DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST

THE STATE OF ASIAN TRADE AND TRADE AGREEMENTS IN 2022

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Guest:

PETER PETRI
Carl J. Shapiro Professor of International Finance, Brandeis International Business School
Nonresident Senior Fellow, John L. Thornton China Center, The Brookings Institution

Host:

DAVID DOLLAR
Senior Fellow, Foreign Policy, Global Economy and Development, and the John L. Thornton China Center
The Brookings Institution

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DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast Dollar and Sense. Today, my guest is Peter Petri, a professor in the business school at Brandeis University and a nonresident senior fellow in the China Center here at Brookings. We're going to talk about recent developments in Asian trade agreements and trade issues for 2022. So welcome to the show, Peter.

PETRI: Thank you very much, David.

DOLLAR: So let's start with the Regional Comprehensive Economic Partnership, which is going into effect right now. What does this entail and why is it important?

PETRI: David, I think you invited me here today because I'm a big fan of RCEP and Asian integration in general. It has a very productive history in terms of economic benefits for the region and indeed the world.

RCEP is probably the biggest trade agreement in history in some dimensions, not in all. It includes 15 countries, 1.8 billion people, about 30 percent of world GDP. And 10 of these countries have already ratified the agreement, the others will do so probably this coming year. Essentially, Southeast Asia is included, but not all of Asia. India, in particular, is missing. It was a member of the negotiations until the very last rounds. And of course, the U.S. is not included. The members are all trade oriented economies. There are already important trade partners with each other, and they are important in global supply chains. So this involves a group of very significant countries. And as we'll see, the agreement is not state of the art in terms of the rigor of its provisions, but it will nevertheless play a large role in integrating them.

And I've been modeling the gains of this, as you know, with my colleague Mike Plummer at Johns Hopkins University. We estimate that RCEP will generate benefits close to $300 billion by about a decade from now, when its provisions begin to take effect.

The second part of this that makes it important is that this stands in sharp contrast with what's happening in the rest of the world. As you know, there's been little progress in new agreements in the World Trade Organization or, for that matter, in other regions. And RCEP, of course, should not be seen in isolation. It comes alongside the CPTPP, the Comprehensive and Progressive Trans-Pacific Partnership agreement, which I know you will want to talk about later. And of course, Great Britain, China, South Korea, Taiwan, and others are lining up to be members of that agreement. So this is part of that kind of larger momentum.

Bottom line, I think RCEP could be a pivotal point in economic history. I'm not entirely sure that this will happen, but it confirms the rise of Asian manufacturing, especially part of the Asian economy, and will benefit will be spurred on by further integration among these countries. Now all of this, and I think the promise of RCEP ultimately depends on policies, will China continue to grow rapidly? Will it, and its smaller partners, find a way to cooperate in a way that's mutually beneficial under fair rules? All of these things are critical, but we don't really have answers to them yet.

DOLLAR: RCEP has been criticized as being not as deep in agreement as, for example, the Trans-Pacific Partnership, which we'll come to in a few minutes. But you've written that ASEAN-driven agreements tend to improve with time. So can you elaborate on that? What kind of improvements might we see over time in the RCEP agreement?

PETRI: Well, let's first sort of node for a minute some of the weaknesses of RCEP. And these include not eliminating all tariffs. It eliminates only 90 percent of tariffs by the time it fully takes effect, compared to the close to 100 percent under the CPTPP. The agreement also has no chapters on labor or environment or state-owned enterprises. And then it grants a lot of flexibility to countries, for example, in important areas like digital trade in services. These differences, these concessions, in a sense, were no doubt necessary given RCEP's very wide range of coverage across developed and less developed economies.

Now RCEP does have built-in mechanisms for change it. For example, investment protections will come online in three years. This is written into the agreement. The agreement also sets up a whole bunch of standing committees that will continue to evaluate opportunities for making improvements. The new results will not require a renegotiation. So I would guess that tariffs will fall and enforcement provisions will get stronger and the officials would chip away in their regular meetings on regulatory barriers that that impede trade.

Now, a really good example for this is ASEAN itself. These are the 10 core countries that help to negotiate, smaller Southeast Asian countries that helped to negotiate the agreement. They started out by citing a first very kind of minimal trade agreement in 1977 among five members. Today, they have 10 members. They have revised the agreement updated with modern free trade agreements several times since, and eliminated virtually all tariffs, and are now working on an ambitious next phase, an ASEAN Economic Community, which will have a pretty rigorous set of common rules for a wide range of activities. So this is this is a model of, I think, what they have in mind, although obviously this is a wider range of countries more difficult to do.

DOLLAR: So we've already hinted at some of the differences between RCEP and TPP. And yet you've written that the two agreements are complementary. So how do you see that?

PETRI: The big difference between them is in rigor, but in terms of structure, they are quite similar. This is partly because RCEP borrowed, although I don't think the people who wrote the agreement will be ready to take credit for this, but they borrowed some of the language from what was once the Trans-Pacific Partnership, the TPP, and which has become now the CPTPP. So you have similar chapters. In some cases, you could replace a “made” with a “must,” and suddenly you have the much more rigorous version of the provision that the CPTPP contains.

Now, some chapters are missing in RCEP, they are in CPTPP. I already mentioned some of them, the labor, environment, SOEs are the most important ones. So those would have to be added and obviously they would be contentious. The two agreements have seven members in common, and that's another important point of correspondence. RCEP members may graduate, that is, also join the CPTPP if they feel they are ready to take on more rigorous commitments, and at least three countries are now considering that.

I just sort of think of RCEP—as you and I are experienced in graduate education—I think of RCEP as passing the qualifying exams in graduate school. Once you get through them, you can go on to your Ph.D. And forgive me for stretching this analogy too far, but this is really equivalent to becoming a member also of the CPTPP. So if it all goes well and a lot of this also will depend on politics, the overlap will keep the agreement's aligned and you will see movement both in improving RCEP and in countries moving to the more rigorous CPTPP.

DOLLAR: So let's talk a little bit about CPTPP in more detail. That's been going for about a year now. You had a nice blog post on our Brookings website, I think it was in December, urging South Korea to join in, arguing there were a lot of benefits. As I understand it, South Korea has now made a decision to join, so congratulations. You obviously had a significant impact. But can you walk us through, well what are the benefits to South Korea of now joining that CPTPP group?

PETRI: I'm not willing to take credit for the South Korea decision. It's something they've been thinking about for a long time, and I've been a fan for a long time for the reasons that I think I can outline shortly. But I was obviously not a lone fan, I had taken my cues from many distinguished Korean colleagues. Korea already trades a lot with the TPP region, especially with Japan, and trade needs modern rules. Eliminating barriers offers big payoffs—again in our quantitative estimates, we would guess this would amount to about

$100 billion per year for Korea, not an insignificant amount, one of the largest gainers from the agreement, assuming it continues to expand as it now seems to be.

But the real benefits will be, I think, political. The reason that Korea did not join earlier, and it was interested as early as 2013, is its troubled history with Japan. As listeners know, Japan occupied Korea for much of the first half of the 20th century. And this issue continues to inflame political passions on both sides, both in Japan and in Korea. And even today, partly as a result of these conflicts, the two countries supply pretty extensive restrictions on exports-imports vis-à-vis each other. Both countries, I think would like to put these disputes into the past, especially their effects on economic interdependence. But politics makes that very, very hard to do.

Joint membership in the CPTPP would offer the two countries a way of moving the issue from a bilateral, very contentious framework to a multilateral rules-based framework. Politicians could use international rules essentially as a reason to do things that they could not otherwise do domestically for political reasons. And I think that's a big potential benefit for not only for Korea and Japan, but for the East Asian economy in general.

And finally, Korea needs to be at that CPTPP table. This is partly because the CPTPP is going to grow, as I mentioned before, several countries, several important economies are now signed up to be members—China, Taiwan most importantly, and possibly the United States some years down the line. And these entry processes will take negotiations. There will be rules changed, new rules implemented, deals made, and Korea will want to be a part of them. These are all of the countries coming in are likely to be important trade partners of Korea.

And then there's another point. Korea often has contentious relations with some of its big partners. It tends to punch above its weight in technology and other areas. For example, with China, Japan, and the United States it has had disputes, economic disputes, from time to time. And it needs to form alliances with other middle powers, those like the ones in the CPTPP, to acquire greater leverage, and they all need this vis-à-vis these larger partners and efforts to contain political coercion. So I think there are a lot of reasons for Korea, and I think the decision-makers there have realized this but have been held back by the politics of the agreement in past years.

DOLLAR: There's a nice general point there, Peter, about spillover benefit of trade agreements, multilateral trade agreements, when two countries have a contentious history, so very hard to sort of sit down and negotiate. For us economists, opening up the economy is not really a concession, it's a benefit. But politically it's often seen as a concession and hard to make a concession to a country with which you have difficult relations. So the multilateral framework really helps ease that.

PETRI: This is, by the way, this is very similar to the idea that the Japanese believe in very strongly, this idea of *gaiatsu*, which is that you make concessions to international institutions that you cannot normally make to your domestic political constituencies. In other words, you adopt reforms that are beneficial for the country but have large domestic political cost. This is a translation of that into the international sphere.

DOLLAR: So you mentioned, Peter, that China is also applying to join the Trans-Pacific Partnership, the CPTPP. That seems like a heavy lift to me, recognizing that the we've already discussed how CPTPP is higher standard with chapters on issues like state enterprises and subsidies, other structural issues. So, how do you see that playing out? Do you think the existing members of CPTPP will agree to water down the agreement in some sense? Or will China step up and meet these new standards? How do you see that working out?

PETRI: Yeah, this was a big surprise. Not surprising in the sense that many of us, including Mike and I, have written about this possibility in the past, but it was a big surprise that it happened now. It happened actually the day after the United States announced the

AUKUS security arrangement with Australia, so it may have had some relationship to that. But it was a big surprise, and it is potentially a very interesting option. As you say, China has many hurdles to clear. These range from transparency of its state-owned enterprises, controlling subsidies for various kinds of activities, greater market access for foreign firms, labor reforms, and many others. It will take consensus among all members to admit China, and especially Australia and Japan will be very tough to convince.

But remember, Vietnam, Singapore, and Malaysia are all now members with very significant similar interventions in their domestic economies, which they managed to overcome. Some of these were solved through side letters or extending the time over which the agreement would be implemented, so that they found solutions because all members wanted them to join.

Now the bottom line is that this decision, too, will be largely a political one. As I mentioned, consensus is required. A lot of negotiations will be involved among members. And if it turns out that the that the membership's predominant goal is to admit China because of its economic importance to the group and the region, and along the way to moderate some of the economic practices that the other members are objecting to on the areas we already mentioned, then it's likely that a solution can be found, and side letters or extended terms or new provisions could probably find some solution. But if the goal is to keep China at arm's length, then that may very well be the consensus, or at least the consensus among some critical members for security reasons or to accommodate U.S. pressures. Then it will not be hard to find reasons to not admit China.

So ultimately, I think this is not an economic decision so much as it is fundamentally about the geopolitical issues that preoccupy much of our concerns with East Asia these days.

DOLLAR: What's striking in our conversation so far, Peter, is that the U.S. just seems to be left out of all of this. The U.S. is still the largest Asia-Pacific economy. It's not part of

RCEP. President Trump dropped out of the Trans-Pacific Partnership, and President Biden has not shown any appetite for joining. What we do have is a Phase One trade deal between the U.S. and China. China committed to buying larger quantities of different products from the United States. We're essentially coming to the end of that agreement, and China's at about 60 percent of its purchase commitments. Many of us thought the commitments were pretty impossible even before the pandemic hit and affected the trade for a short period there.

So I'm curious what you think the Biden administration is likely to do. China hasn't really met the commitments. On the other hand, U.S. exports to China actually rose quite significantly over the last year. Farmers, in particular, have sold an unprecedented amount of soybeans. And so it seems to me you've got a difficult set of choices. You could declare that China didn't meet its commitments and ramp up some additional tariffs, but that's going to hurt certain groups in the U.S. You can ignore the fact that China didn't meet the commitments, which will probably generate some political heat in the United States. How do you see that one playing out?

PETRI: Yeah, I mean, I don't know exactly how the messaging will go on the Phase One agreement. But as you mentioned, I think the real surprise is that the trade between the two countries has not done so badly despite the trade war and restrictions that we have put on trade in Phase One. And I think the effects of this surprise are due not so much to Phase One, but they happened despite Phase One. As you mentioned, no one really expected that the quantitative targets of Phase One to be met. But the real point of Phase One was to regularize the very high tariffs that had been reached before Phase One in the tit-for-tat trade war between the two countries. So those tariffs stay in place, and I've not heard much from the Biden administration that would suggest that they are planning to remove them in the near future.

So the surprise is that despite all of this, trade has remained strong. As you mentioned, U.S. exports maybe as much as 20 percent above what I think of as the pre-pandemic average. But U.S. imports from China are up, too, about 5 percent or so—much less, but it's a much larger total value. So it doesn't look like anything really dramatic happened as a result of the Phase One agreement. And I think the story is that this is an exchange between the world's top manufacturer of consumer products and a lot of other manufactured goods and it's hungriest market, and its most successful at hungriest market, which is, of course, the United States. And that combination seems irresistible. We do seem to get a lot of trade as a result of both the supply capabilities of China and the demand that is fortunately doing so well as a result of American economic recovery. Now, the caveat here is there are a lot of turmoil in the data, and so we really don't quite see clarity yet because of supply shortages, because of the pandemic and so on.

At the same time—and this is, I think, important to point out—is that higher level cooperation, economic cooperation, between the United States and China on technology, on the environment, on actually the world economic order, all of this seems to be plummeting. If you look at two way flows of investments, two way flows in research, in entrepreneurs, in scientists, all of these are now controlled by both sides pretty significantly, and they are shrinking rapidly. Investment, for example, bilateral investment has fallen off very sharply from earlier pre-pandemic levels. We are partially decoupling. I mean, this is the phrase that we have long been using. And I'm not sure that this is all bad news. The remaining relationship, as we've discussed, is still significant. And the parts that are being cut back satisfy important political needs in both countries. We may yet pay a price for that. But for the time being, if one looks at the economic relationship in isolation from the politics, it looks reasonably stable and reasonably beneficial to both countries.

DOLLAR: So, Peter, last question for you. Given America's absence from RCEP and the CPTPP, the Biden administration is planning a new comprehensive Indo-Pacific Framework to signal continued economic engagement in the region. Do you have a sense of what this is likely to contain and is this going to work?

PETRI: Yeah, this is a difficult question. It's clear that the Biden administration would like to correct some of the Trump administration's retreat from Asia, particularly Southeast Asia, with which we have long had very positive relationships. But if you look at this closely, we don't know all that much about what they are planning to do. This has been advertised but not yet revealed—it will be probably sometime early this year. But it doesn't look to me like we are prepared to do what it will take to repair the damage.

After Trump, we have much less credibility in the region as an economic and security partner, and that doesn't go away quickly. That cannot be fixed easily. And to make up for that, I think we would need to offer substantial new market access to Asian economies, such as we were prepared to offer the CPTPP, in what was then the TPP, or offer significant resources, support of some sort. Nothing I've heard so far suggests that either of those is on the table.

The comprehensive Indo-Pacific Framework, or economic framework, is interesting. It may have some potential areas, but I think if it misses these critical “put food on the table” components, it may not accomplish what the administration would like to see. One potential, for example, is the digital economy agreement. Many countries in the region are interested. The United States could influence its shape, and it would have significance not just within the region, but as a kind of counterpart to the European efforts to develop the framework for digital trade agreements. So it would have global significance as well as regional ones.

But the framework, at least parts of it that are expected by observers, will probably dwell on security issues and securing supply chains, and securing technology chains, or the usage of technology. And this is code for keeping China out of the transactions between the United States and its partners in the region. And it may mean less engagement rather than more engagement with Asian partners for those companies that are, for example, already closely tied to Chinese markets or suppliers.

And we were also sending mixed signals about access to U.S. markets. We talk about nearshoring or reshoring some of the supply chains that come from East Asia. We talk about buy American policies, stricter compliance with U.S. labor standards. All of these will sound a bit jarring to the ears of very pragmatic East Asian decision-makers. So, I don't quite see how this package will solve the problem that Biden, I think, correctly recognizes but has very limited either political means or possibly fundamental interest in solving.

DOLLAR: I'm David Dollar, and I've been talking to Peter Petri about these complex new Asian trade agreements—RCEP, CPTPP, the U.S. Free and Open Indo-Pacific Framework, and there's no better person to explain the details and the estimated benefits. So thank you very much, Peter.

PETRI: Thank you, David. It's a pleasure.

DOLLAR: Thank you all for listening. We'll be releasing new episodes of Dollar and Sense every other week, so if you haven't already, follow us wherever you get your podcasts and stay tuned. Dollar and Sense is part of the Brookings Podcast Network. It's made possible by support from producer Fred Dews, our audio engineer Gaston Reboredo, and other Brookings colleagues. If you have questions about the show or episode suggestions, you can email us bcp@brookings.edu, and follow us on Twitter @policypodcasts.

Until next time, I'm David Dollar and this has been Dollar and Sense.