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Objectives and Future Direction for Rebalance Economic Policies

Prepared statement by

Elizabeth Economy

C.V. Starr Senior Fellow and Director, Asia Studies
Council on Foreign Relations

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Hearing on "China and the U.S. Rebalance to Asia"

The Rebalance to Asia

President Obama's 2011 pivot or rebalance to Asia reflects two complementary strategic imperatives: first, an acknowledgement and reassertion of enduring U.S. security, economic, and political interests in the region; and second, a response to the call by America's allies and partners in the Asia Pacific for a more deeply engaged United States as a hedge against a rising, and potentially destabilizing, China.

While much of the world's attention on the rebalance has been on the security commitment, the importance of the economic component cannot be overstated. The Asia Pacific is a center of global economic growth and a critically important trade and investment partner for the United States. In 2014, Asia Pacific Economic Cooperation (APEC) countries accounted for 58 percent of global GDP, and during 2000–2014, the value of Asia's import market jumped by 261 percent from $1.5 trillion to $5.4 trillion.[1] The Association of Southeast Asian Nations (ASEAN) represents the fourth largest export market for American

[1] Jay Chittooran, "Losing Ground in Asia: Why the U.S. Export Market Share has Plummeted," *The Third Way*, August 5, 2015, www.thirdway.org/report/losing-ground-in-asia-why-the-us-export-market-share-has-plummeted.

goods and services, and it supports nearly 500,000 American jobs.[2] China's significance as an export market for American companies also continues to grow: from 2005 to 2014, U.S. exports to China increased by 198 percent, making the country America's third largest export market. [3]

The Asia Pacific is also an important source of investment for the United States and investment destination for American companies. Japan was the second largest source of foreign direct investment in the United States (after the Netherlands) in 2014 and is the second largest cumulatively (after the United Kingdom). Japanese investment, particularly in the automobile sector, accounts for as many as 400,000 U.S. jobs. [4] Chinese investment in the United States, which has been rising over the past several years, supports about 80,000 jobs.[5] Cumulatively, the United States is the largest investor in Southeast Asia, but on an annual basis, over the past three years, it has been superseded by the European Union, Japan, and China. The value of U.S. trade and investment ties with Asia Pacific countries is likely only to grow. According to one estimate, by 2030, over two-thirds of the world's entire middle class will be in Asia, [6] providing a significant new market for U.S. consumer and other goods.

The Obama administration's rebalance has acknowledged the importance of the economic relationship in several different ways. Most significantly, it contributed to the successful completion in November 2015 of the Trans-Pacific Partnership (TPP) agreement. The free trade accord involves twelve countries (the United States, Japan, Australia, Malaysia, Vietnam, Singapore, New Zealand, Brunei, Mexico, Canada, Peru, and Chile) and represents roughly 40 percent of global GDP and 25 percent of world exports. It is notable for the high standards it sets for labor rights, the environment, and intellectual property rights protection, among other issues. A study by the Peterson Institute predicts the United States will gain $78 billion in annual exports from the TPP, while opportunities for outward investment will increase by $169 billion and inward investment by $47 billion. Other countries will also benefit: Vietnam and Japan will be biggest winners; China will be a significant loser as long as it remains outside the deal.[7]

The administration has also rolled out a number of additional economic and trade initiatives in the region, such as the U.S.-ASEAN Expanded Economic Engagement initiative, a U.S.-Pakistan Economic Partnership Week, and the New Silk Road.

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[2] Charles H. Rivkin, "Advancing U.S. Economic Engagement in Asia," testimony before the House Foreign Affairs Committee, May 14, 2015, http://www.state.gov/e/eb/rls/rm/2015/242411.htm.
[3] The US-China Business Council, "US State Exports to China (2005-2014): Executive Summary," 2015, https://www.uschina.org/reports/us-exports/national.
[4] Theodore H. Moran and Lindsay Oldenski, "Japanese Investment in the United States: Superior Performance, Increasing Integration," Peterson Institute for International Economics, February 2015, http://www.iie.com/publications/pb/pb15-3.pdf.
[5] Jamil Anderlini, "Surge in US workers employed by Chinese companies," *Financial Times*, May 22, 2015, http://www.ft.com/intl/cms/s/0/0da0c392-0042-11e5-a908-00144feabdc0.html#axzz42ysBhKgh.
[6] Jay Chittooran, "Losing Ground in Asia: Why the U.S. Export Market Share has Plummeted," *The Third Way*, August 5, 2015, www.thirdway.org/report/losing-ground-in-asia-why-the-us-export-market-share-has-plummeted.
[7] Peter A. Petrie and Michael G. Plummer, "The Trans-Pacific Partnership and Asia-Pacific Integration: Policy Implications," Peterson Institute for International Economics, June 2012, http://www.iie.com/publications/pb/pb12-16.pdf.

Progress, albeit very slow, continues to be made in advancing a bilateral investment treaty (BIT) with China. As China continues the process of economic reform and continues to seek positions of economic leadership globally, a BIT will be a critical mechanism for ensuring fair and open access for U.S. companies to the Chinese market.

In addition, with the rebalance, U.S. government agencies have stepped up to the plate to support American business interests in Asia. The Export-Import Bank (Ex-Im Bank) has supported a number of significant deals in Asia, including the export of fleets of Boeing aircraft to Korean Airlines and Indonesia's Lion Air. [8] In November 2012, the Ex-Im Bank announced $5 billion in export financing, particularly targeted toward clean energy under President Obama's U.S.-Asia Pacific Partnership for a Sustainable Energy Future. This will buttress other collaborations the bank has undertaken to support gas-fired and solar power in India. [9] The bank also is helping finance sixty-two General Electric wind turbines in Vietnam.

The rebalance has also evinced an activist commercial diplomacy. Secretary of Commerce Penny Pritzker has ratcheted up the level of American commercial diplomacy in Asia, traveling at least seven times to the region during 2013–2015, including a trip to Vietnam, Myanmar, and the Philippines, with CEOs and the U.S.-ASEAN Business Council. Under her watch, the administration has also added Foreign Commercial Service offices in Wuhan, China, and Yangon, Myanmar. [10] Secretary Pritzker has also focused particular attention on clean energy, leading commercial delegations to Japan and South Korea on healthcare and energy, as well as to China on green infrastructure and energy efficient industries. [11]

While most countries in the Asia Pacific welcome an increased level of U.S. economic engagement through new trade and other arrangements, China has a more ambivalent stance. It has its own economic ambitions in the region, which it is pursuing aggressively, and a renewed emphasis on U.S. economic engagement is not always welcomed. In addition, as long as China remains outside the TPP, assuming it comes to fruition, the agreement is likely to exert a profoundly negative impact on the Chinese economy. Nonetheless, there are some areas of overlapping interest between the United States and China that can be pursued for common gain.

The Chinese Perspective

[8] Export-Import Bank of the United States, "Ex-Im Bank Approves $1.1 Billion in Financing for U.S.-Manufactured B737-900ER Aircraft to Indonesia's Lion Air," March 5, 2013, http://www.exim.gov/news/ex-im-bank-approves-11-billion-financing-for-us-manufactured-b737-900er-aircraft-indonesias.

[9] Fred P. Hochberg, "ASEAN Ambassadors' Breakfast on East Asia Energy Partnership: Welcoming Remarks," January 16, 2013, http://www.exim.gov/news/archives/speeches/asean-ambassadors-breakfast-east-asia-energy-partnership.

[10] United States Department of Commerce, "U.S. Secretary of Commerce Penny Pritzker Leads CEO Mission to Show U.S. Commitment to Asia," May 30, 2014, https://www.commerce.gov/news/blog/2014/05/us-secretary-commerce-penny-pritzker-leads-ceo-mission-show-us-commitment-asia.

[11] Penny Pritzker, "U.S. Secretary of Commerce Penny Pritzker Addresses the American Chamber of Commerce in South Korea," Department of Commerce, October 23, 2014, https://www.commerce.gov/news/secretary-speeches/2014/10/us-secretary-commerce-penny-pritzker-addresses-american-chamber-0.

China's energies in the Asia Pacific have been devoted to advancing its own economic centrality in the region. Chinese President Xi Jinping has pressed forward with a trade, investment, and security architecture that, if fully implemented, will reshape the political and economic landscape of the Asia Pacific. Beijing has successfully established the Asian Infrastructure Investment Bank (AIIB), with participation from almost sixty countries. The AIIB expects to lend $10–15 billion annually for the first several years, and the bank's leadership has stated that it will maintain high standards for transparency as well as social and environmental safeguards, although it will not enforce IMF lending standards.[12] According to one Chinese analyst, Chinese officials see the AIIB as helping with overcapacity, increasing demand for Chinese commodities, spurring RMB internationalization, and helping China increase its influence in setting world economic and financial rules.[13]

Beijing's regional economic platform also includes the sixteen-member Regional Comprehensive Economic Partnership, which is scheduled to be completed by the end of 2016 and is estimated to help trade between China and the rest of the region reach $1 trillion by 2020.[14] Further into the future, President Xi has also proposed a Free Trade Area of the Asia Pacific, which the Peterson Institute estimates would benefit China more than any other country.

China's most significant initiative, however, is its grand-scale One Belt, One Road initiative, which in part recreates China's traditional Silk Road, providing land and maritime connectivity from China through Asia, the Middle East, Africa, and Europe. If realized, the One Belt, One Road will connect sixty nations across four continents. Beijing has pledged $40 billion to support the development of transportation and trade networks, with additional funding planned from the AIIB. Originally conceived as a trade and investment opportunity, the project has now expanded to include financial arrangements, people-to-people exchanges, and a call to advance Chinese soft power. As *Global Times* journalist Ding Gang has commented, "China's new leadership has proposed building a community of common destiny with its neighboring countries. Such a community cannot be simply established through a connection of rails, highways, and airplanes. Spiritual commitment is equally important… the exchange and compromise of interests cannot make a country's diplomacy resonate; its charisma can only be amplified through ethical strength."[15]

While these initiatives are primarily designed to advance Chinese economic interests, Chinese analysts also understand them in the context of countering the rebalance. Renmin University Professor Wang Yiwei, for

[12] Sue-Lin Wong, "China launches new AIIB development bank as power balance shifts," Reuters, January 17, 2016, http://www.reuters.com/article/us-asia-aiib-investment-idUSKCN0UU03Y.
[13] Zhang Maorong, "Significance of Establishing the AIIB," *China-US Focus*, February 19, 2016, http://www.chinausfocus.com/finance-economy/significance-of-establishing-the-aiib/.
[14] "ASEAN-China trade expected to reach 500 bln USD by 2015," Xinhuanet (Novmeber 14, 2014) http://news.xinhuanet.com/english/china/2014-11/14/c_133788265.htm
[15] Ding Gang, "Unconditional aid shows true strength," *Global Times*, November 13, 2013, http://www.globaltimes.cn/content/824725.shtml.

example, has noted, "The New Silk Road Initiative [another term for One Belt, One Road] could help redirect the centre of geopolitical gravity away from the US and back to Eurasia."[16]

With particular regard to the pivot or rebalance, Chinese analysts and officials express a range of views. Initially, most believed that the TPP was an effort to contain China by excluding it from the most significant multilateral trade agreement in the region. America analyst Zhang Zhixin, for example, referred to the TPP as "another example of American aggression against China."[17] Some Chinese scholars also expressed fears about the real costs to China associated with the agreement. One Chinese scholar, citing the Peterson report, pointed out that by 2025, the TPP is estimated to cause a drop in China's GDP of .3 percent by 2020 and cost China 1.2 percent of exports due to trade diversion by 2025.[18] Others, particularly in the Ministry of Finance and the Ministry of Foreign Affairs, however, have argued that the TPP offers opportunity. Vice Finance Minister Zhu Guangyao has stated, "As China becomes more open, it's very important for us to be integrated into the global trade system with a high standard."[19] Many Chinese economists believe that the TPP will be a useful prod to China's own domestic economic reform effort.

While the official position is to remain open to participation in the TPP, there are also concerns that the demands for intellectual property protection and state-owned enterprise (SOE) reform are "excessively high" and that it will be challenging to achieve "competition neutrality" in which Beijing would not grant privileges to its SOEs.[20] In private conversations, a number of Chinese businesspeople and analysts have also complained that if Vietnam is included, China should be as well.

Ensuring Balance in the Rebalance

The rebalance is often understood as three distinct strands of policy—maintenance of open and secure sea lanes; adherence to free market–based trade and investment; and promotion of good governance, including protection of intellectual property, the rule of law, transparency, and free-flowing information. It is better understood, however, as a type of strategic triangle, with each side providing critical reinforcement to the other two. A stable security environment enables economic growth and human rights to prosper. Good governance is necessary to ensure long-term stability and economic development. And economic development is an essential underpinning of long-term military and political stability.

[16] Wang Yiwei, "One Belt One Road: Opportunities for Europe-China cooperation," *Europe's World,* May 13, 2015, http://europesworld.org/2015/05/13/one-belt-one-road-opportunities-europe-china-cooperation/#.VuwqgOIrK70 .

[17] Zhang Zhixin, "Why China Has Good Reason to Worry About the US Rebalance Strategy?" *China-US Focus,* July 8, 2014. http://www.chinausfocus.com/foreign-policy/why-china-has-good-reason-to-worry-about-the-us-rebalance-strategy/.

[18] Zhang Xiaotong, "China's Views of the TPP: Take it or Leave It, That is the Question," Wuhan University Center for Economic Diplomacy, November 21, 2014, http://www.whuced.com/show/?id=110&siteid=3.

[19] Keith Bradsher, "Once Concerned, China is Quiet About Trans-Pacific Trade Deal," *The New York Times,* April 28, 2015, http://www.nytimes.com/2015/04/29/business/international/once-concerned-china-is-quiet-about-trans-pacific-trade-deal.html.

[20] Zhang Xiaotong, *op. cit.*

Enhancing America's economic engagement, therefore, requires not only fulfilling pledges on the economic front, but also in the security and political realms. There are several steps the United States should take to ensure that its economic interests in the region are realized:

- Above all, the U.S. Congress should ratify the TPP. It is the economic heart of the rebalance and its realization is critical to the credibility of the United States in the region.

- If not underway already, the USTR should initiate dialogues with other nations interested in joining the TPP, such as the Philippines, Taiwan, South Korea, and China.

- The next administration should make the realization of a BIT with China a top priority. As the European Union moves forward with its own China BIT negotiations, the United States should coordinate its positions to the extent possible. The BIT provides the United States with the best opportunity to achieve a level playing field with China through greater access to the Chinese market for U.S. financial services, national treatment for U.S. investors, reduced caps on foreign ownership, increased transparency, relaxed controls on repatriated profits, enhanced cross-border data flows, and the elimination of policies such as enforced technology transfer and forced localization of production.[21]

- The United States should develop a strategic plan for how it wants to participate in the next stage of Asia's economic development. It could, for example, target three or four particular areas of infrastructure development, such as transportation, clean energy, agriculture, and telecommunications, and focus the energy of U.S. agencies around those issues. Without such strategic guidance, U.S. trade and investment efforts will suffer in Asia's highly competitive economic environment, particularly in the face of China's, and even Japan's, strategic economic planning.

- Congress should ensure continued and unwavering support for the Ex-Im Bank. The political gamesmanship surrounding the Bank is detrimental to the interests of thousands of U.S. companies. In order for U.S. firms to be competitive with those of other countries, particularly those from countries such as China that receive strong state support for their commercial activities abroad, export finance is essential.

- The White House should more closely integrate U.S. commercial diplomacy with the region's strategic economic plans. The Asia Pacific has significant infrastructure needs in agriculture, information and telecommunications, and energy. Targeted delegations as part of presidential summits in these particular arenas would be particularly beneficial for boosting the visibility and impact of U.S. firms.[22]

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[21] Dan O'Flaherty, "The U.S.-China BIT Debate," *Investment Policy Central,* 2012, http://www.investmentpolicycentral.com/content/us-china-bit-debate.
[22] Lucio Blanco Pitlo III, "US-ASEAN Summit: Is the US Catching up with China," *China-US Focus*, March 9, 2016, http://www.chinausfocus.com/foreign-policy/us-asean-summit-is-the-us-catching-up-with-china/.#

- The Obama administration should breathe life into dormant initiatives. The U.S. New Silk Road, which engages Central and South Asia, was announced in 2011 with four main areas of focus: regional energy markets, trade and transport, customs and border operations, and business. To date, the United States has invested roughly $1.7 billion in developing energy and transportation infrastructure, primarily in Afghanistan. Additional projects are progressing slowly. If greater support is not provided, the initiative will cost the United States its credibility, particularly in light of the far more robust Chinese One Belt, One Road initiative, and the deep engagement of both China and Russia in the region. Opportunities to cooperate and partner in the region with others such as Japan or the European Union should also be explored**.**

- Congress should increase funding for NGO work throughout the Asia Pacific that contributes to strengthen good economic governance. The United States devotes roughly 4 percent of its global aid spending to Asia, a very small amount given the population of region.[23] Support for organizations such as the Asia Foundation,[24] the National Endowment for Democracy, and the International Republican Institute should be increased. These organizations help nascent and emerging democracies establish the foundations of governance for open and well-functioning markets. The Asia Foundation, for example, supports a program in the Philippines to improve the effectiveness of the judicial system, has worked with Mongolia to improve transparency and accountability in the country's anti-corruption effort, and has supported legal education for Indonesia's top law schools.

The rebalance, at its heart, is about rules of the road in the Asia Pacific and what those rules should look like for the better part of the twenty-first century. Now that the Obama administration has reaffirmed its vision for what those rules should be, it will be up to the next administration to ensure that they are advanced and implemented.

[23] Joshua Kurlantzick, "The Pivot in Southeast Asia: Balancing Interests and Values," *Council on Foreign Relations,* January 2015, http://www.cfr.org/asia-and-pacific/pivot-southeast-asia-balancing-interests-values/p35925.

[24] I have served a board member of the Asia Foundation since 2014.