

## **IHS Markit examines the long list of Asian national governments' concerns that free-trade agreements across the Asia-Pacific region will have to navigate following the US withdrawal from the Trans-Pacific Partnership.**

The United States' withdrawal from the Trans-Pacific Partnership (TPP) in January suspended eight years of contentious negotiations aimed at creating the world's largest free-trade bloc. The unratified agreement would have been between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam and the US, together representing nearly two-fifths of global economic output and more than a quarter of trade. The remaining signatories aim to negotiate a new agreement, while China, which was not included in the original TPP deal, is spearheading a Regional Comprehensive Economic Partnership (RCEP) with the 10 Association of Southeast Asian Nations (ASEAN) members as well as Australia, Japan, India, New Zealand and South Korea. The prospect of a China-led trading bloc is compelling: the RCEP would create an economic bloc with a combined population of approximately four billion, accounting for nearly 30% of global trade. During the Asia-Pacific Economic Cooperation (APEC) Summit in November 2016 in Lima, Peru, Chile and Peru expressed their interest in joining the RCEP in anticipation of US withdrawal from the TPP. Meanwhile, the chances of forming a Free Trade Area of Asia-Pacific (FTAAP) involving 21 Pacific Rim countries are also increasing since Chinese president Xi Jinping's pro-globalisation speech at the World Economic Forum in Davos.

**China will push for FTAs within the Asia-Pacific region and beyond in a bid to boost its slow-growing economy and expand its strategic influence.** When Xi became president of China in November 2013, the RCEP, first suggested for discussion in 2011, was still nascent, while the TPP concept, first discussed in 2005, was gathering momentum as a primarily Japanese and US initiative. Xi eschewed both to focus on the 'One Belt, One Road' (OBOR) initiative from late 2013. Rhetorically, OBOR aims to revive the classical and medieval 'Silk Road' and create land and sea links through Central Asia, West Asia, the Middle East, and Europe – spanning about 60% of the world's population and 40% of global GDP. If operationalised, it would be as economically and politically significant as the TPP and the Transatlantic Trade and Investment Partnership (TTIP), a still-inchoate trade agreement envisaged between the European Union and the United States. The inclusion of OBOR in China's 13th Five-Year Plan (2016–20) highlights Xi's attachment to it as his landmark achievement before his second and constitutionally last term ends in 2022. So far, projects worth more than USD900 billion are either planned or under way across OBOR, according to a 2017 Fitch Report. The concept, which subsumes several previous and concurrent initiatives, has become a key component of China's economic ambitions in Asia and beyond. The extensive infrastructure development implicit in it – infrastructure in which Chinese state-owned firms often retain control – will enable new trade links to flourish and ensure that China's USD11-trillion economy sits at the centre of any future trade agreement in Asia.

**Through the Beijing-based Asian Infrastructure Investment Bank (AIIB), China will help fund huge ambitious project investments across Asia-Pacific.** The AIIB, another initiative launched by Xi in October 2013, has emerged as a

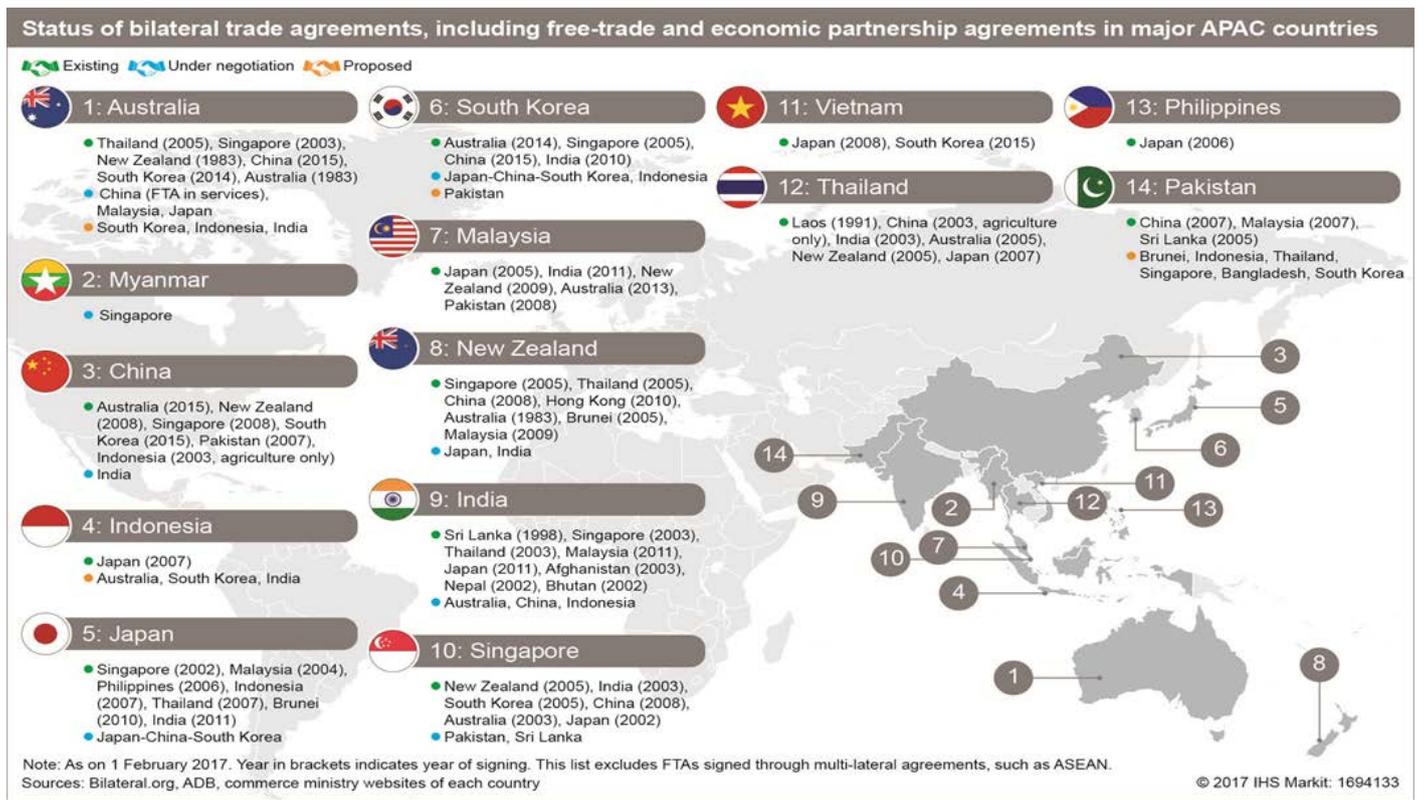


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significant alternative to the US-dominated World Bank (WB) and Japan-dominated Asian Development Bank (ADB). The AIIB has approved projects worth about USD800 million across Asia-Pacific, and funding for projects worth similar amounts is under consideration. In addition to this financing, China was one of the leading foreign direct investors in Australia, Laos, Malaysia, Pakistan, and Singapore in 2015, according to data compiled by The Heritage Foundation, a Washington-based think tank. These investment drives will probably play a major role in forging trade relationships in the region, increasing China's bargaining power in any eventual RCEP or TPP deal including China.



### Political roadblocks

However, trade logic alone will not compel an Asian FTA. Political concerns including territorial disputes, security, and domestic constituencies will temper Asian governments' enthusiasm for any deal that leaves their producers over-reliant on Chinese demand or undercut by Chinese suppliers.

### Japan

Although Japan was a relative latecomer to the TPP, Prime Minister Shinzō Abe's administration has been a staunch supporter of the agreement since the country's application was approved in March 2013. In part, this is because the government sees the agreement as serving Japan's competition with China for diplomatic, economic, and trade dominance in the Asia-Pacific region. Despite initial official talks in March 2013, a China-Japan-South Korea FTA never emerged. Chinese and Korean insistence on formal Japanese apologies for actions during the Second World War has long sullied negotiations. Then, the sharp deterioration in China-South Korea relations after then-South Korean president Park Geun-hye's July 2016 decision to allow the US Terminal High Altitude Area Defence (THAAD) system to be based in South Korea abruptly ended the so-called 'new honeymoon' in Sino-Korean relations touted by Chinese officials and media as recently as 2015. Japan and China also continue to compete for influence and market share in ASEAN economies, where they eagerly fund infrastructure and power projects through development aid, soft loans, and state-owned enterprises (SOEs; more in China's case), and through the ADB and the AIIB, respectively.

Nonetheless, in early January, Japan became the second national legislature to ratify the TPP after New Zealand, despite the incoming US administration making clear its intention to withdraw the United States from it. This was probably intended to signal commitment to the deal for powerful domestic constituencies: Japan's ratification had been delayed by US-Japan disagreement over the domestically controversial issues of agriculture and the automotive sector.

Even if the TPP or another regional agreement were to progress, Japan would continue demanding long lead times to gradually reduce its tariffs or import quotas for key products such as beef or rice; rice farmers, in particular, wield a significant influence on Japan's politics. Nonetheless, free trade enjoys broad, cross-party support across Japan's policy-makers. Therefore, it will continue to be promoted beyond the current Liberal Democratic Party (LDP) coalition government. Nevertheless, Tokyo is engaged in a territorial dispute over the East China Sea with Beijing, and controversial historical references to the Second World War continue to sour bilateral meetings. Unless China and Japan, the region's leading economies, resolve their territorial dispute and create trust, the formation of a meaningful regional multilateral trade deal is highly unlikely in the short term.

## Vietnam

Given Vietnam's huge economic dependence on foreign trade – more than 150% of GDP – the government will pursue its commitment to developing bilateral trade in the region and beyond. This can be seen in its record of enacted FTAs with all its major trading partners: Australia, China, the European Union, India, Japan, New Zealand, South Korea, the United States, and nine other ASEAN countries. Several of these FTAs have been entered into through ASEAN, reflecting Vietnam's shared interest with its fellow ASEAN member states of having an economy open to international trade.

In November 2012, the Communist government supported negotiation of the RCEP as a way to deepen and harmonise the trade and investment links between all 16 countries. Vietnam's commitment to free trade was also evidenced in its strong support of the TPP until it was cancelled. Vietnam's newest FTA is with the European Union, for which negotiations were launched in June 2012 and concluded in December 2015, with the FTA due to come into force in early 2018. As a result, the government has begun harmonising its regulations to EU standards and lowering tariffs on agriculture items from 67.7% to nearly 30% over the next three years. After the US withdrawal from the TPP, Hanoi has signalled its intention to foster a stronger trade and economic relationship with Beijing. Vietnam has also softened its stance over the contested islands in the South China Sea, following the visit of Nguyễn Phú Trọng, the general secretary of the Communist Party, to Beijing in January. Hanoi's censorship relating to the Sino-Vietnam War (1979) during that visit indicates the government's willingness to strengthen ties with China.

## Malaysia

Malaysia will continue to support regional efforts to create an FTA to aid its economic diversification away from commodities. Successive Malaysian prime ministers have supported FTAs, both bilateral and regional. Prime Minister Najib Razak has signed the TPP agreement and now supports the RCEP. He has forged closer economic ties with China in the past 12 months, securing a commitment to USD33 billion of new investments on his visit to Beijing in November 2016. Malaysia also has an FTA with China as part of the broader ASEAN-China agreement. Although the government supported the FTA, it had concerns about its ability to protect its SOEs and locally owned businesses and managed to secure exemptions against non-discriminatory procurement rules.

Future Malaysian governments will probably continue to protect SOEs and locally owned businesses from greater competition. In 2016, the Hope's Pact (Pakatan Harapan: Pakatan) opposition coalition voted against Malaysia joining

the TPP on the grounds that increased competition will hurt small domestic businesses and increase prices for essential goods such as medicines because of greater patent protection. In the highly unlikely event that Pakatan takes power after the next election in 2018, it will probably also support joining the RCEP, despite its protests against the TPP because most Pakatan leaders were former members of the ruling National Front (Barisan Nasional: BN) party, and they share a similar outlook on trade.

### Other major Asian economies

South Korea, China's second major trading partner in the region, signed an FTA with Beijing in June 2015 after just three years of negotiations. The ongoing political paralysis, sparked by the impeachment of Park, is likely to provide little room to feature the country's foreign trade policy. Besides that, South Korea refrained from signing the TPP to maintain balance in its economic relations with China and the United States. Singapore, with the lowest tariff in the region, will remain committed to free trade and investment, and is keen to be part of the RCEP. Meanwhile, Philippine President Rodrigo Duterte has forged a strategic relationship with China, withstanding the territorial dispute in the South China Sea. In fact, since the fallout of the TPP, Philippine officials have shown support for the RCEP, which includes China. Furthermore, China's historical ties with Cambodia were further strengthened when both countries signed a new pact to boost trade and investment in September 2016. As a recipient to China's military and financial aid, Cambodia will welcome any multilateral trade deal involving China.