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Statement before the U.S. Senate Committee on Foreign Relations, Subcommittee on East Asian and Pacific Affairs

"U.S. ECONOMIC ENGAGEMENT IN EAST ASIA AND THE PACIFIC"

A Statement by

Matthew P. Goodman

William E. Simon Chair in Political Economy

Center for Strategic and International Studies (CSIS)

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446 Dirksen Senate Office Building

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Mr. Chairman, Mr. Ranking Member, Members of the Subcommittee, thank you for this opportunity to offer my thoughts on U.S. economic engagement in East Asia and the Pacific.

Economics is at the heart of U.S. involvement in the Asia-Pacific region. This statement is as true today as it was in 1784, when the first U.S. merchant ship set sail from New York bound for Canton; or in 1853, when Commodore Perry arrived in Tokyo Bay in his "black ships" seeking refueling rights for the American whaling fleet. Trade, investment, and other economic ties across the Pacific today are measured in the trillions of dollars and are critical not only to U.S. growth and jobs but also to our national security.

The Obama Administration has put economics at the center of its Asia-Pacific strategy. Indeed, the overall success of the Administration's policy of "rebalancing," or "pivoting," to Asia rests on its ability to carry out a successful economic strategy in the region, in particular completion of a high-standard Trans-Pacific Partnership (TPP) trade agreement.

The Economic Pull of Asia

U.S. economic engagement in Asia is driven by the numbers. The 21 member economies of the Asia-Pacific Economic Cooperation group (APEC) account for roughly 55 percent of global gross domestic product (GDP).[1] The region contains the world's three largest countries by GDP – the United States, China, and Japan – and half of the top 20 economies. Moreover, according to the International Monetary Fund in its most recent outlook, the Asia Pacific is the fastest-growing region of the world, with real GDP growth in developing Asia expected to average 6.3 percent in 2013.[2]

[1] U.S. Department of State, "21st Annual APEC Economic Leaders' Meeting Fact Sheet," October 8, 2013, http://www.state.gov/r/pa/prs/ps/2013/10/215195.htm

[2] International Monetary Fund, "World Economic Outlook Database," October 2013, https://www.imf.org/external/pubs/ft/weo/2013/02/weodata/index.aspx

The APEC region also accounts for 44 percent of world trade, with nearly $10 trillion worth of goods and services flowing around the Pacific last year.[3] U.S. exports to APEC economies totaled nearly $1.2 trillion in 2011, accounting for over half of total U.S. exports.[4] Our exports to the Asia Pacific have more than doubled over the past decade, and six of our top 10 trading partners are in APEC.

Financial flows across the Pacific in the form of both direct and portfolio investment are also substantial. The stock of U.S. direct investment in Asia totaled nearly $600 billion at the end of 2011 and grew some $45 billion that year.[5] In the same year, nearly $20 billion worth of foreign direct investment flowed into the United States from Asia-Pacific countries, adding to an accumulated stock of over $400 billion invested here.[6] Meanwhile, China and Japan each hold over $1 trillion of U.S. Treasury securities,[7] and Asians and Americans have trillions of dollars invested in each other's stock markets and other private financial instruments.

This enormous volume of economic activity across the Pacific translates into jobs for Americans. According to one estimate, roughly 1.2 million American jobs were supported by exports to Asia in 2012.[8] Asian companies investing in the United States directly employed some 900,000 Americans in 2011, with many more jobs supported indirectly by these operations.[9]

Our economic engagement with Asia also poses challenges. We have large and persistent trade imbalances with a number of major Asian countries, including a $315 billion deficit with China in 2012.[10] Americans companies face an array of barriers both at and behind the border in these countries, and unfair trade practices in the region burden both our businesses and workers. In addition, macroeconomic imbalances – including an excess of savings in many Asian economies – produce large financial flows from Asia to the United States that bring near-term benefits but may pose longer-term risks to the U.S. economy. These challenges require active U.S. policy engagement in the region.

Policy Objectives in Asia

Against this backdrop of tremendous opportunities and challenges, U.S. economic policy toward the Asia-Pacific region over the past several administrations has been driven by three broad objectives. The first is growth and jobs. As described above, the Asia-Pacific region is one of the world's largest and fastest-growing economic areas,

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[3] WTO, "World Trade 2012, Prospects for 2013," April 10, 2013, http://www.wto.org/english/news_e/pres13_e/pr688_e.pdf
[4] U.S. Department of State, "21st APEC Fact Sheet"
[5] Bureau of Economic Analysis, "Balance of Payments and Direct Investment Position Data," U.S. Department of Commerce, http://www.bea.gov/iTable/index_MNC.cfm
[6] *Ibid.*
[7] U.S. Department of the Treasury, "Major Foreign Holders of Treasury Securities," August 2013, http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt
[8] East-West Center, "Asia Matters for America," http://www.asiamattersforamerica.org/overview
[9] Organization for International Investment, "Insourcing Facts," August 2012, http://www.ofii.org/resources/insourcing-facts. Estimate based on Asia's share of overall U.S. inbound FDI.
[10] Bureau of Economic Analysis, U.S. Department of Commerce

making it an increasingly important source of demand for the U.S. (and global) economy. Among other benefits, stronger demand and growing purchasing power in Asia mean more U.S. exports, which in turn are a vital source of growth and jobs at home.

The second broad objective is upholding and updating the rules of the international economy. The open, rules-based system of trade and investment championed by the United States since World War II has produced broad benefits not only for this country but for the rest of the world. But the prevailing rules are increasingly out of step with the realities of today's global economy, which is characterized by integrated value chains and digital connectivity; Asia is at the center of these trends. As discussed further below, TPP is designed to address this gap by establishing "21st-century" rules governing not only tariffs and other border measures but also behind-the-border issues such as intellectual property protection, regulatory transparency, labor and environmental standards, and the investment climate.

The third objective of U.S. economic strategy in the Asia Pacific is supporting America's long-term presence in the region. The United States is a Pacific power by nature and necessity (i.e., geography as well as the pull of historical, security, and economic forces) but also by design. Successive administrations since World War II have worked deliberately to embed the United States in the Asia Pacific through an array of political, security, and economic arrangements. The network of U.S. alliances with Japan, South Korea, Australia, and others, and the troops and ships deployed in the region, are the most visible manifestation of that policy. Binding trade arrangements like the U.S.-Korea free trade agreement (KORUS FTA) and TPP can be seen as the economic equivalent of America's security alliances in the region. That is, they enmesh the country in regional affairs and give all Asia-Pacific countries an increased stake in each other's prosperity and security.

<u>How the United States Engages</u>

In support of all three objectives described above – growth, rules, and presence – recent U.S. administrations have pursued a multipronged approach to economic engagement in the Asia-Pacific region. For more than 30 years, Washington has worked to promote strong domestic-demand-led growth in large Asian surplus economies. Japan, then the world's second-largest economy, was the initial target of this policy in the 1970s and 1980s, but attention has broadened in recent years to other large, growing economies with persistent current-account surpluses, notably China. With U.S. and European consumers and governments alike forced to borrow less and export more in the wake of the 2008-09 financial crisis, Washington has argued that large surplus economies need to consume and import more, or global growth will suffer. This is why the Obama Administration has made "strong, sustainable, and balanced growth" the mantra of its policy engagement with China and other large Asia-Pacific economies in both the G-20 and bilateral channels.

U.S. trade policy has also supported the macroeconomic growth agenda. Recent administrations have pursued an active trade agenda in the region, including President George W. Bush's initial negotiation of the KORUS FTA and the Obama Administration's launch of the TPP negotiations. Enforcement of existing trade agreements has also been an increasingly important feature of trade policy in the past two administrations. All of these efforts have been designed to reduce barriers to U.S. exports, enhance America's own competitiveness, boost growth and jobs, and reinforce the rules of the international trading system.

TPP is part of a broader strategy pursued by presidents since George H.W. Bush to tap into and shape aspirations in the Asia Pacific for regional economic integration. Bush's Secretary of State, James Baker, embraced his Australian counterpart's proposal to create APEC in 1989 as a venue for foreign ministers from the region to discuss trade and investment liberalization and capacity-building. President Bill Clinton invited his APEC counterparts to a summit on Blake Island off Seattle in 1993, giving top-level political imprimatur to the forum's economic integration mission.

Washington's approach to regional economic integration has been marked by two key characteristics that distinguish it from approaches championed by other countries in the region: it is trans-Pacific rather than Asia-centric; and it emphasizes high standards of liberalization and rule-making.

The first characteristic is, of course, largely driven by the fact that the United States is a Pacific but not an Asian country. But higher-level policy considerations also play a part. In promoting APEC, Secretary of State Baker was clearly animated by concerns about East Asian aspirations for community-building that would exclude the United States; he later noted that such efforts would "draw a line down the middle of the Pacific."[11]

In addition, strategic considerations in the Western Hemisphere have played a part in U.S. insistence on including Pacific-facing Latin American countries in regional economic integration efforts. President Clinton invited the Mexican President to the Blake Island Summit and soon after championed Chile and Peru's membership in APEC. It is no coincidence that the TPP negotiations include all five APEC economies in the Western Hemisphere: Canada, Chile, Mexico, Peru, and the United States.

The second distinguishing feature of the U.S. approach to regional economic integration is a preference for comprehensive trade and investment liberalization and high-standard rules of the road. This has inspired Washington's approach to APEC since the inception but took on new substance with the launch of "21st-century" treaty negotiations with Korea and the TPP partners. The George W. Bush and Obama administrations have insisted on the broadest and deepest possible liberalization, as well as state-of-the-art disciplines on trade and investment-related policies both at and behind the border. By contrast, Asia-only integration initiatives, including bilateral and sub-regional FTAs, have generally covered only border measures and included numerous exceptions to full liberalization.

A mix of economic and political considerations lies behind this second feature of U.S. regional integration policy. Removing most impediments to trade and investment and imposing tough rules of the road maximize economic efficiency and growth.

[11] Cited in Claude Barfield and Philip I. Levy, "Tales of the South Pacific: President Obama and the Transpacific Partnership," *American Enterprise Institute*, December 2009, http://www.aei.org/files/2009/12/18/09-IEO-Dec-g.pdf

Washington believes that the narrower and "shallower" agreements reached to date in Asia have done little to improve efficiency and may pose a threat to U.S. competitiveness. As U.S. Trade Representative Michael Froman said in a recent interview, "A race to the bottom is not a race we can win."[12] Moreover, Congressional support for trade agreements increasingly hinges not only on breaking down barriers to U.S. exports but also on advancing other American policy objectives such as labor rights, environmental regulation, and intellectual property protection; hence the emphasis on these issues by U.S. negotiators in TPP and other recent trade talks.

The "Rebalance" to Asia

The Obama Administration's economic strategy in the Asia Pacific is broadly consistent with the traditional objectives and approach discussed above. But the stakes have been raised by the Administration's strategy of "rebalancing" to this important region of the world.

From its earliest days in 2009, the Administration has put the Asia Pacific at the center of its foreign policy. This can be seen on three levels: symbolism, including Hillary Clinton's decision to make her first overseas trip to the region as Secretary of State; rhetoric, notably a prominent Clinton article in the fall of 2011 in which she first articulated the Administration's strategy of shifting resources and attention from the greater Middle East to the Asia Pacific;[13] and substance, with the decisions to join a second regional leaders' forum alongside APEC, the East Asia Summit, and to embrace TPP as the centerpiece of the Administration's trade policy in the region.

Economic engagement is critical to the overall rebalancing strategy. In addition to its intrinsic value, it helps balance the military and diplomatic elements and thus bolster the strategy's credibility both in the region and at home. While most of the focus has been on TPP, the Obama Administration has in fact pursued a multi-pronged economic policy in the region, covering three levels of interaction.

Bilaterally, the Administration has engaged with most of the major economic powers of the region, in a variety of formats. With China, it reconfigured a high-level forum created by the Bush Administration and established the Strategic & Economic Dialogue (S&ED). Along the S&ED's economic track, the Administration has sought to encourage more balanced growth in China, to promote financial liberalization and movement to a more flexible currency system, and to advance a bilateral investment treaty (BIT). Meanwhile, engagement with Japan has been focused on encouraging Tokyo to restructure its economy to generate sustainable growth, including through the decision earlier this year to bring Japan into TPP. Renegotiating, passing, and implementing the KORUS FTA has been the organizing principle for U.S.-Korean economic relations, while the Administration has had active bilateral dialogues with other important regional players such as Australia and Indonesia.

[12] "U.S. to China: Play by our Economic Rules," *The Atlantic*, November 13, 2013, http://www.theatlantic.com/china/archive/2013/11/us-to-china-play-by-our-economic-rules/281433

[13] Hillary Clinton, "America's Pacific Century," *Foreign Policy*, November 2011, http://www.foreignpolicy.com/articles/2011/10/11/americas_pacific_century

Engagement at the global level is another implicit element of the Administration's Asian economic strategy. Largely in recognition of the increasing weight of large emerging countries, including China and India, in the global economy, the Administration embraced the G-20 as the premier forum for international economic cooperation in 2009 and has worked within that group to encourage strong, stable, balanced growth in Asian economies. The Administration has also worked in other international institutions, such as the World Trade Organization and the World Bank, to more deeply embed China and other leading Asian countries in the global rules-based system.

A principal focus of Obama Administration economic strategy in the Asia Pacific has been at the regional and sub-regional level. While the President himself has not attended the last two APEC leaders' meetings, the Administration has remained actively engaged in that forum, including as host in 2011. In 2012, the Administration launched a so-called "Enhanced Economic Engagement (E-3)" initiative with the Association of Southeast Asian Nations (ASEAN); this initiative is ultimately designed to bring all 10 members of that group into high-standard trade arrangements with the United States. Meanwhile, TPP has been the sharp end of the spear when it comes to Obama economic strategy in Asia.

The Trans-Pacific Partnership

TPP was conceived in the waning days of the Bush Administration, when the White House notified Congress in late 2008 of its intention to negotiate a trade agreement with four small APEC economies – Brunei, Chile, New Zealand, and Singapore – that had already reached their own deal two years earlier; Australia, Peru, and Vietnam soon joined the effort. The Obama Administration embraced TPP in late 2009, and negotiations among the eight original countries began in March 2010. Malaysia joined the talks later in 2010, Canada and Mexico in 2012, and Japan in the summer of 2013, bringing the total number of participants to 12.

TPP illustrates the objectives and characteristics of U.S. economic strategy enumerated earlier. Its three-part purpose is to stimulate American growth and jobs, strengthen the rules of the regional (and global) trading system, and lock the United States more deeply into regional affairs. As its name and membership suggest, it is trans-Pacific in nature, incorporating North and South American as well as Asian countries. And it is explicitly designed to produce, as President Obama said in announcing his embrace of TPP in late 2009, "the high standards worthy of a 21st-century trade agreement."[14]

In addition to lowering border barriers such as tariffs, TPP aims to establish disciplines on an array of behind-the-border measures that impede trade and investment such as excessive or non-transparent regulation; preferences for domestic, especially state-owned, enterprises; and inadequate intellectual property protection. The hope is

[14] White House, "Remarks by President Barack Obama at Suntory Hall," news release, November 14, 2009, www.whitehouse.gov/the-press-office/remarks-president-barack-obama-suntory-hall

that, if successful, TPP will become the driver and *de facto* template for a new multilateral system of rules.

As I have argued elsewhere, a number of myths cloud regional perceptions of TPP.[15] One is that the negotiations are "splitting Asia," since not all Asian economies are eligible to join, while those that are eligible must choose between joining TPP, viewed as led by the United States, and an alternative track preferred by China, the Regional Comprehensive Economic Partnership (RCEP). Yet in principle, TPP is open to any APEC economy willing to strive for high-standard rules; indeed, U.S. strategy from the outset was to begin the negotiations with a small group of "like-minded" countries and to incentivize others to join over time – a strategy that is ostensibly working. Conceptually there is no reason that even non-APEC economies like India and Myanmar should forever be excluded; indeed, the logic of the E-3 initiative is to help all ASEAN countries meet the high standards being sought in TPP.

As for having to "choose" between TPP and RCEP, the seven Asian countries participating in both negotiations clearly view the two approaches as compatible. Moreover, TPP and RCEP could one day converge in a region-wide agreement, or at least become interoperable, with potential annual gains to world income as high as $2.4 trillion by 2025.[16]

Another myth that until recently was popular in Beijing is that TPP is part of an effort by Washington to "contain" China. Yet no Asia-Pacific country wants to exclude China from regional integration; on the contrary, all want to deepen their economic ties with that country. True, one goal of TPP is to create a level playing field that, among other things, will allow other countries to better compete with China, but this is a far cry from "containment." Over the past few months, élite opinion in Beijing has shifted substantially from rejecting TPP outright to seeking a better understanding of it; indeed, there are some signs – such as Beijing's willingness to negotiate a comprehensive BIT with the United States on American terms, as well as the recent launch of the Shanghai Free Trade Zone – that China's leadership is preparing the ground for eventual membership in a high-standard regional agreement.

A third myth is that the high standards Washington is espousing in TPP are too ambitious for Asia. Yet all participants – including less advanced members like Vietnam – have made clear that they believe there are substantial welfare gains to be had from a high-standard agreement that opens up new market opportunities and helps each country address structural impediments in its own economy. Moreover, participating countries understand the political dynamics in Washington that, alongside the economic benefits, drive U.S. ambition in the talks. And most welcome an active U.S. role in championing high-standard rules and norms in the region.

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[15] Matthew P. Goodman, "Global Economics Monthly: Five Myths about TPP," *CSIS*, April 30, 2013, http://csis.org/publication/global-economics-monthly-five-myths-about-tpp

[16] Peter Petri, Michael G. Plummer, and Fan Zhai, "The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment," Peterson Institute for International Economics, November 2012.

With the failure to reach agreement at this month's ministerial meeting in Singapore, it is now clear that the TPP negotiations will not be concluded by the self-imposed deadline of the end of 2013. Although most of the agreement's 29 chapters have reportedly been closed, significant differences among the parties apparently remain on a number of challenging issues, notably intellectual property, competition, and environmental standards, as well as the market-access provisions. Moreover, in the absence of trade promotion authority (TPA) from Congress, the Obama Administration has struggled to persuade TPP partners that it can ultimately deliver on U.S. commitments in the talks.

However, the ministerial statement from Singapore reflects a shared sense of determination to complete the agreement as soon as possible. Trade negotiations are always darkest – and noisiest – before the dawn, as differences are narrowed to the most politically contentious issues. But insofar as they involve political rather than technical decisions, the final deals can be done quickly if the will is there. Thus a basic accord in the next few months – perhaps by the time of President Obama's planned trip to Asia in April 2014 – remains within reach.

The stakes could not be higher for the Obama White House. Conclusion of TPP is the *sine qua non* of success not only for the Administration's regional economic policy but arguably for the entire Asia rebalancing strategy. In addition to its economic benefits, a successful agreement would anchor the United States more firmly in the Asia Pacific and bolster American leadership there. Without TPP, the "rebalance" would contain little of substance that is new and would be perceived in the region as driven primarily by military considerations.

Conclusion

America's interests in the Asia Pacific are broad, deep, and enduring. None is more important than the U.S. economic stake in the region. As Hillary Clinton explained in laying out the rationale for the rebalancing strategy, "Harnessing Asia's growth and dynamism is central to American economic and strategic interests and a key priority for President Obama. Open markets in Asia provide the United States with unprecedented opportunities for investment, trade, and access to cutting-edge technology. Our economic recovery at home will depend on exports and the ability of American firms to tap into the vast and growing consumer base of Asia."[17]

Even beyond near-term recovery, a successful economic strategy in the Asia Pacific is essential to sustaining American growth and jobs into the 21st century. It is also central to Washington's efforts to remain a champion of the global rules-based order. And it underpins America's long-term presence in the region, which in turn contributes importantly to the region's security and prosperity. For all these reasons, the United States is likely to remain an active – even impatient – participant in the economic affairs of the Asia-Pacific region.

Thank you for your attention.

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[17] Clinton, *op. cit.*