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Securing a high-standard Indo-Pacific economic architecture

Briefing note for the United States-Australia Indo-Pacific Cooperation Dialogue, 26 January 2018

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Executive Summary

- Economic regionalism in the Asia is in flux. Since 2010, a variety of new multilateral initiatives have attempted to geographically and functionally reconfigure the regional economic architecture.
- A high-standard, US-Australia-Japan-backed 'Indo-Pacific' model for regional integration currently competes with a minimalist and China-led 'Asian' alternative.
- Since the Trump Administration took office in 2016, the US has ceased to be an active player in this architectural contest. The prospects for the high-standard model have suffered as a result.
- Given the longstanding importance of US leadership for Asia, this poses the risk that a sub-optimal, if not wholly-adverse, regional economic architecture may emergence in its absence.
- For members of the high-standard coalition, strategies must be developed and enacted now to mitigate these risks. These will ensure they retain the capacity to shape the newly-emerging regional economic architecture.

The contested economic architecture of the Asia/Asia-Pacific/Indo-Pacific region

The Asia economic architecture is undergoing a process of reconfiguration. For much of the early 2000s economic cooperation efforts in Asia was bilateral, dominated by the negotiation of over 100 bilateral free trade agreements. But since 2010, a diverse set of new multilateral economic initiatives have been launched by regional governments. These promise an architectural shift for the Asian economic region, under which multilateral rather than bilateral institutions are used to liberalise trade, facilitate investment, and advance regulatory rule-making.

However, these multilateral initiatives are qualitatively differentiated, and can be classified into two broad models. One is a higher-standard model, which seeks to advance economic integration through the making of new regulatory rules in areas traditionally excluded from the WTO (such as investment, services, and IP). This model is backed by the US and the higher-income economies in Asia, and has an open membership approach targeted at all countries of the Indo-Pacific. The other is a lower-standard model, which instead uses traditional methods – tariff reduction and investment promotion – to foster greater regional economic integration. This model is favoured by China, India, and the lower-income members of ASEAN, and uses closed groups centred on the ASEAN+3 or +6. The table below summarises the principal features, and key multilateral institutions, of these two economic integration models.

Competing models for multilateral economic integration in Asia, early 2018

		High-standard model	Low-standard model
Features	Liberalisation strategy	"21st century" approach via new regulatory rule-making in investment, services, IP, labour, environment, etc	'Traditional' approach using existing liberalisation methods (tariff reduction and investment promotion)
	Principal supporters	Australia, Japan, Korea, US, higher-income ASEANs	China, India, lower-income ASEANs
	Geographic scope	Open regionalism, typically for all in 'Indo-Pacific' on voluntary opt-in	Closed regionalism, typically on ASEAN-Plus-X basis
Institutions	Economic diplomacy	Asia-Pacific Economic Cooperation, Indian Ocean Rim Association	ASEAN-Plus-X sectoral dialogues
	Trade and investment	Trans-Pacific Partnership (TPP-11 since February 2017)	Regional Comprehensive Economic Partnership
	Development financing	Asian Development Bank, World Bank, OECD-DAC aid agencies	Asian Infrastructure Investment Bank, Chinese non-OECD-DAC agencies
	Infrastructure and connectivity	Partnership for Quality Infrastructure (Japan/ADB)	Belt and Road Initiative (China)

These models are inherently competitive: while both promise multilateral strategies for economic integration, they have divergent objectives, include different memberships, and offer distinct intergovernmental institutions. This competition reflects two 'regional divides' that characterise contemporary Asia. The first is an *economic divide* that partitions the region by development level, with higher-income countries favouring ambitious liberalisation strategies and lower-income ones more conservative traditional methods. The second is a *geostrategic divide*, which separates the US and those allied or aligned with it from China and its informal clients. Importantly, these economic coalitions are only loosely organised at present, and many key players – including India, Indonesia, Malaysia and Vietnam – are yet to commit decisively to either approach.

US regional economic leadership: From the Pivot/Rebalance to 'America First'

Since the end of the Cold War, the US has played an important leadership role in economic regionalism in Asia. The Pivot/Rebalance to Asia policy of the Obama Administration intensified this trend. Particularly significant was the Trans-Pacific Partnership (TPP), which was widely labelled the 'economic wing' of the Pivot. Beyond the particular rules which it sought to advance, the TPP also signalled to regional governments – including both friends and rivals – that the US was committed to both security and economic leadership in Asia, and would use its soft and hard power resources to advanced rule-making and institution building.

The Trump Administration has brought most forms of economic engagement, let alone leadership, to an end. Withdrawal from the TPP significantly compromised efforts to create new trade and investment rules, and the remaining members have since struggled to find consensus on a way forward for the agreement.

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Explicit threats against NAFTA do not directly harm Asian partners, but have stoked fears the US may use coercive trade diplomacy even against its friends. The vaguely-defined 'America First' trade policy excludes participation in nearly all regional trade agreements, as few are likely to deliver the desired trade surpluses to the US given existing patterns of comparative advantages. The Trump Administration has yet to substantively execute the trade threats promised against China during the 2016 campaign; but if this does occur will further diminish regional perceptions of the US as a responsible economic partner.

Like-minded countries have attempted to sustain momentum behind the high-standard model in the US's absence. The most visible were efforts to secure a 'TPP-11' agreement during 2017. Unfortunately, these efforts failed in the face divisions amongst the remaining group members. Without the anchoring provided by the US – whose economy accounted for two-thirds of the TPP bloc – it proved impossible to secure consensus behind a set of high-ambition regulatory reforms. The precise cause of the TPP-11 failure, and prospects for success if re-attempted in 2018, remain a matter of debate. But the unequivocal message is that the high-standard model will face considerably tougher challenges absent US leadership.

In the meantime, efforts to realise the lower-standard model continue apace. China has seized upon the election of the Trump Administration to make a renewed bid for economic leadership, declaring itself to be the new leader of globalisation and economic openness in the region. Negotiations for the RCEP agreement are ongoing, and despite roadblocks from India did gather pace in 2017. The Asian Infrastructure Investment Bank (AIIB) continues to grow its membership, technical capacity and loan portfolio. Belt and Road Initiative (BRI) investments continue to accrete: by one count[1], there are now 95 individual projects stretching from Russia to the Middle East and Central Europe. China is also in a leading position to link the BRI to sub-regional integration initiatives, such as the *Masterplan on ASEAN Connectivity* and *Greater Mekong Subregion* project.

Economic regionalism without US leadership? Short, medium and long-term risks

For the first time in three decades, the US is not an active player in discussions over regional economic integration in Asia. Yet its withdrawal comes at the very time when the regional economic architecture is changing most dramatically. For likeminded partners such as Australia, Japan, Korea and Singapore, US absence poses three risks:

In the short-term, there is a risk that in-train initiatives fail to either gain traction or make progress. The experience of the TPP-11 in 2017 illustrates this possibility. But other less-prominent, yet equally important, initiatives may suffer the same difficulties. Japan's recently announced Free and Open Indo-Pacific initiative, reinvigorated efforts to fund infrastructure connectivity in a *transparent* and *good governance* manner through the ADB and World Bank, and the ongoing regulatory and policy dialogues managed by APEC, may also face stiffer headwinds. Without the soft leadership and hard material resources provided by the US, remaining members of the high-standard coalition have less capacity to advance their preferred model.

[1] As per Centre for Strategic and International Studies' *Reconnecting Asia* Database: https://reconnectingasia.csis.org/

In the medium-term, there is a risk that 'undecided' countries may decide to favour the lower-standard model. The middle-income ASEAN members – Malaysia, Indonesia and Vietnam – are particularly relevant. These governments have offered qualified support to the high-standard model, and have anxieties over the geostrategic implications that excessive dependence on China and its BRI may pose. Yet they are also clearly frustrated by the US abandoning efforts it had spent several decades promoting; and see Trump's unilateral threats against NAFTA and China as evidence of a more coercive US approach to economic diplomacy. If these countries are back the China model from frustration and/or fear, they may be lost to the coalition supporting high-standard economic reform.

In the long-term, it is possible that the lower-standard alternative will take root and become the new regional economic architecture. The BRI is already transforming connectivity on the ground throughout the region, and is unlikely to slow given the large financial and political investments being made by the Xi Administration. If RCEP is completed and establishes the region's first genuinely multilateral trade system, it will be much harder to make the case for a TPP-style agreement with fewer members and higher accession costs. China retains a 'governance veto power' within the AIIB, and in future years could use its financial leverage to transform the institution into something more akin to a Chinese-style policy bank. First-mover advantage applies to international institutions. If these low-standard designs are established and become architectural, institutional lock-in will make it much harder for high-standard institutions to succeed.

In early 2018, these risks remain just that – risks. Medium- and longer-term risks will take time to be realised, while the short-term costs incurred during 2017 can still be mitigated. Governments, policy-makers and businesses from the high-standard coalition now have an opportunity to develop and enact strategies that ameliorate, manage, and potentially neutralise adverse outcomes. While uncertainty means the ideal form for such strategies remains a matter of debate, it is imperative that steps are taken now to ensure Australia, the US and likeminded partners can shape the newly-emerging Asian economic region.

Questions for discussion

- What is the best way to advance the "TPP model" in the absence of the US?
  - Is the TPP-11 proposal politically and/or economically viable?
  - In light of the challenges revealed at APEC 2017, is it preferable to compromise on TPP rules, or to maintain the original design and 'wait' for the US to re-engage?
- Who comprises the group – beyond Australia, Korea, Singapore and Japan – that might support a high-standard model for regional economic integration?
  - How can a political coalition be created and sustained that includes them?
  - How can the concerns of undecided players – such as Malaysia, Indonesia and Vietnam – be assuaged?
- How do we respond to Chinese initiatives such as the BRI, AIIB and RCEP?
  - What level and type of engagement is appropriate?
  - How can the terms for such conditional engagement be communicated?