POLICYBRIEF

REDEFINING U.S. ECONOMIC RIVALRIES IN ASIA

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SUMMARY

Promising to level the playing field with China has been a vote-winning mantra among Democrats and Republicans alike. From deliberately weakening China's currency to flooding the world with cheap goods, Beijing has been accused by investors and policymakers of making it difficult for U.S. businesses to remain competitive in the global economy. Yet competition for new markets, natural resources, good jobs, and global talent is as likely to come from Japan and South Korea as from China. As much as the two countries are key U.S. allies in the Asia-Pacific region, the United States needs to recognize that the new normal in international economic rivalries is not simply about trade imbalances. Continued U.S. economic competitiveness depends as much on the country investing within its own borders and pushing forward with tax reform and other policies that will spur growth as it does on clamoring for fair trade practices from rival nations.

Of course, citing Japan as an economic rival may sound absurd to many people, given that it is the second-most-indebted nation after Zimbabwe in terms of the ratio of debt to gross domestic product (GDP). Yet despite nearly two decades of sluggish growth, Japan remains the world's third-largest economy, and its appetite for markets outside of the Asia-Pacific region in particular should give U.S. legislators and investors cause for pause. South Korea, meanwhile, continues to be a heavily export-driven country at a time when global market size is seemingly shrinking. Yet the drive by Japan and South Korea to expand into Africa and Latin America, in particular, in addition to securing natural resources and new export markets in emerging economies, puts those countries in direct competition with the United States.

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RACE FOR AFRICA, LATIN AMERICA, AND FORMER ROGUE STATES

Certainly, more developing nations are looking for capital flow from Northeast Asia to jump-start their own private sector growth. In 2012, first-quarter foreign direct investment (FDI) outflow from Japan and South Korea reached $26.3 billion and $6.3 billion, respectively. Meanwhile, Chinese FDI reached $14.8 billion during the same period. The race among Asian nations for resources and market access in Africa has been particularly intense, with Japanese and Korean companies closing the gap with their Chinese counterparts and often beating out U.S. businesses. Mitsubishi's development of oil and gas in Liberia, Sumitomo's investment in a Tanzanian thermal power plant, and natural gas development in Mozambique by Mitsui all illustrate Japanese private sector commitment to Africa over the past 12 months. Meanwhile, Korea National Oil, Samsung C&T, and Posco are among the South Korean groups committed to developing natural resources and building infrastructure across South Africa, the Republic of Congo, and Ethiopia. Asian eyes have also been turning increasingly to Latin America, which hitherto had been dominated by U.S. investments. Although the United States remains the single biggest trading partner with the region, Asia is now in second place, accounting for over 20 percent of total share at $442 billion in 2011. Japan, meanwhile, has displaced China as the top Asian investor in the region, with money flowing to secure commodities such as copper and silver.

Expanding outreach within Asia is also a priority, especially access to the nascent market of Burma. Uninhibited by government sanctions, unlike their U.S. counterparts, Japanese businesses have been particularly aggressive about penetrating the Burmese market, and Tokyo has stepped up efforts to forgive Burma's $3.7 billion in debt and provide new loans to the tune of $3.2 billion. Although a handful of U.S. companies, including General Electric and Coca-Cola, have returned to Burma since the 2012 elections in Yangon, Japanese companies currently account for nearly half of all foreign businesses in the country. Tokyo's gamble in identifying Burma as the final frontier for massive investments in the region carries huge risks, but Japanese commercial banks, airlines, and manufacturers have all eagerly embraced the opportunity in recent months.

FALLING BEHIND IN THE GREEN TECHNOLOGY QUEST

The United States is competing head-on with Northeast Asia not only for new markets; a dearth of natural resources has forced both Japan and South Korea to develop energy-efficient products over the decades and is now pushing those countries to be at the forefront of investing in alternative energy sources. In Japan, the impetus to develop green technology and increase energy efficiency has increased still further following the Fukushima nuclear disaster of March 2011. To compensate for a severe postdisaster energy shortage, the government has introduced incentives for companies to develop alternative technologies, including increased profit margins for solar providers.

The public sector is also encouraging more private investments to flow into the green technology industry. For instance, the Tokyo metropolitan government commissioned an asset management group to start an infrastructure fund with $19 million to invest in mega solar and wind plant projects as well as small-grid technology companies. Meanwhile, private investors such as Masayoshi Son, whose company SoftBank recently bought

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out Sprint Nextel, are calling for investing in 10 mega solar plants, of which 6 are already under construction. SoftBank itself has contracts with 36 Japanese prefectures to develop renewable energy projects. South Korea, meanwhile, is taking the global lead in emissions trading in an effort to reduce its dependence on crude oil.

Both South Korea and Japan view wind energy, in particular, as one of the most viable longer-term energy sources. Japan's New Energy and Industrial Technology Development Organization unveiled the country's largest offshore wind turbine in October, and in South Korea, the world's largest offshore wind farm is expected to be completed by 2014. The United States, in contrast, has yet to develop offshore wind power despite its long coastlines.

Japan's and South Korea's clear commitments to developing renewable energy sources have already led research in the area to flourish, and corporate investments to the industry have been rising steadily. While President Barack Obama rallied for more manufacturing jobs to return to the United States on the campaign trail, Japan and South Korea clearly are leading in the race to develop green technology on a scale that will meet national energy needs. Like the East Asian nations, not only must the United States invest more in research and development to keep up with global developments in the green energy sector; it also will need to introduce tax credits and other financial incentives for companies to take on development risks.

Meanwhile, Japan is pushing aside its territorial dispute with Russia over the Kuril Islands and is looking to jointly develop a $7 billion liquefied natural gas plant outside of Vladivostok. This effort would change Russian-Japanese relations, driven by a quest for energy. It also signals Moscow's growing need to turn to Tokyo as a counterbalance against China's military as well as economic rise.

ASIAN RISKS, U.S. OPPORTUNITIES

Economic fundamentals point to the considerable risks that continue to face Japan, in particular, not least its unsustainable debt levels. Geopolitical risks facing Northeast Asia also could hamper growth, including the ever-present menace of North Korea, which will continue to challenge the new Korean leadership in December.

The ongoing tensions between Japan, Taiwan, and China over the Senkaku/Daioyu Islands in the East China Sea have already led to a slump in trade among the three nations. Tokyo's dispute with Seoul over ownership of Takeshima/Dokdo too has soured relations between the two sides. Trade between China and Japan, in particular, has been hard hit since August, and though no clear solution to the territorial dispute is in sight, the conflicts have already cost the three countries the chance to move forward with their free trade zone negotiations, which were slated to begin later in 2012. The three countries account for about 20 percent of global GDP, compared to 27 percent for the North American Free Trade Agreement partners (the United States, Canada, and Mexico).

Still, the delay in the creation of a massive Asian trade bloc is an opportunity for the United States to move ahead with the Trans-Pacific Partnership agreement and to continue to play a key role in ensuring economic as well as military stability in the region. The United States must continue to press ahead with making the partnership a reality, but at the same time, it also needs to recognize that trade imbalances are often self-created and that it has the opportunity now to invest in its own industries to stay ahead of the game.

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