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Trumping Obama in US-Asia Economic Relations

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East Asia's population exceeds two billion, and including South Asia pushes the number to over half the global total. The world's second- and third-largest national economies are in East Asia, and India, in South Asia, will inevitably compete with them. In Southeast Asia, the combined population of Indonesia, the Philippines, and Vietnam exceeds 450 million, and all three have the potential to sustain better than 5% GDP growth. President Obama clearly and correctly made US relations with the Asia-Pacific a high priority.

The Obama administration, however, made errors of omission and commission. These errors could be corrected by Donald Trump's incoming administration in tandem with the new Congress,. If they are corrected, it would help improve both the American economy and America's economic role in the Asia-Pacific. The central actions the Trump administration and Congress should take are:[1]

(1) Let the TPP go. It was a very good but possibly infeasible idea, with a weak outcome. Make new trade rules only if they definitely help Americans.

(2) Do not try to zero out the trade deficit. It will not create jobs.

(3) Propose substantial steps forward on trade and investment in the Asia-Pacific. These can range from difficult, bilateral free trade negotiations to Japan to narrower talks on the food sector with Indonesia.

(4) Consider quick action, such as commercial bans, in response to China's intellectual property (IP) theft. Document Chinese subsidies, including but not focused on currency, to inform ensuing policy choices.

(5) Adopt unilateral measures that will bolster the American economic role in the Asia-Pacific, from lowering self-defeating US trade barriers to corporate tax reform.

The Past Eight Years

The Obama administration's main economic initiative in the Asia-Pacific was, of course, the Trans-Pacific Partnership (TPP). The TPP was absolutely the right idea—the US would certainly benefit from deeper and more secure market access in East Asia. And a successful initial round featuring Japan, Malaysia, and Singapore would have been a powerful lure for Indonesia, among others. Those supporting the TPP, starting with but certainly not limited to the Obama administration, had some sound reasons to do so.[2]

The final text of the TPP unfortunately fell well short of high aspirations. This may have been unavoidable with such a diverse group of countries. Whatever the reason, qualitative and quantitative assessments of the TPP estimated insignificant economic gains for the US.[3] In particular, the extent of national exemptions from the liberalization of services trade means that, despite being the world's most competitive services exporter, the US could expect only very small increases in services exports. The TPP would need to be considerably improved to be worthwhile for the US economically.

Partly as a result of this serious shortcoming, the Obama administration and its allies took to praising less tangible aspects of the TPP. Most of these are diplomatic in nature. My testimony does not address diplomacy, but it should be self-evident that the first "21st-century trade agreement," involving a dozen countries and three of the four largest US trade partners, cannot be a diplomatic initiative first and a trade initiative second or third. This implicit dismissal of its importance is a poor way to make the case for open trade and likely to foster rather than combat protectionist sentiment, especially when economic gains do not become visible.

A concrete illustration is the refrain concerning the need to make the rules.[4] This seems to suggest eventual commercial benefit but, in that case, just making rules cannot be the end in itself. Rules must offer at least a possibility of greater income for American companies and workers. The TPP fell short on this score, most notably in weak restrictions on state-owned enterprises, which could easily be circumvented by a country committed to protecting its firms from competition.[5]

Table 1. SOEs in World's Top 50 Companies, 2015

Ranking	Company Name
2	Sinopec (China)
4	CNPC (China)
7	State Grid (China)
18	ICBC (China)
26	Gazprom (Russia)
28	Petrobras (Brazil)
29	China Construction Bank (China)
36	Agricultural Bank of China (China)
37	China State Construction Engineering (China)
38	Japan Post Holdings (Japan)
39	PDVSA (Venezuela)
43	Lukoil (Russia)
45	Bank of China (China)
47	Pemex (Mexico)
50	Fannie Mae (United States)

Source: Fortune, "Global 500, 2015," http://fortune.com/global500/.

The Obama administration's emphasis on rules also does not hold up well in light of its failure to enforce existing US law. As perhaps the most painful example, IP theft has cost legitimate American companies something on the order of $2 trillion in total sales over the past eight years.[6] The administration joined Congress in creating the Defense of Trade Secrets Act but has done almost nothing to sanction IP thieves. No sanctions been applied in response to cyber espionage under the new authority provided in the 2015 National Defense Authorization Act;[7] even the mandated report has not been submitted. This passivity has been a mistake and change will benefit the US.

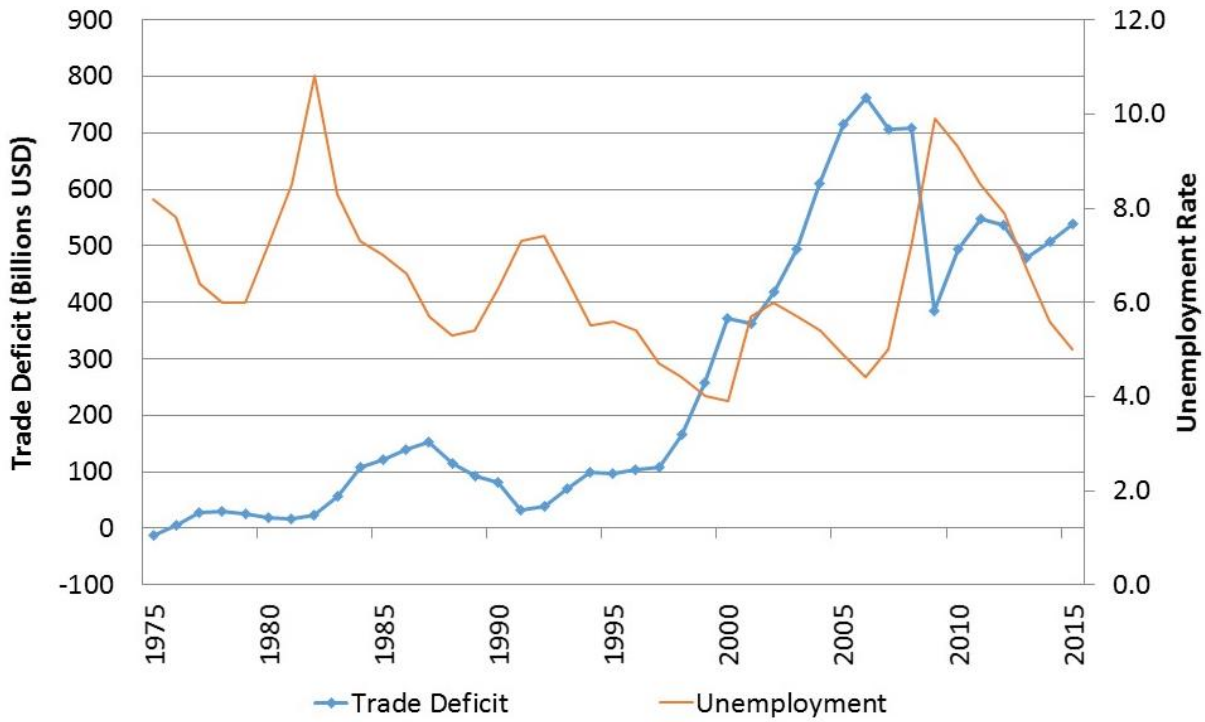
What *Not* to Change: Imports Are Not Losses

The rhetoric of the Trump presidential campaign can be taken as suggesting a goal to limit trade. This would be self-defeating. Americans voluntarily choose to participate in trade and do so because they prosper from it. This includes buying imports as much as making exports. The most fundamental issue, which drives decisions about trade agreements and sanctions, is how to treat the trade deficit.

The Trump campaign website approvingly quoted the Economic Policy Institute, which makes conventional protectionist arguments in sync with those made by organized labor.[8] The arguments depend almost entirely on the idea that a trade deficit automatically means lost jobs. This is wrong.

After the US fell into the Great Depression, the Congress passed sweeping tariffs in 1930. And the US ran large trade surpluses from 1929 to 1935 and 1937 to 1941.[9] Neither the tariffs nor the large trade surpluses helped the economy. While that was 75 years ago, in 2009 the economy crashed, and the trade deficit crashed with it. Trade became more balanced, as protectionists want, yet

Figure 1. US Trade Deficit vs. Unemployment Rate, 1975–2015



Sources: US Census Bureau, "U.S. Trade in Goods and Services," February 5, 2015, http://www.census.gov/foreign-trade/statistics/historical/gands.pdf; and US Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey," March 28, 2016,

unemployment soared. The explanation is simple: when Americans are poorer, they buy fewer imports. Lower imports are not a sign of success.

The pattern extends far beyond 1930 and 2009. There is no statistical relationship between the trade deficit and unemployment from 1975 to 2015, no evidence that the trade deficit means lost jobs over the most recent 40 years (see Figure 1). This applies to the raw trade deficit figure and the deficit as a percentage of gross domestic product (GDP). It applies to trade and employment measures during the same year and to trade one year and employment the next.[10]

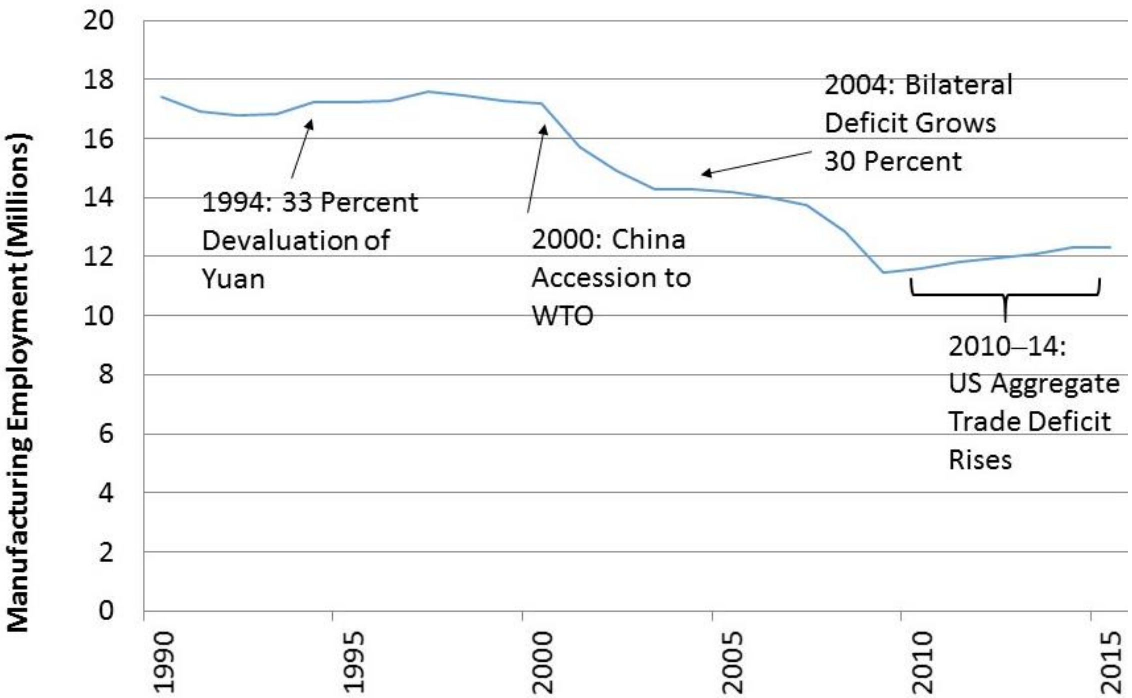
Because protectionists cannot link the trade deficit to jobs, they link it to GDP.[11] There is nothing magical about GDP; it is just an accounting tool. One view of GDP considers (in isolation) all imports to be harmful—every dollar of imports reduces GDP by a dollar. Because GDP is just accounting, this can be technically true. It's also ridiculous: if the US Navy blockaded our own ports, GDP would rise?

The next step in this flawed view is to assume GDP brings jobs. But GDP cannot cause job changes; as an accounting device, it cannot cause anything. Judging by GDP growth, 2010 should have been an excellent time for jobs.[12] Unemployment only fell that year because people gave up looking for work. You cannot save or spend your share of GDP because it has no value in the real world. GDP per person rose in 2010, but most people earned less money.[13] Using GDP to say trade should be balanced is a trick used by special interests because they cannot make the direct link to jobs. The Trump administration should set it aside.

What to Change: China

If the trade deficit is set aside as an issue in itself, sound policy can emerge. Regardless of the trade deficit, for example, the first five years after NAFTA went into effect saw *lower* unemployment, higher labor force participation, higher manufacturing employment, and higher manufacturing wages.[14] In

Figure 2. Manufacturing Employment, 1990–2015



Source: US Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey," March 28, 2016, http://data.bls.gov/timeseries/LNS14000000

contrast, American manufacturing jobs were lost when China entered the World Trade Organization—2.9 million from just 2001 to 2003 (see Figure 2). While these were not all due to China, some were.[15] Policies regarding China can save American jobs, but only if we choose the right ones.

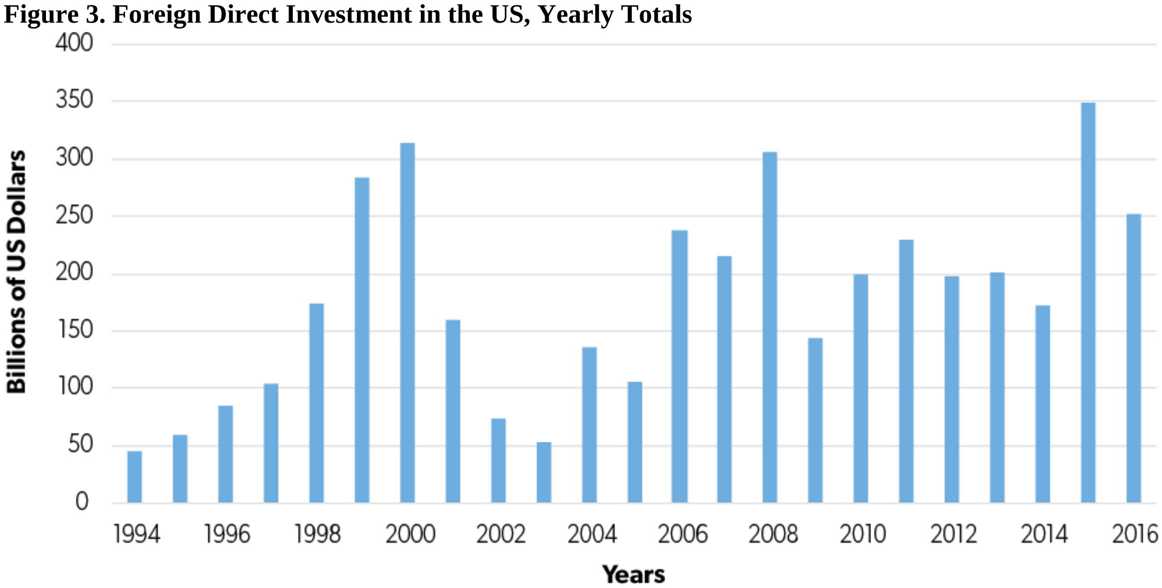
As an illustration, the Chinese yuan's exchange rate against the dollar did not drop at all while manufacturing jobs were being crushed. Later, from the middle of 2005 through 2008**,** the yuan rose as American currency critics want it to. (It was flat in 2009.) Yet the US job situation deteriorated starting in 2007. Labeling China a currency manipulator is technically accurate. At the time of writing, Beijing is allowing the yuan to fall. If sustained, this would call for US sanctions.[16] But focusing on the yuan would be a mistake. As with trade deficits, no long-term relationship can be found between China's currency and American jobs. Jobs were lost in 2001 with a stable exchange rate, and a weaker dollar was no help in 2007.

Examining trade in isolation, the biggest problem is Chinese subsidies, which is point 6 of the Trump campaign trade plan. When imports are cheap, Americans at least gain from low prices. When Beijing effectively blocks American exports, it is a pure loss for the US. China subsidizes its own firms and harms others in two main ways: (1) with basically no-cost loans from state-owned banks and (2) by preventing competition with state-owned enterprises (SOEs) in industries from insurance to machinery.[17]

While the political emphasis is on trade, investment is increasingly important. Chinese investment in the US in 2016 will shatter the previous record and could amount to tens of billions of dollars annually for years to come.[18] Most of it comes from quasi-private corporations, so restricting SOEs would do little. Cutting across trade and investment is IP, which includes cyber espionage and protection of trade secrets (Trump trade plank point 7). Americans are the best innovators in the world and China the biggest innovation thief.[19] As noted, IP-related loss is probably the single most costly aspect of our commercial relationship with China.

In the case of IP, the simple solution is best: companies that benefit from stolen IP are breaking the law and should be banned, with the length of the ban depending on the amount of theft. In response to trade and investment barriers, the principle of reciprocity could be invoked. With Beijing blocking

Figure 3. Foreign Direct Investment in the US, Yearly Totals



Source: US Department of Commerce, Bureau of Economic Analysis, "Foreign Direct Investment in the U.S.: Balance of Payments and Direct Investment Position Data," accessed November 14, 2016, http://www.bea.gov/international/di1fdibal.htm.

foreign participation in various sectors, the US has no obligation to permit unrestricted Chinese participation. When to insist on reciprocity, however, should be carefully considered. For one thing, the sectors that matter to the US are not the same as those that matter to China.

What to Change: Everyone Else

Trade issues sometimes get boiled down to China, which does a disservice to both trade and the American people. Despite mistakes in our policies, most Americans benefit from foreign trade and investment. Consumer goods are cheaper, permitting even the poor to own cell phones, for example. More Americans can be employed in industries such as agriculture and aviation because they export heavily.[20] Foreign investment in the US supports millions of jobs (see Figure 3). A China focus naturally leads to encourages limits on trade. A focus on the rest of the Asia-Pacific can lead to a (two-way) trade expansion that boosts our economy.

In this vein, the new administration's first action should not be applying tariffs. It should be assessing existing economic relationships in balanced fashion, opportunities as well as failures. In terms of opportunities, market size makes the Asia-Pacific the prime place to start. In terms of failures, detailed examinations of problems such as the extent of subsidies and IP theft are needed to make any sanctions effective. Smart negotiating requires good information, and gathering this information first will make all ensuing decisions more productive and credible.

It would greatly assure millions of Americans and dozens of our foreign partners, as well as wrong-foot critics, for the new administration to seek trade opportunities before or simultaneous with preparing any barriers. The president-elect has said he prefers bilateral agreements to multilateral agreements like the TPP.[21] Campaign rhetoric makes it difficult to imagine quickly moving toward new free trade agreements (FTAs) with developing economies, which feature cheap labor. But there are multiple developed economies in the Asia-Pacific worth contemplating: Japan, New Zealand, and Taiwan.[22]

New Zealand is the symbolic FTA. It's hard to imagine serious objections. Benefits would be similarly small, but it could be concluded quickly and would indicate to friends and allies a continued American commitment to free trade.

Bilateral talks with Japan would be entirely different. On top of opposition within the US, Japan has typically preferred multilateral arrangements and may well reject a bilateral FTA outright. On the other hand, a truly high-standard deal with Japan would offer hefty benefits, and the TPP embodies considerable progress toward such a breakthrough. Trump should inquire if Tokyo is interested.

Taiwan might be the happy Asia-Pacific compromise. It would be a worthwhile FTA—Taiwan is in the top 10 of American trade partners and global top 25 for GDP.[23] Yet Taiwan's tiny population means there is no job threat to the US (if transshipment is tightly restricted). Diplomatic risks in negotiating directly with Taiwan are paired with advantages in pressuring China. The island is a raucous democracy that may balk at open trade.[24] But our side looks good: congressional support for Taiwan is high, and boosted by President Trump having Trade Promotion Authority,[25] a Taiwan deal could sail through.

Beyond FTAs

Table 2. Countries Listed by Population

Rank	Country Name	Total Population
1	**China**	1,373,541,278
2	**India**	1,266,883,598
3	European Union	513,949,445
4	United States	323,995,528
5	**Indonesia**	258,316,051
6	Brazil	205,823,665
7	**Pakistan**	201,995,540
8	Nigeria	186,053,386
9	**Bangladesh**	156,186,882
10	Russia	142,355,415
11	**Japan**	126,702,133
12	Mexico	123,166,749
13	**Philippines**	102,624,209
14	Ethiopia	102,374,044
15	**Vietnam**	95,261,021

Source: CIA World Factbook, "Country Comparison: Population," accessed November 28, 2016, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2119rank.html.

While FTAs are a clear way to assure the Asia-Pacific that the US is not withdrawing, they are certainly not the only option. It is vital that the US move forward in the region in some fashion. The areas of the world with the potential to grow most substantially are both in Asia: India and the Indonesia-Philippines-Vietnam nexus. Negotiations with any of them will be challenging, but even limited, issue-specific achievements could bring sizable long-term payoffs.

There are also unilateral actions to spur the American economy and our ties to the Asia-Pacific. The Trump administration could identify and lower harmful US barriers, such as the Jones Act, which raises the cost of all goods shipped to companies and consumers just to protect a few American companies.[26] Finally, the new administration and Congress will likely craft policies to boost international competitiveness, such as simplifying corporate taxes. Domestic policies are beyond the scope of this testimony, but they are in fact more important for the US.

Conclusion

The trade lesson from the Obama years is that a laudable vision cannot overcome the mistake of treating the economic benefits from trade as secondary. The TPP fell short economically and, despite being touted as strategic, therefore fell short politically. Similarly, apparently to avoid rocking the global boat, punitive action against China on IP and market access has been minimal, fostering resentment of trade among ordinary Americans. The US needs to return to seeking partners for genuinely open trade and investment, while tending to our own house.

Notes

[1] This testimony draws on my recent paper *The Art of the Trade Deal*. See Derek Scissors, *The Art of the Trade Deal*, American Enterprise Institute, November 17, 2016, https://www.aei.org/publication/the-art-of-the-trade-deal/.
[2] Derek Scissors, *What a Good Trans-Pacific Partnership Looks Like,* Heritage Foundation, March 8, 2013, http://www.heritage.org/research/reports/2013/03/what-a-good-trans-pacific-partnership-looks-like.
[3] United States International Trade Commission, "Trans-Pacific Partnership Agreement*:* Likely Impact on the U.S. Economy and on Specific Industry Sectors," May 2016, https://www.usitc.gov/publications/332/pub4607.pdf.
[4] The White House, Office of the Press Secretary, "Statement by the President on Trans-Pacific Partnership," press release, October 5, 2015, https://www.whitehouse.gov/the-press-office/2015/10/05/statement-president-trans-pacific-partnership.
[5] Derek Scissors, *Grading the Trans-Pacific Partnership on Trade*, American Enterprise Institute, December 9, 2015, https://www.aei.org/publication/grading-the-trans-pacific-partnership-on-trade/.
[6] The Commission on the Theft of American Intellectual Property, *The IP Commission Report*, National Bureau of Asian Research, May 2013, http://www.ipcommission.org/report/ip_commission_report_052213.pdf.
[7] United States House Committee on Rules, Rules Committee Print 113-58, House Amendment to the Text of S. 1847, December 2, 2014, http://www.armed-services.senate.gov/imo/media/doc/CPRT-113-HPRT-RU00-S1847.pdf.
[8] Donald J. Trump for President Inc., "Trade," https://www.donaldjtrump.com/policies/trade/.
[9] National Bureau of Economic Research, http://www.nber.org/databases/macrohistory/rectdata/07/m07047.dat.
[10] These correlations ignore domestic productivity and income gains that could explain both trade and jobs. They are just the first step in trying to prove trade deficits represent lost jobs. The first step fails.
[11] Danny Vinik, "We've Been Worrying About the Wrong Deficit," New Republic, April 30, 2014, https://newrepublic.com/ article/117594/gdp-report-reminder-trade-deficit-hurting-growth.
[12] US Bureau of Economic Analysis, "Real Gross Domestic Product," https://fred.stlouisfed.org/series/A191RO1Q156NBEA.
[13] US Census Bureau, "Income, Poverty and Health Insurance Coverage in the United States: 2010," press release, September 13, 2011, https://www.census.gov/newsroom/releases/archives/income_wealth/cb11-157.html.
[14] US Department of Labor, Bureau of Labor Statistics, "Databases, Tables & Calculators by Subject," http://data.bls.gov/ timeseries/CES3000000003?data_tool=XGtable.
[15] David H. Autor, David Dorn, and Gordan H. Hanson, "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade" (working paper, National Bureau of Economic Research, January 2016), http://www.nber.org/ papers/w21906.
[16] Derek Scissors, *China Edges Toward a Big Mistake,* AEIdeas, November 22, 2016, https://www.aei.org/publication/china-edges-toward-a-big-mistake/.
[17] Derek Scissors, "The Importance of Chinese Subsidies," testimony before the Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, US Senate, December 11, 2013, http://www.banking.senate.gov/ public/_cache/files/87eaf06c-3510-4222-ae9b-f9bc243f3d2a/23C6AE00CC53D93492511CC744028B5E. scissorstestimony121113.pdf.
[18] Derek Scissors, *Chinese Investments in the United State,* American Enterprise Institute, June 2016, http://www.aei.org/ chinese-investments-in-the-united-states/.
[19] The Commission on the Theft of American Intellectual Property, *The IP Commission Report*.
[20] US Census Bureau, "U.S. International Trade Statistics," http://censtats.census.gov/naic3_6/naics3_6.shtml.
[21] William Mauldin, "Five Takeaways from Donald Trump's Trade Speech," *Wall Street Journal*, June 28, 2016, http://blogs.wsj.com/economics/2016/06/28/five-takeaways-from-donald-trumps-trade-speech/.
[22] Beyond the Asia-Pacific, I have previously advocated an FTA with the United Kingdom. Unfortunately, this would have to wait until the painfully slow exit from the EU is farther along.
[23] US Census Bureau, "Top Trading Partners—December 2015," https://www.census.gov/foreign-trade/statistics/ highlights/top/top1512yr.html.

[24] Michael Gold and James Pomfret, "Over 100,000 Protest in Taiwan over China Trade Deal," Reuters, March 30, 2014, http://www.reuters.com/article/us-taiwan-protests-idUSBREA2T07H20140330.

[25] Ian F. Fergusson and Richard S. Beth, *Trade Promotion Authority (TPA): Frequently Asked Questions*, Congressional Research Service, July 2, 2015, https://fas.org/sgp/crs/misc/R43491.pdf.

[26] Bryan Riley, "The Jones Act: Protecting Special Interests, Not America," Heritage Foundation, June 15, 2016, http://www.heritage.org/research/commentary/2016/6/the-jones-act-protecting-special-interests-not-america.