Obama's Trade Policy toward Asia: Preparing for the U.S. Host of APEC in 2011

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Transformation of the U.S. Economy

The U.S. economy is undergoing one of its biggest transformations in decades. The crisis and then the recession for the last two years put an abrupt end to the old economic model. The house prices have fallen by 29% and share prices by a similar amount since their peak. Households' wealth has shrunk by US$ 12 trillion, or 18%, since 2007. As a share of disposable income it is back to its level in 1995. Consumers are less inclined to spend and banks are also less willing to lend. Consumer debt rose from an average of less than 80% of disposable income 20 years ago to129% in 2007 (Economist, 2010a). Consumer spending and housing rose from 70% of GDP in 1991 to 76% in 2005. And by the year of 2009, it had fallen back to 73% (see Chart 1).

Chart 1

Virtually every industry has shed jobs in the past two years, with those that cater mostly to consumers suffering the most. Employment in residential construction and car-making is down by almost a third, in retailing and banking by 8%. In 2008, the median size of a new home shrank for the first time in 13 years. The number of credit cards in circulation has declined by almost a fifth (Economist, 2010a).

In order to avoid the stagnation that afflicted Japan in the 1990s, the federal government has stepped up its borrowing to counteract the drop in private consumption and investment. Over the next few years, this stimulus will be withdrawn. Barak Obama wants the deficits to come down to 3% of GDP by the middle of this decade. Furthermore, the situation of cheap oil which pushed up America's imports began to change a few years before the crisis as the dollar fell and emerging markets' growing appetite put pressure on global production capacity. A fourfold increase in oil prices since the 1990s has rearranged both consumption and production. Policies to boost conservation and renewable energy have become popular, and imports of oil have dropped by 10% since 2006 and likely to come down further (Economist, 2010a).

Another trend worth noticing is the higher energy prices. A fourfold increase in oil prices since the 1990s has changed bother the consumer and producer behavior. Sport-utility vehicles are no longer popular and policies were adopted to boost conservation and renewable energy. The housing bust recently has tied many Americans to homes they cannot sell. On the other hand, as the knowledge-intensive industries are rising, areas well-endowed with infrastructure and specialized skills are more in favor. People have to make smart choice and go to places where the probability of rising productivity is high so that it would enable them to repay some of their debt yet continue to spend. Overall, business investment accounts for only 10-20% of GDO, so it will never be a full substitute for consumer spending.

In the past, other countries were looking up the United States as a huge market absorbing their exports. But now, it is other countries' market that American firms must increasingly rely for sale. Though competition from low-wage countries, especially China, has increasingly taken over the markets of domestic industries such as furniture, clothing or consumer electronics, shift in the pattern of global growth and the dollar are laying the path for the U.S. exports. The United States used to be the consumer of the world and emerging markets are the producer. That has changed. Now the United States accounts for just 27% of global consumption this year against emerging markets' 34%, roughly the reverse of their shares eight years ago (Economist, 2010a). America's current-account deficit with the rest of the world shrank from 6% of GDP in 2006 to 3% in 2009 (see Chart 2).

Exports Are the Key?

As America's economic transformation will require businesses to rely less on selling to Americans and more on selling abroad, the emphasis will be on high-value products and services rather than on labor-intensive items such as furniture and clothing. When Barack Obama in his state-of-the-union speech called for exports to "double in five years", many thought he is asking for a mission impossible. Yet exports do not have to double for trade to lead economic growth: all they have to do is to grow more rapidly or fall more slowly (in dollar terms) than imports. That has already happened. Between 2008 and 2009 exports dropped by US$ 272 billion whereas imports fell by US$ 589 billion (Economist, 2010b). So the trade deficit narrowed sharply.

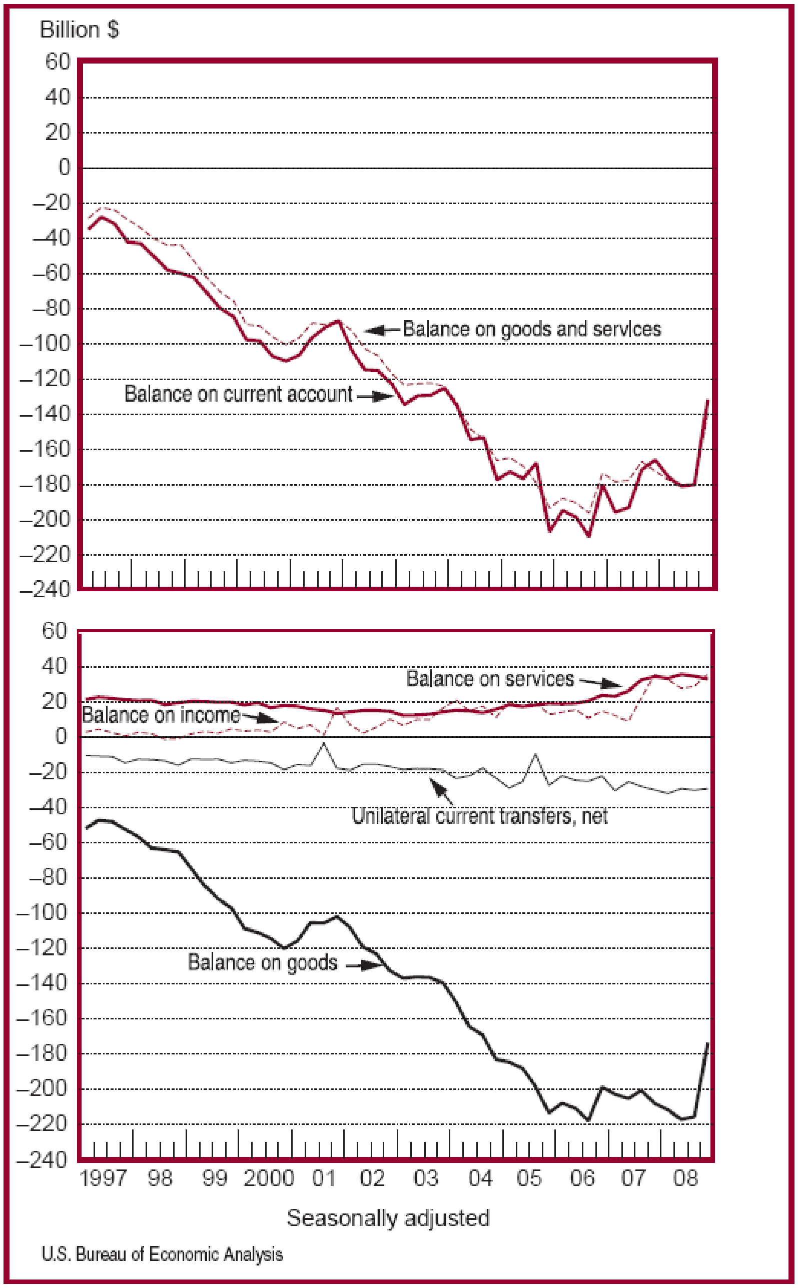

Chart 2 U.S. Current-Account Balance and Its Components

Source: Weinberg *et al*. (2009).

This happened before. The U.S. exports grew at a rate of 8.2% per year from 1987-1994, far faster than the economy as a whole or even the manufacturing sector. Bernard and Jensen (1998) examined the source of this export boom and argued that the boom itself has been less remarkable for the rate of exports than for the striking increase in export *intensity*. This increase in export intensity has occurred both in the aggregate and for individual plants across a wide range of industries. Their test showed that changes in exchange rates and rises in foreign income are the dominant source for the export growth, while productivity increases in U.S. plants play a relatively small role. The result suggested that slower growth rates of U.S. trading partners and an appreciation of the dollar will have strong negative effects on the growth rate of U.S. manufacturing exports.

Free trade is essential for a market-based economy to produce the greatest total wealth with various natural, human and financial resources. The United States has been eager to encourage other countries to adopt freer trade policies. As a consequence, developed countries have become more interconnected through trade as well as investment with each other and other developing countries. Most developing countries have also become more open, seeking to promote their exports as well as to reduce barriers to imports and foreign investment.

On the other hand, trade policy is also an expression of a country's own domestic society. It is destined to safeguard a society's security. The United States practices freer trade because its society gives a high priority to consumers' welfare, as more freedom of choice could provide consumers more goods and services of lower prices and better quality. According to the thesis on "embedded liberalism" around the 1980's, external free trade was "embedded" in internal social commitment: free, commercial competition abroad was to be offset by social protection at home (see, *e.g.*, Ruggies, 1982). Capitalists gained from access to foreign markets while labor was assured of employment and rising income at home.

It could be observed that, in recent years, one of the major goals of the U.S. trade policy was the expansion of market, which was more prominent since the Clinton years (see, *e.g.*, Schott, 2001). How the goals were achieved? It is undeniable that the so-called "aggressive unilateralism", in which such as the Super 301 or Special 301 were used to pry open other countries' markets, was quite important, but we have witnessed an increasing and more prominent role of preferential trading arrangements (PTAs). The United States is pushing hard on the negotiations of Free Trade Agreement of Americas (FTAA), in addition to North American Free Trade Agreement (NAFTA), allowing American firms to penetrate anywhere in the Western Hemisphere. In Europe, the U.S. is actively conveying the concept of Transatlantic Free Trade Area (TAFTA), originally raised by Klaus Kinkel of Germany. As for Asia, the U.S. is trying to resist trade liberalization measures based on the principle of most-favored nations (MFN) and instead insisting on the opening of Asian market to the U.S. reciprocally.

In fact, this was not what the U.S. used to be. It is well known that there is no other places of the world which could be comparable to Europe in the degree, and duration, of regional integration. On the contrary, the United States was sternly against the practice of regional arrangement and insistent on using multilateral negotiations to reduce trade barriers. After the Second World War, she was adamantly opposing bilateral agreements, which, she thought, could have resulted in substantial restrictions on the post-war world trade. Under the supervision of GATT, the United States consistently stuck to the principle of multilateralism until the Tokyo Round of 1979, continued to resist the notion of regional agreements and even rejected the proposal of establishing the North Atlantic Free Trade Area by the United Kingdom. European Economic Community was the only regional organization supported by the U.S. in the hope to fight against the Soviet group (Lin, 2002: 77-78).

The historical turning point was 1982, when the U.S. was somewhat blocked from initiating the 8th round of multilateral negotiations while the GATT ministers was gathering in Genera, and also was frustrated by stagnation of the European economy. She began to realize that regional trade arrangements could be a more feasible path to promote trade liberalization. U.S. Trade Representative William Block was then so upset that he admitted the feasibility of going the way other than multilateral negotiations (Bhagwati, 1993). The U.S. thus began to negotiate bilateral agreements with several countries and subsequently signed agreements with Israel and Canada in 1985 and 1988 respectively. As the EEC was endeavoring to establish the single European market around the beginning of 1990s, this rendered the U.S. another reason for negotiating free trade area with Mexico beginning from 1989 and, with the subsequent joining in of Canada, the NAFTA was established at the end of 1992.

After changing her mind, the U.S. had recognized that regional arrangements could also be relied upon to rectify the stickiness of the world trade system. She began to adopt twin approaches: to promote multilateral negotiations along with promulgation of regional concessions. Furthermore, as she found that it was not so advantageous by sticking to the principle of unconditional MFN since other countries would not willing to give in so much in responding U.S. concessions. This has resulted in huge trade deficits on the side of the U.S. and pushed her to change policies into conditional liberalization. The U.S. would render concessions only when other countries reciprocally give her comparable concessions. Therefore, the U.S. would accept no matter it was multilateral, trilateral or plurilateral, as long as trade barriers could be eliminated.

However, not everyone was convinced by this argument, because since the 1950s people such as Jacob Viner have continuously raised doubts on motivations of regional agreements (Viner, 1950). Viner believed that one has to clarify relationships between eliminating trade barriers and trade movement in order to understand why there are regional trade agreements. A smart politician always knows how to achieve protectionist goals with the elimination of trade barriers. This had induced later development of the theory of "effective trade protection" (Balassa, 1971; Bruno, 1972). For instance, many vulnerable industries were usually the most active promoters of trade agreements and therefore, when agreements finally established, it was likely to result in trade diversion[1] where the third country (the country excluded from the agreements) was negatively affected, because of the protection implicit in the agreements (Grossman and Helpman, 1995).

U.S. Trade Strategy toward APEC

The Asia Pacific Economic Cooperation Forum (APEC) had been very cautious during the first four years since its establishment, tackling every issue with unanimity, without any formal negotiation and formal secretariat. It was the U.S., on the other hand, who was more active in promoting APEC towards a formal free trade organization, which became evident in the 1993 leaders' meeting and culminated in the Bogor goal of free trade in the next year.

After Bogor, the U.S. kept encouraging developing member countries to engage in liberalization policies while she insisted that she would not give in any further on tariff reductions based on the principle of MFN. The U.S. intention was revealed evidently in report drafted by the Eminent Persons Group (EPG), which was dominated by her. In its 1994 report, the EPG explicitly warned APEC members, especially the larger ones, not to liberalize unilaterally substantially or it might risk losing valuable bargaining chips, especially against the European Union (APEC, 1994). The point of the EPG was very clear: The

[1] If imports from a partner country replace those originally imported by a third country which is excluded from the trade agreement, then there is trade diversion. It is the reduction of tariffs on imports from the partner country, as the agreement is signed, that renders imports from the third country not be able to come in. This is a protectionist policy against the third country. On the other hand, products from partner country may also not be able to come in because sometimes the buffer period of tariff reductions in trade agreement has been elongated due to the lobby by domestic industries.

U.S. would not engage in any unilateral reduction in trade barriers unless members of APEC adopt discriminatory measures toward non-members. Nevertheless, the effect on small members would be negligible. Anyway, we would not be able to tell whether the opinion of EPG really reflected the true intention of the U.S., but we could tell that the U.S. was becoming more impatient and unwilling to liberalize by her own, as she oftentimes complained toward such countries as Malaysia, Thailand and the Philippines for their reluctance to reduce trade barriers. We could also recognize her intention by the fact that she never mentioned about accelerating the speed of lifting import quota from Asian countries.[2]

Now as Obama has come on the stage and as he called for U.S. exports to double in five years, expectations are running high for Barack Obama's policies, especially, toward Asia. And nowhere is the expectation greater than among the 10 members of ASEAN which held their first-ever summit with a U.S. President following the APEC leaders' summit in November 2009. Obama was making true of his campaign promise that he wants to listen to the regional states, and work with the regional organizations. As China's influence in the region keeps growing, closer U.S.-ASEAN coordination matters more now than ever. China has replaced the U.S. as the largest trading partner for several Asian countries. In this year (2010) as the ASEAN-China Free Trade Area comes into force, both parties will drop most tariffs on farm and manufactured goods. They have held annual summits for many years, and China has beefed up its role in other regional groupings that exclude the U.S., such as the ASEAN Plus Three and the East Asian Summit. China also extended its diplomacy to the region. For the past ten years, when the U.S.

[2] We could also observe from the Individual Action Plans (ISPs) provided every year since 1996 by each APEC member countries that the U.S. never raised any new proposition except reiterating what she had committed in the Uruguay Round negotiations. This again could prove that the U.S. would not commit any more concession before she receives a more definite reciprocal concession from other member countries. See Lin (2002).

attention was diverted by wars in the Middle East and Afghanistan, China took advantage of that period to advance its interests in Asia, particularly in Southeast Asia and within APEC (Balfour, 2009).

The United States has remained engaged, but focus has ebbed and flowed. President Clinton hosted the first APEC Leaders Meeting in 1993, but missed two summits. President Bush missed one too but with a good excuse: the U.S. was at war. The challenge for Obama is to deepen and sustain U.S. engagement and investment in Asia. The U.S. announced in March 2008 that it would join the negotiations of the parties to the Trans-Pacific Strategic Economic Partnership Agreement (P4)—Brunei, Singapore, New Zealand and Chile on financial services and investment. These issues were deferred when the P4 was signed in 2005. Three rounds of negotiations had been held by March 2008 when the Bush administration announced that these negotiations would be extended to a full FTA. In the wake of the U.S. announcement, Australia, Peru and Vietnam also decided to join the talks.

The P4 agreement has been viewed as broadly comprehensive and high quality. It includes liberalization on all tariff lines for Chile, Singapore and New Zealand, and 99 percent for Brunei (phased in over time). The services chapter contains a negative list. Some of the 20 chapters include sanitary and phytosanitary standards (SPS), technical barriers to trade (TBT), competition policy, intellectual property rights, government procurement, and dispute settlement. It contains some labor and environmental provisions in separate MOU. Two additional chapters on financial services and investment were to be completed within two years of the agreement. Critically the document also included an accession clause to allow other economies to join the agreement in the future.

The first round of negotiations including the U.S. was scheduled for March 2009, "on the assumption that the incoming administration could put their own stamp" on the talks (Elms, 2009). Instead, the talks were postponed, pending a thorough review of U.S.

trade policy.

The outcome of that review was in considerable doubt all the way up to Obama's departure for Asia in November 2009. In his speech in Tokyo, President Obama said, "The United States will also be engaging with the Trans-Pacific Partnership[3] countries with the goal of shaping a regional agreement that will have broad-based membership and the high standards worthy of a 21st century trade agreement (cited in Elms, 2009)." Listeners in the audience just could not help to be confused at what the President mean by "engage". It was left to U.S Trade Representative (USTR) Ron Kirk to clarify the position the next morning at the APEC meetings in Singapore. He unambiguously announced that the United States was going to participate in formal negotiations. Although officials at USTR argued vigorously for a strong commitment to Asia, it was not clear whether the TPP was the appropriate vehicle for engagement, nor was it clear whether the U.S. ought to be committing to any further trade liberalization talks at all. After all, three existing free trade agreements (including one with South Korea) were still waiting for the right time for ratification by Congress.

Nevertheless, the momentum had shifted in favor of action on the TPP. First of all, as the free trade agreement between the European Union and South Korea has been signed, this galvanized businesses to argue more forcefully in favor of an active U.S. approach to trade in Asia. And Secondly, alternative economic integration in Asia such as the ASEAN Plus Three (China, Japan and South Korea) or ASEAN Plus Six (adding Australia, New Zealand and India) all poised to exclude the U.S. out of Asian markets. Japan's proposal for an East Asian Community further marginalized the United States. And finally, the TPP gave the United States a seat in the economic group in Asia wherein the above-mentioned alternatives did not.

[3] The Trans-Pacific Partnership (TPP) will expand on P4 and presumably will lead, in the future, to a pan-APEC free trade agreement.

TPP is the first positive initiative on trade the Obama administration has taken in any area. It is driven by Obama's emphasis and priority on Asia, recognizing the need to engage actively and constructively with Asia on trade and economic issues, partly because he recognizes Asia is moving toward its own arrangements that would otherwise discriminate against the United States and hurt U.S. trade interests (Bergsten, 2009).

But will the TPP really provide sufficient incentives to exporting interests to mobilize against domestic protectionist forces and pressure governments to proceed with a high quality, multilateralized agreement? One problem is that existing PTAs already link many of the TPP partners. Only three of them—Brunei, New Zealand and Vietnam have not already signed a PTA with the United States. And the big prize in an expanded TPP would also be preferential access to the U.S. market for these three countries. Although the two countries most likely to benefit from improved access under the TPP to the U.S. market—New Zealand and Vietnam together account for less than one half of one percent of total U.S. exports, the two come with a host of challenges. For example, opening the American market to further imports of New Zealand dairy products will be quite difficult, as will negotiations over textiles and footwear with Vietnam (see, *e.g*., Ravenhill, 2009).

Other problem is that, besides failure to secure congressional consent to the U.S.-Korea FTA, the President would need new congressionally sanctioned trade negotiation authority. Moreover, the U.S. also needs to upgrade the desultory negotiations with ASEAN—the Trade and Investment Framework Agreement to full-fledged FTA negotiations and express its willingness to dilute, or stretch out, the so-called "Gold-Standard" liberalization provisions usually demanded by the United States (see, *e.g.*, Barfield, 2010). The U.S. also needs to revisit the stalled bilateral FTA negotiations with Thailand and Malaysia. And the last but not the least, the U.S. still needs to discuss with Japanese leaders to establish common goals and concrete steps to achieve meaningful trade and investment liberalization in APEC at the 2010 and 2011 summits, including at least preliminary discussion of how to integrate existing sub-regional arrangements (such as the TPP) into APEC. Both parties also need to involve key allies such as Singapore, Korea, Australia and, possibly, Indonesia in the discussion and planning.

As Secretary of State Hillary Clinton made clear, APEC would be the central focus of U.S. regional interests. But she also suggested that the Obama was open to participate in, and even join, the East Asian Summit and other intra-regional institutions such as the ASEAN Plus Three. She warned, "It is important that we do a better job in trying to define just which organizations will best protect and promote our collective future (cited in Barfield, 2010)." She reinforced the U.S. APEC commitment by promising to work with Japan to take advantage of the fact that Japan would host the APEC Summit in 2010, followed by the United States in 2011, with the assumption that both nations would push to "deliver" advances in regional integration at these meetings.

Concluding Remarks

We have described in this paper how the United States economy is undergoing a transformation after the global economic crisis started by her. The profligate consumption of the American people made available by low-price and high-quality imports from, especially, emerging market economies in the past has to be changed. Now the situation seems reversed with the United States accounting for less global consumption against emerging markets which even resulted in a shrinking of her current-account deficit.

President Barack Obama's timely calling to double the U.S. exports in five years needs to be fulfilled by practical actions. And as he committed to deepen and sustain U.S. engagement and investment in Asia, countries in the region, especially those ASEAN members, are all expecting to see how he makes those campaign promises come true. Despite the barriers he faces at home as well at abroad, President Obama seems to be determined to look for all possibilities in joining regional agreements in Asia. The

Trans-Pacific Partnership (TPP) arrangement emanated from the APEC forum looks like a promising avenue for the U.S. to enter this area more deeply.

The TPP provides most flexibility in coverage and membership and involves individual ASEAN members, which could facilitate melding of integration plans. But the U.S. needs to modify U.S.-style "gold standard" to manage agriculture problems and developmental concerns. Also, the APEC integration pact needs to address interrelated challenges facing APEC members in the 21st century such as energy security, food safety and security, border security, and climate change. Furthermore, the rights and obligations related to PTAs will have to be regionalized starting, for example, by harmonizing and cumulating rules of origin. Many blocking issues such as agriculture, labor and environment need to be resolved by, for example, focusing on food security and safety, on implementation of ILO principles and specific labor services barriers, and on energy security/environment linkages. On the other hand, the broadening of participation in such regional pact as the TPP needs to be considered, such as engaging bilaterally, besides Canada and Mexico who already expressed their interests, with TPP core economies like Japan and South Korea, once U.S.-Korea FTA is ratified. But what about China? Linking ASEAN-Plus-One pacts with cross-Pacific FTAs is the key to whether TPP will become a vehicle for Asia-Pacific integration. China will be interested in such Asia-Pacific initiatives if President Obama can convince her leaders that (see, *e.g.*, Schott, 2009)

- involving the U.S. could provide a buffer in China-Japan competition in East Asian arrangements;
- the pact could facilitate her dealings with Taiwan;
- it renders a better channel to resolve bilateral disputes with the U.S.; and
- it may complements collaboration with the U.S. on North Korea.

In sum, the challenge for Barack Obama in engaging APEC members is huge. He has to convince a skeptical public and Congress to embrace further market access and harmonization of existing rules of trade. He will need to cajole the TPP partners into accepting bargains on some items, like stronger labor and environmental rules, than most would prefer. And finally, he will have to make the final package attractive enough to encourage other economies to join in future tranches of negotiations. If these missions were not accomplished somewhat satisfactorily, then it will not lead to major changes in the economic structure in the Asia Pacific that his backers hope to achieve.

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