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The Future of Trade Diplomacy in East Asia

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EXECUTIVE SUMMARY

- As President Donald Trump withdraws the US from the TPP, the ASEAN-led RCEP receives attention as a significant alternative.
- While Washington is likely to adopt bilateral trade diplomacy to match its immediate domestic interests, its decision to retreat from TPP may serve China's strategic interest in accelerating RCEP talks and promoting the FTAAP as the trade architecture of the future.
- However, China's strategic gain is not completely straightforward. RCEP has many hurdles to cross yet and an FTAAP within the APEC framework is unlikely to come to fruition anytime soon. Beijing may therefore pursue FTAAP on a bilateral basis and develop it within the context of its own Belt and Road Initiative.
- The general interest among ASEAN countries lies in pursuing a cooperative relationship both with the US and China. In the absence of the TPP, these countries may consider bilateral trade pacts with the US while pushing for a conclusion to RCEP negotiations in 2017.

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INTRODUCTION

On 23rd January 2017, President Donald Trump signed the executive order to withdraw the US from the Trans-Pacific Partnership (TPP), a 12-nation trade pact led by the US since 2010 and signed in February 2016.¹

Over the last few years, the TPP was negotiated in parallel with another trade pact, the Regional Comprehensive Economic Partnership (RCEP), which is spearheaded by ASEAN. Separately from these, China, during its Asia-Pacific Economic Cooperation (APEC) chairmanship in 2014, promoted the Free Trade Area of the Asia-Pacific (FTAAP) and launched its own Belt and Road Initiative (BRI).

Both the RCEP and FTAAP are often billed as China-led processes and are seen as counteracting initiatives to the TPP. Now with the demise of the 12-member TPP, attention is shifting to the other two trade deals. Chinese President Xi Jinping both during the APEC Summit of 2016 and the World Economic Forum (WEF) Annual Meeting in 2017, proposed an early conclusion to RCEP negotiations and the realisation of an FTAAP.²

This paper discusses the possible path of US trade diplomacy under the Trump presidency, the challenges facing RCEP and China taking the lead in Asia-Pacific regional economic cooperation, and concludes with a discussion on the implications of these for ASEAN states.

TRUMP'S TRADE DIPLOMACY

Over the last few years, the US has been working hard using the TPP to make its mark in writing international trade rules. It marketed the agreement as a 21st Century trade deal covering issues going far beyond market access. It advocated not just free trade but also a fairer one with labour and environment standards, discipline over state-owned enterprises, stricter intellectual property rights enforcement, and a free and open internet.

The TPP was the core strategy of the Obama administration's 'pivot to Asia'. According to the previous Defence Secretary Ash Carter, besides boosting US exports, the TPP would strengthen Washington's influence in the Asia-Pacific and signal its commitment to the region.³ For many, the deal's strategic value was in constraining China's economic rise or at least in ensuring that it adhered to established trade rules.

¹ <http://www.straitstimes.com/world/united-states/trump-moves-to-withdraw-us-from-tpp-deal-on-day-1>

² <https://www.weforum.org/agenda/2017/01/full-text-of-xi-jinping-keynote-at-the-world-economic-forum>

³ US leaving TPP: A great news days for China, BBC, 22 Nov 2016 (<http://www.bbc.com/news/world-asia-china-38060980>)

During the US electoral campaign in 2016, however, both the major candidates went against the deal. While the Republicans' Donald Trump called TPP a disaster and accused it of reflecting interests of a small group, Democrat Hillary Clinton blamed TPP of falling short of its promised high standards. TPP opponents saw the pact as an avenue for American firms to shift jobs overseas or, conversely, to keep wages low in the US manufacturing sector.

Soon after the election, President-elect Donald Trump communicated his intent to pull out of the pact on his first day in office.⁴ After his inauguration as the 45th US President on 20 January 2017, he did indeed withdraw the US from the TPP deal.

This does not mean that the US will completely close down its border on international trade. President Trump has categorically stated his wish to renegotiate the North American Free Trade Agreement (NAFTA) involving the US, Canada and Mexico.⁵ He has also mentioned that he will 'negotiate fair bilateral trade deals that bring jobs and industry back' to his country.⁶ Trade pundits have often argued that bilateral trade deals are easy to negotiate and can more closely and immediately match a country's domestic interests.

Bilateral trade deals between the US and the Asian countries are currently limited to Australia, South Korea and Singapore and this is likely to pick-up steam. New Zealand, Malaysia and Japan have already expressed their intention to sign bilateral trade pacts with the US. It should not be surprising if the US and China decide to negotiate a bilateral trade agreement. The possibility of this happening already surfaced in the media soon after the US election.⁷ Although Trump has threatened to punish Beijing for unfair trade practices, he may not completely follow through on it since a trade war between the US and China will hurt both, with the US being more affected. Alternatively, both countries may sit down to iron out their differences over border tariffs and investment issues and also work out how China can compensate the US for the latter's growing trade deficit.

Meanwhile, there are discussions going on that the TPP will move ahead without the US and will do so under Japanese and Australian leadership.⁸ However, amendments to the enactment rules will be needed if US participation is out of the question.⁹ In addition, the

⁴ Trump to withdraw from Trans-Pacific Partnership on first day in office, The Guardian, 22 November 2016

⁵ <http://edition.cnn.com/2017/01/22/politics/trump-renegotiate-nafta/>

⁶ <https://www.theguardian.com/us-news/2016/nov/21/donald-trump-100-days-plans-video-trans-pacific-partnership-withdraw>

⁷ <http://english.caixin.com/2016-11-22/101010105.html>; <https://www.cnbc.com/2016/11/22/the-end-of-tpp-could-herald-a-new-era-in-us-china-relations.html>

⁸ <http://www.straitstimes.com/world/tpp-leaders-meet-to-see-ways-forward-on-landmark-trade-deal>

⁹ The current form of TPP requires that no fewer than six members representing at least 85% of the pact's total GDP ratify it in their legislatures before implementation. As the US accounts for 57% of the combined GDP, Washington's consent is essential.

11 remaining members may revisit some of the provisions to make up for the loss of the US market access.

CHALLENGES TO THE RCEP

Amid the growing uncertainties around TPP, attention has shifted to the RCEP as a significant alternative. The RCEP was initiated by ASEAN in 2012 as a comprehensive FTA. From the beginning, it was said to improve on the existing ASEAN+1 FTAs, covering regular trade issues.¹⁰ The agreement promised to take into account the development stages of negotiating members, which led many to believe that the RCEP will not meet the level of standards included in the TPP and hence will be a low-quality FTA.¹¹

By the end of 2016, 16 rounds of RCEP negotiations had been carried out with two chapters concluded on small and medium enterprises and technical cooperation. Most of the other chapters continue to face hurdles. For example, in trade in goods, the proportion of products that will be included in the agreement is not yet finalised. Anything between 80 to 92 per cent seems plausible.¹² ASEAN's proposal of 92 per cent has met resistance from countries that have growing trade deficits with China. Moreover, India is pitching for simultaneous negotiation of trade in goods and services, which would slow things down given the complexities in the services sector and related regulations.¹³

For the investment chapter, the issue of investor-state dispute settlement (ISDS) remains controversial concerning the right of private sector actors to file lawsuits against a state. It has been reported that there are currently 50 lawsuits worth US\$31 billion pending at international arbitration tribunals against the governments that are participating in RCEP negotiations.¹⁴ India, Indonesia and Australia wish for the ISDS mechanism to be reconsidered before discussions take place about the rights of investors. Similarly, the IPR chapter is a contentious one as some members are demanding for data exclusivity, which is likely to delay regulatory approval for medicines that go off-patent. A provision like this goes beyond the WTO agreement on Trade-Related Aspects of IPR (TRIPS) and is problematic for less-developed countries that are dependent on accessibility of affordable medicines.

¹⁰ RCEP involves 10 ASEAN members and Australia, New Zealand, China, India, Japan and South Korea. The latter six have FTAs with ASEAN as a region. Trade issues include: trade in goods, services, investment, intellectual property rights, competition policy and technical cooperation

¹¹ <https://www.adb.org/news/op-ed/will-asias-largest-fta-make-difference-jayant-menon>

¹² <http://www.bworldonline.com/content.php?section=Economy&title=rcep-countries-seek-free-trade-in-up-to-92%25-of-all-product-types&id=137426>

¹³ <http://economictimes.indiatimes.com/news/economy/foreign-trade/india-for-parallel-talks-on-goods-services-at-rcep-nirmala-sitharaman/articleshow/55545172.cms>

¹⁴ <https://www.tni.org/en/publication/the-hidden-costs-of-rcep-and-corporate-trade-deals-in-asia>

There are also concerns voiced by around 300 civil society organisations, as they worry over the import of TPP formulations into the RCEP agreement. This has been possible since seven of the RCEP members are also part of the TPP deal. It is feared that since all RCEP members are developing economies, complying with rules similar to those found in the TPP will be very difficult for them.

Despite the challenges, the negotiating parties are optimistic that the negotiations will likely conclude by the end of 2017. The media have repeatedly portrayed China in a leadership role in RCEP and both during the 2016 APEC Summit and the 2017 World Economic Forum Annual Meeting, President Xi Jinping has called for an early conclusion to the negotiations. However, much will depend on the participating countries' success in reconciling the divergent interests over the services, ISDS and IPR chapters, to name a few.

STRATEGIC OPENING FOR CHINA

Since the early 2000s, China, in commensuration with its economic rise, has been signing FTAs with its neighbours, including ASEAN. This had a domino effect, and other Asian economies – Japan, South Korea, India, Australia and New Zealand – followed suit and entered into trade pacts with ASEAN as a region. Building on these smaller regional FTAs, these same countries began promoting Asia-wide pacts that are either led by China such as ASEAN+3 or by Japan and few others such as ASEAN+6. This eventually resulted in RCEP.¹⁵

However, the US was missing from these critical trade policy decisions. Although aware of the booming economies of the East, it was unable to institutionalise much of its trade relations with the region,¹⁶ mainly because Washington has a national mandate only to sign FTAs that are of high standard. This implies that the US cannot adopt an FTA partner that follows unfair treatment of workers or relies on environment degradation to generate comparative advantage in exports. This, in turn, means that Washington cannot match Beijing's economic diplomacy. And so, Washington had tried to remedy its strategic absence from Asia through the TPP, which involved four ASEAN members and three others from Asia.

But now with US' withdrawal from the TPP, China has better leeway for promoting its preferred trade agendas. The RCEP process is one priority. Beijing has been an important member of the RCEP since the beginning and has repeatedly lobbied for an early conclusion to the negotiations. It should be noted however that Beijing is not driving the RCEP agenda.

¹⁵ RCEP is seen as a compromise between ASEAN+3 (+ China, South Korea and Japan) arrangement, led by China, and ASEAN+6 (additional India, Australia and New Zealand) arrangement led by Japan and few ASEAN countries.

¹⁶ The US could conclude bilateral FTAs with advanced economies of Asia, such as Singapore, South Korea and Australia.

It is ASEAN that is leading the negotiations, and since the RCEP includes big economies such as India and Japan, the risk of Beijing becoming the dominant partner is limited.

Then there is the FTAAP process. The FTAAP, originally conceived within APEC in 2006, was given renewed attention in 2014 when China, during its APEC chairmanship, placed emphasis on FTAAP and persuaded the members to undertake a strategic study of the issue. The study was concluded in 2016 under the joint leadership of Beijing and Washington.

President Xi at the 2016 APEC CEO Summit remarked that FTAAP ‘is a strategic initiative critical for the long-term prosperity of the Asia-Pacific.’ He further said that ‘we should firmly pursue the FTAAP as an institutional mechanism for ensuring an open economy in the Asia-Pacific’.¹⁷ However, as with the RCEP, the FTAAP under an APEC framework involves many other economies, including the US and Japan, and these will doubtless resist China’s wish to set the agenda.

Further concerns remain about how the FTAAP will be pursued in the future. It is highly likely that while APEC will continue to function as an incubator for the FTAAP, eventual negotiations are bound to be carried out outside its structure. This is because of the way the organisation functions: APEC is an inter-governmental economic and trade forum and discusses elimination of trade and investment barriers without requiring its members to enter into legally binding commitments.

The timing for FTAAP negotiations remains uncertain. It is not likely to materialise soon in a form involving both the US and China. The current US President has repeatedly flagged his distaste for regional trade deals and is unlikely to work towards garnering domestic political support for the FTAAP.¹⁸

One possible path through which the FTAAP can develop is through a series of bilateral FTAs that China enters into. The country already has bilateral FTAs with 13 of the 21 APEC economies and is presently negotiating a bilateral investment treaty with the US. As mentioned earlier, a bilateral trade deal between Washington and Beijing should not be altogether disregarded. China already has a regional FTA with ASEAN. Hence, in the event of difficulty in concluding RCEP negotiations and US’ prolong absence from regional economic activities, China may work for an FTAAP by aggregating its bilateral trade deals.

In his keynote address at the APEC CEO Summit in 2015, President Xi also linked open and integrated economies to an increased connectivity, thereby implying that while FTAAP is essential for reducing policy barriers to international trade and investment, the Belt and Road Initiative (BRI), a connectivity agenda propagated by China since 2014, is important for facilitating the movement of goods, services and people.¹⁹ The BRI agenda is also well-supported by the related financing mechanism of the Asian Infrastructure Investment Bank

¹⁷ http://www.china.org.cn/world/2016-11/20/content_39745443.htm

¹⁸ The Political Economy of the Asia-Pacific, Vinod Aggarwal, Business Asia, Volume 14, Issue 2

¹⁹ <http://thediplomat.com/2015/11/as-tpp-leaders-celebrate-china-urges-creation-of-asia-pacific-free-trade-area/>

(AIIB). Both BRI and the AIIB do not include the US at the moment. BRI encompasses around 60 economies from Asia and Europe and has a combined GDP of US\$21 trillion, and the AIIB has attracted 57 members since its inception. The idea of BRI is still evolving and tries to improve trade facilitation measures and policy coordination, in addition to physical connectivity.

That said, it remains to be seen how China uses the present strategic opening that it has to its advantage. It can play a constructive role in concluding RCEP negotiations and thus emerge as a responsible world leader, or it can put in place building blocks of bilateral FTAs, and then aggregate them into a regional FTAAP. The latter approach fits well with its BRI initiative, which, though a regional plan, is currently being pursued through bilateral arrangements.

CONCLUSION – TRADE DIPLOMACY IMPLICATIONS FOR ASEAN

Since 2010, both the TPP and the RCEP have created immense hype as frameworks for Asia-Pacific integration. Besides their economic importance, they were seen as the strategic tools of trade diplomacy of Washington and Beijing, respectively. They were also viewed as pathways to FTAAP, implying that both the US and China would play their part in setting the future trade rules in the region.

However, the policy landscape changed dramatically in 2016 and in early 2017 the Trump administration, fed by the hostility of voters towards trade deals and globalisation, withdrew the US from TPP. This brings into focus the future course of US trade diplomacy, which, based on current indications, seems to be bilateral in nature. The uncertainties around TPP triggered speculations on China's subsequent actions to push for regional integration. During the 2016 APEC Summit and the 2017 WEF Annual Meeting, China remarked on accelerating RCEP negotiations and emphasized the need for an FTAAP. However, it is highly unlikely that Beijing can drive the RCEP and FTAAP agendas. RCEP is officially led by ASEAN and both the trade pacts include members that may hinder China from dominating negotiations. Alternatively, China has its own integration measure of BRI, which along with the AIIB and bilateral FTAs, may serve as effective tools of strategic influence in the region.

For small ASEAN countries, their interests lie in pursuing a cooperative relationship with both the US and China, i.e. both RCEP and TPP are welcome. However, with the demise of the 12-member TPP pact, the countries are weighing the reliability of American and Chinese pledges. As Singapore Prime Minister Lee Hsien Loong mentioned during his Washington visit in August 2016, the TPP puts America's 'reputation on the line' with its partners in the

region.²⁰ He reiterated similar points in an interview with Times Magazine in October.²¹ Quitting the TPP, in other words, undermines US leadership in Asia.

ASEAN countries are also caught in the dilemma of whether or not to continue with the TPP as an 11-member trade deal and undertake domestic reforms accordingly as earlier planned or to completely support China in building an Asia-Pacific trade order. Worries about China's economic expansive may encourage some ASEAN countries to seal bilateral trade deals with the new US administration.²² This will align with Trump's interest as well.

Although many stumbling blocks are still in the way, ASEAN will push for a conclusion to RCEP negotiations in 2017, leveraging on China's supportive mood. It will try for an early conclusion to avoid Beijing going ahead with its own bilateral deals as a pathway to a future FTAAP. Moreover, ASEAN would like to finalise RCEP during its 50th anniversary.

It is highly likely that ASEAN will strive for a better quality trade pact in the absence of the TPP. As seven of the TPP members are also in RCEP, there is a possibility that some of these countries may push for conditions in the RCEP which are already finalised under the TPP.

This will lead to an improved trade pact that can facilitate the formation of a comprehensive FTAAP.

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²⁰ Obama, Singapore Prime Minister Lee Hsien Loong Vow to push for Trade Pact, The Wall Street Journal, 2 August 2016, (<http://www.wsj.com/articles/obama-to-host-singapore-prime-minister-lee-hsien-loong-for-state-visit-1470144045>)

²¹ Singapore's Lee Hsien Loong on the US election, Free trade and why Government isn't a startup, Time, 26 October 2016 (<http://time.com/4545407/lee-hsien-loong-singapore-globalization/>)

²² <http://www.nst.com.my/news/2017/01/206006/malaysia-may-look-bilateral-ftas-tpp-members-mustapa>