Testimony before the U.S.-China Economic and Security Review Commission
"China and the U.S. Rebalance to Asia"
March 31, 2016

Matthew P. Goodman
Simon Chair in Political Economy and Senior Adviser for Asian Economics
Center for Strategic & International Studies (CSIS)

Introduction

The ground is shifting in the Asia Pacific. Demographic, technological, and other structural changes are reshaping the region's economies and politics. In particular, the reemergence of China as a regional power has created enormous new opportunities and risks. All of this has profound implications for U.S. interests; no other region of the world will do more to shape long-term U.S. prosperity and security. Washington needs a robust, comprehensive strategy to seize the opportunities and manage the risks of a changing Asia Pacific. Economics is the lifeblood of regional affairs and must be at the heart of this strategy.

The Obama Administration's "pivot," or rebalance, to Asia was an acknowledgment of these realities. After a decade of focus elsewhere, the rebalance was designed to put greater U.S. policy attention on the world's fastest-growing and most populous region. The Administration has made noteworthy progress in advancing this agenda. Since formally announcing the rebalance in 2011, the United States has joined the East Asia Summit, strengthened existing alliances and built new partnerships in Southeast Asia, and concluded negotiation of the Trans-Pacific Partnership (TPP) trade agreement.

But this is not enough. Against the shifting facts on the ground, Washington needs even more vigorous statecraft in the Asia Pacific, especially in the economic realm. Early ratification of TPP is critical to U.S. credibility in the region and the foundation for broader rule-making efforts there. Greater efforts are needed to preserve and extend areas of U.S. comparative advantage, notably in technology and digital services. In light of growing demand for infrastructure in Asia and the proliferation of initiatives led by other countries, Washington needs a more strategic approach to infrastructure investment in the region. And U.S. government leaders need to do more to explain the importance of the Asia Pacific to the American people.

The good news is that there is strong and growing demand for U.S. leadership in Asia. The queue of countries from South Korea to Indonesia eager to join TPP is one indication of the appeal of U.S.-led initiatives. However, to capitalize on these advantages in a more challenging and competitive environment, Washington needs a new mindset and approach to its economic engagement in the Asia Pacific.

U.S. Economic Engagement in Asia

Since World War II, U.S. policy toward the Asia Pacific has had three core objectives: ensuring peace and stability via a favorable balance of power; advancing prosperity via an open trans-Pacific economic order; and promoting the spread of shared values. The past eight U.S. presidents, from Richard Nixon through Barack Obama, have pursued a broadly consistent strategy to advance these interests. They have shown up, invested in security and economic initiatives that underpin regional peace and stability and advance U.S.-preferred norms, and sought to integrate China more deeply into the rules-based order.

Trade, investment, and other economic policies have been central to U.S. strategy in the Asia Pacific. The traditional U.S. approach to economic engagement has had two distinct features. The first stems from the fact that the United States is a Pacific but not an Asian power. Because of this, Washington has been a vocal and consistent champion of a trans-Pacific, rather than an Asia-only, economic order. This is the logic behind U.S. support for the 21-economy Asia Pacific Economic Cooperation (APEC) forum, which includes five Western Hemisphere countries: the United States, Canada, Mexico, Chile, and Peru. It is no coincidence that these same countries are also all TPP members.

Second, the United States has sought to promote comprehensive trade and investment liberalization and high-standard rules of the road. Since APEC's founding in 1989, Washington has used the forum's non-binding, consensual approach to socialize countries to these objectives and win support for U.S.-preferred rules and norms. More recently, the Korea-U.S. Free Trade Agreement (KORUS) and TPP have been vehicles for Washington to promote broader, deeper, and legally binding liberalization. By comparison, Asia-only integration efforts, such as the Regional Comprehensive Economic Partnership (RCEP), have tended to be shallower and less ambitious.

This engagement has supported impressive growth in U.S. economic ties with Asia. Five of America's top ten trading partners today are Asian countries. Last year, the United States exported more than $750 billion worth of goods and services to the region, a figure that has roughly doubled over the past decade. Nearly two-thirds of foreign students in the United States hail from Asia, and more than 10 million tourists from the region visited the United States in 2015.[1] These and other exports support more than a million American jobs.[2] The region is also a vital source of direct investment in the United States, with Asian companies having invested more than $500 billion as of the end of 2014.[3] Estimates suggest that Asian investments in the automobile sector alone directly and indirectly supported more than 1.5 million U.S. jobs last year.[4]

Through the rebalance, the Obama Administration has signaled a renewed commitment to economic engagement and institution building in the Asia Pacific. TPP has been at the core of

---

[1] http://www.asiamattersforamerica.org/overview; http://www.statista.com/statistics/254156/forecasted-inbound-travel-from-asia-to-the-us/
[2] http://www.asiamattersforamerica.org/overview
[3] http://www.bea.gov/itable/
[4] http://www.jama.org/wp-content/uploads/2015/12/report_final_US_121015.pdf

these efforts. The agreement brings together 12 Asia-Pacific countries representing 40 percent of the global economy. It includes wide-ranging market access commitments and new rules covering intellectual property protection, labor and environment standards, behavior of state-owned enterprises, regulatory procedures, and other behind-the-border impediments to trade and investment.[5]

TPP promises three broad benefits for the United States. The first is economic: by lowering barriers abroad and encouraging more foreign direct investment in the United States, TPP is expected to produce U.S. income gains on the order of half a percent of GDP.[6] Second, the agreement will update and uphold the rules of the international trading system, at a time when multilateral negotiations are stalled and other countries are challenging established rules. Finally, TPP will embed the United States more deeply in the Asia-Pacific region, complementing the country's security presence there.

Since negotiations concluded in October 2015, a number of Asian economies have expressed interest in joining TPP, including South Korea, Taiwan, the Philippines, Indonesia, and Thailand. This shows the power of U.S. economic leadership in the region. The United States remains the largest economy in the world, and Asians still want unfettered access to our markets, technology, and capital. They may not like U.S. hectoring about norms and standards, but most Asian governments know that market opening and strong rules support their own economic progress. From the perspective of most Asian countries, the problem with U.S. economic engagement in the region is that there is not enough of it.

A Changing Strategic Landscape

Despite these successes, current U.S. strategy is insufficient to meet the shifting trends the region, in particular the rise of China. More than three decades of rapid growth have transformed China from an economic backwater into the second-largest economy in history. This breakneck expansion has raised standards of living for hundreds of millions of Chinese citizens and helped to spur growth across the region. Supported by its membership in the World Trade Organization—a development championed by Washington—China now sits at the center of regional and global value chains. It is the largest trading partner of more than 43 countries, including the United States and virtually every country in Asia, and is one of the world's largest aid donors.[7]

Today, however, the Chinese economy is in the midst of a difficult transition. A slowdown from the double-digit growth of the previous three decades was inevitable, but sustainable growth over the medium term depends on Beijing's ability to manage a transition of the country's economic model from one driven by investment and exports to one led by consumption and services. This in turn requires well-sequenced reforms in the direction of liberalization. Beijing recognizes this

[5] https://ustr.gov/tpp/
[6] http://www.worldbank.org/en/publication/global-economic-prospects/GEP-Jan-2016-Implications-Trans-Pacific-Partnership
[7] http://www.businessinsider.com/chart-how-china-has-quickly-become-a-top-trading-partner-2015-9

challenge and, at the Third Plenum of the Communist Party in November 2013, presented ambitious reform plans to deal with it.

However, over the past year, serious questions have arisen about Beijing's capacity and competence to manage the economic transition. Reforms are widely viewed to have stalled, the authorities have committed several policy errors, and a tightening of political controls has impeded the necessary transition to more innovative growth (as well as created a far less favorable climate for U.S. businesses investing in China). Moreover, massive industrial overcapacity and rising debt have raised concerns about a near-term hard landing in China. At a minimum, the rest of the world will likely need to brace itself for several years ahead of Chinese economic underperformance.

A second, longer-term risk that China's rise poses is strategic. Island building in the South China Sea and grand plans to build infrastructure across Asia are two of the most visible signs that the Chinese leadership under President Xi Jinping is determined to restore the country's historic position at the center of regional affairs. Xi has declared that, "It is for the people of Asia to run the affairs of Asia," a statement clearly at odds with U.S. policies and interests in the region.[8] This ambition to restructure the regional order is undiminished by China's current economic challenges—and may even be fueled by them, insofar as slower growth undermines the legitimacy of the Communist Party.

These actions are provoking reactions. One beneficial consequence is growing demand for American leadership and engagement in all areas of policy—political, security, and economic. Yet the combination of China's economic slowdown and more assertive foreign policy is arguably making the regional order in Asia its most unstable in decades.

Elements of a New U.S. Economic Strategy

Against this backdrop, Washington needs to rethink its strategy toward the Asia Pacific. The first step is to acknowledge that the United States is no longer the sole or even dominant power in the region; we will increasingly be required to live with a more capable challenger willing to assert is newfound economic might in ways that are often at odds with U.S. interests. As the success of the TPP negotiations illustrates, Washington can still set the agenda in Asia, but it will need to be smarter and avoid committing unforced errors, as the Obama Administration did in its handling of China's proposal to create an Asian Infrastructure Investment Bank (AIIB).[9]

In substance, the first priority is to ratify TPP, ideally before the end of this administration. Failure of TPP would be a body blow to U.S. credibility in the Asia Pacific; as a senior U.S. official in Asia said to this author recently, "It would have been better never to have started out on this road." Even an extended delay in ratification—likely if the process slips into a new administration—would give the initiative to China as it asserts its leadership in the region. By contrast, ratification would be a powerful statement of U.S. commitment to the region at a time when Asians have grown wary of overdependence on China.

[8] http://www.china.org.cn/world/2014-05/28/content_32511846_2.htm
[9] http://csis.org/files/publication/150424_global_economics.pdf

Even if it succeeds in winning passage of TPP, the Obama Administration is likely to have little time or capital left for bold new departures on Asia policy before it leaves office in January 2017. It will be up to the next administration to reboot U.S. economic strategy toward Asia. Building on the successful elements of the rebalance, the new administration should design a strategy that includes a number of priority elements.

First, successful international economic policy begins with a strong economy at home. The medium-term outlook for U.S. growth is uncertain, and renewed stimulus policies may be needed early in the next Congress and administration. In addition, Washington should do more to invest in the foundations of U.S. economic strength—especially infrastructure, education and training, and innovation. Tax, social security, and regulatory reforms are also important to long-term economic success.

Second, a new strategy should put a priority on sustaining U.S. technological primacy. The United States is a global technology leader, with attendant benefits for national security and economic growth. To maintain this position, Washington needs to ensure that we are both running faster than others—e.g., by investing in basic research—and preventing competitors from undermining our technological edge—through cyber-enabled intellectual property theft, mandatory technology transfer requirements, or forced data localization. In addition, Washington should review its current export-control and investment-review procedures to ensure that sensitive technology is not leaking to potential adversaries.

Extending the TPP model of rule making and standard setting to other countries and policy areas would be another valuable element of a new economic strategy toward Asia. As mentioned earlier, there is a queue of countries waiting to join TPP; following ratification, priority should be placed on accession by South Korea and other countries willing to live up to TPP's high standards—ultimately including China if it prove its readiness. Moreover, the gravitational pull of TPP suggests that it could be a model for other economic initiatives outside trade and investment. Wherever the United States has an interest in spreading high-standard rules—whether in finance, development, or energy—the lessons learned from the successful TPP approach of starting small with like-minded countries and incentivizing others to join could be instructive.

Finally, a new strategy should include a U.S. vision and plan for infrastructure investment in Asia. There is a new great game underway in Asia, as seen in China's One Belt, One Road strategy, Japan's quality infrastructure initiative, and similar plans by other powers in the region. At stake is the physical structure and geographic orientation of the regional economic order. In particular, an infrastructure network where all roads, railways, and data highways lead to Beijing will entrench Chinese centrality in regional value chains and reinforce a Sinocentric economic geography. The United States is not an infrastructure superpower, but it does bring formidable assets—great companies, plentiful capital, rule of law, and high standards—to this new competitive playing field in Asia.

A New Mindset

An effective Asia strategy is not just a matter of updating Washington's substantive policy toolkit. It also requires a new mindset, one that starts and ends with confident assertion of U.S. interests. Washington must understand the key role economics plays in regional political and security affairs. There must be a willingness not only to incentivize countries to follow the U.S. lead but also to impose costs on bad behavior. A successful strategy requires Washington to work with allies and partners in the region, and to engage effectively with the private sector—the sharp edge of the spear of our engagement in Asia. And the administration must develop messages and modes of engagement that resonate with key constituencies in Asia and at home, including local governments and civil society.

This is a tall order for any administration, given the inevitable press of other business both at home and abroad. Asia is not burning—but it is transforming in profound ways that may not always favor U.S. interests. A well-conceived and energetically executed strategy toward the world's most dynamic region is not only worth the investment of time, resources, and political capital; it is essential to long-term U.S. prosperity and security.

To help the next administration develop an effective economic strategy toward Asia, CSIS has established a high-level, bipartisan commission consisting of 18 senior former officials, business people, and scholars with deep experience on Asia and/or international economic policy. Co-chaired by former U.S. Trade Representative Charlene Barshefsky, former Utah Governor and U.S. Ambassador to China Jon Huntsman, and Chubb CEO Evan Greenberg, the CSIS Asia Economic Strategy Commission (AESC)[10] plans to issue its analysis and recommendations this summer. We look forward to briefing the Commission on our findings.

[10] http://aesc.csis.org