Leveling the Playing Field for U.S. Trade with Asia

by Kent H. Hughes

SUMMARY

Current negotiations over trade deals—the TPP across the Pacific and the TTIP across the Atlantic—offer the United States its best chance in decades to create international standards limiting foreign governments' support for their home industries. The administration should focus its efforts on pushing the world trading system away from its pattern of ignoring the impact of state-led or state-influenced economies, which produced a series of East Asian Miracles but also handicapped developed countries' economic competitiveness and threatened their international political leadership.

The Trans-Pacific Partnership (TTP) negotiations, started by President George W. Bush and significantly expanded by President Obama, are designed to expand the existing international system by proposing rules for state-owned companies and intellectual property—two key components of East Asian development strategies. They do not—at least not yet—deal with the full range of systemic differences, such as currency manipulation, export subsidies, and the impact of competitors' industrial strategies. State-influenced enterprises often benefit from government policies that range from preferred access and credit to often opaque subsidies. Creating global standards for state-owned or -influenced companies is only a first step, but a step that can lay the basis for further negotiations that will confront the full array of differences.

On the other coast, the Trans-Atlantic Trade and Investment Partnership (TTIP) is a parallel effort to develop a much more extensive set of rules and regulations for Europe and the United States. Like the TPP, the TTIP could establish a template that could lead to global standards for trade in a host of industrial, service, and even agricultural products. TTP could stimulate complementary negotiations on rules governing global capital markets. If the world's two largest economies, the European Union and the United States, agree on a set of rules and regulations, the rest of the world will have powerful incentives to agree.

Some critics worry that the focus on regional trade agreements could erode the standing of the principal multilateral trade authority, the World Trade Organization. But the WTO, with 159 members and a one-country, one-vote governance structure, has inclined toward consensus decision-making and, consequently, toward gridlock. It is increasingly criticized for what it is not doing rather than for any specific initiatives. TPP and TTIP, if successfully completed, could lead to the strengthening of the WTO by demonstrating broad agreement on two major aspects of international trade and creating templates for subsequent global negotiations.

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The Clash of Magic and Miracles

When President Obama and Chinese President Xi met in California in June 2013, magic and miracles were hovering in the background. The magic of the marketplace was competing with the East Asian Miracle, creating an economic clash between the two countries.

After World War II, when the United States and Great Britain worked to design a new trading system, they assumed a world in which the market would receive only limited guidance or intervention from governments. Private companies would compete freely against one another, once the Marshall Plan period of recovery ended.

But by the 1960s a new approach to growth emerged in East Asia. Governments worked closely with business to achieve a presence in key industrial sectors. The focus was on export-led growth. Developing countries had to meet global competition, and they tipped the scales by subsidizing exports, limiting competing imports, keeping their currencies undervalued, and borrowing (often without pay) intellectual property from the advanced industrial countries.

Japan was the first of the major countries to challenge the underlying assumptions of the world trading system. In different variants, Korea, Taiwan, and Singapore followed. China is now pursuing its own version of what started as a Japanese strategy. The sheer success of the East Asian Miracle approach suggests that other, rising Asian powers will follow in the footsteps of China and Japan.

The East Asian Miracle has often yielded truly miraculous results. Japan set a record for rapid economic growth before allowing bursting bubbles to slow growth to a crawl for the past two decades. Korea, Taiwan, and Singapore have had successes without suffering that slowed growth. China has stunned the world with 10 percent annual growth compounded over three decades.

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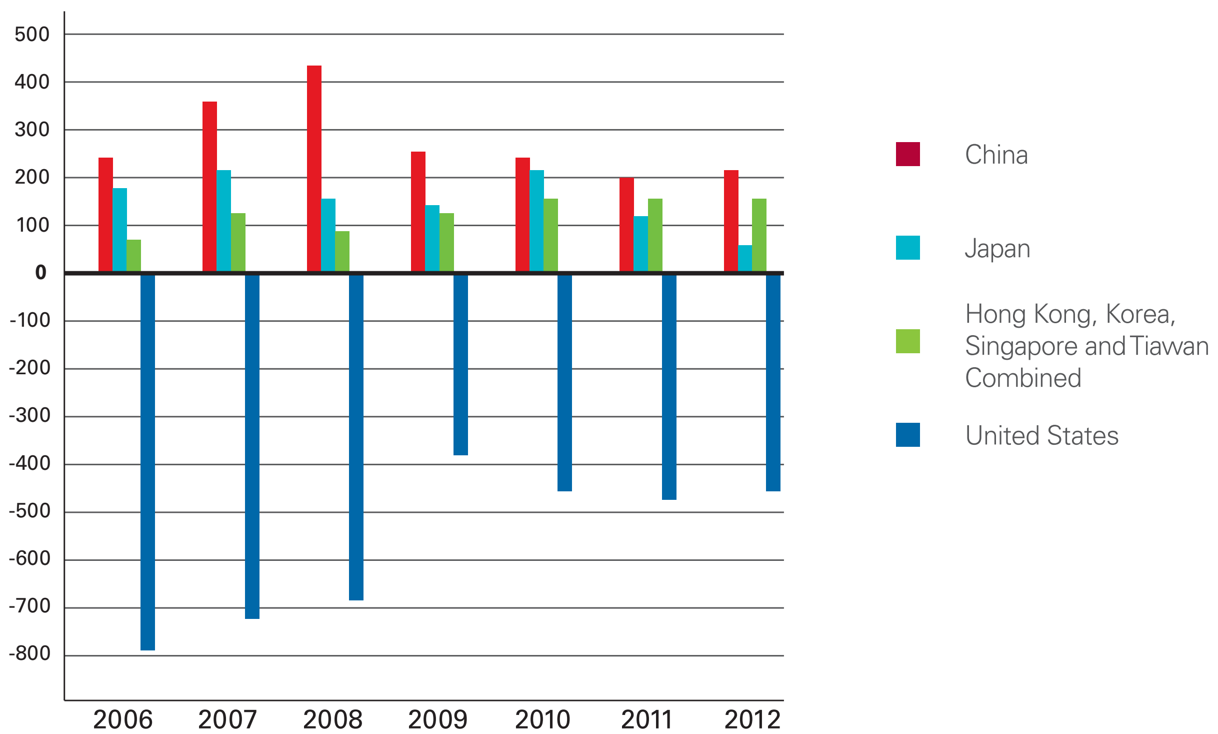
Japan's success was not based solely on trade practices and industrial coordination. The country had high levels of domestic saving and investment. It put an enormous emphasis on education, with high school graduates having a solid grounding in mathematics and science as well as Japanese language and culture. Industrial success was a national priority.

Like Japan, China has paid attention to fundamentals with high rates of saving and investment, an emphasis on education, and the development of modern infrastructure. But it has also followed the Japanese example in manipulating its currency, adopting trade practices to support its exports and limit imports, guiding (or directing) industry, and acquiring intellectual property. Unlike Japan, China has actively courted foreign direct investment through a variety of subsidies. China has coupled the courting of investors with a requirement that they share their technology with a Chinese partner.

Summary of Balances on Current Accounts



Even if policies are similar, the structures of the economies inevitably reflect their industrial histories. Japan's legacy of family-owned industrial conglomerates, the Zaibatsu, led to more flexible, privately owned conglomerates, the Keiretsu. Maoist China had adopted a Soviet model of central planning and state-owned enterprises. When China entered into global economic competition, a range of private, albeit-state influenced, industries emerged, while the remaining state-owned enterprises are still a very powerful force in the Chinese economy.

"China's export-led growth has helped it acquire an estimated $4 trillion-plus dollars in financial reserves."

Contemporary China poses two other challenges. While China now has a large middle class, its remaining millions in poverty keep its average income in the developing country range. Because international trade rules give developing countries some advantages, China wants to keep that status while seeking to grow out of it. Second, China's export-led growth has helped it acquire hard currency reserve with an estimated value of more than four trillion dollars. The reserves help China pursue access to raw materials, technology, and other assets. China's reserves provide more than ample insurance against a future financial crisis and can also be a powerful source of international influence.

China and the other rising powers do not ignore how much magic there is in the marketplace. After all, the success of the East Asian Miracle countries has depended, in part, on embracing the global market and in fostering the competitive strength of their own industries.

Benefits and Costs for the U.S.

The East Asian challenge has also had some benefits for the more market-oriented countries. Chinese investment in U.S. Treasury bonds has helped keep long-term interest rates low in the United States. That bargain rate on borrowing *could* have fueled U.S. investments in infrastructure, factories, research laboratories, and education.

Low-cost imports have also helped average American consumers stretch their incomes while wages were tending to stagnate. Bargains fill retailers' shelves for American consumers, and many of those bargains come from Asian producers.

But the United States and other market-oriented countries have paid a price as well. Subsidized imports have created an unfair burden for domestic manufacturers—driving many of them out of business or overseas. When manufacturing plants move, design work and research and development often follow. Innovators find it more difficult to translate their ideas into domestic production and wealth creation, because key parts of the innovation system have gone not with the wind but with the competitive gales coming from East Asia.

Low-cost imported goods have also contributed to record trade and current account deficits. After World War I, the United States emerged as the world's largest creditor. Starting in 1982, the United States moved into debtor status. The amount of red ink in the current and trade accounts has varied from one year to the next, but not the bright red color signaling a growing international debt. The debt grew faster in the 2000s and has left the United States as the largest debtor the world has ever seen. That imbalance has geopolitical as well as more strictly economic implications.

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Even the cheap credit ended up having a negative impact. Instead of supporting growth-fueling investments, cheap credit contributed to the housing bubble, the related financial crash, and the Great Recession. It was, of course, the failure of public and private American institutions to provide proper regulation, not Chinese investment, that led to disaster.

How to Respond

How should the United States respond? The George W. Bush administration urged China to open its market, stop manipulating its currency, and protect intellectual property. The Bush Commerce Department continued the Joint Commission on Commerce and Trade (JCCT) and added a Treasury-led Strategic Economic Dialogue. Most observers praise the effort, note some specific positive results, but also agree that few fundamentals actually changed.

The Obama administration has made similar appeals with regard to currency, market opening, and intellectual property, also with modest success. The Obama Administration has also filed several complaints with the World Trade Organization about Chinese trade practices, including one dealing with China's restrictions on the export of rare earth metals—raw materials critical for a number of electronic products. But individual cases are not the way to solve systemic problems. U.S. companies find themselves competing with companies and governments at the same time. There is a growing understanding of the need to find a way for two different systems to work together.

The TPP and TTIP are the best chances currently on the table for agreements that will expand trade and create the basis for broader, trade rule–strengthening negotiations. The TPP can take the first step in setting rules for how state-owned and influenced enterprises compete on a level playing field with private companies. By establishing clear, trade-supporting standards, the TTIP can take a complementary step in broadening and deepening international trading rules that build on the existing WTO system.

China is the latest East Asian country to pursue a variant of the East Asian Miracle approach to growth. The clash between "magic" and "miracles" has been and will continue to be a source of tension between the United States and China. One positive sign is that China has had a somewhat positive response to the invitation to join the TPP negotiations.

And although China is the current focus of anxiety, it is a mistake to think only of China. America faces a double challenge that goes well beyond our relations with any single country. First, we face a systemic challenge that puts the American economy and many American companies at a serious disadvantage. But secondly, America's ability to be pursue leadership abroad and the American Dream at home depend on a strong economic and innovative base. The East Asian Miracle has threatened both. How America responds will have a great deal to say about America's future.

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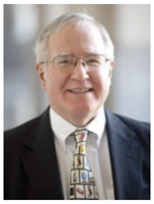

Hughes is the author of *Building the Next American Century: The Past and Future of American Economic Competitiveness* (Woodrow Wilson Center Press 2005). He has served as associate deputy secretary of Commerce, and president of the Council on Competitiveness, and in a number of senior positions with the U.S. Congress.

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