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# America's Best Resource is Our Market


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*The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute, as the latter is frequently too discordant to be properly represented.*

It does not, in fact, "take money to make money." Ideas and innovation can make money, so can rich land and skilled labor, especially when these are combined with protection of private property and the willingness to compete.

To successfully engage Asia economically, which will enhance prosperity both at home and for American partners, the U.S. does not need to pour in either financial or human resources. Those are luxuries. Our wealth, technology, natural resources, skilled labor, and – making these much more valuable -- our willingness to conduct free and open exchange have shaped Asia in the post-war area. If we act wisely, they will do so for decades to come.

It is certainly true that the U.S. must be consistently involved in the institutions (acronyms) that matter to Asia, from the Association of South East Asian Nations (ASEAN) and the East Asia Summit (EAS) to the Trans-Pacific Partnership (TPP) and Asia-Pacific Economic Community (APEC).[1] So a bit more funding for plane flights, hotel stays, and specialists at the office of the United State Trade Representative and elsewhere would be useful. But U.S. economic openness will count far, far more than any combination of government programs and personnel.

The core of engagement with Asia should be to guarantee to maintain and extend that openness, in exchange for steps by our partners to better protect property rights and enhance competition in their markets. These steps will vary by country and characterizing each situation is a book-length endeavor. A partial list of American priorities includes: (i) accepting in policy terms the benefits of imports and the costs of export subsidies; (ii) quickly concluding a strong TPP to boost regional economies, especially Japan's, and (iii) with more difficult partners, matching the level of ambition in bilateral talks to the extent and direction of internal reform.

## What Matters Most

Our economic engagement in the Asia-Pacific rests on more than six decades of access to the U.S. market. This access was transformative in post-war Japanese economic reconstruction and in the development of Korea and Taiwan. It was transformative in the expansion of the Chinese economy.[2] It could yet prove transformative in the development of India and Vietnam. Of course, these countries primarily needed and still need to make wise policy decisions concerning savings and other factors but they frequently make them in order to take advantage of the indispensable American market.

The reference point for understanding the American economic role in Asia, both for the U.S. and the region, is our imports from Japan. From zero in 1945, these reached $69 billion in 1985. This

[1] "Asia-Pacific Economic Cooperation" is grammatically irritating.

[2] See, respectively, Aaron Forsberg, *America and the Japanese Miracle: The Cold War Context of Japan's Postwar Economic Revival, 1950-1960*, (Chapel Hill: UNC Chapel Hill Press, 2000), Charles Harvie and Hyun-Hoon Lee, "Export Led Industrialization and Growth – Korea's Economic Miracle 1962-89," (working paper series, University of Wollongong, 2003), http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1066&context=commwkpapers; Robert E. Baldwin, Douglas Nelson, "The Political Economy of U.S.-Taiwanese Trade and Other International Economic Relations," in *Trade and Protectionism*, ed. Takatoshi Ito and Anne O. Krueger (Chicago: National Bureau of Economic Research, 1993) http://www.nber.org/chapters/c8079; and Thomas I. Palley, "External Contradictions of the Chinese Development Model: export-led growth and the dangers of global economic contraction," *Journal of Contemporary China* Volume 15, Issue 46, 2006, pg.69-88.

was almost exactly the same as American imports from Canada (our largest trade partner for nearly all of our history) and the equivalent of five percent of Japanese GDP, which was then second-largest in the world and fast-rising.[3] American capacity and willingness to import in these quantities was highly visible and highly sought by others.

South Korea did not have Japan's pre-war legacy of development. In 1960, it was comparable in wealth to countries in sub-Saharan Africa and exports to the U.S. were negligible. By 2000, its exports to the U.S. exceeded $40 billion, or 7.5 percent of GDP, and South Korea was well on its way to being a rich nation.[4] In 1960, Taiwan was only modestly richer than Korea at the time and exports to the U.S. were negligible. In 2000, exports exceeded $40 billion, 12 percent of GDP, and Taiwan was solidly upper middle-income.[5] These facts were well-appreciated for decades but now sometimes seem to be forgotten on both sides of the Pacific.

Chinese development was not initially linked to the U.S. However, the second wave of Chinese reform, starting in late 1992, improved corporate efficiency and prepared the way for WTO accession, an accession driven by Sino-American agreement.[6] From 1992 to 2012, Chinese exports to the U.S. increased by a factor of 17, or $400 billion. In 2012, they were the equivalent of five percent of China's GDP, which is second-largest in the world and fast-rising.[7] The parallel to Japan is striking.

[3] "Foreign Trade: U.S. Trade in Goods by Country," United States Census Bureau, Department of Commerce, http://www.census.gov/foreign-trade/balance/index.html and "GDP (current US$)," World Development Indicators, The World Bank, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?page=2

[4] Dani Rodrik, "Getting interventions right: how South Korea and Taiwan grew rich," *Economic Policy* Volume 10, No. 20, 1995, http://isites.harvard.edu/fs/docs/icb.topic442978.files/Rodrik%20--%20How%20Korea%20and%20Taiwan%20grew%20rich.pdf and Charles R. Frank Jr., Kwang Suk Kim, and Larry E. Westphal, "Economic Growth in South Korea since World War II," in *Foreign Trade Regimes and Economic Development: South Korea* (Chicago: National Bureau of Economic Research, 1975), http://www.nber.org/chapters/c4063.pdf; "Foreign Trade: U.S. Trade in Goods by Country," United States Census Bureau, Department of Commerce, http://www.census.gov/foreign-trade/balance/index.html, and "GDP (current US$)," World Development Indicators, The World Bank, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?page=2.

[5] Dani Rodrik, "Getting interventions right: how South Korea and Taiwan grew rich," *Economic Policy* Volume 10, No. 20, 1995, http://isites.harvard.edu/fs/docs/icb.topic442978.files/Rodrik%20--%20How%20Korea%20and%20Taiwan%20grew%20rich.pdf and Robert E. Baldwin, Douglas Nelson, "The Political Economy of U.S.-Taiwanese Trade and Other International Economic Relations," in *Trade and Protectionism,* ed. Takatoshi Ito and Anne O. Krueger (Chicago: National Bureau of Economic Research, 1993) http://www.nber.org/chapters/c8079, "Foreign Trade: U.S. Trade in Goods by Country," United States Census Bureau, Department of Commerce, http://www.census.gov/foreign-trade/balance/index.html and "GDP, current prices," Econ Stats, World Economic Outlook data, International Monetary Fund, http://www.econstats.com/weo/V004.htm.

[6] Harry G. Broadman, "China's Membership in the WTO and Enterprise Reform: The Challenges for Accession and Beyond," (working paper series World Bank, Washington, DC, United States, 2000), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=223010 and "Bilateral Agreement on China's Entry into the WTO Between China and the United States," Ministry of Foreign Affairs of the People's Republic of China, 2000, http://www.fmprc.gov.cn/eng/ziliao/3602/3604/t18051.htm.

[7] "Foreign Trade: U.S. Trade in Goods by Country," United States Census Bureau, Department of Commerce, http://www.census.gov/foreign-trade/balance/index.html and "GDP (current US$)," World Development Indicators, The World Bank, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?page=2.

In light of the Chinese experience, another obvious candidate to walk this path is India. There is little sign of India being willing to undertake fundamental reform in order to sell on a large scale to the American market, but this was also true in China in 1991. Smaller but still notable in size is Vietnam. Through its negotiations in the TPP, Vietnam is attempting first and foremost to win market access to the U.S. and follow the path of its neighbors.[8]

Investment has been much less important than trade in Asia-American economic relations and can play a larger role. Japan is by far the largest Asian investor in the U.S., while flows from Korea and Taiwan, as well as Australia, are inconsistent in size. Chinese money goes overwhelmingly into low-yield bonds. [9] Drawing steadier investment from the richer countries and more productive investment from China does not require financial incentives - American respect of property rights, huge consumer market, and natural resources are more than enough incentive. All that is needed is information from local governments and a timely, transparent approval process at the federal level.

### Some of the implications

The matter of open American markets to many Asian countries, and the lack of reciprocal openness in some cases, has been subject to extensive political debate in the U.S. In one important respect, the debate is misguided: the large trade deficits the U.S. runs with Asia as a whole, and China in particular, do not necessarily represent lost American jobs.

Imports from Asia-based producers, even improperly subsidized imports, benefit consumers and thus strengthen the American economy. They can even create jobs directly here, in offloading, transportation, sales and so on. It is no surprise that the sharp downturn in 2009 saw the U.S. trade deficit with our top six Asian trade partners at $290 billion while the recovering economy of 2012 saw the deficit exceed $430 billion.[10] At the same time, subsidized American exports are a type of income redistribution program – taxpayer money going to certain exporters – and do not benefit the country as a whole.

It is certainly true that many Asian policy-makers have show mercantilist tendencies over the years, inhibiting American exports and denying the associated benefits to American workers and

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[8] Derek Scissors, "What Indian Economic Reform Could Mean for the U.S.," (Washington, DC: Heritage Foundation, August 18, 2011), http://www.heritage.org/research/reports/2011/08/what-indian-economic-reform-could-mean-for-the-us and "U.S.-Vietnam basic accord clears major hurdle to TPP deal," Kyodo News International, September 14, 2013 http://www.globalpost.com/dispatch/news/kyodo-news-international/130914/us-vietnam-basic-accord-clears-major-hurdle-tpp-deal.

[9] "Foreign Direct Investment in the U.S.: Balance of Payments and Direct Investment Position Data," Bureau of Economic Analysis, U.S. Department of Commerce, http://www.bea.gov/international/di1fdibal.htm and "Foreign Portfolio Holdings of U.S. Securities," Department of the Treasury, Board of Governors of the Federal Reserve (Washington: 2013), http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/shla2012r.pdf.

[10] Derek Scissors, Charlotte Espinoza, and Ambassador Terry Miller, "Trade Freedom: How Imports Support U.S. Jobs," (Washington, DC: Heritage Foundation, September 12, 2012), http://www.heritage.org/research/reports/2012/09/trade-freedom-how-imports-support-us-jobs and "Foreign Trade: Top Trading Partners," United States Census Bureau, Department of Commerce, http://www.census.gov/foreign-trade/statistics/highlights/top/index.html.

companies.[11] Congress has struggled to influence these policies without resorting to denial of access to the U.S., which would harm both trade partners and American interests. The solution is to continue to leverage our open market.

Leveraging has already occurred - despite domestic political dissatisfaction, American demands for open trade have powerfully shaped Asia compared to the pre-WTO era. More recently, China joined the WTO to protect its access to the U.S., signing up for rules put in place at America's behest.[12] Japan, Vietnam, and Malaysia are willing to go beyond the WTO and join the American-led TPP for the same reason. The institutional engagement with ASEAN and, to a lesser extent at the EAS and APEC, offers additional opportunities.

In contrast, a protectionist turn by the U.S. would be destructive for the region and our role in it. A truly closed American market, featuring high tariff walls imposed for political reasons, would shatter the Sino-American relationship and alienate other countries which are not treaty allies. It would leave the U.S. with an unpleasant and possibly untenable role as security guarantor, only, in an economically damaged and increasingly hostile region.

While withdrawal is not on the table at the moment, fortunately, there is also risk from the failure to engage. If restrictive rules of origin in the TPP make it more like a bloc than the core of an Asia-Pacific free trade zone, it will force countries to decide to be "with us or against us." This may lead to one of the regional endeavors, such as ASEAN+3, becoming a counter- bloc. Even if nothing so dramatic happens, the absence of American economic leadership will almost surely lead to more mercantilist competition within the region, which already lingers just below the surface in exchange rate policy.[13] The region will see more political tension and offer less in the way of benefits to the U.S.

## U.S Policy Tour

Writing about Asia is similar to trying to plan a trip to Asia: there are too many places to go. The economic kingpins, Japan and China, naturally merit the most attention. There are also particularly interesting American choices to be made with regard to Taiwan, India, the Philippines, and Indonesia. All involve leveraging the U.S. market and other economic strengths to drive Asian policy choices.

### The large economies

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[11] "The Real Asian Threat: Mercantilism," *Bloomberg BusinessWeek*, April 14, 1996, http://www.businessweek.com/stories/1996-04-14/the-real-asian-threat-mercantilism.

[12] DG Supachai Panitchpakdi, "American Leadership and the World Trade Organization: What is the Alternative?" (speech at the National Press Club, Washington, DC, February 26, 2004), http://www.wto.org/english/news_e/spsp_e/spsp22_e.htm.

[13] Derek Scissors, "Rules of Origin Can Make or Break the Trans-Pacific Partnership," (Washington, DC: Heritage Foundation, August 27, 2013), http://www.heritage.org/research/reports/2013/08/rules-of-origin-can-make-or-break-the-trans-pacific-partnership and Vidya Ranganathan, "Korea becomes the red flag for Asia's currency war," *Reuters*, January 31, 2013, http://www.reuters.com/article/2013/02/01/markets-currency-war-idUSL4N0B01SL20130201.

The TPP is not the only game in town but it is the biggest one. It became the main event when Japan joined and Tokyo now very much needs a good TPP.

Prime Minister Abe's program to end the long period of economic stagnation has begun to founder on delays in much-touted structural reform.[14] The TPP could deliver the painful changes necessary while allowing Abe to claim they are not his doing, but rather unavoidable in light of the economic importance of the TPP group as well as Japan's current standoff with China. Agriculture reform in particular would improve Japan's land usage, which constitutes a fundamental shift, and is a high American negotiating priority.[15] A TPP which both helps reinvigorate Japan's economy and improves access for goods and services in which the U.S. has a comparative advantage would be the single biggest accomplishment of the Asia pivot.

As ever, China's impact is multifaceted. In terms of the TPP, most member states want China to be able to join. Several, including the U.S., want China to be able to join if and only if it fulfills the terms of a high-standard agreement. Negotiating with China will involve the same issues as negotiating with other parties but one stands out as more pointed: the treatment of state-owned enterprises (SOE's). This is being done in the TPP through a chapter on "competitive neutrality."

The idea behind competitive neutrality is SOE's should not be granted competitive advantages over private firms. But existing versions of competitive neutrality, such as Australia's, were formulated for countries that wish to limit SOE's. It is not clear Singapore and Vietnam qualify and it is entirely clear China does not qualify.[16] So this is a two-stage process. First, TPP talks must yield a strong version of competitive neutrality that binds hesitant countries. Second, the TPP grouping must become a sufficiently powerful lure for China to meet the obligations.

Beyond the TPP, Asian countries understand that Chinese policy is based essentially on convenience, while American economic policy is based on principle. China welcomes foreign commodities and other goods and services that it considers valuable at the time, the U.S. welcomes foreign goods and services that offer quality and low prices. This provides the U.S. with a major diplomatic advantage and counterweight to Chinese practices. At the bilateral level, the record shows that negotiating change from outside does not work.[17] Internal Chinese reform must precede an investment treaty, it will not come about from an investment treaty.

### Pivotal smaller economies

A challenge of a different sort for U.S. policy involves Taiwan. With only 23 million people, Taiwan remains in the top 13 of American trade partners. This impressive performance is also a vulnerability: to remain prosperous, Taiwan must remain in the forefront of global trade

[14] Alexis Xydias, "Abenomics to Fail Without 'Third Arrow,' Allianz Global," Bloomberg, November 12, 2013, http://www.bloomberg.com/news/2013-11-13/abenomics-to-fail-without-third-arrow-allianz-global.html.
[15] "TPP or no, aging farm sector needs true reform," *The Japan Times*, March 26, 2013, http://www.japantimes.co.jp/news/2013/03/26/business/tpp-or-no-aging-farm-sector-needs-true-reform/#.Uqp8EtJDtac.
[16] Derek Scissors, "Why the Trans-Pacific Partnership Must Enhance Competitive Neutrality," (Washington, DC: Heritage Foundation, June 6, 2013), http://www.heritage.org/research/reports/2013/06/why-the-trans-pacific-partnership-must-enhance-competitive-neutrality.
[17] "Shade of Grey," *The Economist*, December 10, 2011, http://www.economist.com/node/21541408.

evolution. This has been extremely difficult due to Chinese intimidation of much of the world with regard to Taiwan's signing bilateral and some multilateral trade agreements.[18]

Offering Taiwan economic alternatives is just as important as the American security commitment in ensuring the island's citizens can choose their own destiny. Given regional politics, the U.S. must either lead a multilateral effort to engage Taiwan or work toward purely bilateral accords. While Taiwan-U.S. economic negotiations have sometimes been unpleasant, American shale shipments could have extremely high value to Taiwan and enable needed improvements in the treatment of agriculture products.[19]

Other difficult economic negotiations have involved India. To be the kind of economic and, ultimately, security partner the U.S. wants, India must fundamentally liberalize rural land ownership, manufacturing labor laws, and economic exchange across its own states. Yet the India-U.S. bilateral economic relationship is shaky and India is often constitutes the chief obstacle to progress at the WTO Doha round.[20]

The best - perhaps the only - place to make progress may be in forums with Asian countries that have successfully liberalized. These have adopted a number of principles India has repeatedly infringed, for example with regard to taxation and intellectual property. Progress may be elusive, but it will certainly damage the relationship and encourage more disruptive Indian behavior in the WTO and elsewhere if the U.S. starts closing the door to Indian workers. Taxing Indian labor to pay for internal American programs, as in early 2011, is harmful in this regard.[21]

Two members of ASEAN not currently involved in the TPP and therefore not receiving much American policy attention are Indonesia and the Philippines. The latter is, of course, a U.S. treaty ally. It boasts an economy where household spending has accelerated to better than six percent growth annually and manufacturing and services are now far outperforming the traditional sector leaders agriculture and mining.

To maintain this performance and create the jobs necessary to absorb more than 10 million unemployed will require pro-market reform.[22] With reform and given the large Filipino labor

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[18] Mac William Bishop, "Taiwan's free trade troubles," Asia Times Online, July 14, 2004, http://www.atimes.com/atimes/China/FG14Ad05.html.

[19] "After five years, Taiwan-US trade talks resume," Taiwan Insights, March 27, 2013, http://www.taiwaninsights.com/2013/03/27/after-five-years-taiwan-us-trade-talks-resume/ and Song Yen Ling, "Taiwan keen to import US LNG from shale gas-fed projects: report," Platts, June 6, 2013, http://www.platts.com/latest-news/natural-gas/singapore/taiwan-keen-to-import-us-lng-from-shale-gas-fed-27050534.

[20] Peter Alford, "India cripples World Trade Organization's Doha Round hopes," *The Australian*, December 4, 2013, http://www.theaustralian.com.au/news/world/india-cripples-world-trade-organisations-doha-development-round-hopes/story-e6frg6so-1226775236139 and Doug Palmer, "U.S. trade chief urges India to heed to U.S. companies' complaints," Reuters, July 12, 2013, http://in.reuters.com/article/2013/07/12/usa-india-trade-chidambaram-idINDEE96B01J20130712.

[21] "Ignoring India's concerns, Obama signs 9/11 health care bill," The Economic Times, January 3, 2011, http://articles.economictimes.indiatimes.com/2011-01-03/news/28430935_1_obama-signs-health-and-compensation-act-health-care.

[22] "Philippine Economy posts 7.0 percent GDP growth in Q3 2013," National Statistical Coordination Boar, Republic of the Philippines, November 28, 2013, http://www.nscb.gov.ph/sna/ and Poverty Reduction and

force, a maturing industrial sector would become quite competitive on world markets, making this the most promising time yet to enhance the Philippines-U.S. economic relationship. The security relationship means American political support for closer economic ties is high, the question of whether a bilateral or multilateral approach is superior should be answered by internal Philippines politics.

Indonesia is the largest ASEAN member, with a population about equal to that of the U.S. in 1989. It also has a growing labor force and, unlike some of its neighbors, has shown no particular tendency to run large trade surpluses. Indonesia's policy record, though, is uneven at best. It is contemplating a year-long ban of unprocessed ore exports, which would be illegal under the WTO, and a mercantilist turn that could have a considerable impact in the region. [23] It is not clear how best to engage Indonesia economically and the obstacles and potential in doing so are perhaps the best justification for active American participation in the EAS.

## Recommendations

The U.S. has already changed Asia, especially East Asia, for the better with our openness. The ideal course is to continue to do so. Economic engagement of Asia should be based on, but not limited to, the following guidelines:

1) Do not treat imports as if they automatically cause job losses here. Do not treat subsidized exports as contributing to national prosperity.

2) For foreign investors, provide information rather than opaque or politicized review processes.

3) Ensure the competitive neutrality provisions in the TPP tightly constrain countries that continue to seek to subsidize their state-owned enterprises.

4) Quickly conclude a strong TPP that offers Japan benefits in autos and elsewhere in exchange for better access to the Japanese agriculture and services markets.

5) Do not move forward on a bilateral investment treaty with China until it is clear that relevant internal reform is under way there.

6) In the trade and investment framework talks with Taiwan, bundle two key commodities: Taiwan can be treated as free trade partner in oil and gas if it is also one in agriculture.

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Economic Management Unit, "Philippine Economic Update: Accelerating Reforms to Meet the Jobs Challenge," The World Bank, May 2013, http://www.worldbank.org/content/dam/Worldbank/document/EAP/Philippines/Philippine_Economic_Update_May2013.pdf.

[23] "Foreign Trade, Export by Month, Year 2013," Badan Pusat Statistik, Statistics Indonesia, http://www.bps.go.id/eng/exim-frame.php?kat=2, "Indonesia Economic Quarterly, Policies in focus," The World Bank and Bank Dunia, December 2012, http://www.worldbank.org/content/dam/Worldbank/document/IEQ-DEC-2012-ENGLISH.pdf and "Go-Ahead for Indonesia's Controversial Ban on Unprocessed Mineral Exports," Indonesia Investments, December 7, 2013, http://www.indonesia-investments.com/doing-business/business-columns/go-ahead-for-indonesias-controversial-ban-on-unprocessed-mineral-exports/item1397.

7) Treat India as a vital but long-term partner. Negotiate under the bilateral economic dialogue for basic reform and do not punish Indian services firm for the failure of their government.

8) Be quick in seizing an unprecedented opportunity to engage the growing but fragile economies in the Philippines and Indonesia either on a bilateral basis or through the TPP.

The U.S. does not need a large commitment of resources to successfully engage Asia economically. We just need the willingness to maintain and extend our openness.