

The New Geopolitics of Northeast Asian Regional Integration

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It's a great honor to be here. This is a very important region, and a very important conference on that region. I will try to provide a summary about how the events that are underway in the United States are affecting the region and what its responses might be to some of these trends.

Northeast Asia is very important. It is bound to become, over the next few decades—and already is in many ways—the world's most important zone of production and of innovation. If Northeast Asia works well, and if its economies are closely connected, they will be very productive. Relations among them will tend to be peaceful and they will have great bargaining power in their relationships with the rest of the world. Therefore, this conference about Northeast Asian economic integration is indeed very important.

I've been following the progress of Northeast Asia since 1976, which is when I completed my PhD thesis on trade between the United States and Japan. That was 42 years ago, and there has been a huge difference in how the world has since changed. We today have very strong economies in this region: not just Japan of course, but also the ROK, China, and increasingly Russia. There is high trade and investment, and by and large the relationships in the region have been peaceful, albeit from time to time tense. Supply chains have become ubiquitous. They connect industries across these countries, and many more. There has even been some slow progress toward building institutions to connect the economies of the region. I'm specifically thinking of the two important trade agreements that Mr. Kiribe mentioned a few minutes ago, the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP). In the former case, the Trans-Pacific Partnership connects Asian countries as well as countries on the other side of the Pacific. In the case of RCEP, the focus is primarily on East Asia and South Asia. In fact, over the last few years, I've done a lot of research on the Trans-Pacific Partnership, actually working with the governments

in the United States, and to some extent in Japan, to try to understand what the implications of it might be, and how it might benefit all of the economies involved.

Over the last year, there has been more change, and more dramatic and unexpected change than I think any of us working on the economics of this region would have expected. Most of that change has to do with the sudden reversal of the position of the United States toward trade in general, and trade with the countries in this part of the world specifically. The United States has withdrawn from the Trans-Pacific Partnership which it had led for approximately eight years. It has threatened very high tariffs on Japanese, Chinese, and ROK products, and has essentially declared protectionism as its main objective. It has essentially said that America First takes priority over the international relationships which the United States had tried to build over the previous 70 years. That's what my talk is about: What is actually happening today after these big reversals in statements, and what are the implications for Northeast Asia?

We are living in the Trump era, suddenly and unexpectedly. What does that really mean? Well, first of all it means an enormous amount of confusion. And this is not just confusion for the rest of the world, this is confusion for Americans also, including those who have been very closely involved with policymaking in the United States in recent years. Confusion means that sometimes the President will say one thing only to reverse himself later. Sometimes the President will say one thing and his Secretary of State will say the opposite. Just last week, there was a remarkable event in which the Secretary of the Treasury said, "Well a weak dollar is very good for the United States," and then two days later the President said, "No, we want to make sure that the dollar remains strong." There's a great deal of confusion and, as we've heard, the importance of predictability is critical to financing and to investment, and essentially what we have now is policy which is very difficult to predict. Having said that, if

one looks at the actual actions that the government has taken—and I will give more examples of this later—the actual actions have been much less chaotic and uncertain than the statements about them.

The last point that I'd like to make about what is happening now is that the present situation is not likely to go away quickly. First of all, the President is president, and is likely to remain so for several more years, and he's not likely to change the way he behaves.

Second, even if the Democratic Party were to take over from the current Republican Party, it's not clear that the effects on international relations, and particularly trade, would be very different. The United States today is very divided. It has a nationalist-right power center, which is represented by the President. It has a nationalist-left power center, which is represented by people like Bernie Sanders, who was a very effective campaigner in the last election. Then there are the people in the middle—I think I would put most economists into that category, and there are some Republicans and some Democrats in that category—but that middle is shrinking. Therefore, I think the possibility is pretty high that the current kind of chaotic and essentially nationalist policies that the United States is pursuing will stay in effect for some years. There's no quick solution. As an economist, I believe that in the long run the underlying economics ultimately works, and ultimately drives policy, but the time that is required for those reversals to happen may be quite long.

In the meantime, as you know, the US economy is extremely strong. Unemployment is very low, stock markets are very strong, and inflation looks like it's beginning to tick up a little, but just a little, which is, in the minds of most monetary policymakers, just right, and we need a little more inflation than we have had. The United States is extremely lucky, and, for example, one reason we are so lucky is that we have very good resources. Oil is very plentiful, and oil prices in the world are going up. From a number of different perspectives the United States is riding the end of a very strong recovery, and the recovery continues extremely well.

My conclusion from this is that the uncertainty and unpredictability that the United States is generating right now is probably more harmful for the rest of the world than it is for the United States itself. But in the long run all of these chaotic processes ultimately have to give way to some kind of reasoned stability, and I'm hopeful that that will happen in the long run.

What are the implications of this for Northeast Asia? As a result of these uncertainties, we are living in relatively difficult times. Whenever the economic environment becomes risky, in my mind the natural reaction is to diversify, to find multiple ways of pursuing the national goals of the region, and not to rely on a single partner or a single strategy, but rather to have multiple ways of building the future. What does that mean right now? My sense is that it means the region ought to prioritize regional integration. Regional integration in fact is a very good strategy. For much of the region, many of the economic benefits can be derived from growth from regional integration itself.

A second strategy is to diversify the region's international relations, and that means looking beyond the United States. Relationships with the United States will continue, and they may even remain quite strong. But again, in order to minimize risks, for the time being other partners such as Europe look very good. And Europe, as you know, is very much interested in this region and in

building stronger relationships with it.

And last but not least, it's very important for the region to take stronger global leadership. The World Trade Organization is critical to smaller countries against the very large countries which increasingly dominate international commerce. Therefore for the ROK or for Japan—Japan is obviously not small, but it is small compared to the United States, or even Europe, or at this point China—it's very important for the mid-sized and smaller countries to make sure that the World Trade Organization remains a rules-based system that can manage the world trading system fairly. Specifically, I would like to see this region pay particular attention to these new trade initiatives which might sustain the role of rules in the global trading system, and to Japan's excellent results in moving the TPP forward. And in working on a stronger regional system, it is also important for the countries of Northeast Asia to reduce the tensions that now divide their economies. I realize this is a very difficult thing to do, and that a great deal of trust is lacking and needs to be restored, but there is some evidence that actually, as the United States withdraws, there is an effort by governments in the region—certainly some of the initiatives between China and the ROK and also between China and Japan—to reduce tensions, and these are worth supporting and strengthening.

With that as background, let me give you some more detail on the specific points of the argument that I have made. What has happened so far in the United States under President Trump? What, in fact, are the actions that he has taken? Then I'll move on to what the actions are which are currently underway, and finally I will cover the issues of what Northeast Asia and this region can do in response.

First, the President has withdrawn from the TPP. The TPP was a 12-country agreement, including several countries in East Asia, several countries also in Latin America, and our partners in North America: Canada and Mexico. It was an agreement that for the first time in approximately two decades had updated the rules of international trade to take into account some of the big changes that happened in areas such as digital commerce, intellectual property, and so on. In many respects, it was an important new agreement which had received strong support from countries around this region. On 23 January 2017, the President's first action was to withdraw from this agreement. Exactly one year to the day, on 23 January 2018, Japan led the remaining 11 countries in agreeing to continue to implement the agreement and specifically to sign it on 8 March. On the other side, the government had turned to a series of old regulations, to a series of old laws to increase tariffs. Specifically, they have taken action against steel and aluminum. In order to impose tariffs on steel and aluminum, they have used a very old piece of US legislation which said that we can increase tariffs on items that threaten national security. It's very difficult today—in the context of cyber threats, nuclear threats, and massive air-based security threats—that somehow steel production and aluminum are essential and their import threatens a country's security.

We have also taken action against solar panels and washing machines. We have heard about this recently. The solar panels are primarily from China, and the washing machines primarily from the ROK. Somewhat middle-level tariffs were applied, but they were also applied on the basis of an old regulation which allowed

industries that were shrinking in the United States to be essentially saved through the safeguard measures as applied through those tariffs. Those tariffs are in the 20–50% range, and they will have to be phased out over a period of four years and therefore they will not be permanent. Nevertheless, they can produce a lot of damage meantime. As a percentage of total US trade, however, these two items still amount to a relatively small share of US imports.

Also, the government has applied anti-subsidy tariffs on Canadian Bombardier aircraft. These were very high: 300% tariffs which would have more or less prohibited imports of these Canadian airplanes into the United States. Interestingly, two days ago the United States International Trade Commission (USITC) said that those tariffs were not justified. Given US law, the President will have to follow the procedures recommended by the USITC and that particular tariff will not take effect. You can see how this give-and-take of the US government system is constraining some of the more extreme actions which the President had been targeting. Nevertheless, on every level, the number of government actions is increasing and on the whole the government has mounted a pretty wide-ranging attack on imports into the United States.

Let me now turn to what threats are still remaining: essentially the renegotiation of trade agreements which the United States had already entered into. The TPP, as I mentioned, had already been taken off the table, but here too it was off the table until about four days ago, when the President in Davos said, “Well, maybe I might reconsider joining the TPP if we could really negotiate it to make it a much better deal.” I would urge people to not immediately take one statement as the sign of a big policy change. We just don’t know where this is headed yet, and many countries are rightly taking a more conservative path in diversifying their strategies or policy.

In NAFTA in particular, the United States has made a series of very serious requests to its partners, which include raising to a very high level the minimum degree automobiles must be produced in the United States in order to make zero tariffs applicable under NAFTA, much to the objection of the Mexican and Canadian negotiators. In addition, the government has asked to limit the access to US government contracts for services which the US government might buy from service providers. It has wanted to introduce a sunset clause into the negotiations, meaning that even if the NAFTA trade agreement is renegotiated and signed, it would again have to be renegotiated five years later. It would disappear unless it were once again passed by the United States Congress five years later. At this time, as we look at the agreement, most of these provisions are not acceptable to the US partners. Most of these provisions are probably not going to be in a final agreement. So far history shows that when a decision finally comes down to a point of either abandoning a smart economic policy from the past or giving into it, a solution is somehow found. Therefore, I’m still optimistic that these will work out properly, but at the moment it’s still very much up in the air.

I won’t go into details of the Korea–US Free Trade Agreement. There are some very similar characteristics with the very strong demands by the United States on the ROK, but the ROK initially had put up so much resistance to the United States’ wish to abandon the earlier agreement that the United States has now agreed to just negotiate amendments, and not to renegotiate the treaty as a whole. Here, too, you can see some kind of compromise emerging.

Finally, regarding the WTO, the United States has threatened at various times to withdraw from the WTO, but it has not done that. At the same time, however, it has slowed down the operations of the organization by blocking the appointment of judges who help to determine trade cases as they come before the WTO.

All of this leads to a very murky environment today, and what I’d like to now close with are some observations on what can be done without the United States, or at least without the United States as seen today. The United States might well change in the future, and in the meantime what can the rest of the world do to remain within the system that had been established over the last seventy or so years? First of all, I think it’s very important to note at the outset that for all of the economic power of the United States, it still amounts to only about 11% of world trade. Therefore, 89% of world trade has nothing to do with the United States, and it ought to be managed according to rules that the rest of the world finds productive and effective. Asia matters a lot in this, because its scale, dynamism and role in production chains makes it very important in world commerce.

So what can be done without the United States if Asia wants to move forward? The most important part is to create new agreements that reflect some of the changes in the digital economy, in intellectual property, and in production chains that cut across countries, and that reflect the contemporary need for trade. That’s what the TPP tried to do, and it’s an important priority for Asia and for Northeast Asia to exploit.

Second, Asia can exploit some of the very substantial gains that come from continuing to liberalize trade. Just because the United States is not doing so anymore doesn’t mean that all of the arguments for doing so have gone away. On the contrary, powerful production chains across this region argue more than ever for effective trading relationships.

Finally, and this is not trivial now, by creating these new systems of rules, Asia can strengthen its own bargaining relationships vis-à-vis the United States or other countries that might become mercantilist, or other countries that might try to dominate the regional trading system. Several agreements are in progress that can make this happen. For China, trade with Northeast Asia and with the United States is roughly equal, and if you look at Japan and the ROK, Northeast Asia is considerably more important than the United States. For all three Northeast Asian nations, the rest of the world is by far the most important element of their trade relationships. The region depends on the United States quite heavily, but not all that heavily. A very large majority of their trade is either with themselves or with third countries.

So with that as background, let me now talk very briefly about the specific initiatives that are underway. The first is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), to which Japan has just led the agreement on 23 January. It’s a good agreement, but it is not quite Northeast Asia-focused. It doesn’t yet have either China or the ROK in it. However, the ROK has indicated on several occasions that it would be very interested in joining once the agreement was completed. So I think the timing is now quite right for the ROK to come into it. Just as Canada and Mexico ultimately joined the agreement in part to show the United States their strength in negotiations in NAFTA, so too I would think that the

ROK might have a strong incentive to join to show the United States that it has options if the negotiations on the Korea–US Free Trade Agreement become too difficult. If this agreement among the 11 countries left from the TPP were extended to include still additional countries from the East Asian region—and therefore not all Northeast Asian economies—very substantial gains could result, making the agreement just about as good as the original TPP would have been with the United States included.

The second avenue, which is underway and many negotiators say may be completed this year, is RCEP. RCEP is among 16 Asian economies and it has a very strong Northeast Asian core. It has China, Japan and the ROK as central members, and indeed when it was first proposed, people had envisioned that the China–Japan–ROK (CJK) agreement would be the first to be concluded, and then the other countries around it in the RCEP agreement would reflect some of the CJK provisions more broadly. That hasn't happened, but nevertheless the agreement represents a very good opportunity for these three countries—China, Japan and the ROK—to agree at least on a minimum set of standards that help to improve their trade and reduce tensions, and that might lead to even stronger agreements in the future.

Finally there is the Belt and Road initiative—also very interesting—in this region, although it is less easy to see how it might be extended to include all of the member economies of this region, such as the ROK and Japan, as well as China. It is now very much focused on eventually connecting China and its trade routes with Europe, but more immediately with Central Asia. It's a very interesting initiative: ambitious, visionary, but not quite what Northeast Asia needs to make this region itself better integrated and more focused. I think that some of the financing issues involved in the Belt and Road initiative might make the agreement more consistent with Northeast Asian economic integration. For example, if some of the Belt and Road projects were built by companies more widely distributed across Northeast Asian partners, that would go a long way toward integrating the region's own objectives with the Belt and Road's wider objectives of connecting East Asia with Europe.

What exactly might the benefits of these agreements be? The

gains—based on some very careful modeling work that a group of us which includes a Japanese economist, a Chinese economist, myself and a colleague from Europe, and that the group of us have been studying for several years—applied first to the TPP agreement, but now also to the new versions of agreements that are emerging in the region. The CPTPP, the new 11-member TPP agreement, would generate income gains that are significant even though the United States is no longer part of it. It's worth about one-third of what the agreement with the United States as part of the TPP would have been. Were 5 more countries—all of which have expressed interest in the agreement in the past, including the ROK—to be added to the 11, then the gains would grow very substantially, and in fact would be just about as large as under the TPP agreement including the United States.

The reason why this agreement would be so attractive is it would create altogether new production chains connecting Northeast and Southeast Asia. It would create production chains that involve the high technologies of Japan and the ROK with low-cost manufacture and labor in Vietnam, and some of the intermediate service providers, say in Singapore, and other members of the 16-country group. This would be a tremendous advance in terms of how the world production system works. No longer would China be the only economy within which you could find a complete production chain going from technology all the way to low-cost labor. There would be alternatives available as well. In addition, if China itself were included, the value of the agreement would further increase, probably doubling or tripling, above the level where it would have been just among the 16 economies. There is a route here, even without the United States, to bigger and better agreements that would generate very substantial economic benefits for the region.

And last but not least, along this road someplace it will be very important for the United States to rejoin this critical part of the world economy. Therefore, I would see the strategy of building a route to rules-based trade in Northeast Asia, and more generally the Asia-Pacific, as also a very solid route for getting closer back toward the point where we were a few years ago, and that is building a stronger rule-based trading system for the world that is up-to-date with the new technologies that are now emerging so rapidly around the world.