U.S. Economic Strategy in the Asia-Pacific Region: Promoting Growth, Rules, and Presence

by

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Introduction

Economics is at the heart of U.S. engagement 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 not territory but refueling rights for the American whaling fleet.

The numbers make clear why the United States is drawn to Asia today. The 21 member economies of the Asia-Pacific Economic Cooperation group (APEC) account for roughly 55 percent of global GDP and 44 percent of world trade.[1] According to the IMF, developing Asia is expected to grow by an average of 6.3 percent in 2013, making it the fast-growing region in the world.[2] U.S. exports to

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[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.

APEC economies totaled nearly $1.2 trillion in 2011, accounting for over half of the country's total exports.[3]

Economic exchange with this dynamic region makes a vital contribution to U.S. growth and jobs. In the wake of the financial crisis of 2008-09 and resulting shifts in the structure of the U.S. economy, exports to the Asia Pacific have become an increasingly important source of demand and employment. By one estimate, roughly 1.2 million American jobs were supported by exports to Asia in 2012.[4]

With this much at stake, it is not surprising that the United States has been an active participant in Asia-Pacific economic integration efforts over the past 25 years, going back to the decision of the George H.W. Bush Administration to co-found APEC in the late 1980s and seen today in the Obama Administration's focus on completing a Trans-Pacific Partnership (TPP) trade agreement. Linking these efforts over the years, and the subject of this paper, are a number of common objectives and characteristics that distinguish the American approach to regional economic integration from that of other countries in the region.

U.S. Economic Policy Objectives in Asia

In designing and implementing economic policy toward the Asia Pacific, recent U.S. administrations have been animated by three broad objectives: promoting growth and jobs; strengthening the global rules-based system; and underpinning America's long-term presence in the region.

The first priority is *growth.* As mentioned above, the Asia-Pacific region is one of the world's largest and most dynamic economic areas. It is an increasingly

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[3] U.S. Department of State, "21st APEC Fact Sheet".
[4] East-West Center, "Asia Matters for America," http://www.asiamattersforamerica.org/overview.

important source of demand for the global economy. Stronger demand and greater purchasing power in Asia mean (among other things) more U.S. exports to the region, which are an important source of growth and jobs at home.

For more than 30 years, successive U.S. administrations have worked to promote strong domestic-demand-led growth in the major surplus economies of Asia. 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 save more in the wake of the 2008-09 financial crisis, Washington argues 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 negotiation of a U.S.-Korea free trade agreement (commonly known as 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. A core objective of all these efforts has been to reduce barriers to U.S. exports, enhance America's own competitiveness, and boost growth and jobs at home.

Regional trade policy also supports the second broad objective of U.S. economic strategy in Asia: *upholding and updating the rules of the international* *economic system.* As discussed further below, TPP (like its sister negotiation launched this year with the European Union, the Transatlantic Trade and Investment Partnership, or T-TIP) is aimed at establishing "21st-century" trade and investment rules. These cover not only tariffs and other border measures but behind-the-border conditions governing trade and investment, such as intellectual property protection, regulatory transparency, labor and environmental standards, and competition.

As a region representing roughly half of global GDP and trade, the Asia Pacific is an important testing ground for developing and implementing these new rules. After a decade of failing to conclude a comprehensive, multilateral agreement under the Doha Development Round, the United States and willing trade partners have been forced to pursue other more targeted approaches, including mega-regional agreements like TPP and T-TIP. The hope is that, if successful, these agreements will become the *de facto* template for a new multilateral system of rules.

Washington's championing of the rules of the international economy extends beyond trade and investment. The Obama Administration has worked through the G-20 to push for enhanced global financial regulation, stronger disciplines against corruption, and a phase-out of wasteful fossil-fuel subsidies. Since roughly half the member countries of the G-20 are also APEC members, these efforts should be seen as part of Washington's broader Asian economic strategy.

The third consistent objective of U.S. economic strategy in the Asia-Pacific region is *to support a long-term American presence in the region.* The United States is a Pacific power by nature (geography) and necessity (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 firmly in the region through an array of political, security, and economic arrangements.

The country's network of alliances in the region – with Japan, South Korea, Australia, and others – and the troops and ships deployed in support of those alliances are the most visible manifestation of that policy. Binding trade arrangements like KORUS 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 through expanded trade and investment and give Asia-Pacific countries an increased stake in each other's prosperity and security.

<u>Regional Economic Integration: The U.S. Approach</u>

In support of all three objectives described above – growth, rules, and presence – recent U.S. presidents going back to George H.W. Bush have invested in Asia-Pacific regional economic integration (REI). 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 the forum's REI mission top-level political imprimatur. George W. Bush launched and completed the KORUS FTA negotiations and initiated TPP at the end of his term. Barack Obama re-negotiated KORUS and passed it through Congress, then embraced and launched the TPP negotiations.

Washington's approach to REI in this region has been marked by two key characteristics that distinguish it from other approaches championed by other countries: it is *trans-Pacific,* versus Asia-centric; and it *emphasizes high standards* of liberalization and rule-making.

The first characteristic is driven first and foremost 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 pushing APEC to the fore, 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."[5]

In addition, strategic considerations have played a part in U.S. insistence on including Pacific-facing Latin American countries in REI efforts. President Clinton invited the Mexican President to the Blake Island Summit in 1993, 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 REI 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. Both the George W. Bush and Obama administrations have insisted on the broadest and deepest possible liberalization and 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-

[5] Cited in Claude Barfield and Philip I. Levy, "Tales of the South Pacific: President Obama and the Transpacific Partnership," *American Enterprise Institute*, December 2009, 1, http://www.aei.org/files/2009/12/18/09-IEO-Dec-g.pdf.

regional FTAs, have generally covered only border measures, with numerous exceptions to full liberalization.

Both economic and political considerations lie behind this second feature of U.S. regional integration policy. Washington believes that removing most impediments to trade and investment and imposing tough rules of the road maximize economic efficiency and growth. It feels that the narrower and "shallower" agreements reached to date in Asia have done little to improve efficiency and may cause trade diversionary effects that outweigh their trade-creating benefits.

Of course, the persistence of its own market-access restrictions on imports of some agricultural and other sensitive items shows that Washington does not always practice what it preaches with regard to high standards. This highlights the role of domestic politics in U.S. REI policy: to win Congressional support for trade agreements it has negotiated, the White House must achieve the best possible results for U.S. export interests, uphold U.S. labor and environmental standards, and minimize the damage to domestic vested interests. Washington's insistence on high standards in the negotiating room to a great extent reflects these political realities back home.

<u>Obama's "Rebalance" to Asia</u>

The Obama Administration's economic strategy in the Asia Pacific is broadly consistent with the traditional objectives and characteristics discussed above. But the stakes have been raised by this administration's strategy of "pivoting," or "rebalancing," to this critical 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, quickly dubbed "the pivot";[6] 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 a central feature of the overall rebalancing strategy. While most of the focus has been on TPP, the Obama Administration has in fact pursued a multi-pronged approach to 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). Bolstered by the decision earlier this year to bring Japan into TPP, engagement with Asia's second-largest economy has been focused on encouraging Tokyo to restructure its economy to generate renewed growth. Renegotiating,

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

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.

Engagement *at the global level* is another important element of the Administration's Asian economic strategy. Largely in recognition of the increasing weight of large emerging countries 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. Meanwhile, since China joined the WTO in 2001, the Administration has devoted much of its policy energy toward getting that country to follow through on its WTO commitments and to abide by the rules of the international trading system.

But the principal focus of Obama Administration economic strategy in the Asia Pacific has been *at the regional and sub-regional level.* TPP is the sharp end of the spear in this regard and will be discussed further in the next section. Though 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. The Administration also launched a so-called "Enhanced Economic Engagement (E-3)" initiative with the Association of Southeast Asian Nations (ASEAN); this is ultimately designed to bring all 10 members of that group into high-standard trade arrangements with the United States. By contrast, Washington has chosen not to seek membership in the ASEAN-centered Regional Comprehensive Economic Partnership (RCEP).

<u>The Trans-Pacific Partnership</u>

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, as well as with Australia, Peru, and Vietnam. 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 most of the Pacific-facing countries of the Western Hemisphere as well as a number of Asian economies. 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."[7] 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.

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[7] 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.

As this author has argued elsewhere, a number of myths cloud regional perceptions of TPP.[8] 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 RCEP, preferred by China. 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; in fact, 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 tracks clearly view the two approaches as not mutually exclusive. And as discussed further below, TPP and RCEP could one day converge in a region-wide agreement, or at least become interoperable, with enormous potential gains to world income.

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 – including the United States – wants to exclude China from regional economic 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, allows other countries to better compete with China, but this is a far cry from "containment."

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

Over the past few months, élite opinion in Beijing has shifted noticeably from rejecting TPP outright to seeking a better understanding of it; indeed, there are some signs – such as Beijing's embrace of a comprehensive BIT with the United States and 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 that 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.

The prospect of early conclusion of the TPP negotiations – certainly by the current deadline of the end of 2013 – remains very much in doubt. Although most of the agreement's 29 chapters have been closed, by all accounts significant differences remain on a number of challenging issues, notably intellectual property, competition, and environmental standards, as well as the market-access provisions.

One of the greatest sources of uncertainty is whether the Obama Administration will be able to persuade the U.S. Congress to support a final agreement without so-called trade promotion (formerly "fast track") authority, which is traditionally required to provide the political clarity U.S. negotiators need to close trade deals. Although there is a clear majority in favor of trade liberalization in Congress – including among so-called "Tea Party" members – there is concern that not even broadly supported legislation could pass Congress in the current environment of mutual distrust and dysfunction.

However, negotiators in the talks themselves report a shared sense of urgency and determination among all participating countries to complete the agreement quickly, and a basic accord in the next few months remains possible. Trade negotiations are always darkest before the dawn, as differences are narrowed to the most politically difficult issues. But insofar as they involve political rather than technical decisions, the final deals can be done quickly if the will is there.

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 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 "pivot" would contain little of substance that is new.

The Path to FTAAP

The parallel negotiation of two major regional trade agreements in the Asia Pacific – TPP and RCEP – raises the prospect of harmful trade diversion and a patchwork of inconsistent rules that could hamper rather than facilitate regional economic integration. This concern is heightened by the plethora of other arrangements being negotiated in the region, including the trilateral China-Japan-

Korea FTA.[9] Competition between the different tracks could also accentuate geopolitical strains in the region as countries line up in one economic camp or another.

A more benign interpretation of these trends is that the various trade agreements under negotiation are not mutually exclusive and may eventually converge at the broader APEC vision of a Free Trade Area of the Asia Pacific (FTAAP). Petri, *et al.,* have shown that the potential economic benefits of such a region-wide agreement are enormous, with annual global income gains on the order of $1.3 to $2.4 trillion by 2025.[10]

Full convergence of TPP and RCEP may be impossible given their different scope and the varying standards each will produce. However, there may be ways to harmonize important parts of the two agreements that would make them interoperable in practice.

As argued in a forthcoming CSIS report,[11] common rules on value-chain management would be one promising place to begin. The emergence of global value chains as the defining feature of 21st-century trade and investment patterns, in which a product idea is conceived in one country, inputs are procured and produced in others, assembly occurs in yet another, and the final product is shipped and marketed around the world, has fundamentally altered the stakes in trade negotiations. Rather than bargaining primarily for market access for their goods

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[9] According to the Asian Development Bank's Asia Regional Integration Center, there are currently 75 FTAs involving at least one ADB member under negotiation and another 51 either proposed or under consultation and study as of October 2013.
[10] 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.
[11] Matthew P. Goodman, Scott Miller, and David A. Parker, "Enhancing Value Chains: An Agenda for APEC," *CSIS*, December 2013 (forthcoming).

and services exports, countries must also ensure unrestricted value chains, i.e., the smooth flow of investment, technology, and inputs across and behind borders.

All of the regional arrangements under negotiation, including TPP and RCEP, will likely cover an array of value-chain disciplines including logistics procedures, services and investment liberalization, and information/communications technology facilitation. Consistency and high standards across these efforts would facilitate regional integration and promote better economic outcomes. One major report has estimated that reducing key value-chain barriers worldwide halfway to established best practices could boost global GDP by $2.6 trillion.[12]

As the oldest and arguably most successful forum for trade and investment integration in the Asia-Pacific region, and one that works by non-binding consensus, APEC could serve an important role in facilitating value-chain harmonization. Since adopting the Bogor Goals of free trade and investment in 1994 and its more recent FTAAP vision, APEC has served for a quarter century as an incubator for regional integration efforts. As host in 2014, China has a unique opportunity to launch a process aimed at making the value-chain provisions of the region's numerous trade arrangements interoperable at a high standard.

APEC has so far focused specifically on key cross-border logistics issues in work programs on "supply chain connectivity." For instance, APEC economies set a goal in 2010 of achieving a 10% reduction in the time, cost, and uncertainty of cross-border transactions by 2015. This has been important – and little heralded – work. The CSIS report recommends that China lead a broader initiative on value chains,

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[12] World Economic Forum, Bain and Company, the World Bank, "Enabling Trade: Valuing Growth Opportunities," (Geneva, 2013), 4, http://www3.weforum.org/docs/WEF_SCT_EnablingTrade_Report_2013.pdf.

building on APEC's existing work but incorporating a number of other policy issues along the value chain, including investment, data flows, and regulatory coherence.

Conclusion

From Washington's perspective, a successful economic strategy in the Asia Pacific is essential to sustaining American growth and jobs in the 21st century. It is also central to Washington's efforts to remain a champion of the international 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, and thus to America's own. For all these reasons, the United States is likely to remain an active – even impatient – participant in regional economic integration efforts.