

In Focus

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# What the Trump Era Portends for Trading Relations in Northeast Asia

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# The Liberal Trading Order under Assault: A US Perspective

## By Vinod K. Aggarwal

In Focus: Aggarwal

GIVEN THE hotly contested US presidential election and the surprising victory of Donald Trump, it is easy to lose sight of the broader challenges to the US-promoted post-Second World War economic order. These come from systemic changes, American domestic political conflicts and a rethinking of the ideological consensus around the benefits of free trade.

After 14 years of fruitless, contested negotiations, members essentially terminated the Doha Round of the World Trade Organization (WTO) in December 2015. Instead, countries have increasingly focused on bilateral free trade agreements (FTAs), sectoral agreements, regional accords, and more recently so-called unilateral mega-FTAs. And yet, despite active US promotion of two of these mega-FTAs, the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), neither appears to be on the verge of seeing the light of day. The problems in ratifying the TPP provide us with an early-warning indicator of the pressures driving US trade policy under a Trump administration. The implications could well bring us to the “World without the West” identified by Barma, et al, in 2007.<sup>1</sup>

### GROWING CHALLENGES TO THE MULTILATERAL TRADING ORDER

Even before the demise of the Doha Round, growing frustration with the slow pace of multilateral negotiations led many countries to seek alternatives to liberalize international trade. First, countries negotiated sector-specific multilateral agreements, including the Information Technol-

ogy Agreement (1997, expanded in 2015), the Basic Telecom Agreement (1998) and the Financial Services Agreement (1999).

Second, on a regional basis, countries have continued to pursue trade liberalization through arrangements such as the European Union, the North American Free Trade Agreement (NAFTA) and the Association of Southeast Asian Nations Free Trade Agreement of 1992, which evolved into the ASEAN Economic Community in 2015.

Third, since the late 1990s, countries have negotiated a flurry of bilateral FTAs. While there were only 47 in 1994, the number had increased to 262 by the end of 2015.<sup>2</sup> Major economic powers such as the US, the EU, China and Japan, and medium-sized economies such as South Korea, Chile, Mexico and Singapore, have all negotiated a “noodle bowl” of bilateral FTAs, often with strategic and political objectives in mind.

All three approaches can be problematic. Sectoral agreements tend to undermine the global coalition for free trade by focusing solely on “winners” from trade agreements.<sup>3</sup> Regional approaches create their own sets of rules and procedures, and often have regional content requirements that impede global sourcing efforts. And bilateral FTAs, with their varying provisions, can lead to significant discrimination and impede trade, particularly given the Asia-Pacific’s complex supply chains. Indeed, this growing complexity has provided one of the key motives for countries to turn to mega-FTAs: multilateral FTAs that involve a large number of participants. The goal of these agreements has been in part to rationalize the multiplicity of bilateral FTAs. With the prolifera-



Newsmaker: US President-elect Donald Trump is featured in a Chinese newspaper headlined “Outsider counter-attack” at a newsstand in Beijing. China is wary of trade wars in his administration, but sees opportunity in his opposition to TPP. Photo: AP/Ng Han Guan

tion of both bilateral and regional accords in the Asia-Pacific region, it is no surprise that the region was among the first to embark on mega-FTA negotiations. Twelve countries in Asia and the Americas negotiated the TPP trade deal, with negotiations concluding in October 2015, but now facing a very uncertain future with a new US president.

In part, the TPP has its origins in the difficulty of transforming the Asia-Pacific Economic Cooperation (APEC) forum into a true pan-regional trade agreement. By 2008, the effort to create a so-called Free Trade Area of the Asia-Pacific (FTAAP) seemed to be going nowhere. Meanwhile, the Trans-Pacific Strategic Economic Partnership agreement, known as the P4, created in 2002 by Chile, New Zealand, and Singapore (with Brunei joining the negotiations in 2005), called for trade liberalization that went beyond traditional border barriers to include the regulation of intellectual property, rules of origin, government procurement and other “behind-the-border” measures. In November 2009, the Obama administration affirmed an earlier Bush administration decision to take part in TPP negotiations, which concluded in October 2015.

TPP’s problems have given a boost to the Asian-focused Regional Comprehensive Economic Partnership (RCEP), which includes 16 countries. With six countries having signed FTAs with ASEAN as a bloc, the next logical step seemed to be a broader FTA. Japan first proposed a free-trade area covering the so-called ASEAN+6 countries. China initially pushed for an ASEAN+3 grouping, excluding India, Australia and New Zealand, but finally agreed to the ASEAN+6 approach. The idea of creating RCEP was first discussed in November 2011 and formalized a year later. Currently, negotiations are ongoing and 14 rounds have been completed. Although participants have set the end of 2016 as the target for completion, this deadline will almost certainly be missed. But were the RCEP to succeed and TPP to die, China could even lead a broader regional agreement.

### TRIPLE THREAT TO THE WESTERN LIBERAL TRADING ORDER

What has led to the problems that we see in the Western liberal trading order? The candidates include declining US hegemony and the rise of

1 Naazneen Barma, Ely Ratner, and Steven Weber. "A world without the West." *The National Interest* 90 (2007), pp. 23-30.  
 2 See: World Trade Organization, "Regional Trade Agreements," [www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm).  
 3 See Vinod K. Aggarwal and John Ravenhill, "Undermining the WTO: The Case against 'Open Sectoralism,'" *AsiaPacific Issues*, No.50 (Honolulu: East-West Center, February 2001).

4 David H. Autor, David Dorn, and Gordon H. Hanson, "The China Syndrome: Local Labor Market Effects of Import Competition in the United States," *American Economic Review*, 2013, 103(6), pp. 2121-2168.  
 5 For the extensive political science and economics literature on this topic, see Sonia N. Aggarwal and Vinod K. Aggarwal, "Industrial Policy: Theory and Practice," forthcoming.

6 Vinod K. Aggarwal and Simon J. Evenett, "Do WTO rules preclude industrial policy? Evidence from the global economic crisis," *Business and Politics*, Vol.16, No.4, pp. 481-509, 2014, part of a Special Issue on Industrial Policy, edited by Vinod K. Aggarwal and Simon J. Evenett.  
 7 Barack Obama, "Here's the Deal: the Trans-Pacific Partnership," Nov. 6, 2015, [www.whitehouse.gov/blog/2015/11/06/heres-deal-trans-pacific-partnership](http://www.whitehouse.gov/blog/2015/11/06/heres-deal-trans-pacific-partnership).

8 Brock Williams et al., *The Trans-Pacific Partnership: Strategic Implications*, R44361, Congressional Research Service, Feb. 3, 2016.

9 Ashton Carter, US Secretary of Defense Speech "Remarks on the Next Phase of the U.S. Rebalance to the Asia-Pacific," Tempe, Arizona, April 6, 2015, [www.defense.gov/News/Speeches/Speech-View/Article/606660/remarks-on-the-next-phase-of-the-us-rebalance-to-the-asia-pacific-mccain-instit](http://www.defense.gov/News/Speeches/Speech-View/Article/606660/remarks-on-the-next-phase-of-the-us-rebalance-to-the-asia-pacific-mccain-instit).

10 Gary Clyde Hufbauer, "Could a President Trump Shackle Imports?" *16-6 Assessing Trade Agendas in the US Presidential Campaign* (2016), p. 5.

China, a fraying US domestic coalition for free trade and an erosion of the ideological consensus — particularly among rich countries — on the benefits of trade.

A systemic explanation focuses on the relative balance of power between the dominant state, the US, and a rapidly-rising China. During the Cold War, the US promoted open markets among its allies as a bulwark against the Soviet bloc. Yet, following the end of the Cold War, the security justification for supporting "free-riding" allies began to erode, and Trump during his campaign fully exploited this changing sentiment. Following the inclusion of China into the WTO in 2001, its rapid export growth began to pose a new challenge to the US-led trading order. From the standpoint of the theory of hegemonic stability, China has increasingly moved toward becoming a peer competitor of the US, making policy co-ordination more difficult.

At the domestic level, rapid Chinese import penetration of the US market,<sup>4</sup> often with US companies located in China leading the charge, has led to the disappearance of domestic manufacturing jobs, eroding the political consensus for free trade in the US. This should not have come as a surprise to liberal economists except for their self-induced, formalized naiveté about the economic costs of adjustment. The mantra of "let them adjust" ignored the massive literature on active labor market policies, lobbying and other aspects of the political economy of trade that has long been a staple of international and comparative political economy. By ignoring these costs, liberal economists have been directly responsible for the rise of protectionist populism.

The other aspect of the domestic political economy of trade concerns industrial policy. While economists have been highly skeptical of the ability of states to successfully promote industrial policy, they have often ignored the success of at

least some states in getting intervention right.<sup>5</sup> Recent work on China's aggressive support for its companies, both state-owned and private, shows that even "green" new-growth sectors — where presumably developed countries would find a comparative advantage — have fallen victim to the glut of Chinese bank-led financing in the wind, solar and other sectors.<sup>6</sup>

From an ideological perspective, non-governmental organizations have played an important role since NAFTA in promoting an alternative vision of the costs of trade. In addition to arguments about health and environmental implications, criticism of multinational companies has found its way into the mainstream. Moreover, this theme has been taken up not only by activists and unions but by prominent academic economists such as Paul Krugman, Larry Summers and Joseph Stiglitz.

The political implications of these three developments are quite clear. The major party candidates in the US presidential election both turned protectionist. In June 2016, Trump called TPP a "rape of our country" and NAFTA the "worst trade deal in the history of the country." Both candidates, but particularly Trump, also singled out China for opprobrium.

#### SELLING THE TPP: SECURITY FRAMING

In the face of sharp opposition to trade liberalization, and to globalization more generally, the Obama administration (and the Bush administration before it) pushed the importance of the TPP as balancing China — economically, politically and from a broader strategic standpoint. Obama argued that "if we don't pass this agreement — if America doesn't write those rules — then countries like China will."<sup>7</sup> Returning to the post-Second World War tactic of selling trade accords in a security context, there is now an increasing reliance on oversold strategic claims

with respect to the TPP.<sup>8</sup> As current Secretary of Defense Ashton Carter put it, "In terms of our rebalance in the broadest sense, passing TPP is as important to me as another aircraft carrier. It would deepen our alliances and partnerships abroad and underscore our lasting commitment to the Asia-Pacific."<sup>9</sup>

The temptation to frame the TPP in economic and strategic balance-of-power terms diverted attention from the specifics of the agreement. The result has been a failure to promote TPP on its economic merits. With its likely demise, the Chinese have lost no time in moving forward with RCEP.

#### LOOKING TO THE FUTURE

Some have suggested that RCEP could provide a stepping-stone to the broader regional free-trade agreement in APEC that was initially pushed by the US. Originally, the idea was that both TPP and RCEP could become part of the FTAAP, with the former going further in its liberalization efforts than the latter. But with the election of Trump, the US appears set to give up its leadership on trade issues in the Asia-Pacific region and even risks being excluded from agreements such as RCEP.

RCEP is likely to follow the Chinese approach of signing first and negotiating later. It is also much less focused on behind-the-border measures, which were the subject of the TPP. With most Asian countries pursuing active industrial policies, strongly binding rules that would constrain government behavior seem unlikely.

What comes next is unclear. The US president has the legal authority to raise tariffs both across-the-board and selectively.<sup>10</sup> Thus, the constraints that Trump faces are more in the realm of political economy than law. A trade war with China would have costly implications for all parties concerned, and particularly for smaller Asian states that are part of the Asia-Pacific global supply chain.

Still, some of the calls for high tariffs and naming China a currency manipulator may simply be an opening gambit in a businessman's approach to trade negotiations. NAFTA is due for modernization and the TPP had genuine problems with respect to environmental provisions and investor-state dispute settlement. Trump has argued that he favors a bilateral approach to trade agreements, a policy pursued actively in the 2000s but with the resulting "noodle bowl" problem that motivated larger agreements such as the TPP. Yet, without attention to the very real issue of promoting domestic adjustment programs for workers, it is unclear how new trade agreements will satisfy Trump's core constituency.

It remains to be seen if the US can again provide leadership on trade or if it will abdicate this role to China, which would see a Trump presidency accelerating the demise of the post-Second World War liberal economic order.

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