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***Session III: Globalization, economic interdependence  
and new trade agreements***

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## Enough Noodles in the Bowl Already

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An economic fairy tale has taken hold in the public discussion about the Asia Pacific region. It goes like this: Deepening economic integration among the region's countries offers one of the best prospects for reducing geopolitical tensions. More globalization in the Asia Pacific would go a long way toward ensuring peace among the Chinese, Japanese and their neighbors. So let a hundred flowers bloom in the realm of trade and investment agreements, which will generate so much goodwill and economic opportunity as to overcome maritime disputes and historical grievances.

Starry-eyed believers extol the potential benefits for stability and harmony of the Trans Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership (RCEP), and the Japan-Korea-China free trade agreement. Just last month, for example, the *Japan Times* carried an article by Shinji Fukukawa, a former Japanese vice-minister of trade, rhapsodizing about the support among Chinese, Korean and Japanese participants at a Tokyo conference for concluding the Japan-Korea-China deal as soon as possible. "My firm view is that if the three countries formulate a framework for the trilateral FTA," Fukukawa concluded, "it will help to end the present unstable diplomatic situation and restore relations built on trust."

If only Fukukawa were right. As the father of two half-Japanese sons, I fervently wish Beijing, Seoul, and Tokyo would put higher priority on economic and social interactions among their people and less on squabbles over rocks in the middle of the ocean. But it would be delusional to rely on regional agreements like TPP, RCEP and the China-Japan-Korea deal to help much in this regard. The costs and risks of such agreements, including the potential for creating new points of friction, far outweigh the gains. Perhaps worst of all, their proliferation may ultimately undermine the multilateral trading system, which is essential to resolving explosive trade disputes that can fuel international conflict.

My argument is not based on opposition to globalization--quite the contrary. Anyone familiar with my work as a journalist and author would know that I'm not in the anti-globalization camp. But it is all too easy to oversell the virtues of regional and bilateral free trade deals--or, as many trade specialists (including me) prefer to call them, preferential trade agreements (PTA's), because they are aimed at creating advantageous trade preferences among the participating countries at the expense of others. And one of the oversold claims for PTA's is that they help to overcome geopolitical differences.

Indeed, my argument is at bottom a pro-globalization one. The tremendous progress made since World War II in integrating economies, especially in trade and direct investment, has generated major benefits not only economically but geopolitically; and in Asia those benefits should already suffice to keep tensions under control. As Richard Katz noted in *Foreign Affairs* last year, the economic relationship between China and Japan is so crucial to the welfare of both countries that, barring an extremely unfortunate accident, their governments will surely stop short of allowing military clashes to erupt over their territorial disputes. China has raced ahead of the United States as the largest single overseas market for Japanese exports, and Japan--China's largest single source of imports--supplies Chinese industry with critically-needed machinery and high-tech components. I wouldn't go as far as Katz did when he wrote, "Take away those [Japanese] imports, and China's exports collapse," but if I were an economic planner in Beijing, I would be very nervous about the consequences of a rupture in Sino-Japanese commerce. Small wonder that the Japanese business community has been quietly urging Prime Minister Shinzo Abe to tone down his nationalistic proclivities. I assume Chinese business leaders have been doing the same with their government.

So what's wrong with more of a good thing? Since economic integration has already proven to be such a geopolitical boon, shouldn't we strive in every way possible for integrating at an even deeper level, in particular by concluding PTA's, which offer the easiest way to integrate? I offer three reasons for answering firmly in the negative:

1. The upside is nowhere near as great as pro-PTA propoganda might lead you to believe.

The world is not where it was in the 1950s, when trade was seriously impeded by barriers that had been erected during the protectionist era of the 1920s and 30s. The Kennedy Round, Tokyo Round and Uruguay Round of global trade negotiations reduced those obstacles to a small fraction of their previous dimensions. True, a few "peak tariffs" remain, on goods such as light trucks in the United States; dairy products in Canada; and rice, beef and wheat in Japan. But the number of such items pales by comparison to the list of sectors in which trade is virtually free. Average tariffs in the United States are now 3.4%, and in Japan, 4.6%. I'm well aware that the TPP, in particular, is touted as being much more than a tariff-reduction exercise; it is envisioned to cover services, regulations, intellectual property rights and state-owned enterprises, among other things. Powerful multinational corporations support the TPP because they want rules in these areas changed in their favor. But that hardly means

the rest of us ought to share their enthusiasm. The overall economic impact would surely be a lot closer to “modest” than “major”. Although I can't pretend to offer quantitative evidence to back up my views, the fancy economic models purporting to show substantial GDP gains from PTA's should be taken with huge grains of salt, based on past experience with such models and the obvious bias of the modelers.

An anecdote may help illustrate my point. When I went to Australia in 2007, I asked business people whether the 2004 U.S.-Australia Free Trade Agreement was helping Australian firms increase sales in the U.S. market. Since the U.S. economy is much larger than Australia's, I thought surely the deal would be giving some sort of boost to Aussie exporters. But almost everywhere I went, the reply was the same: no, the U.S. market was pretty much wide open already, so we haven't gained anything substantial (sheepmeat being one noteworthy exception). Even economic officials at the U.S. embassy in Canberra admitted they hadn't heard of a single example of an Australian company that had clearly benefited from the lowering of barriers. One Australian organization that had strongly backed the deal promised to send me a survey of Australian firms documenting numerous “case studies” of companies picking up new business in the United States, but when I got the survey, it turned out that most of the respondents shrugged off the impact as insignificant.

In addition to the fact that trade barriers are pretty low already, there's another key reason limiting the benefits of PTA's. They are laden with “rules of origin,” designed to make sure that products receiving duty-free treatment aren't actually made in some other country outside of the pact. These rules are inevitably lengthy and detailed—specifying, for example, how much of a garment's fabric and stitching must be Mexican-made to qualify for duty-free treatment at the U.S. border under NAFTA. Compliance can be so onerous, thanks to the paperwork required to clear customs without paying duty, that many firms simply bear the financial burden of paying the modest tariffs. Partly for this reason, only a small fraction of the goods Singapore ships to the United States--somewhere on the order of 5 to 10 percent--come in under the terms of the U.S.-Singapore Free Trade Agreement. In Southeast Asia, a similarly small portion of trade takes place under the terms of the longstanding PTA among members of the Association of Southeast Asian Nations (ASEAN).

In sum, PTA's aren't going to make enough of a difference in the amount of Asia Pacific economic integration to change the odds of geopolitical tensions boiling over. If the existing degree of integration proves inadequate to prevent military conflict, that will be quite a testament to the incompetence of our leaders and diplomats.

2. Although PTA's sometimes foster a friendly atmosphere among countries--especially when the deals are signed and smiling trade ministers are shaking hands for the cameras--they may also produce the opposite effect.

Memories are still fresh in this country of the Greek demonstrators who were waving signs with swastikas on them, and the articles in *Bild* denouncing Greeks as lazy freeloaders. The lesson is that globalization is a double-edged sword; the more countries integrate, the more reasons they may have to cooperate but the more reasons they'll find to quarrel about. This is true not only of currency unions but of trade agreements, even trade agreements that are just under consideration. A few years ago, when the United States was trying to negotiate a bilateral deal with Thailand, the Thais were in an uproar over efforts by American trade negotiators to include rules regarding the protection of drug patents. The controversy passed almost unnoticed in the United States, but the Thai news media was ablaze with headlines about U.S. bullying. Riots in Seoul over U.S. insistence on opening the Korean market to American beef were another illustration of the risk that using PTA's to cement alliances may go awry. Similar examples abound--as Europeans know from some of the hostility that has arisen here regarding certain provisions of the TTIP.

More important, though, are the negative effects of PTA's on relations with countries that are left out. Sometimes these effects are purely economic; Bangladeshi-made clothing, for instance, has a hard time competing in the U.S. market with apparel from nations in Latin America that have implemented PTAs with Washington. In the case of the TPP, however, the exclusion of one country--China--could have ramifications far beyond the commercial sphere. China's perception that the TPP is aimed at containing Chinese power is exacerbating the country's general sense of insecurity, which could boost forces in Beijing that favor a more aggressive posture in the Asia Pacific. The Chinese have already responded by ardently pursuing negotiations to conclude RCEP, which excludes the United States. Beijing has even fewer scruples than Washington about using carrots and sticks to get what it wants from smaller countries. So it is not hard to imagine an intensified Chinese effort to counter U.S.-led PTA's with Chinese-led ones--the upshot being increased risks of splintering the trading system. That point offers a perfect segue into my next one.

3. Weakening the World Trade Organization, which is already in plenty of trouble, would be terrible for security in Asia--yet that's exactly what more PTA's would do.

For all its flaws (and it has many), the WTO plays a crucial role in fostering stability, both economically and geopolitically. It is the current embodiment of the multilateral system that was established after World War II to prevent a reversion to the 1930s, when protectionism deepened the Great Depression and the formation of trade blocs stoked rivalries among the great powers. Countries take their trade disputes to WTO tribunals for adjudication rather than engaging in tit-for-tat retaliation. That keeps trade wars from erupting, and so do WTO members' pledges to keep their tariffs within legally bound limits. The WTO is also the guardian of the most favored nation principle, which broadly requires member nations to treat the products of other members alike—a bulwark against exclusive trade groupings.

The spread of PTA's--which currently number in the hundreds--has steadily diminished the WTO's role as the central rule-maker and arbiter of trade. This problem is compounded by disappointment over the WTO's Doha Round; the failure of these talks to deliver on their grand promise has dealt another blow to the organization's credibility. Although the WTO is not going to disintegrate overnight, the danger is that its authority will gradually erode to the point that member nations will start to flout their commitments and ignore the rulings of WTO tribunals. That would greatly increase the threat of trade wars and a breakdown in the stability of the system that has helped keep trade blocs and protectionism at bay.

Many advocates of PTAs, while admitting that the multilateral approach is preferable, are understandably frustrated with the Doha Round and contend that multilateral negotiations are too cumbersome and unproductive. Even so, PTAs are not the answer.

Trade policymakers ought to be spending their time and energy shoring up the credibility of the WTO, rather than subverting it by adding to the spaghetti and noodle bowls of bilateral and regional arrangements.

### TPP: A special case?

The arguments above, persuasive as I hope they may be in eviscerating the case for PTA's in general, do not address the special case for the TPP in particular. Champions of the TPP offer compelling reasons for why it is essential to the promotion of peace and security in the Asia Pacific, and these deserve careful consideration.

The geopolitical case for the TPP is that it will keep the United States anchored in Asia. Without the TPP, the argument goes, China will increasingly use its mounting economic power to set regulations for a host of key sectors in the region, and these regulations will be aimed at boosting the fortunes of Chinese companies rather than fostering open competition. U.S. firms will gradually lose interest in what they perceive as a rigged market, the result being a lessening of America's economic stake in the region--and ultimately the withdrawal of the U.S. military from Japan, South Korea, and the western Pacific. The best way to ensure against such a scenario unfolding is for the United States to forge a trade agreement with a number of countries in the region that is both broad and deep.

This argument has considerable merit. I wonder, however, whether the threat of China's desire, and ability, to exercise major influence in the international regulatory sphere is overblown. I vividly remember hearing similar concerns raised in the 1980s and 90s about Japan, whose mercantilistic economic system was deemed in certain quarters to be incompatible with the American one. Fears abounded that Tokyo would end up writing all the important rules for commerce in the Asia Pacific, which would then come under the total domination of Japanese *keiretsu*. The fact that those fears failed to materialize, and that the Japanese are now seen as critical partners in the effort to protect the western-style rules system, doesn't necessarily mean that the same will happen with China. But it does suggest that assumptions about this issue ought to undergo pretty rigorous examination.

Even supposing the Chinese are hellbent on becoming the region's rule-setters, another question is whether a TPP deal would help much in stopping them. Trade agreements are inherently static, and often become outdated in the face of economic and technological change. Consider the WTO's Information Technology Agreement: When signed in 1997, it was hailed as freeing trade in the world's cutting-edge sectors, but a few years later, realization dawned that many of the goods covered by the deal had become obsolete or soon would be. Similar problems would presumably plague a TPP. If so, the impact on China's rule-setting ambitions would be commensurately limited.

So the ultimate question about the TPP is whether its benefits are worth the costs mentioned earlier, namely the likelihood that China's reaction to being excluded would lead to bad outcomes. One response from TPP advocates is that China will eventually be included. The prospect of China joining this "platinum standard" trade agreement, embracing rules-based international commerce even more enthusiastically and meaningfully than it did when it joined the WTO in 2001, is tantalizing indeed. But it strikes me as a pipe dream. Differences between the United States and China

were one of the main reasons for the failure of the efforts in the WTO to agree on the broad terms for the Doha Round--a much less ambitious undertaking than a fully elaborated TPP. And since one of the main advantages of a TPP is to stop China from dictating rules, regulations and standards in the region, I am at a loss to understand how, and on what terms, Beijing could sign up.

All that said, I will confess that the case for the TPP is a lot less specious than for garden-variety PTA's.

### Multilateralism, the right (albeit unglamorous) answer

If trade negotiators in the Asia Pacific want to do what's best in the long run--for the region, for their countries, and for the world, both economically and geopolitically--they ought to go back to the drawing board in Geneva and devise an agenda for a new, more ambitious WTO round. A new multilateral round could address many of the world's concerns about China--its exchange rate policies, its industrial policies, its control over certain strategic materials--and in return it should address many of China's legitimate concerns. Beijing worries about sanctions being imposed on Chinese exports by countries with stricter carbon emissions rules; it worries about the reliability of energy supplies; it worries about the rights of its companies to invest abroad. All of these issues have arisen since 2001, when the Doha Round was launched. They would be very tough to resolve on a multilateral basis, but they desperately need resolving, and the WTO is probably the only practical place to do so. World prosperity will be endangered--and so will world peace--if trade wars erupt over these issues.

For many in the trade community, this idea has about as much appeal as root canal surgery. Trade ministers, and the people who work for them, vastly prefer negotiating PTA's, because as former WTO Director-General Pascal Lamy has noted, when trade ministers sign such trade deals they get on television. Cynical as this may sound, I have come to the conclusion--after years of covering trade issues for the Washington Post and authoring a book about the WTO--that Lamy's comment captures the essence of the bureaucratic and political motivations behind many accords. Former U.S. trade officials have told me that they liked working on negotiations with individual countries because WTO talks were too tedious, and because once they had helped complete a deal they had "trophies" they could hang on the wall, which made them more marketable to private-sector employers.

So I'll face reality: PTA's will continue to be the order of the day, both in the Asia Pacific region and elsewhere. But facing reality also means recognizing that, for the region's geopolitical tensions, these pacts offer nothing close to a panacea.