



THE REBALANCE TO ASIA: WHY SOUTH ASIA MATTERS

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Mr. Chairman, Mr. Ranking Member, and Members of the Subcommittee, thank you very much for the opportunity to testify before you today on why South Asia matters to the U.S. rebalancing toward Asia.

The rise of Asia in all its dimensions has profound implications for America's future. President Obama's strategic balancing strategy recognizes this and seeks to deepen American engagement with the region at many levels. The ultimate objective of the rebalancing strategy should be to support the rise of a stable, peaceful, and prosperous Asia that drives global growth to the benefit of the region and the world and works in partnership with other members of the global community to resolve regional and global challenges. A peaceful and dynamic Asia, integrated with the rest of the global economy, and actively participating in global institutions, is central to America's interests and will work to the long-term benefit of American companies, American workers, American jobs, and ultimately the American economy.

Extending America's rebalancing to include South Asia is not just important, it is essential. South Asia matters because a stable, peaceful, and outward looking South Asia that joins East Asia's production networks will offer a counterpoint to China's economic predominance in the region and provide additional impetus and resilience to Asia's rise. The Indo-Pacific region incorporating East Asia and South Asia—driven by the unrelenting logic of markets and geography—has the potential to become the world's economic powerhouse. Its peaceful rise should be a core objective of American foreign policy.

To be successful, the rebalancing strategy needs to have clear objectives and well-defined indicators of success, be comprehensive in reach, engage China, South Asia, and Southeast Asia, and be coordinated across its security, diplomatic, and economic dimensions in a whole-of-government approach.

Congress and the administration face growing challenges in the Indo-Pacific—from rising tensions in the South China Sea to the withdrawal of American combat troops from Afghanistan. At the same time, America's interests in the region have never been greater. The strategic rebalancing was a timely signal of America's long-term commitment to the region and its willingness to work toward common objectives with its Asian allies and friends.

China's Central Role in East Asia's Economic Integration

In the past three decades, the rapid growth of developing Asia has tripled its share of global GDP. The driver of this Asian renaissance was China, where the growth rate averaged 10 percent a year between 1980 and 2010. Indeed, if mainland China's 31 provinces were individual countries, then they would all be among the 32 fastest growing countries in the world.

The interplay between markets and geography played a central role in this transformation. A key ingredient was the rapid development of trade and investment links between China and its neighboring economies—Japan, South Korea, and most importantly, Southeast Asia. Today, intra-East Asian trade as a share of GDP is approaching the levels seen in the European Union. Geographical proximity, declining transport and communication costs,

and a relatively free trade and investment environment helped create East Asian production networks that have captured benefits of scale and specialization to become highly competitive in international markets.

In the next decade the forces of Asian integration will likely accelerate, not weaken. Just as the liberalization of trade in goods was the engine of growth in East Asia over the last three decades, the liberalization of trade in services will further integrate the economies of the region and drive growth in the next three decades. Similarly, investment in transport infrastructure is pouring into Southeast Asia—from the Asian Development Bank, World Bank, Japan, and China—strengthening the foundations of a highly integrated economy between Southeast Asia and southern China.

Finally, Chinese outward foreign investment within Asia is expected to increase sharply in coming years and, as Japanese investment did in the 1970s, will act as another integrative force among the economies of the region.

Why South Asia Matters

Three recent developments are spreading East Asia’s economic integration further west to South Asia.

First is India’s recognition that it must not only “look east” but also “engage east.” Over the last decade, India’s trade with China and Southeast Asia has grown at 40 percent and 20 percent a year, respectively. These rates of growth in trade could be higher still if India addresses its infrastructure and regulatory constraints. Furthermore, an expected wave of liberalization in services trade, supported by revisions to the India-ASEAN Free Trade Agreement, will play to India’s strengths and boost its exports further. (Services already account for 35 percent of India’s total exports.)

Increasingly, Japanese and Southeast Asian investors consider India as a potential location for their export-oriented investments as a hedge against their perceived over-dependence on China. India offers a large domestic market, industrial depth, urban centers, and sophisticated financial services—comparable to what China offered in the 1990s. While India’s progress may initially not be as rapid as China’s, and its policy process may occasionally be baffling and frustrating, it is only a question of time before it becomes an integral part of Asia’s production networks and enjoys sustained rapid growth.

Second is Myanmar’s pivot toward the outside world and away from autarky and dependence on China. This development has created new opportunities for India, opening a potential land bridge to Southeast Asia and southern China, and putting in place the last piece in the jigsaw for further integration between South and Southeast Asia.

Third is the South Asian Free Trade Agreement signed in 2004, which is on track to create a South Asia Free Trade Zone by 2016 (including Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka). Albeit still at low levels, intra-South Asian trade has grown at an average rate of 16 percent a year over the last decade—faster than growth in intra-Southeast Asian trade (12 percent a year). This is despite infrastructure weaknesses and lingering trade barriers. It is only a question of time before markets and geography in South

Asia overcome the legacy of suspicions and hostility that have plagued the region for more than half a century and build the trade and investment links that will drive South Asian growth in the future.

Challenges to Asia's Peaceful Rise and America's Rebalancing

Worryingly, Asia's rapid growth and integration is occurring among neighboring countries at a time when many issues—land borders, competing claims in the South China Sea, distribution of transnational riparian rights—remain unsettled between them. The ability of Asian countries to press their claims, however, is hardly symmetric. China's economic rise has been accompanied by an even faster rise in its military strength and reach, and this is rapidly concentrating power in the region. As China's neighbors have discovered, its willingness to exert its territorial claims has strengthened in proportion to its relative military capabilities. If this trend continues into the future then it gives cause for serious concern about the prospect for cooperative and peaceful solutions.

America's rebalance toward Asia, therefore, comes at a crucial time. It has been welcomed by most countries in the Indo-Pacific region—being seen as a useful contribution toward restoring the balance of power, maintaining the freedom of navigation, ensuring the safety and security of sea lanes of communication, and supporting peaceful resolution of disagreements between countries through dialogue and negotiation. But the countries of the Indo-Pacific have also made it clear that they do not wish to choose between the United States and China. They see the rebalancing as an opportunity to build deeper bilateral relations with the United States, but without sacrificing their relations with other countries, including China.

Policy Options to Strengthen America's Rebalancing Strategy

The substantial U.S. security, diplomatic, and economic investments underpinning the rebalancing can be justified on the grounds that a stable Asia is essential for regional and global peace and prosperity—and by implication critical to the long-term benefit of American companies, American workers, American jobs, and ultimately the American economy. U.S. interests will be served best by an Asia that promotes a nuclear-free Korean peninsula, drives global growth, and works in partnership with other members of the international community to resolve global challenges.

While the rebalancing of U.S. security, diplomatic, and economic resources has been broadly welcomed in Asia, it faces several challenges:

- First, whether the new U.S. security posture in the Asia-Pacific can be sustained over the long term given the country's fiscal challenges and tepid economic recovery and that tensions in other parts of the world could draw America's attention away from the region.
- Second, how U.S. policy toward China can more effectively build on convergent areas of interest that could then provide a platform for resolving more difficult regional and global challenges.
- Third, how the U.S. can build a strategic partnership with India, and through India draw South Asia into an Indo-Pacific arc of strengthened trade and investment links

- and a regional institutional architecture committed to cooperative solutions to common problems.
- Fourth, how America's myriad foreign policy initiatives in support of Southeast Asia can be made more effective.
 - And fifth, how best the U.S. can advance regional trade and investment liberalization that will benefit the region and the world.

Restoring America's economy clearly ranks as the highest priority in ensuring the credibility of the rebalancing policy toward Asia. As Secretary of State John Kerry has noted, America cannot be strong abroad if it is not strong at home. While this is not the focus of this hearing, it will be central to the efficacy of future policy toward Asia.

Engaging China on common concerns should be a priority. Working together on issues such as food safety, a multilateral investment treaty, improved governance in international financial institutions, and even cybersecurity, could be an effective way to create the environment required to successfully extend the effort to bigger and more challenging tasks. The U.S.-China relationship holds the key to peace, stability, and prosperity in Asia, and it must lie at the heart of America's rebalancing strategy.

In building that relationship, the narrative underpinning the U.S. strategic rebalancing should focus less on its security and more on its economic and diplomatic dimensions that seek mutually beneficial outcomes. The change in China's leadership opens fresh opportunities for such a dialogue. Encouragingly, U.S.-China engagement is broad and deep—through diplomatic exchanges, the U.S.-China Strategic and Economic Dialogue, and the U.S.-China Joint Commission on Commerce and Trade, as well as in multilateral settings, including Asia-Pacific Economic Cooperation (APEC), the East Asia Summit (EAS), IMF, World Bank, and the WTO.

Fortunately, as the economic gap between China and the U.S. shrinks, the areas of convergent interests expand. They now include an open multilateral trading and investment system, international financial stability, open and secure sea lanes of communication, and protection of intellectual property rights. (China now spends more on research and development than any country apart from the U.S.). China takes its international treaty obligations seriously and recognizes that if it expects other countries to observe global rules and norms, it must do so too.

There are an increasing number of areas of common interest to China and the U.S. Progress could be made on developing clear safety standards throughout the food value chain from farm to market; fashioning a multilateral investment treaty that holds all foreign investors to the same standards; ensuring the governance of international financial institutions better reflects the economic strength of emerging markets; and crafting a multilateral cybersecurity agreement that applies rules of cyber conduct and enforcement for all signatories. Other possibilities for partnership include improving health care systems, developing clean energy technology, ensuring environmental protection, and establishing global research and development networks. Cooperation in these areas confers shared benefits that can build trust and mutual respect, and could provide the foundations for resolving larger and more contentious issues.

Engaging India with the same intensity as China is an equally important priority for America's rebalancing. India's preeminent position in South Asia makes the U.S.-India relationship central to maintaining a counterpoint to China's emergence as Asia's predominant economic and military power. Furthermore, there is little doubt that the U.S. and India share similar geostrategic interests based on common values, a commitment to democracy and human rights, a common front against radical Islam, and a shared desire for an institutional architecture in the Indo-Pacific that promotes cooperation between countries. The two countries are further drawn together by the shared bond of a large Indian-American community, a common language, and both being multi-ethnic and multi-religious societies. Finally, India's good standing with Afghanistan's government makes it a vital partner in pursuing U.S. security interests in the region after 2014.

It is unfortunate, therefore, that their divergences have on occasion framed the narrative between the two countries rather than their expanding areas of cooperation and interaction. India's leaders have emphasized that the country's size, location, complexity, resources, history, and development imperatives demand that its foreign policy retain strategic autonomy—and America should expect neither reciprocity nor alignment from India. Instead, the success of U.S. policy toward India should be measured by whether India succeeds in developing its national power and becoming a positive force in advancing a peaceful and prosperous Indo-Pacific.

With President Clinton's visit to India over a decade ago, the U.S. made a long-term bet that Asia and the world would be a better place with a stronger India. Notwithstanding occasional disappointments since, that bet is still worth making today. It is true that India's foreign policy decisions may occasionally be puzzling, and its ability to translate aspirations into reality questionable, but India's entrepreneurs and market system, its growing trade and investment links with East Asia, a growing middle class, and an electoral system that is beginning to reward economic performance all augur well for the country's future growth and development. U.S. policy toward India should be anchored in the belief that a stable, independent, democratic, outward-oriented, and prosperous India is an essential cornerstone of the emerging architecture of the Indo-Pacific region—the development of which will serve the long-term interests of the U.S. in the region.

The policy options for future U.S. strategic support to India are many and reflect the multi-layered connections between the two countries:

- an energy-hungry India dependent on coal would benefit greatly from U.S. exports of shale gas, as well as transfers of energy-efficient and low-carbon technologies;
- setting aside disappointments with the medium multi-role combat aircraft deal, the U.S. should continue to respond positively to India's defense modernization needs. This includes equipment sales, training, joint exercises (U.S. naval exercises with India are already greater in number than with any other country), collaborative manufacturing, and technology partnerships. India, after all, is the world's largest military importer and is among the largest foreign buyers of U.S. defense equipment;
- the U.S. should use its leverage in the region to reduce the risk of hostilities between India and Pakistan;
- the U.S. should also consider championing India's membership of APEC. India's presence would make APEC a stronger and more inclusive institution which would

- be more likely to serve U.S. interests, and India could gain from participating in cutting-edge approaches to international trade and financial cooperation;
- U.S. authorities could boost India's services sector by easing and simplifying visa requirements, rather than complicating and restricting them;
 - in a time of fiscal consolidation, NASA could benefit by using India's very competitive launch technologies for low-earth orbit satellites for civil and scientific purposes; and
 - U.S. officials and businesses should increasingly reach out to the leaders of India's states, some of whom are displaying innovative leadership and could prove to be receptive partners for public and private sector projects. This is true across a range of areas, including transport and energy infrastructure, urbanization, education, and health.

Engaging Southeast Asia should be no less a priority in America's rebalancing strategy. This is in part simply because of Southeast Asia's strategic location astride the Malacca Straits. But it is also because of its strong links and historical relationship with the U.S., its active regional organizations, and the region's increasing security concerns vis-à-vis China. The U.S. is already an active participant in the EAS, the ASEAN Defense Ministers' Meetings, the ASEAN Regional Forum, and more recently the U.S.-ASEAN Leaders Meeting, and is involved in a range of initiatives through ASEAN, as well as bilaterally with each of its member countries.

Late last year, the ASEAN Eminent Persons Group presented the U.S.-ASEAN Leaders Meeting with a comprehensive set of very sensible recommendations on measures needed to strengthen U.S.-ASEAN relations, ranging from supporting the development of a code of conduct in the South China Sea to creating an ASEAN-U.S. center in Washington. At the same meeting, President Obama announced the Enhanced Economic Engagement (E3), which is designed to assist implementation of trade facilitation measures and identifies specific cooperative activities to increase the efficiency of trade flows.

There are, therefore, more than enough recommendations and initiatives on the table for ASEAN to implement. The challenge is not to introduce more initiatives, but to make sure existing initiatives are effectively implemented and the whole is greater than the sum of its parts.

Most important among ASEAN's priorities—and deserving of U.S. support—is the finalization of the Code of Conduct in the South China Sea that includes the other major Pacific powers, especially China and the U.S. At this point, ASEAN's focus should not be on resolving competing claims, but on lowering tensions by getting all sides to implement confidence-building measures that reduce the risk of hostilities. Only when cooler heads prevail can the countries of the region turn their attention to the more difficult task of resolving the causes underlying the tensions in the South China Sea and developing cooperative solutions toward exploiting the mineral riches that lie under the seabed.

The U.S. also needs to offer Southeast Asia a comprehensive partnership that binds together its myriad components into one cohesive whole that presents a clear narrative, embodies principles of equality and mutual respect, and includes arrangements for joint monitoring of progress and mid-course corrections.

This is not a new concept. The United States already has a comprehensive partnership with a Southeast Asian country—Indonesia—that covers three broad dimensions: economy and development; political and security; and socio-cultural (which includes education, science and technology, environmental protection, and democracy promotion, among others).

These areas are being developed through six joint U.S.-Indonesian working groups. The U.S. secretary of state and the Indonesian foreign minister review their progress every six months. By working together on a broad range of topics of mutual interest and importance, both sides are building cooperative structures that will deepen understanding and advance shared interests.

Given the diversity of countries in Southeast Asia, developing a comprehensive partnership with the entire Southeast Asian region will prove difficult. Instead, the approach adopted by the U.S.-Indonesia comprehensive partnership is a model that could be advanced on a bilateral basis with other countries in the region.

Certainly, Thailand, Malaysia, Philippines, and Vietnam would be excellent candidates for deepening bilateral cooperation. But perhaps the most important could be Myanmar, where conditions are the most fragile and the forces for reform, human rights, democracy, and free markets deserve the greatest encouragement. The areas for partnership and joint development would need to be identified separately for each country and will likely be different in each case. Over time, however, as these partnerships develop, they will undoubtedly display common features that have the potential of being brought together gradually across the entire Southeast Asian region.

Finally, the U.S. could support a comprehensive review of the ASEAN Secretariat, which should emerge with recommendations on how the secretariat could be strengthened. ASEAN's aspirations tend to outrun its implementation capacity. Its secretariat of fewer than 300 staff organizes around 1,300 meetings a year—an average of between three and four every day—and is stretched thin across numerous initiatives, programs, and projects. Ironically, although countries like the U.S., Japan, and China have accorded ASEAN considerable importance in their relationship with the region, ASEAN members themselves have not been willing to strengthen the secretariat's capability to monitor, implement and follow up decisions made at ASEAN's many meetings.

These shortcomings weaken ASEAN and consequently weaken the impact of America's rebalancing toward Southeast Asia. It is in ASEAN's interest, as well as in America's, that the grouping is served by a strong institutional architecture capable of identifying strategic issues, putting forward sensible solutions, and monitoring implementation.

Advancing trade and investment liberalization in Asia has been complicated by two competing trade initiatives—the Trans-Pacific Partnership (TPP) supported by the U.S. and viewed as a critical element in the rebalancing strategy, and the Regional Comprehensive Economic Partnership (RCEP) which was launched late last year by ASEAN's ten member countries and the six countries with which it has free trade agreements (Australia, China, India, Japan, Korea, and New Zealand). If negotiations for the RCEP are successful, it will become the largest free trade agreement in the world.

At this point, negotiations for the TPP are more advanced, but they face significant challenges before they can come to closure. Discussions on the RCEP have only just begun and also face obstacles, but progress could accelerate if agreement on the basic parameters is reached soon.

While both trade agreements can coexist, they not only include a different combination of countries (most significantly, the TPP excludes China and the RCEP excludes the United States), but also represent different philosophies on how economic integration should be achieved. The philosophy behind the TPP is that trade agreements should include external commitments that promote domestic reform. That of the RCEP, on the other hand, is for domestic reforms to drive trade and for trade agreements to reflect market developments and prevent a retreat into protectionism. Although the RCEP will initially reflect the standards of the country least willing to liberalize its trade and investment, it is likely to be more adaptable—as the India-ASEAN and the China-ASEAN free trade agreements have proved.

One possibility is that as the RCEP is gradually upgraded to address behind-the-border trade barriers, its differences with the TPP could narrow to the point that it would make sense for the two trade agreements to be merged. Another possibility is that the U.S.-EU trade agreement announced by President Obama earlier this year would form such a large market (accounting for 50 percent of global GDP and \$4 trillion in cross-border investment) that the prospect of access would attract a number of other countries to join which, in the long term, could even include India and China.

Conclusion

The U.S. rebalancing strategy toward the Indo-Pacific is a timely recognition of the profound shifts taking place in the global economy. A lot has been accomplished in the 18 months since it was announced—the increased U.S. security footprint in the region, the progress in TPP negotiations, and the announcement of the Enhanced Economic Engagement (E3) initiative. The challenge now is to deepen and sustain the effort and broaden it to include South Asia, in particular by strengthening ties with India, enhancing bilateral cooperation with the ASEAN nations, and advancing trade and investment liberalization across the entire Indo-Pacific. By doing so, Congress and the administration can advance core American political, economic, and security interests in the world's fastest-growing and strategically most vital region.