

Four economic building blocks for a “Free and Open Indo-Pacific”

Written by: Dinesh Ahluwalia for the *Macroeconomics, Trade & Investment Policy Group* at the *Indo-Pacific Dialogue* September 10th, 2019

Abstract: The purpose of this report is to propose an outline of four economic policy proposals to help strengthen and provide continued leadership for a rules-based order within the *Indo-Pacific region* that supports macroeconomic stability and a framework for increased trade and investments within the region.

This paper sets the stage with a narrative that US security policy in the larger Asian theater combined by its largely liberal free trade policy back in the US, have helped transform the *Indo-Pacific region* into one of the world’s most sought after consumer and investment markets that we know today. However recent geopolitical events along with the ongoing US-China trade wars have accelerated an ideological divide that has been simmering for years that have created significant amounts of uncertainty within this region.

This paper looks at events leading to the US announcement of the *Indo-Pacific strategy* along with its call for a *Free and Open Indo-Pacific* and counters the notion that these depictions as some competitive answer by the US to China’s ambitious Belt and Road Initiative. The paper observes these *Indo-Pacific* representations as being a continuation of very deep rooted US commitment to the *Indo-Pacific region*.

The paper argues that it is in the economic interest of the US to protect its long held leadership position within the Asian theater and support in the investment and development of institutional building strategies that addresses 21st century challenges to include cybersecurity, intellectual property, artificial intelligence, digital trade, infrastructure investments, bond market development and Climate Change.

As its main thesis, the paper proposes an outline for current and future US administrations, with four economic policy proposals that should be considered as building blocks for a *Free and Open Indo-Pacific*.

In conclusion the paper reasons that **costs** associated with US institutional building in the Indo-Pacific will provide US businesses the **benefits** to the largest and most lucrative markets outside the US for future generations and also ensure continued shared peace and prosperity within the *Indo-Pacific region*.

Conversely the paper also highlights to policy makers within the *Indo-Pacific region* that security policies implicitly underwritten by the US for decades should also ensure reciprocal access to markets, intellectual property protection and fostering of the ‘ease of doing business’ within their respective markets.

The Asian Economic Forum (a nonprofit organization) is an economic focused ‘think tank’ with a research interest in public policy. Our long term goal is to highlight economic policies that enable economic growth, stability, transparency and free markets in Asia and also enable global stakeholders to have more engagement opportunities in Asia in addition to their traditional points of interaction. The conclusions and recommendations of any Asian Economic Forum Policy Paper(s) are solely those of its author(s), and do not reflect the views of the Asian Economic Forum, its management, or its other Research Resident or Non-Resident Fellows or Scholars.

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The Asian theater post-World War Two

Post-World War Two has seen 74 years of US leadership in the Asian theater that has underwritten an implicit security arrangement despite the ebbs and flows of the Korean and Vietnam conflicts. US security policies within the Asian sphere have unequivocally freed up large amounts of capital and human resources. Nations within the *Indo-Pacific region* have been beneficiaries to one less worry; security.

The US security umbrella has generally enabled peace and stability for the larger *Indo-Pacific region* from the mid-1970's onwards. The peace dividend has enabled almost all countries within the region to focus their efforts from nation building to the financing of various governmental and societal institutions. The ensuing regional stability provided for countries within the region an opportunity to focus their efforts primarily on economic policies based on their ideologies with varying degrees of success.

The US has additionally, during this time period, provided itself as the world largest and most accessible consumer market for every imaginable product to be sold from Asia and globally, in scale and volumes not previously imagined. Free trade policies by which the US has provided its consumers access to whatever it needs at the lowest cost have also been supported by a rules-based order with the belief that its trade deficits will be overcome by innovations and intellectual property creation in the US that results in productivity gains and competitiveness within its private sector.

During this time period Asian countries that implemented market friendly economic policies supplemented by access to cheap labor markets and their willingness to adopt technical skill sets attracted significant foreign direct investments from the US and other Western nations. This combination in turn helped shape what has become the bedrock of the transformation of hundreds of millions of lives into what we call the Asian middle class today. Additionally, reliable access to US consumer markets, in turn helped create considerable wealth amongst the entrepreneurs, companies and state owned organizations within Asia.

Looking back, it should be noted that Asia and much of the *Indo-Pacific region* have made great economic strides in the last 74 years, equally to the credit of their own sacrifices, focus on education, savings along with brilliant execution of policies in some countries. These facts should not be overlooked or understated.

Recent events as a harbinger of macroeconomic instability

The term "**Macroeconomic Stability**" often describes an economy that has minimized vulnerability to external shocks, which in turn increases its prospects for sustained growth and a **measure of stability**.

Stability within East Asia seems to be dissipating with alarming speed in recent months. Tensions in the South China Seas or in the Taiwan Straits are not new however coupled with the ongoing US-China trade war and an ill-conceived extradition bill in Hong Kong that first resulted in protests by large sections of Hong Kong's society and the ensuing downgrade by a credit rating agency adds to a disturbing trendline.

Two additional developments regionally that have escaped the larger global news headlines. Violations of Vietnamese sovereignty within its territorial waters that threaten its energy security. A rapidly accelerated trade war between the governments of South Korea and Japan which could potentially destabilize global supply chains within the electronics and semiconductor industry. When viewed in combination they point perhaps towards a harbinger of *macroeconomic instability* within the region in times to come.

This brings us to an appropriate time to pause and reflect on what would it take for a throwback to days of the past when the emphasis was on trade and economic prosperity for most of the Asian continent.

Timing of the Indo-Pacific strategy

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It is within the backdrop these recent geo-economic and geo-political events and many others that have been simmering for many years that we explore economic policies that could help bring *macroeconomic stability* and a framework for increased trade and investments within the *Indo-Pacific region*.

Trade and economic tensions within this region is not new. China is a rising and a competitive power to the US. China is determined to establish its global leadership and its economic ideology and vision with what it sees at its rightful place at the center of the new world order.

China's Belt and Road Initiative (BRI) as first announced in 2013 is an ambitious infrastructure initiative spanning 152 countries and international organizations in Asia and globally combined with the launch in 2014 of the Asian Infrastructure Investment Bank (AIIB) a multilateral development bank that aims to support the building of infrastructure within the Asia-Pacific region are just some of the many tools that China is using to sharpen its geopolitical ascent to the world stage.

While China's posture in the Asian theater including its stated goals and actions within the South China Seas has been growing muscular over the last decade, the US for its part has been distracted by the polarization of internal politics and ideologies that have ratcheted up with intensity over the last 20 years.

Diverted in mindshare by the Afghanistan and Iraq wars post the horrific events of 9-11 the US seems to have taken a second seat in the Asian sphere at least seen through the lens of most policy makers and business leaders in Asia. Furthermore, the very visible withdrawal by the US from the *Trans Pacific Partnership (TPP)* in early 2017 added to the uncertainty of American commitment to the region.

Fast forward to November 2017 when the outlines of an ***Indo-Pacific strategy*** first emerged at an APEC Summit in late 2017 followed by a more robust announcement in July 2018 which advocated the call for a ***Free and Open Indo-Pacific (FOIP)***. These announcements were initially received unenthusiastically and created some comparisons, albeit to this day, on what amount of dollars are being spent by the US within the Indo-Pacific region, vis-à-vis China's massive outlay on BRI.

Perhaps some of these reactions are understandable in the context of instant narratives and the desire to sensationalize numbers. However, a counter balance to the instant comparative inferences would be a historical observation that lead back to circa. November 1792 when the US first established a consular presence in Calcutta under the leadership of its first President, George Washington. By the 1860's the Calcutta Consulate General had under its jurisdiction seven consular agencies to include the important trading and strategic outposts of the days all the way from Aden in Yemen to Rangoon in Burma.

Reminders that the '*Indo-Pacific*' is therefore not a new competitive answer of phraseology to keep up with a relatively recently announced BRI, but a practical and robust framework of trading history and strategic relationships that have been shaped by trade and security alliances that have weathered storms of changing regional and global powers and world wars over that last 227 years, uninterrupted.

Additionally, a deeper dive on the current *Indo-Pacific strategy and the tenants that a FOIP* currently advocates also reveals an artful balance between economics, governance and security.

Perhaps an ideal opportunity in time for stakeholders to convene, discuss and build upon for future policies that could lead to an even more thoughtful, pragmatic approach to what is needed for the 21st Century.

Rebalancing for 21st Century practicalities

Since 1945 the US has invested enormous sums of resources and assets in maintaining a security policy within the vast *Indo-Pacific region*. Combined with liberal trade policies, capital flows and market driven investments, the US like no other country globally has been primarily responsible for economic prosperity within the *Indo-Pacific region*. Benefits of these policies to the US private sector enabled the deployment

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of capital towards intellectual property creation, technological and productivity enhancements all contributing to ever increasing amounts of wealth creation. Benefits to the US consumer notwithstanding.

Over time benefits of these policies have also come at a significant cost to the US in the form of ever increasing trade deficits and an alarming loss of intellectual property theft. Trade deficits have become a contentious issue to the current US administration as highlighted by the ongoing US-China trade wars.

Without diving into the specifics of the structural changes currently being negotiated by the US and China it would be fair to point that rules of trade previously negotiated do not really apply in today's largely digitally interconnected world of supply chains across multiple geographies. Furthermore, without a proper framework upgraded for the challenges of the 21st century or investments in new institutions that can impose costs on intellectual property theft and cybercrimes, we will see an erosion of a rules based order that has to date helped create an environment of *macroeconomic stability* for decades. Without the support of critical domain expertise and new institutional mechanisms, we risk the wealth creation attributes of a free market based order carefully nurtured over the last 74 years within this region.

Moving forward, regardless of any change of administration in the White House and leadership in Congress in 2020 and beyond, the US should provide leadership on a *FOIP* with a more pragmatic calibration of the times that not only recognizes that the world in 2020 and beyond is very different from that of 1945 and that the new complexities and challenges in the *Indo-Pacific region* should be brought into unison especially when looked through the lens of US security architecture and policy in the region.

Investing in 'Four economic building blocks for a FOIP'

The calibration that US leadership can and should provide to policy makers in various capitals within the *Indo-Pacific region* via a *FOIP*, should be mutually beneficial economic policies and institutional opportunities that bridge the *Indo-Pacific region* and its stakeholders. Apart from robust security leadership that the US currently provides within the *Indo-Pacific region*, the four economic building blocks that should also be essential to integrate within a future *FOIP* must also include the consideration for:

1. The US through its leadership for a *FOIP* should bring institutional knowledge directed towards the challenges faced by sophisticated intellectual property theft and cybercrimes that threaten the economic prosperity of the *Indo-Pacific region* along with all its wealth creation attributes.

Traditional forms of regulation will become increasingly challenged to a host of nefarious activities such as digital fraud, genome malpractice and money laundering.

The establishment of a US agency or institution housed in the *Indo-Pacific region* working with regional stakeholders designed to help combat these issues and potentially recommend corrective measures on bad actors, would be an essential building block of a 21st century *FOIP*.

2. The US through its leadership for a *FOIP* and in working with regional stakeholders can help accelerate knowledge sharing mechanism designed specifically to mitigate challenges associated with next generation payments systems, non-traditional banking, deposit taking, lending, communications (to include social media), insurance products cross-border and trade settlements and a host of future products and services that will all become more prevalent in tomorrow's technologically & mobile savvy societies especially once enabled by *Artificial Intelligence (AI)*.

AI investments have accelerated across the Asia-Pacific region. As *AI* gains traction within capital budgets and sees its deployment across the entire Digital architecture, what are the rules of the game seems to be an open-ended and unanswered question. The impacts of how tomorrow's trade and commerce are conducted along with how privacy, data access and ownership rules are written will depend entirely who creates and defines the standards of tomorrow's *AI* and *Digital Trade*.

A US lead Center for Excellence housed in the *Indo-Pacific region* working with regional regulators

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and stakeholders, designed to help facilitate the establishment and implementation of a framework of regulatory best practices that can help *establish a new order for Digital Trade within a FOIP*.

3. A US lead *FOIP* should also re-engage and provide leadership on an updated regional trade policy, some of which lie within plain sight of the previously negotiated TPP. Once updated with precision these trade policies can help establish greater levels reciprocity, transparency, governance, verification and the respect of individual rights within the countries within the *Indo-Pacific region*.

In the post *TPP* world, Asian countries are pursuing a *Regional Comprehensive Economic Partnership (RCEP)* with an enhanced sense of urgency. Although the final outcome of *RCEP* negotiations is not a forgone conclusion as considerable ideological challenges remain. The larger point is that countries within the *Indo-Pacific region* and *ASEAN* in particular, want to be engaged in a meaningful trade pact that brings greater economic integration, reduces tariffs and friction.

A US lead *FOIP* with an updated regional trade policy can play a pivotal role in liberalizing the international exchange of goods and trade in the *Indo-Pacific region* that brings far greater positive outcomes and market access as compared to the alternatives or disengagement.

Conversely, countries in the *Indo-Pacific region* that subscribe and benefit from the enhanced security architecture of a *FOIP* should also do a better job by aggressively tackling bureaucratic hurdles that range from foreign ownership restrictions within reason to all the components that facilitate cross border trade as highlighted by the World Bank's 'ease of doing business index'.

4. A 2017 report by the Asian Development Bank (ADB) highlights a need for infrastructure investments of approximately \$1.7 trillion per year until 2030 (approximately \$20 trillion over the next 11 years) just to maintain growth momentum, tackle poverty and respond to Climate Change.

The *FOIP* could also be looked by US businesses and capital market participants as opportunities to create new markets and finance infrastructure projects. US leadership in a *FOIP* should also institutionally help advance free market principles where transparency, governance and credit rating assessed projects are the norm and where market forces can freely assess and price risk.

A new US agency or institution with *Indo-Pacific* headquarters tasked specifically to support bond market development than can also work with governments, central bankers and regulators on macroeconomic trade and investment policy assessments with more immediacy, will enrich a *FOIP*.

Institutional building mechanisms would ensure the growth of *Asia's fixed income markets** into larger and more efficient sources of funding especially for regional infrastructure projects for the benefit of local municipalities and provinces. In turn these steps could also help create the world's largest Green/Blue Bond market for *Climate Change* needs within the *Indo-Pacific region*.

The potential of providing an alternative investment mechanism to channel savings directly via an efficient bond market, will be transformational within the *Indo-Pacific region*. The societal impact on billions of lives would in turn ensure a stable, vibrant and economically prosperous *FOIP*.

To help formulate such objectives requires greater precision of leadership and economic policy coordination. US development agencies such as Overseas Private Investment Corporation (OPIC) and United States Agency for International Development (USAID) that already operate in the region could also be valuable regional domain knowledge contributors to such an endeavor.

This new US agency or institution tasked with *Indo-Pacific* regional bond market development and trade and investment policy assessments could also be strengthened with empowering it with oversight capabilities to oversee the investments and aid disbursements of US development agencies in the region to ensure maximum leverage of policy goals for a *FOIP*.

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Furthermore, greater co-ordination on the decision making on investments made by multilaterals that receive US funding within the larger Indo-Pacific region is needed. This new US agency or institution housed within the Indo-Pacific could ensure gaps in governance, oversight and transparency are being addressed in a coherent manner for positive outcomes.

All these steps in combination will have a high correlation to ensure efficient bond markets and greater *macroeconomic stability* within the *Indo-Pacific region*.

Funding for all the new lead agencies as proposed above can be potentially reallocated initially from existing programs. US tax payers would be well served with having their monies appropriated within the *Indo-Pacific region* for 21st century practicalities and engagement that also serves US national security interests and simultaneously protects the interests of US businesses along with their Asian stakeholders.

The US Treasury Department as a part of its International Policy works with other federal agencies, foreign governments, and international financial institutions to encourage global economic growth, raise standards of living, and to the extent possible, predict and prevent economic and financial crises. The US Treasury would therefore be also ideally suited in working with the State Department and advising the US Congress and the Executive branch on how best to augment some of these building blocks proposed.

** A word of caution on financial contagion, currently Asian fixed income markets are vibrant and growing rapidly, however on observation, the High Yield market segments signals an over dependence on issuance by the Real Estate sector especially from Mainland China, with a recent trend of issuer preferences to shorten maturities. Asian High yield bonds, covenants are less onerous than standard credit facility covenants. Reminiscent of early indicators (flight from maturity) of the subprime mortgage crisis of 2008.*

Cost versus benefit conclusions

Within the US they will be voices questioning the reallocation of resources from existing programs or for the rationale of additional investments in these new US lead agencies. It would perhaps be wise in those corridors to be reminded that the Asian markets represent the largest and potentially most lucrative markets for US businesses outside the US, so monies invested in these institutions would be the insurance policy for our shared economic prosperity and interests in the *Indo-Pacific region* for future generations.

Conversely it should be observed that the *FOIP* is currently and primarily looked by sovereign nations in the *Indo-Pacific region* by their security and geo-political interests especially in light of the very visible US-China trade wars, China ascension to a global economic and military superpower status next only to the US and the continued tensions that have emanated in the South China Seas.

A *FOIP* however, should also be looked by nations in the *Indo-Pacific region* as a continuation of US trade and security policies that have flowed from 227 years of history. These US policies have been the bedrock of *macroeconomic stability* and prosperity in Asia for the last 74 years. An insurance policy for keeping the prosperous times ongoing within the *Indo-Pacific region* should include reciprocal access to markets, intellectual property protection and advancing all the principles of the 'ease of doing business' index.

The *FOIP* as it continues to be defined also offers US policy makers opportunities to course correct on past oversights and build a stronger more inclusive and prosperous *Indo-Pacific region*.

The success of a *FOIP* over the next few decades, will be dependent on decisions and affirmation of sovereign countries, their leaders and policy makers, their entrepreneurial communities and their larger societies. In the meanwhile, as conveners of the **Indo-Pacific Dialogue** we look forward to playing our small role in helping facilitate positive outcomes for all stakeholders involved.

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