disputes, respect for international law, and freedom of navigation. The United States should continue to resist pressure

to take sides in sovereignty disputes and maintain an even-handed approach. However, when countries, including China, take actions that we view as inconsistent with international law, the United States should impose costs, including via official statements, diplomatic efforts to organize opposition to illegal or destabilizing actions, and enhancing security cooperation with regional allies and partners. The United States must maintain its military capabilities and be willing to act to assert its own interest in freedom of navigation, including by military activities that challenge excessive maritime claims. If carried out on a routine basis, there will be less need to publicize each freedom of navigation operation.

Enhancing the rebalance's focus on maritime capacity-building in Southeast Asia will be an important benchmark of the next administration's commitment to regional stability and security. At the same time, given the diversity and complexity of the Asia-Pacific region, alliances and partnerships should not be viewed as being exclusively threat-centric. They can also play an important role in building regional order by strengthening cooperation in dealing with nontraditional security issues, thereby enhancing confidence among states. Efforts to work with allies and partners in enhancing regional security cooperation will strengthen U.S. political and diplomatic leadership in the region.

### **Shaping the Asia-Pacific Order**

Scholars have long argued that the Asia-Pacific region lacks the web of multilateral organizations that have facilitated European integration. Explanations for Asia's under-institutionalization include the region's economic and cultural diversity, mutual suspicions between countries, and the impact of Cold War political divisions. In 1967, the governments of Indonesia, Malaysia, the Philippines, Singapore, and Thailand came together to create ASEAN. For over two decades, ASEAN stood as the lone multilateral institution in the region. However, recent decades have seen the creation of new regional organizations and meetings that may become building blocks for a new regional order.

As the Cold War was ending in 1988, Malaysia's Prime Minister Mohammed Mahathir advanced the concept of an East Asia Economic Caucus that would exclude the United States. U.S. opposition doomed the caucus, but in 1989 Australia, with strong U.S. support, established the Asia-Pacific Economic Cooperation to advance regional trade liberalization. With the establishment of APEC, Asian multilateralism gathered momentum. In 1993, ASEAN created the ASEAN + 3 (China, Japan, South Korea) format, followed by the ASEAN Regional Forum in 1994, the East Asian Summit in 2005, and the ASEAN Defense Ministers Meeting Plus in 2010—ASEAN + Australia, China, India, Japan, New Zea-

land, the ROK, Russia, and the United States. In addition, the annual Shangri-la Dialogue sponsored by the International Institute for Strategic Studies in Singapore has served as a high-level multilateral forum for the discussion of political and security issues.

In 2008, the Bush administration appointed the first U.S. Ambassador to ASEAN, a clear recognition of the growing importance of ASEAN and of the region's expanding multilateral, diplomatic, economic, and security forums. One explicit goal of the rebalance was to increase the U.S. ability to help shape the emerging multilateral architecture in the Asia-Pacific region. The Obama administration has paid particular attention to high-level participation in the region's multilateral institutions and dialogues, with the President, Secretary of State, and Secretary of Defense regularly attending meetings in Asia. Countries across the region have welcomed the Obama administration's sustained high-level attention, but are concerned whether the next administration will place an equally high priority there. U.S. interests would be best served by continued high-level U.S. participation and active U.S. engagement in efforts to shape the regional order.

### **The Trans-Pacific Partnership**

The priority that almost all Asia-Pacific governments place on economic growth means that trade and investment agreements are a critical aspect of international relations in Asia and important building blocks for the emerging regional order. If the United States is not actively engaged, other countries will be allowed to shape regional economic rules, norms, and standards in ways that may work against U.S. interests. The centerpiece of the Obama regional economic agenda has been the Trans-Pacific Partnership, a "gold-standard" free trade agreement. Ten countries reached agreement on the deal in October 2015, but Congress will need to approve the agreement in an up-or-down vote.

Ambassador Michael Froman, the U.S. official in charge of negotiating the agreement, told a Center for Strategic and International Studies audience:

*TPP is a critical part of our overall Asian architecture. It is perhaps the most concrete manifestation of the President's rebalancing strategy toward Asia. It reflects the fact that we are a Pacific power and that our economic well-being is inextricably linked with the economic well-being of this region. . . . TPP's significance is just not economic, it's strategic—as a means of embedding the United States in the region.<sup>39</sup>*



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Similarly, Assistant Secretary of State for East Asian and Pacific Affairs Daniel Russel cast TPP as a “strategic agreement . . . the economic leg and ‘crown jewel’ of the Obama Rebalance Strategy . . . one that convincingly demonstrates that sustained engagement by the U.S, as a Pacific nation, is shaping an open, prosperous, rules-based region.” Russel went on to state, “That’s why TPP is worth as much to Defense Secretary Carter as a new aircraft carrier, as he recently said.”<sup>40</sup>

In interviews across the region over the past 2 years, political leaders, diplomats, and military officials all underscored the strategic importance of TPP as a benchmark of long-term U.S. commitment to the region and the cornerstone to securing a rules-based, open international trading order in Asia. Failure to enact TPP would be viewed as a sign of U.S. strategic withdrawal from the region. Beyond TPP, negotiations with the European Union on the Trans-Atlantic Trade and Investment Partnership (TTIP) will provide the next administration an opportunity to structure a rules-based trade and investment order that includes more than one-third of global gross domestic product. Taken together, TTIP and TPP provide the United States an opportunity to shape a rules-based international economic order that advances its long-term economic and strategic interests.

### **China Policy: Managing a Mixed Relationship**

One of the most difficult policy challenges will be dealing with China, which has the ability to affect a range of U.S. global, regional, and domestic interests. The U.S.-China relationship is marked by a mix of cooperation and competition; the policy challenge is to maximize cooperation in areas where common interests exist, while competing successfully in areas where U.S. and Chinese interests are opposed. Both countries have a strong interest in maintaining an effective bilateral working relationship in order to pursue important global, regional, and domestic goals. High-level leadership will be needed on both sides to keep the competitive and cooperative aspects of the relationship in balance.<sup>41</sup>

Cooperation is important for the United States because China has become an important global actor, with the ability to influence the effectiveness of global institutions such as the UN Security Council and World Trade Organization. On some issues, such as climate change and dealing with North Korea’s nuclear and missile ambitions, progress is impossible without cooperation with China. While Chinese leaders view some aspects of global institutions as unfair and are not interested in shoring up U.S. hegemony, they like a rules-based global economic system and view the United Nations as the most legitimate institution of global governance.<sup>42</sup> China has been one of the biggest beneficiaries of

the open global trade system established by the United States after World War II, which facilitated its economic rise. Beijing seeks to wield greater influence within global institutions, and where possible to work with other countries to adjust international rules and norms to better reflect its own interests and perspectives. Nevertheless, China remains reluctant to take on the costs, risks, and commitments necessary to play a global leadership role; its actions are usually focused on defending narrow Chinese interests rather than aspiring for global leadership. Given that China's main interest in most parts of the world is to maintain stability and secure access to resources and markets, its interests will often be relatively compatible with those of the United States.<sup>43</sup>

U.S. and Chinese interests are less aligned at the regional level, where there is increasing competition for influence. Over the last decade Beijing has become more critical of the U.S. alliance system, arguing that it reflects Cold War thinking and emboldens U.S. allies to challenge Chinese interests. The U.S. rebalance to the Asia-Pacific and increased U.S. regional security cooperation have stoked Chinese fears of U.S. encirclement or containment. Beijing's proposed alternatives emphasize nontraditional security cooperation and the importance of resolving disputes through peaceful dialogue. Beijing has resisted making any binding commitments that might restrict its military capabilities or ability to employ military power to defend its core interests. Its increasing military capabilities and more assertive approach to maritime territorial disputes have heightened regional concerns about how a strong China will behave, leading most countries to improve their security ties with the United States. If the United States emphasizes its alliances, expanding security cooperation with other partners, and active engagement with regional multilateral institutions, it will be able to deal with Chinese regional security initiatives and actions from a position of strength and successfully resist Chinese efforts to erode the U.S. alliance system.

Although cooperation with China is important, U.S. policymakers should be careful to resist Beijing's efforts to create a U.S.-China condominium or "G-2"-like arrangement. Such an arrangement would be unlikely to last and would probably require unacceptable compromises to accommodate China's so-called core interests (including accepting China's territorial claims to Taiwan and in the South China Sea and East China Sea). Accepting a Chinese sphere of influence or giving the appearance of siding with Beijing against U.S. allies would damage U.S. credibility and compromise the U.S. position in the Asia-Pacific region.

The next administration will have the opportunity to develop a new label for the U.S.-China relationship to replace Beijing's preferred formulation of a "new type of major country relationship." It will be important

to adopt a label that reflects the importance of the U.S.-China relationship but does not suggest that the United States values its relationship with China above its relationships with its treaty allies.

China's more assertive regional behavior is partly the product of misreading global power trends (including the mistaken assessment that the 2008 global financial crisis marked a fundamental shift in the relative balance of power between the United States and China). Current Chinese Communist Party efforts to tighten political control over the Chinese population and restrict the flow of information into China reflect increasing concerns about domestic stability in the face of slowing economic growth. China's successful economic model needs to be adapted to place more weight on markets and domestic demand, but there are widespread concerns that the political system may not be able to push through the necessary reforms. Moreover, past efforts to stimulate the economy in the wake of the financial crisis have created debt burdens at various levels of the Chinese financial system that increase the risk of a major financial crisis.

Although an economic collapse that brings down the Chinese regime is unlikely, the next U.S. President will likely face a Chinese leadership more focused on maintaining domestic stability and less inclined to engage in provocative international behavior. This will heighten the importance of a cooperative working relationship with the United States to give China the space to deal with its internal problems and should give U.S. policymakers more leverage. China will continue its military modernization and regional infrastructure investments through the Asian Infrastructure Investment Bank and One Belt, One Road initiative but may have fewer resources to devote to these efforts. Chinese leaders are unlikely to engage in provocative international behavior to divert attention from domestic problems but will be concerned that other countries may seek to exploit a distracted Chinese leadership.<sup>44</sup> The result may be an increased interest in stabilizing maritime territorial disputes and avoiding challenges to Chinese sovereignty claims. This approach might also spill over into more interest in engaging with the Democratic Progressive Party on Taiwan to work out an acceptable formulation for cross-strait relations.

## Conclusion

Over the next 4 years, the United States will be challenged to maintain its leadership of a rules-based order in the Asia-Pacific region. U.S. diplomacy must play a leading role in strengthening our alliances, partnerships, and regional institutions that widely share the U.S. commitment

to a rules-based order as the foundation of regional peace and stability. The engagement of the highest levels of U.S. leadership with the region will be critical. Allies, partners, and potential challengers will all judge the regular presence of the President, Secretary of State, and Secretary of Defense in the region as a key indicator of U.S. commitment.

The U.S. bilateral alliances with Australia, Japan, the Philippines, the Republic of Korea, and Thailand remain the foundation of our strategic presence in the Asia-Pacific region and need appropriate high-level attention. At the same time, the alliance structure is evolving toward a more open system, with new security partnerships forming across the region. This has been most noticeable in Southeast Asia, where Australia, Japan, and the United States are all engaged in maritime capacity-building with states bordering on the South China Sea. The United States should expand bilateral and multilateral security cooperation with its allies and partners and support their efforts to promote regional security cooperation. Given U.S.-China regional competition, initiatives from other countries may sometimes be the best means of moving forward.

The United States is best positioned to deal with China if it has devoted sufficient attention to its regional alliances, partnerships, and participation in multilateral organizations. The U.S. President will need to engage directly with his Chinese counterpart in order to keep both governments focused on a cooperative agenda and to manage the more competitive aspects of the relationship. The relationship with Beijing will be challenging, but Chinese internal economic and political problems are likely to give U.S. policymakers more leverage. Chinese leaders will remain suspicious about U.S. intentions to contain China. U.S. policymakers should stress that the United States supports open, rules-based regional and global organizations, which will require China's active participation and support if they are to achieve their goals and, at the same time, can help generate international pressure on China to be a constructive participant.

As it has since the turn of the century, U.S. trade and investment in the region will continue to expand. The U.S. economic presence is the ultimate foundation of long-term U.S. presence and commitment. Providing a rules-based order for commerce and investment and, in turn, sustained economic growth is the focus of the Trans-Pacific Partnership. Legislation to provide for U.S. accession is now before Congress. There are many competing studies on the effect of TPP on U.S. growth and employment, and political leadership will be faced with a truly historic decision in terms of U.S. participation. U.S. accession to TPP will be viewed as a test of U.S. leadership and commitment to a trade and investment rules-setting agenda.

## Notes

<sup>1</sup> The Association of Southeast Asian Nations (ASEAN) is made up of Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar (Burma), the Philippines, Singapore, Thailand, and Vietnam.

<sup>2</sup> The World Bank, “East Asia Pacific Economic Update, October 2015: Staying the Course,” available at <[www.worldbank.org/en/region/eap/publication/east-asia-pacific-economic-update](http://www.worldbank.org/en/region/eap/publication/east-asia-pacific-economic-update)>.

<sup>3</sup> U.S. Census Bureau, “Trade in Goods with Asia,” available at <[www.census.gov/foreign-trade/balance/c0016.html](http://www.census.gov/foreign-trade/balance/c0016.html)>.

<sup>4</sup> U.S. Census Bureau, “U.S. Direct Investment Abroad for 2012–2014,” September 2015, available at <[http://bea.gov/scb/pdf/2015/09%20September/0915\\_outward\\_direct\\_investment\\_detailed\\_historical\\_cost\\_positions.pdf](http://bea.gov/scb/pdf/2015/09%20September/0915_outward_direct_investment_detailed_historical_cost_positions.pdf)>.

<sup>5</sup> East-West Center, “Asia Matters for America,” available at <<http://www.asiamatters-foramerica.org/overview>>. Note that the Asia Matters for America project includes 40 countries as comprising the Asia-Pacific region.

<sup>6</sup> Walter Lohman, Olivia Enos, and John Fleming, *2014 Asia Update: What's at Stake for America*, Special Report No. 158 (Washington, DC: The Heritage Foundation, October 8, 2014), available at <[www.heritage.org/research/reports/2014/10/asia-update-whats-at-stake-for-america-2014](http://www.heritage.org/research/reports/2014/10/asia-update-whats-at-stake-for-america-2014)>.

<sup>7</sup> China's official growth statistics for 1998 and 2008 do not fully reflect this slowdown, which was partly offset by large economic stimulus packages.

<sup>8</sup> Bonnie S. Glaser, “China's Coercive Economic Diplomacy—A New and Worrying Trend,” *PacNet* 46 (Honolulu, HI: Center for Strategic and International Studies, July 23, 2012).

<sup>9</sup> Christopher Bodeen, “China's Military Spending Increase to Be Smallest in 6 Years,” Associated Press, March 4, 2016.

<sup>10</sup> State Council Information Office, “China's Military Strategy,” May 2015, available at <<http://eng.mod.gov.cn/Database/WhitePapers/>>.

<sup>11</sup> See *Annual Report to Congress: Military and Security Developments Involving the People's Republic of China 2015* (Washington, DC: Department of Defense, 2015).

<sup>12</sup> David Shambaugh, ed., *Power Shift: China and Asia's New Dynamics* (Berkeley: University of California Press, 2006); Evelyn Goh and Sheldon W. Simon, eds., *China, the United States, and Southeast Asia: Contending Perspectives on Politics, Security, and Economics* (New York: Routledge, 2008).

<sup>13</sup> See David Shambaugh, *China Goes Global: The Partial Power* (New York: Oxford University Press, 2013); Phillip C. Saunders, “China's Role in Asia: Attractive or Assertive?” in *International Relations of Asia*, ed. David Shambaugh and Michael Yahuda, 2<sup>nd</sup> ed. (Lanham, MD: Rowman and Littlefield, 2014), 147–172.

<sup>14</sup> “Remarks by President Obama to the Australian Parliament,” Canberra, Australia, November 17, 2011, available at <[www.whitehouse.gov/the-press-office/2011/11/17/remarks-president-obama-australian-parliament](http://www.whitehouse.gov/the-press-office/2011/11/17/remarks-president-obama-australian-parliament)>.

<sup>15</sup> Hillary Clinton, “America's Pacific Century,” *Foreign Policy* 189 (November–December 2011), 56–63.

<sup>16</sup> For an analysis of the origins of the rebalance, see Phillip C. Saunders, “China's Rising Power, the U.S. Rebalance to Asia, and Implications for U.S.-China Relations,” *Issues and Studies* 50, no. 3 (September 2014), 19–55.

<sup>17</sup> See the fact sheets from the U.S. Trade Representative's Office, available at <[www.ustr.gov/tpp](http://www.ustr.gov/tpp)>; Jeffrey Schott, Barbara Kotschwar, and Julia Muir, *Understanding the*

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<sup>18</sup> Ashton Carter, "Remarks on the Next Phase of the U.S. Rebalance to the Asia-Pacific," McCain Institute, Arizona State University, Tempe, AZ, April 6, 2015, available at <[www.defense.gov/News/Speeches/Speech-View/Article/606660](http://www.defense.gov/News/Speeches/Speech-View/Article/606660)>.

<sup>19</sup> For a recent overview of these activities, see Admiral Harry B. Harris, Jr., commander, U.S. Pacific Command, statement before the Senate Armed Services Committee hearing on U.S. Pacific Command Posture, February 23, 2016, available at <[www.armed-services.senate.gov/imo/media/doc/Harris\\_02-23-16.pdf](http://www.armed-services.senate.gov/imo/media/doc/Harris_02-23-16.pdf)>.

<sup>20</sup> For the Japanese position, see Ministry of Foreign Affairs of Japan, "Fact Sheet on the Senkaku Islands," November 2012, available at <[www.mofa.go.jp/region/asia-paci/senkaku/fact\\_sheet.html](http://www.mofa.go.jp/region/asia-paci/senkaku/fact_sheet.html)>; for the Chinese position, see State Council Information Office, "Diaoyu Dao, an Inherent Territory of China," September 2012, available at <[http://news.xinhuanet.com/english/china/2012-09/25/c\\_131872152.htm](http://news.xinhuanet.com/english/china/2012-09/25/c_131872152.htm)>.

<sup>21</sup> Japan Ministry of Defense, available at <[www.mod.go.jp/e/publ/w\\_paper/pdf/2014/DOJ2014\\_3-1-1web\\_1031.pdf](http://www.mod.go.jp/e/publ/w_paper/pdf/2014/DOJ2014_3-1-1web_1031.pdf)>.

<sup>22</sup> *National Security Strategy* (Tokyo: Ministry of Defense, December 17, 2013), 1, available at <[www.cas.go.jp/jp/siryu/131217anzenhoshou/nss-e.pdf](http://www.cas.go.jp/jp/siryu/131217anzenhoshou/nss-e.pdf)>.

<sup>23</sup> See *Annual Report to Congress 2015*.

<sup>24</sup> For an analysis of future scenarios, see Phillip C. Saunders, James J. Przystup, and David F. Helvey, "North Korea 2025: Alternate Futures and Policy Challenges," CSCMA Event Report, February 2, 2016, available at <<http://inss.ndu.edu/Portals/82/Documents/conference-reports/2015-Korea-Symposium-Event-Report.pdf>>.

<sup>25</sup> Alan D. Romberg, "The '1992 Consensus'—Adapting to the Future?" *China Leadership Monitor*, no. 49 (Winter 2016), available at <[www.hoover.org/sites/default/files/clm49ar.pdf](http://www.hoover.org/sites/default/files/clm49ar.pdf)>.

<sup>26</sup> ASEAN, "Declaration on the Conduct of Parties in the South China Sea," November 4, 2002, available at <[www.asean.org/?static\\_post=declaration-on-the-conduct-of-parties-in-the-south-china-sea](http://www.asean.org/?static_post=declaration-on-the-conduct-of-parties-in-the-south-china-sea)>.

<sup>27</sup> See Christopher D. Yung and Patrick McNulty, *An Empirical Analysis of Claimant Tactics in the South China Sea*, INSS Strategic Forum 289 (Washington, DC: NDU Press, August 2015).

<sup>28</sup> *Ibid.*

<sup>29</sup> *Asia-Pacific Maritime Security Strategy* (Washington, DC: Department of Defense, August 21, 2015), available at <[www.defense.gov/Portals/1/Documents/pubs/NDA4%20A-P\\_Maritime\\_Security\\_Strategy-08142015-1300-FINALFORMAT.PDF](http://www.defense.gov/Portals/1/Documents/pubs/NDA4%20A-P_Maritime_Security_Strategy-08142015-1300-FINALFORMAT.PDF)>.

<sup>30</sup> *Ibid.*

<sup>31</sup> "Foreign Ministry Spokesperson Lu Kang's Regular Press Conference on October 27, 2015," Ministry of Foreign Affairs of the People's Republic of China, October 27, 2015, available at <[www.fmprc.gov.cn/mfa\\_eng/xwfw\\_665399/s2510\\_665401/t1309625.shtml](http://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/t1309625.shtml)>.

<sup>32</sup> *Asia-Pacific Maritime Security Strategy*.

<sup>33</sup> In Japan, North Korea's growing missile arsenal raises similar questions regarding missile defense and deterrence.

<sup>34</sup> Brad Roberts, *Extended Deterrence and Strategic Stability in Northeast Asia*, NIDS Visiting Scholar Paper Series, No. 1 (Tokyo: National Institute for Defense Studies, August 9, 2013), available at <[www.nids.go.jp/english/publicationvisiting/pdf.01.pdf](http://www.nids.go.jp/english/publicationvisiting/pdf.01.pdf)>.

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<sup>35</sup> Chang Se-jeong and Ser Myo-ja, “Xi Pressed Park on Thaad System,” *Korea JoongAng Daily*, February 6, 2015, available at <<http://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3000595>>.

<sup>36</sup> Available at <[www.gov.ph/2014/04/29/document-enhanced-defense-cooperation-agreement](http://www.gov.ph/2014/04/29/document-enhanced-defense-cooperation-agreement)>.

<sup>37</sup> “Resourcing the Pivot to East Asia and the Pacific FY 2015 Budget Priorities,” May 20, 2014, House of Representatives Subcommittee on Asian and Pacific Affairs, Committee on Foreign Affairs, 4.

<sup>38</sup> “Fact Sheet: U.S. Building Maritime Capacity in Southeast Asia,” available at <[www.whitehouse.gov/the-press-office/2015/11/17](http://www.whitehouse.gov/the-press-office/2015/11/17)>.

<sup>39</sup> Remarks by Ambassador Michael Froman at the Center for Strategic and International Studies, Asia Architecture Conference, September 22, 2015, Washington, DC.

<sup>40</sup> Remarks of Daniel Russel, Assistant Secretary of State, Bureau of East Asian and Pacific Affairs, at the Asia Society, New York City, November 4, 2015.

<sup>41</sup> See Phillip C. Saunders, *Managing Strategic Competition with China*, INSS Strategic Forum 242 (Washington, DC: NDU Press, July 2009).

<sup>42</sup> Thomasingar, “China’s Vision of World Order,” in *Strategic Asia 2012–2013: China’s Military Challenge*, ed. Ashley J. Tellis and Travis Tanner (Washington, DC: National Bureau of Asian Research, 2012), 342–373.

<sup>43</sup> Phillip C. Saunders, “Implications: China in the International System,” in *The Chinese People’s Liberation Army in 2025*, ed. Roy Kamphausen and David Lai (Carlisle Barracks, PA: Strategic Studies Institute, 2015), 301–333.

<sup>44</sup> John Speed Meyers and Phillip C. Saunders, “Will China Start a Diversionsary War?” unpublished manuscript, April 2015.