# Why is East Asian Economic Integration Important to the United States?

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East Asian economic integration has rapidly advanced through several mechanisms: the economic dialogue in APEC and ASEAN+3, financial cooperation via the Chiang Mai Initiative Multilateralization (CMIM), and infrastructure investment through the Asian Infrastructure Investment Bank (AIIB) and portals for implementing China's One Belt One Road initiative (OBOR). Most recently, the Trans Pacific Partnership joined by 12 Asian Pacific countries has been signed, serving as the cornerstone of the U.S. "pivot to Asia." Why should the United States care so much about the degree of economic integration between East Asian nations – the nations encompassing Korea and Japan in the north, China in the middle, and ASEAN in the south? Like "motherhood and apple pie," economic integration seems like a good thing. But to put the question starkly, does economic integration among the 15 countries of East Asia have any greater importance for the United States than economic integration among the 54 countries of sub-Saharan Africa? The answer is a resounding "yes," both for security and economic reasons. Our paper addresses in turn the security and economic aspects of East Asian economic integration from an American perspective.

## The Security Case

The security case covers several themes, which boil down to the proposition that the United States has an overwhelming national interest in ensuring that East Asian nations do not go to war with themselves and certainly not with the United States. Since the Second World War, U.S. military involvement in East Asia has sought to prevent territorial conquest and the disruption of regional peace. But military deployments are expensive in blood and treasure. East Asia's burst into the world trading system has focused regional attention on economic gains rather than territorial disputes. States that trade with one another generally prefer peace to conflict, among other reasons owing to the economic losses that result from the interruption of trade.[1] Conversely, regional economic integration fosters trade growth, thereby reinforcing political stability and reducing reliance on military guarantees. In this sense, East Asian economic integration benefits the United States by lowering demands on its military budget.

The French economist, Frederic Bastiat (1801-1850) reportedly declared, "When goods are not allowed to cross borders, soldiers will," but the exact phrasing probably originated with Franklin Roosevelt's eminent secretary of state, Cordell Hull (1871-1955). Hull, a dedicated free trader, was fond of quoting Bastiat, and saw economic integration as the best means of averting a Third World War between European powers. This sentiment worked its way into the American political fabric, explaining why the Truman, Eisenhower, and Kennedy administrations championed the original European Coal and Steel Community (established in 1951 by the Treaty of Paris), and its successor the European Common Market (established by the Treaty of Rome in 1957), even though both organizations contained features contrary to U.S. commercial interests.

In the wake of the First World War, the United States emerged as the world's foremost military power, a role that has continued to grow for the past hundred years. The United States has entered every major war over the past century: the Second World War, the Korean War, the Vietnam War, the Bosnian war, two Iraq wars, the Afghanistan war, and now the Syrian war. These wars are extremely costly and, apart from the world wars, each of them grew more unpopular the longer they lasted.

The State Department and the Pentagon fully appreciate that a serious East Asian conflict will likely engage the United States. The same is not true of conflicts in sub-Saharan Africa. Marauding tribal forces in Congo, Rwanda, and Burundi have been fighting for decades, killing tens of thousands, without attracting U.S. military action. But Korea and Japan are military allies, and the United States has close security ties with Taiwan, Singapore, and other countries in the region. Conflict in East Asia would act as a powerful magnet for U.S. military engagement. Not a happy prospect.

Recalling Cordell Hull, strong economic ties within the region will guard against the escalation of friction into conflict. Economic integration inevitably creates networks of firms and individuals who harbor a strong interest in peaceful relations with their neighbors. From the U.S. standpoint, it is welcoming that Taiwanese corporations have invested many billions in China, and that two-way trade between Japan and China exceeded $300 billion in 2014. Strong economic ties do not erase disputes between China and Taiwan, or over control of the Senkaku/Diaoyu islands, but they help keep military solutions off the table.

North Korean provocations, South China Sea islands, and the nine-dashed line furnish the East Asian security worries of the moment. Economic ties do not appear to offer an answer to the paranoid provocations of Kim Jong-un. Like his father and grandfather, the current supreme leader minimizes foreign economic engagement. He might be susceptible to strong economic sanctions imposed by China – North Korea's principal trading partner – but, unfortunately, Kim Jong-un resides in a different world than the one envisaged by Bastiat or Hull.

The most critical player in the region, China, holds the key for U.S. security interests. Realists argue that China's rise will threaten the United States by disregarding the rules and institutions of international system to promote its own security, political and economic interests. Liberalists contend otherwise. In their view, China's rise requires an accommodation with international rules and multilateral institutions.[2] For China, the costs of disruption would be much higher than the gains. Since 2001, China's economic participation in the international system, exemplified by the WTO, deepened its economic interdependence with partners abroad, particularly with the United States. China's merchandise exports to the world increased from $266 billion in 2001 to $2.3 trillion in 2015.[3] The United States has been the largest export market for Chinese goods, accounting for 20 percent of China's exports in 2015.[4] The U.S. foreign direct investment (FDI) stock in China rose from $12 billion in 2001 to $66 billion in 2014.[5] To promote continued economic prosperity, China will need to stay in the global trade and investment system, which entails embracing the system's rules and regulations and building bilateral and multilateral trust with its economic partners.

China's militarization of the South China Sea and its claim over vast ocean territory are different matters. China's prosperity, and the Communist Party's monopoly of power, both depend on economic engagement with the world at large. For that crucial reason, China has advanced its territorial claims in small discrete steps separated by months or years – publishing a map, dredging sand, paving runways, building docks, off-loading missiles and fighter planes. China will likely keep pushing, but not so far or so fast that it provokes a military response or economic retaliation. China will not interfere with vast tonnages of merchant marine cargo or warships that pass through the South China Sea daily, but neither will China withdraw from the islands nor publish a new edition of maps without the nine-dashed lines. The standoff satisfies no one, but it is far better than conflict, and it rests on the mutual economic interests of all parties, including the United States.

The density of merchandise exports between East Asian countries soared over the past four decades, reflecting regional economic integration. Table 1 compares the density of merchandise export trade, expressed as a percent of GDP – an indicator of economic integration – between East Asian countries in 1970 and 2014. Particularly impressive is the outsized role of regional exports for Southeast Asian countries. Average regional exports for these countries increased from 10 percent of GDP in 1970 to 38 percent of GDP in 2014. A large share of GDP in Vietnam and Myanmar in 2014 reflects the impact of obtaining ASEAN membership in the recent past. Meanwhile, South Korea exhibited a six-fold increase in its export dependence on East Asia. This can be explained by its active policies to promote trade liberalization as well as the deep engagement of Korean companies into regional supply chains. For the two East Asian giants, China and Japan, the density of merchandise export trade to the region reached 10 percent and 8 percent of GDP respectively, relatively lower figures than other Asian countries.

**Table 1. Density of Merchandise Export Trade Between East Asian Countries as a % of GDP**

| Country | 1970 | 2014 |
|---|---:|---:|
| Australia | 5 | 13 |
| Brunei Darussalam | - | 56 |
| Cambodia | 3 | 19 |
| Hong Kong | 16 | 114 |
| China | 3 | 10 |
| Indonesia | 8 | 12 |
| Japan | 3 | 8 |
| South Korea | 3 | 22 |
| Laos | 2 | 33 |
| Malaysia | 24 | 48 |
| Myanmar | 1 | 29 |
| New Zealand | 4 | 13 |
| Philippines | 7 | 15 |
| Singapore | 43 | 97 |
| Thailand | 6 | 34 |
| Vietnam | 1 | 36 |

Note: Since 1970 data for China and Malaysia is not available, the authors use data for 1990 and 1980 respectively.
Source: IMF Direction of Trade Statistics and UN Statistics

Although these intra-regional trade links contribute to regional political stability as well as the global economy, regional economic integration in the absence of U.S. leadership has sometimes been viewed as a threat to U.S. interests. This mainly reflects the view that China-centered economic groups, such as the Shanghai Cooperation Organization, ASEAN+3, the East Asia Community, the Chiang Mai Initiative Multilateralism, and the Asian Infrastructure Investment Bank could weaken U.S. ties to the region, and lead to Chinese dominance.

However, this is not likely to happen. As Asian countries deepen their economic integration, dialogue among high-level officials will increase, covering both economic and security issues. Most countries will share a common interest in balancing Chinese and U.S. influence. This will diminish the threat to U.S. security interests in the region.

An illuminating example can be drawn from past events. The original inspiration for ASEAN was to dampen guerilla hostilities between Malaysia, Indonesia, and the Philippines. Only slowly did ASEAN acquire the trappings of a free trade area. Indeed, stiff trade barriers still remain between members, and they are being eroded only slowly by the ASEAN Free Trade Area (AFTA). But enhanced economic ties within Southeast Asia, reinforced by the institutional fabric of ASEAN, have almost eliminated the possibility of recurring guerilla wars. In this manner, U.S. security interests were well served by the formation of ASEAN. Today, Asian countries that welcome U.S. commitments in regional security appreciate both U.S. economic engagement and military presence in the region.

For more than 60 years, the United States has stationed large troop numbers in Europe, Japan, and Korea. Table 2 shows current deployments. U.S. forces serve as both tripwires and rapid responders to threatened aggression from Russia, China, or North Korea. Air, naval, and missile support back up the American military presence on the ground. These combined forces provide a military deterrence that has preserved the peace in Europe and Asia for many decades.

The Obama administration has underlined its "pivot to Asia" by such measures as redeploying its naval forces at a six to four ratio between the Atlantic and Pacific fleets. However, it seems unlikely that the United States will continue to station large troop numbers in Europe and Asia for another half-century. Indeed, prominent politicians are already calling on host nations to pay the full cost of current deployments, and voices are heard both in the United States and host nations for complete withdrawal. As the United States gradually winds down its military forces in Asia, economic integration will become an essential guarantor of U.S. security interests in the region. In this light, TPP, China-Japan-Korea investment and trade agreements, ASEAN agreements with the northern Asian powers, CMIM, and AIIB are all critical building blocks for East Asian security during the next half-century.

## The Economic Case

An integrated market, with the U.S. as a key participant, provides a better field for the United States to advocate high standard rules of commercial conduct. This section will examine how U.S. economic interests are protected or affected by TPP, CMIM and AIIB.

Economic integration in East Asia advances U.S. economic interests, especially when the United States is in the party. U.S. multinational corporations flourish when they can operate in large markets. East Asian economic integration makes it easier to operate global value chains that exchange intermediate goods and services between multiple locations and sell final goods and services to millions of customers.

It would, of course, be wonderful if feuding countries in the Middle East, North Africa, Sub-Saharan Africa, and South Asia turned their attention to economic integration rather than border conflicts and sectarian strife. From a security standpoint, that improbable shift of statecraft priorities would lessen the call for U.S. military involvement, much to the

| Table 2. United States Military Deployment (2015) | | |
|---|---|---|
| **Countries** | **Active Military Personnel** | **Percent Military Personnel Abroad** |
| Africa and Southwest Asia | 33,859 | 19 |
| Afghanistan | 9,800 | 6 |
| Iraq | 3,550 | 2 |
| Kuwait | 12,485 | 7 |
| Bahrain | 3,400 | 2 |
| **Turkey** | 1,590 | 1 |
| Dijibouti | 1,243 | 1 |
| Qatar | 613 | 0 |
| United Arab Emirates | 346 | 0 |
| Saudi Arabia | 338 | 0 |
| Egypt | 263 | 0 |
| South Africa | 231 | 0 |
| Asia Pacific | 77,553 | 44 |
| **Japan** | 48,828 | 28 |
| **South Korea** | 27,558 | 16 |
| British Indian Ocean Territory | 504 | 0 |
| **Thailand** | 298 | 0 |
| Singapore | 187 | 0 |
| **Australia** | 178 | 0 |
| Europe | 63,536 | 36 |
| **Germany** | 37,704 | 21 |
| **Italy** | 11,697 | 7 |
| **United Kingdom** | 9,074 | 5 |
| **Spain** | 2,496 | 1 |
| **Belgium** | 1,196 | 1 |
| **Portugal** | 589 | 0 |
| **Greece** | 408 | 0 |
| **Netherlands** | 372 | 0 |
| Western Hemisphere | 1,348 | 1 |
| Cuba (Guantanamo Bay) | 679 | 0 |
| **Honduras** | 402 | 0 |
| **Canada** | 139 | 0 |
| Greenland | 128 | 0 |
| **Total US troops in non-US territories** | 176,296 | 100 |

Note: Some 54 parties have established military alliances with the United States; they are shown in bold type.
Source: Department of Defense, Defense Manpower Data Center

delight of the Pentagon, the CIA, and the American public. But from the standpoint of U.S. economic interests, integration within those regions is far less important than integration in East Asia with the United States as a member.

Table 3 portrays six regions, showing U.S. exports, imports, inward and outward FDI, as well as GDP and population within each region. The foremost partners for two-way U.S. trade and two-way FDI stocks are the European Union and East Asia. In 2014 the top region for U.S. merchandise trade was East Asia, accounting for $412 billion of U.S. exports and $868 billion of U.S. imports, respectively 25 percent and 37 percent of total U.S. exports and imports. For foreign direct investment, the EU claims more than half of total U.S. outward and inward FDI stocks, while East Asia's share has grown to 14 percent for outward FDI and 18 percent for inward FDI. Considering these economic facts, in terms of present U.S. economic interests, East Asia ranks second to the European Union, and well above South America and other regions shown in Table 3.

**Table 3. US Exports, Imports, Inward and Outward FDI Stock, GDP and Population (2014)**

| | US exports of goods | | US imports of goods | | US outward FDI stocks | | US inward FDI stocks | | GDP | Popula-tion |
|---|---|---|---|---|---|---|---|---|---|---|
| | % | $ billion | % | $ billion | percent | $ billion | % | $ billion | $ trillion at current price | million |
| European Union | 17 | 279 | 18 | 423 | 51 | 2,515 | 59 | 1,724 | 19 | 508 |
| East Asia | 25 | 412 | 37 | 868 | 14 | 710 | 18 | 513 | 21 | 2,264 |
| South Asia | 2 | 25 | 2 | 57 | 1 | 29 | 0 | 8 | 3 | 1,721 |
| Middle East and North Africa | 6 | 97 | 5 | 118 | 2 | 82 | 1 | 21 | 3 | 417 |
| Sub-Saharan Africa | 2 | 26 | 1 | 27 | 1 | 35 | 0 | 2 | 2 | 974 |
| South America | 8 | 125 | 5 | 113 | 3 | 139 | 0 | 9 | 6 | 626 |
| Rest of world | 40 | 655 | 32 | 740 | 29 | 1,411 | 22 | 625 | 24 | 5,340 |
| World | 100 | 1,620 | 100 | 2,346 | 100 | 4,921 | 100 | 2,901 | 78 | 11,851 |

Note: Rest of world includes Mexico, Canada and other countries.
Source: International Trade Centre; Bureau of Economic Analysis; and IMF World Economic Outlook

## Trans Pacific Partnership

If deeper East Asian economic integration advances, with the United States as a party to trade and investment pacts, then U.S. commercial interests will benefit from larger markets and faster growth. Table 4 summarizes estimates by Peter Petri and Michael Plummer of U.S. export and GDP gains from various configurations of economic integration: the present 12-member TPP, a 16-member TPP, an FTA of Asia and the Pacific (FTAAP), and a U.S.-China FTA. Under the current TPP, U.S. GDP is projected to increase by $88 billion or 0.4 percent annually when fully phased in. Exports by 2025 will grow by $263 billion or 8 percent of the baseline projection. If TPP expands to 16 members, U.S. GDP and export gains are projected at $328 and $698 billion respectively.[6] If the United States and China eventually conclude an FTA, U.S. GDP gains are estimated at 0.6 percent annually, corresponding to U.S. export gains of 13 percent over baseline. The FTAAP would deliver the largest gains, boosting U.S. GDP by 1.6 percent and exports by almost 25 percent.

| Table 4. US Export and Income Gains from Various Configurations of Economic Integration | | | | | |
|---|---|---|---|---|---|
| | unit | 2025 change from baseline | | | |
| | | TPP12 | TPP 16 | FTAAP | US-China FTA |
| Income gains | $ billion | 88 | 108 | 328 | 130 |
| | percent | 0.4 | 0.5 | 1.6 | 0.6 |
| Export gains | $ billion | 263 | 191 | 698 | 373 |
| | percent | 7.9 | 6.8 | 24.8 | 13.3 |

Note: TPP 16 includes TPP 12 members plus Korea, Indonesia, Philippines, and Thailand. FTAAP includes TPP 16 members plus China, Hong Kong, Russia, Taiwan and other Asian countries.[7]

Not only are potential U.S. trade and investment gains quite substantial from these assorted configurations of engagement with East Asia, but also prospective agreements will embrace commercial rules very much to U.S. tastes. This was true of chapters agreed in the TPP, and it will very likely be true of other East Asian agreements with U.S. membership. If such rules are widely adopted in East Asian pacts, they will furnish a new template for the WTO rulebook. To provide a flavor of the new rules, we summarize key features of several TPP chapters – features that might not make an appearance in East Asian pacts without U.S. membership.[8]

## National Treatment and Market Access

TPP Chapter 2 extends the general national treatment principle to sub-federal governments, limits performance requirements and export restrictions, and calls for transparent licensing procedures. However, TPP members scheduled numerous exceptions for a wide variety of non-conforming measures. Historically, the elimination of tariffs has been the centerpiece of FTAs. In principle, tariffs on merchandise trade should go to zero in TPP. In practice, negotiators spent a huge amount of time carving exceptions to the zero tariff principle. The exceptions take two main forms: long phase-out periods for certain tariffs and tariff-rate quotas – zero or low tariffs for a defined quantity of imports, then for a time much higher tariffs for imports above the quota for a handful of products, primarily in the agricultural sector. But zero tariffs are the eventual endpoint.

## Sanitary and Phytosanitary Measures (SPS)

SPS refers to rules ensuring food safety and animal and plant health standards. TPP Chapter 7 affirms the U.S. position as to the proper operation of an SPS regime: scientific analysis and risk management as the touchstones for excluding doubtful imports. In addition, the TPP text enables trade in genetically-modified organisms (GMOs) in the chapter on national treatment and market access for goods.

## Technical Barriers to Trade

TPP Chapter 8 reaffirms the role of sound science in writing technical standards, emphasizes open and transparent rule-making procedures, and commends the adoption of international standards. The novel feature of Chapter 8 is national treatment of certifications issued by conformity assessment bodies located in partner countries. To illustrate, if a competent Japanese conformity assessment body certifies that an X-ray machine made in Japan meets U.S. standards, the relevant U.S. authorities must accept that certification. This feature carries out the slogan, "Tested once, accepted everywhere." However, TPP Chapter 8 does not call for mutual recognition of national technical standards – except in select cases like the U.S.-Japanese bilateral side letter on vehicle safety regulations – nor does it establish a process for harmonizing national standards. Consultation yes; progressive harmonization no.

## Investment

Heated and often uninformed objections are focused on the Investor-State Dispute Settlement (ISDS) provisions of Chapter 9. ISDS enables a foreign investor to claim damages from a host state on account of denial of national treatment, denial of most favored nation treatment, denial of "fair and equitable" treatment, or expropriation that is not properly compensated. Although a staple of bilateral investment treaties and FTAs for more than 50 years, ISDS has now come under attack. Put succinctly, the opponents list several reasons for opposing ISDS.

- The most basic objection is that corporate investors should not be permitted to invoke international arbitration panels to sue host governments; suits should be pursued solely in the courts of the host country.
- Arbitrators are often corporate lawyers who may be biased against host governments.
- Briefs and proceedings are often closed to the public.
- Corporations use ISDS cases to undermine legitimate environmental, health, and safety regulations.
- Arbitration awards are final; ISDS has no mechanism for appeals.

The ISDS provisions in TPP Chapter 9 are significantly revised from earlier ISDS provisions (for example in NAFTA) and the changes in TPP answer these charges except for the first and the last.

## Cross Border Trade in Services

The TPP opens up avenues for more than a hundred services to be sold abroad. Expanded exports of services trade potentially rank among the largest TPP payoffs, especially for the U.S. economy. According to forecasts, in 15 years TPP exports of services will expand by $225 billion on account of the pact, and of this total U.S. exports will expand by $150 billion.

Services trade rightly received considerable attention in TPP negotiations. In fact, 12 service sectors and approximately 168 subsectors are identified. Seven TPP chapters are devoted in whole or part to these variegated services. Chapter articles set forth principles of liberalization. In broad terms, with many scheduled exceptions, TPP members have now promised fair and equitable treatment to foreign firms that seek to enter their service markets through trade, investment, or both together.

## Telecommunications

Quite simply, the theme of TPP Chapter 13 "Telecommunications" is competition. In every way possible, TPP members are directed or encouraged to open their markets to landline, Wi-Fi, and mobile services and devices offered by public or private firms based in partner countries. Incumbent carriers, often monopolies, are instructed in considerable detail not to throw up obstacles to foreign firms, and they are directed to make their fixed assets (poles, rights of way, network hubs) available to those competitors at reasonable rates. Roaming rates for mobile phones and other devices should be reasonable.

## Electronic Commerce

Chapter 14 ranks among the outstanding achievements of TPP. For the first time a trade agreement covers the exploding field of digital traffic and electronic commerce – and in a meaningful way. Duties on digital commerce (not involving the shipment of merchandise) are ruled out. Free flows of data and other information are ensured, with the important exceptions of financial data (reserved in Chapter 11), and public interest measures to fight cyber-crime and preserve individual privacy. Individuals and firms are allowed to encrypt their electronic transmissions; again, however, this is qualified by a public interest exception. TPP members commit not to require firms to disclose their source codes, and to allow firms to make their own choices with respect to software and equipment.

## State-owned Enterprises

TPP Chapter 17 was written with China's potential entry in mind. China has over 100,000 SOEs, and complaints about their unfair advantages are mounting. Apart from Malaysia and Vietnam, current TPP members do not have many SOEs; so the immediate impact of SOE disciplines in the TPP will be concentrated on those two countries. TPP basically prohibits SOEs from discriminatory behavior towards other TPP firms when buying or selling goods or services. With exceptions, Chapter 17 also prohibits governments from giving subsidies to their SOEs. Local courts must have jurisdiction over SOEs in civil claims concerning commercial matters, and administrative bodies must regulate SOEs in an impartial manner. Groundbreaking transparency provisions require countries to provide other TPP members with a list of all SOEs and furnish specific information when requested. All SOE provisions are subject to the dispute resolution mechanism of the TPP, meaning that any violation could ultimately result in trade sanctions.

## Labor and Environment[9]

Chapter 19, "Labor," adopts the fundamental labor rights recognized by the International Labor Organization (ILO). As a consequence, TPP promotes freedom of association (trade unions), the right to collective bargaining, the elimination of forced labor, the abolition of child labor, and the elimination of employment discrimination. TPP members are required to have domestic laws governing minimum wages, hours of work, and occupational safety and health. To carry out these mandates, the United States will establish bilateral implementation plans with Brunei, Vietnam, and Malaysia.

Chapter 20, "Environment," addresses environmental challenges such as wildlife trafficking, illegal logging, illegal fishing, and marine pollution. It requires all parties to implement multilateral environmental agreements. TPP also creates enforceable commitments to eliminate tariff and non-tariff barriers to the importation of environmental goods and technologies. As a notable feature, TPP countries agree to ban subsidies to illegal fishermen, and to provide greater transparency for fishery subsidy programs.

## Chiang Mai Initiative Multilateralism (CMIM)

The Chiang Mai Initiative Multilateralization (CMIM) is a multilateral currency swap arrangement between ASEAN, China, Japan, and South Korea. It combines the ASEAN Swap Arrangement among ASEAN countries and bilateral swap arrangements among ASEAN+3 nations. The conceptual origin of this arrangement dates to the Asian Financial Crisis of 1997. Launched by ASEAN+3, the Chiang Mai Initiative (CMI) created a short-term liquidity mechanism that supplemented existing international arrangements. CMI member countries were dissatisfied with the way the IMF (dominated by the United States and Europe) handled the 1997 Asian Financial Crisis, and consequently they created a self-help regional mechanism to address future crises.[10]

Since its inauguration, the CMI has expanded to the CMIM and added the ASEAN+3 Macroeconomic Research Office (AMRO) in 2010. Recent developments include a larger size of potential swap lines, an IMF de-linked portion, and a broader scope of facilities. The total size of the CMIM capital pool has increased from $120 billion to $240 billion, contributed by ASEAN ($48 billion) and the Plus Three ($192 billion). The threshold for IMF linked facilities is currently 30 percent, meaning that borrowing members who need to draw more than 30 percent of their maximum amount must meet IMF lending conditions. As for the scope of facilities, the CMIM established the CMIM Precautionary Line (CMIM PL), a facility that assesses policy implementation before making loans, and the CMIM Stability Facility (CMIM SF), a facility that requires certain policies in listed criteria after loans are extended.[11]

One possible conclusion is that the CMIM will reduce direct reliance on the IMF and thus indirect reliance on the United States.[12] McKay, Volz and Wölfinger argue that a regional financial arrangement can undercut IMF conditionality that requires borrowing countries to adopt rigorous and painful economic policies and structural reforms.[13] In this regard, Asia's financial integration can be seen to weaken the U.S. economic leadership in the region and point to greater autonomy from the key international monetary and financial institution, the IMF.

A more optimistic conclusion, from the U.S. perspective, is that the CMIM will serve as a supplement to the IMF rather than as a challenger.[14] The norms of the CMIM still reflect IMF norms, which in turn answer to U.S. influence. The CMIM requires countries to meet economic performance criteria after loans are extended, which amounts to ex post conditionality just like the IMF. China, Japan and South Korea—the dominant creditors—also require IMF approval in case of significant CMIM loans, to prevent potential borrowers from shopping for bailout loans without conditions.

However, the CMIM is still a work in progress with respect to ex ante conditionality. It remains to be seen whether CMIM rules in this respect will be aligned with IMF guidelines.[15] In this and other respects, the future evolution of the CMIM will shape Asia's relationship to the IMF and the United States. Asian countries could create one voice to encourage changes in IMF rules and norms – perhaps not to U.S. liking. But self-managed liquidity within Asia and a coordinated Asian policy response could limit the domino effects of future crises. In short, from the perspective of U.S. interests, the CMIM is a mixed package. U.S. influence may be diminished, but Asian crises may be less severe, to the advantage of U.S. business interests as well as Asian economies.

### Asian Infrastructure Investment Bank (AIIB)

Launched by China in 2015, the Asian Infrastructure Investment Bank (AIIB) is a new Asian development bank focusing on infrastructure projects. The long-established Asian Development Bank (ADB) has estimated a gap of about $8 trillion (2008 real terms) infrastructure investment between 2010 and 2020 to maintain Asian growth rates.[16] For example, 800 million Asian households lack electricity, and 600 million people have no access to safe water.[17] The AIIB will narrow these gaps by boosting investment in energy, transportation, water, telecommunication, electricity, and other infrastructure sectors. The AIIB is expected to lend $10 to $15 billion per year starting in 2016, both supplementing the World Bank and the Asian Development Bank and co-financing projects with the existing international development banks, gaining from their expertise. The AIIB has 57 members from Europe, the Middle East and Asia, but unfortunately (by their own choice) neither the United States nor Japan.

Infrastructure development is expected to create jobs, decrease trade costs, and promote economic growth in Asia. Many possibilities can be envisaged. For example, construction of roads, railways and harbors can improve access to foreign and domestic markets. Internet cables and wireless towers can engage local firms in e-commerce on a much larger geographic scale. U.S. firms engaged in Asian commerce could obviously benefit these fruits of AIIB activity. Viewed optimistically, TPP can be seen as creating the software for Asian trade and investment, while AIIB can be seen as furnishing the hardware.[18]

For geo-strategists, however, the AIIB is viewed as a rival to U.S. dominated financial institutions, notably the World Bank and the Asian Development Bank, perhaps undercutting their effectiveness. But since many European and Asian countries joined the AIIB, it is now an established institution. Even if China is the largest shareholder with 26 percent, the other 56 participating members have a say in drafting governance rules and lending standards. It remains to be seen whether AIIB practices disadvantage U.S. firms at the construction stage or in on-going operations.

In retrospect, the U.S. decision not to join the AIIB at the outset was a mistake. Bergsten argued that, "concerns about [AIIB] backsliding from standards on transparency, procurement, and anticorruption are justified, but the way to address them is to join the institution and work from within."[19] A future president may accept Bergsten's view and see the AIIB as complementing the TPP. Conceivably the United States might join the AIIB in the same negotiating package that brings China into the TPP.

## Conclusion

The United States will achieve substantial security and economic benefits from continued East Asian economic integration, especially with the U.S. as a partner. From a security perspective, regional economic integration in East Asia can help prevent escalation of tension into conflict because, with integration, the costs of conflict will more likely outweigh any gains in terms of nationalistic pride or acquired territorial. As China becomes more deeply involved in the global economic regime, its accommodation with international rules will become a main path for promoting domestic prosperity, which in turn will restrain China from disrupting regional peace and stability with aggressive military actions. Rapid economic integration in East Asia serves U.S. security interests, reducing the risk that tensions will draw the United States into an Asian military

Looked at from an economic perspective, free trade pacts and infrastructure investment in East Asia will not only expand the regional economy, but also will boost the American economy, especially with U.S. participation. TPP can deliver 21st century commercial rules that reflect U.S. values and can serve as a guide for future East Asian free trade agreements. The CMIM can serve as an emergency responder to regional financial shocks, often applying IMF rules and supplementing the IMF's financial resources. The AIIB, alongside the ADB, can design and finance regional infrastructure spurring job creation and business opportunities, and promoting economic development across East Asia. It seems likely that all three functions will improve the economic climate for U.S business interests in East Asia, even if takes time and careful monitoring to ensure that the CMIM and AIIB respect international rules.

U.S. failure to ratify TPP would amount to a colossal policy error, compounding the mistaken U.S. decision not to join AIIB, and its sidelined position in the CMIM. Even without TPP economic integration will move forward, but at a slower pace and with weaker rules of the commercial road. If the TPP is delayed by U.S. political opposition, the Regional Comprehensive Economic Partnership (RCEP) could enter into effect well ahead of the TPP and establish the template for future Asian integration. But, the scope and pace of trade liberalization under the RCEP will not be equivalent to what the TPP could accomplish. Delay could cause the United States to miss a golden opportunity to establish rules for Asian Pacific trade and investment liberalization. By contrast, if TPP is ratified in 2016 or 2017, and then expanded to add new members over the next five years, and if through an FTAAP the United States and China enter into closer economic relations, perhaps involving the AIIB, the Pacific region will prosper and security tensions will dissipate over the next decade.

## Endnotes

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6. The values discussed for TPP 16, FTAAP, and U.S.-China FTA are expressed in billions of 2012 dollars while the values for TPP 12 are in billions of 2015 dollars.
7. From scenarios reported on asiapacifictrade.org, Peter A. Petri, Michael G. Plummer, and Fan Zhai, "The Effects of a China-US Free Trade and Investment Agreement," in C. Fred Bergsten, Gary C. Hufbauer, and Sean Miner, *Bridging the Pacific: Toward Free Trade Between China and the United States* (Washington: Peterson Institute for International Economics, 2014).
8. The TPP section is drawn from Gary Hufbauer & Cathleen Cimino-Isaacs, "TPP Lessons for TPP," draft February 2016. Summaries of the TPP chapters are based on "Assessing the Trans-Pacific Partnership, Volume 1: Market Access and Sectoral Issues," *PIIE Briefing* 16-1 (Washington: Peterson Institute for International Economics, February 2016); and "Assessing the Trans-Pacific Partnership, Volume 2: Innovations in Trading Rules," *PIIE Briefing* 16-4 (Washington: Peterson Institute for International Economics, March 2016). Also see, Peter A. Petri and Michael G. Plummer, "The Economic Effects of the Trans-Pacific Partnership: New Estimates," *PIIE Working Paper* 16-2 (Washington: Peterson Institute for International Economics, January 2016).

9. The Labor and Environment section is based on USTR (2016), TPP Chapter Summary Labor, https://ustr.gov/sites/default/files/TPP-Chapter-Summary-Labour-1.pdf and TPP Chapter Summary Environment, https://ustr.gov/sites/default/files/TPP-Chapter-Summary-Environment.pdf (accessed on March 3, 2016).
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