

BACKGROUND

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Advancing Economic Freedom Is the Key to Realizing America's Indo-Pacific Vision

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Abstract

The Indo-Pacific region is the most populous and economically dynamic part of the world. The region contains over half of the world's population: one-third in China and nearly another third in India. The region has achieved an average annual economic growth rate of around 6 percent over the past five years. Trade and investment with the Indo-Pacific region has facilitated job growth for American workers, and America is an economic superpower in the region. To maintain its position, the U.S. must encourage the free flow of capital, goods, services, and ideas throughout the Indo-Pacific. Implementing such forward-looking policies would generate and reinforce the economic dynamism and innovation that will lead to an expanded network of free markets and greater economic ties to the region. In what must be a long-term, strategic effort, the U.S. needs to marshal its resources and continue its committed engagement to meet the opportunities and challenges of the Indo-Pacific.

President Donald Trump first outlined his vision for a peaceful and prosperous Indo-Pacific region at the Asia-Pacific Economic Cooperation's CEO Summit in Vietnam last year. Elaborating on that vision in his speech on July 30 this year, Secretary of State Mike Pompeo highlighted the importance of deeper and more strategic U.S. engagement with the world's largest and fastest-growing region. Secretary Pompeo emphasized that "a free and open Indo-Pacific is America's chosen course," and that U.S. strategy would seek to "build environments that foster good, productive capitalism" so that private businesses can succeed and local communities and bilateral partnerships in the region can flourish.¹

This paper, in its entirety, can be found at <http://report.heritage.org/bg3349>

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KEY POINTS

- As a leading Pacific nation, the United States recognizes the strategic importance of the Indo-Pacific. The 2017 National Security Strategy pinpointed that "a geopolitical competition between free and repressive visions of world order is taking place in the Indo-Pacific region."
- The U.S. and its allies in the region have made the strategic choice to defend the principles of a free-market rules-based order over the past decades. Now that choice must be reinforced with stronger commitment and concrete action.
- It is fitting that advancing economic freedom is part of America's broad national security strategy. A strong economy undergirds a strong national defense, and a vibrant economy is an imperative source of the military strength of the United States.
- Economic security driven by the advancement of economic freedom at home and abroad, not by the proliferation of protectionism, truly enhances national security, which in turn buttresses greater economic dynamism.

To effectively capitalize on this practical American approach to the Indo-Pacific, the Trump Administration should focus on advancing economic freedom at home and in the region.

U.S. Economic Interaction with the Indo-Pacific Region

The Indo-Pacific region is the most populous and economically dynamic part of the world. The region contains over half of the world's population: one-third in China and nearly another third in India. The region has achieved an average annual economic growth rate of around 6 percent over the past five years, driven largely by China, India, and other export-oriented economies.

America's two-way trade with the region is \$1.4 trillion, with U.S. direct investment in the region amounting to \$860 billion.² The region hosts slightly less than half the world's trillion-dollar economies, and half of the top 10 economies in terms of gross domestic product measured by purchasing power parity.³ This massive and growing economic activity has corresponded with a significant and sustained rise in U.S. exports to the region. U.S. exports to Indo-Pacific economies—including agricultural products, manufactured goods, and services—totaled over \$480 billion in 2017, accounting for more than half of total U.S. exports.⁴ Four of America's top 10 trading partners belong to the region—China, Japan, South Korea, and India.⁵

Trade and investment with the Indo-Pacific region has facilitated job growth for American workers. An estimated 3.4 million American jobs were

supported by exports to the region in the past few years. Asian companies with direct investments in the United States employed over one million Americans in 2015, with many more jobs supported indirectly by those operations and supply chains across North America.⁶

In addition to these noteworthy benefits to the U.S. economy, the region holds even greater potential for increased U.S. exports in the years ahead. By 2030, the Indo-Pacific region is expected to house over 3 billion middle-class consumers, more than eight times the projected U.S. population.⁷ As the middle class in the region grows and its preference for U.S. goods and services expands, there will be more opportunities for U.S. exports, which, in turn, will stimulate greater income growth and job creation at home.

As for trade in services, the United States is a global leader and accounts for over 15 percent of global services exports, more than any other country by a substantial margin. However, barriers to trade in services remain considerable around the world, which is particularly harmful given the size and competitive advantage of the service sector in the United States and its potential to drive economic growth. A number of countries in the Indo-Pacific region, such as India, maintain considerable impediments to services trade. Reducing these trade barriers would not only create more opportunities for American businesses, but would also inject much-needed efficiency in the countries of the region and thus ensure the greater economic development that they need.

1. Michael R. Pompeo, "Remarks on 'America's Indo-Pacific Economic Vision,'" U.S. Department of State, July 30, 2018, <https://www.state.gov/secretary/remarks/2018/07/284722.htm> (accessed August 15, 2018).
2. U.S. Department of State, "Briefing on the Indo-Pacific Strategy," Special Briefing with Alex N. Wong, Deputy Assistant Secretary, Bureau of East Asian and Pacific Affairs, April 2, 2018, <https://www.state.gov/r/pa/prs/ps/2018/04/280134.htm> (accessed August 15, 2018).
3. International Monetary Fund, "World Economic Outlook: GDP, Current Prices, Purchasing Power Parity," April 2018, http://www.imf.org/external/datamapper/PPPGDP@WEO/OEMDC/ADVEC/WEO_WORLD (accessed August 15, 2018).
4. U.S. Census Bureau, "Foreign Trade: Trade in Goods with Asia," 2017, <https://www.census.gov/foreign-trade/balance/c0016.html> (accessed August 15, 2018).
5. U.S. Census Bureau, "Foreign Trade: Top Trading Partners—December 2017," Year-to-Date Total Trade, <https://www.census.gov/foreign-trade/statistics/highlights/top/top1712yr.html> (accessed August 15, 2018).
6. Matthew P. Goodman, "Opportunities to Expand U.S. Trade Relationships in the Asia-Pacific Region," testimony before the Subcommittee on Trade, Ways and Means Committee, U.S. House of Representatives, October 11, 2017, <https://waysandmeans.house.gov/wp-content/uploads/2017/10/20171011TR-Testimony-Goodman.pdf> (accessed August 15, 2018).
7. Homi Kharas, "The Unprecedented Expansion of the Global Middle Class: An Update," Brookings *Global Economy & Development Working Paper* No. 100, February 2017, https://www.brookings.edu/wp-content/uploads/2017/02/global_20170228_global-middle-class.pdf (accessed August 15, 2018).

A Critical Region Calling for America's Renewed Leadership

As a leading Pacific nation, the United States clearly recognizes the strategic importance of the Indo-Pacific region. The 2017 National Security Strategy pinpointed that “a geopolitical competition between free and repressive visions of world order is taking place in the Indo-Pacific region.”⁸

Indeed, what sets the region apart from other regions is the extraordinary disparity in levels of economic freedom and political freedom among the countries of the region. According to The Heritage Foundation's *Index of Economic Freedom*, eight of the world's 30 freest economies—Hong Kong, Singapore, Australia, New Zealand, Taiwan, Malaysia, South Korea, and Japan—are in the Indo-Pacific region.⁹ However, most other countries in the region, including Sri Lanka, China, and India, remain “mostly unfree” and rank in the bottom half of the 180 countries assessed in the *Index*.

The region is also home to a remarkable mix of political systems, from free-market democracies to communist dictatorships. More than half of the countries in the region remain politically unfree, and antidemocratic forces have been on the march and consolidated repressive regimes' power in recent years.¹⁰

Despite such high degrees of disparity in the economic and political systems in the region, a rules-based international order—resting on the principles of good governance, the rule of law, and free markets—has served the region quite effectively in recent decades, with the inherent appeal of its values bolstered by its economic gains.

Freedom and democracy are not unchallenged in the region, however, and value-driven partnerships require sustained reinforcement. The United States and its allies in the region have made the strategic choice to defend the principles of the free-market rules-based order in the region over the past years. However, now that choice must be reinforced with stronger commitment and concrete action in order to confront a different norm injected by China's Belt

and Road Initiative that is increasingly characterized by domination and dependence.

The overall landscape in the region has been changing. With the risks to U.S. interests increasing on a number of key policy fronts that include economic and security dimensions, America's leadership is being tested both by new challenges confronting the region and by uncertainty about America's own policies, particularly concerning trade and investment.

The United States cannot decide for Asia whether to uphold and defend the rules-based order. Nevertheless, America should make the decision an easier one by demonstrating renewed leadership in the region, by choosing to remain actively engaged in the region as an indispensable partner through economic and commercial engagements. A strong and focused partnership requires leadership that can go deeper than a set of talking points, to the tough and highly complicated issues facing the region, particularly intensified by China's hegemonic bent to reshape the region.

Time to Forge Strategic Partnerships that Center on Economic Freedom

In a time when competition among countries manifests itself more often in the economic and political spheres rather than militarily, America's role as security guarantor is a vital but insufficient indicator of engagement in the Indo-Pacific region. Economic engagement is essential, but will be hollow without leadership in trade and investment. In fact, more than ever, trade and investment issues meld foreign policy and economic policy. There are many areas of potential cooperation, but without vibrant commercial links and practical entrepreneurial interactions, economic cooperation between the U.S. and Indo-Pacific countries cannot flourish.

Fundamentally, a network of vibrant free markets, underpinned by the rule of law, accountable government, regulatory efficiency, and market openness, fosters the spirit of constructive partnership among the countries that share values and economic bonds. At the heart of defending the principles of the rules-

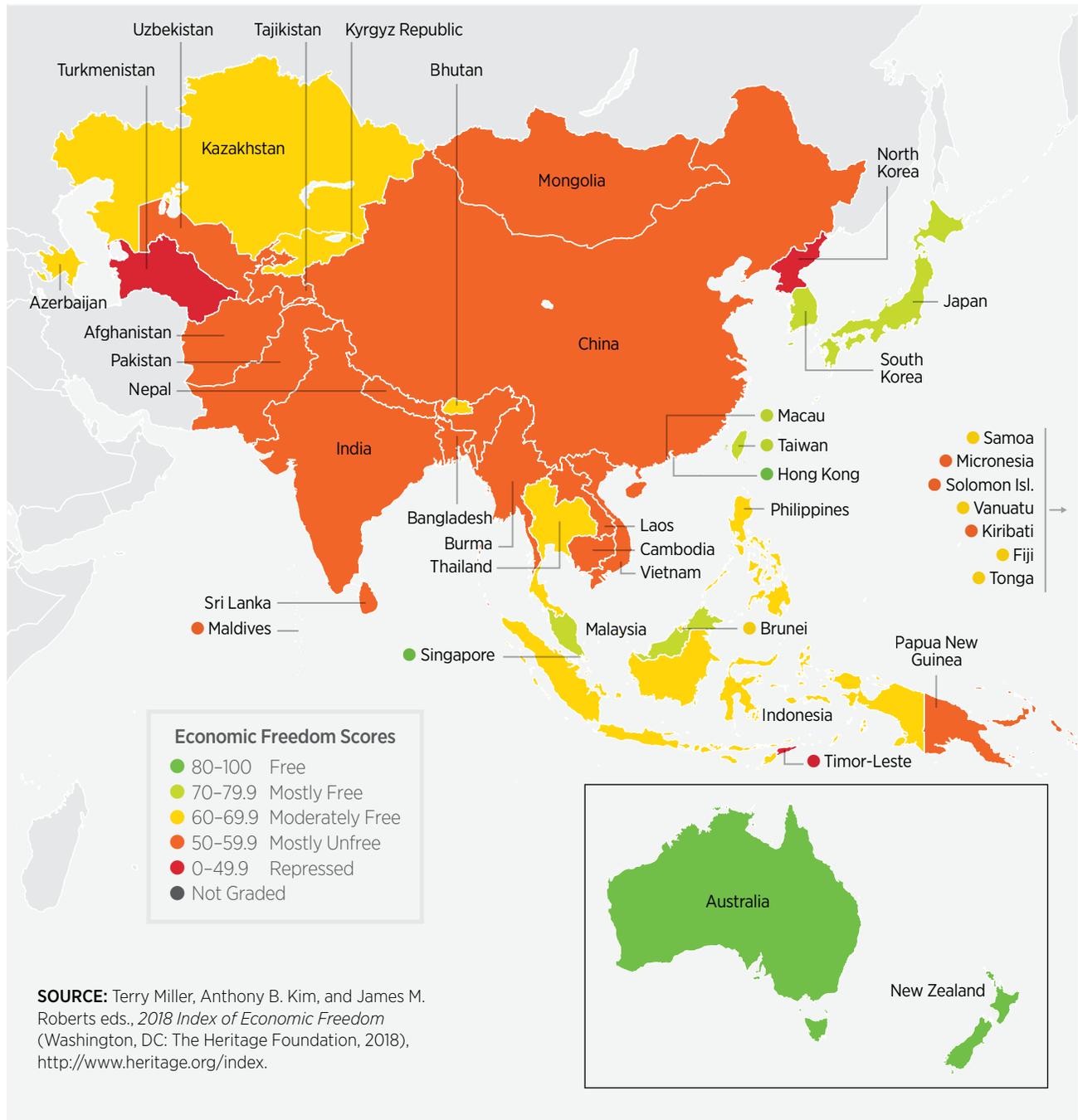
8. The White House, “National Security Strategy of the United States of America,” December 2017, <https://www.whitehouse.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf> (accessed August 15, 2018).

9. Terry Miller, Anthony B. Kim, and James M. Roberts, eds., *2018 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2018), <http://www.heritage.org/index>.

10. Michael J. Abramowitz, “Democracy in Crisis,” in *Freedom in the World 2018* (New York: Freedom House, 2018), https://freedomhouse.org/sites/default/files/FH_FITW_Report_2018_Final_SinglePage.pdf (accessed August 15, 2018).

MAP 1

Economic Freedom in the Indo-Pacific Region



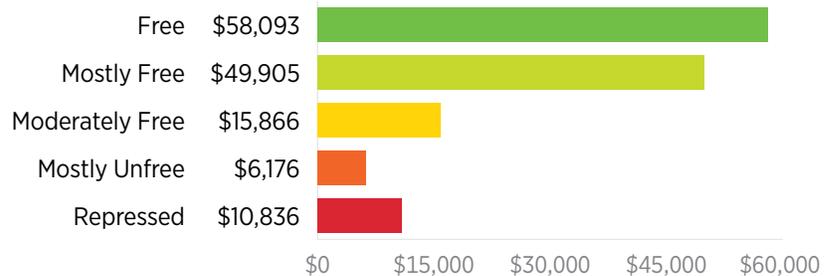
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based order and ensuring broad-based economic dynamism is the task of advancing economic freedom. Economic freedom sustains competitiveness and thus economic prosperity for the countries that embrace freedom-enhancing policies.

Central to that task of enhancing economic freedom in the region must be committed economic statecraft that creates a more inviting playing field for American companies and private investors, as well as recapturing U.S. leadership in market opening and high-standard rulemaking.

CHART 1

Indo-Pacific: Average GDP per Capita, by Economic Freedom Category



NOTES: Figures are GDP per capita, purchasing power parity (PPP), in current international dollars for 2016. Due to data incompatibility, North Korea has been excluded.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts eds., *2018 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and International Monetary Fund, *World Economic Outlook Database*, April 2017, <https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx> (accessed November 29, 2017).

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Market openness is a critical pillar of economic freedom. In an increasingly integrated global market, countries with more open markets benefit from the free exchange of commerce and thereby enjoy greater economic prosperity. This multidimensional relationship is well-documented in the *Index of Economic Freedom*. As shown in Chart 2, Indo-Pacific countries with greater market openness—measured by trade freedom, investment freedom, and financial freedom—are more prosperous than are those with less economic freedom. More specifically, consumers and producers who live in countries with low barriers to trade and investment are better off than those who live in countries with high barriers. Reducing those barriers remains a proven recipe for prosperity.

Given the clear relationship between market openness and economic dynamism, the overarching objective of America’s strategic economic statecraft in the Indo-Pacific region must be to facilitate the expansion of open trade and investment environments that provide the best chance of translating opportunity into prosperity.

The Path Forward

In the end, if the U.S. is to be a credible leading force in the Indo-Pacific, America has to prove itself a positive and dependable actor, not a reactive and unpredictable one. Secretary Pompeo made it clear in his July 30 speech:

Open a map of the Indo-Pacific today, and it is dotted with U.S. public and private efforts to foster self-reliance, build institutions, and promote private sector growth.... The United States does not invest for political influence, but rather practices partnership economics.... [T]he Trump administration is committed to expanding our economic engagement in the Indo-Pacific region. We seek to capitalize on opportunities in accordance with the principles of freedom and openness.¹¹

The U.S. cannot give countries in the Indo-Pacific region the political will that they need to transform their economies according to free-market principles. However, becoming involved at critical levels, the U.S. can ensure that its guidance and concerns are taken into account. The U.S. can also engage at the technical level in a way that enables countries to advance their economic development. Fundamentally, America’s economic strength and competitive advantage in the Indo-Pacific is best exercised through the private-sector engagement that is the catalyst for real economic transformation.

In crafting a coherent and comprehensive road map that will advance America’s strategic interest of building “a network of states dedicated to free markets”¹² in the Indo-Pacific, the Trump Administration should:

11. Pompeo, “Remarks on ‘America’s Indo-Pacific Economic Vision.’”

12. Ibid.

CHART 2

Market Openness Drives Prosperity in the Indo-Pacific Region

GDP PER CAPITA (PPP)



NOTES: Figures are GDP per capita, purchasing power parity (PPP), in current international dollars for 2016. Due to data incompatibility, North Korea has been excluded. Market Openness is measured by the Heritage Foundation's *Index of Economic Freedom* trade freedom score, investment freedom score, and financial freedom score.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts eds., *2018 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and International Monetary Fund, World Economic Outlook Database, April 2017, <https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx> (accessed November 29, 2017).

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- **Make America the engine of global economic freedom.** The powerful role that freedom and free markets play in advancing opportunity and economic dynamism at home and abroad must not be neglected and should be reinforced. The biggest recent threat to U.S. prosperity came from the decline in America's economic freedom during the Obama era. While an uptick in the U.S. economic freedom over the past year reflects the

Trump Administration's achievements in deregulation and tax reform, the critical role of additional such policy changes in restoring the U.S. to its rightful place as a world leader in economic freedom cannot be overemphasized. As President Trump elaborated previously, "America First does not mean America alone. When the United States grows so does the world."¹³ Keeping in mind that negative actions on trade will undercut the benefit from the recent tax and regulatory overhaul, the Administration should continue to pursue reforms that increase America's economic freedom and competitiveness.

- **Elevate existing engagement in the region with more committed outreach.** The U.S. starts with massive advantages, not the least of which are decades of positive engagement in the region, world-class investment and business practices, a global profile, military alliances, partnerships, and foreign assistance. The list of advantages the U.S. has is long. Yet the U.S. can and should step up its own game considerably. The Administration's evolving efforts to become more deeply engaged in the Indo-Pacific region, raise the American profile, and elevate its participation in the region are very well advised. However, without a discernible trade component, particularly America's leadership in building a predictable trading environment, it would be an empty gesture. The U.S. needs substance, and the substance that counts in a concrete and practical way is trade, among other things. America should strengthen enduring alliances and build on nascent ones by increasing measurable economic opportunities and collaboration—by removing barriers to open trade. In some cases, this may mean taking the first step, perhaps even unilaterally, to eliminate barriers to the freedom to trade and invest.
- **Create a bold, consistent narrative about the benefits of market liberalization.** This narrative should highlight positive consequences of economic freedom, including its positive impact on individual states, the value of imports to the national economy, the realities of the global value chains and their value to the U.S., and the salutary

13. The White House, "Remarks by President Trump to the World Economic Forum," January 26, 2018, <https://www.whitehouse.gov/briefings-statements/remarks-president-trump-world-economic-forum/> (accessed August 15, 2018).

effects of economic growth on the environment. The U.S. should highlight the attractiveness of the governance and economic model it exemplifies.

- **Encourage pro-market, pro-investment policies in the Indo-Pacific region.** Many countries in the region need to be encouraged to adopt policies that will lure private investment and facilitate market-led economic growth and development. Asia's phenomenal growth story tends to obscure the destructive tendency of Asian governments to undermine their entrepreneurial citizens with lingering layers of regulations, often in the name of encouraging a handful of favored industries, such as export manufacturing, at the expense of many others. Greater economic freedom means freeing untapped entrepreneurs, who are necessary for sustained growth in the future. Asia cannot afford not to do this, and should be encouraged to adopt free-market policies that facilitate private-sector-led development. Ultimately, the real investments to the region will come from the private sector. As Secretary Pompeo pointed out on July 30, the investments will be made based on the business climates in the Indo-Pacific countries.
- **Exercise strategic flexibility and incentive reforms.** The U.S. should insist on free trade, open investment environments, transparent agreements between nations, and improved connectivity to drive regional ties.¹⁴ That is in the interest of the U.S. and countries in the Indo-Pacific region. But the U.S. can be flexible in other, constructive ways—not necessarily in the context of formal agreements. The U.S. and countries in the region have a mutual interest, for instance, in helping small and medium-sized businesses grow and compete regionally as well as globally.
- **Work closely with the World Bank and the Asian Development Bank.** These development institutions, in which the U.S. has played a leading role as a member and donor, can and should exercise a more practical influence on improving the

entrepreneurial framework in its member nations in the region. Exercising strong leadership in holding the development institutions whose engagement with America has been multifaceted accountable for their practices is clearly in the U.S. interest. Effective development assistance should focus on advancing private-sector growth that aims to eliminate policy obstacles to the facilitation of dynamic entrepreneurship. The Trump Administration should unequivocally stress that promoting policies and projects that advance economic freedom in the Indo-Pacific is the core of the development banks' mission and the foundation of America's engagement with them.

- **Repeal the Foreign Account Tax Compliance Act (FATCA).** FATCA, which President Barack Obama signed into law in 2010 to target illegal tax avoidance, has penalized law-abiding Americans working overseas with layers of tax-reporting obligations that treat these Americans like suspected tax cheats and money launderers. FATCA has not only made it increasingly difficult for Americans to live and work overseas, but also hurt U.S. economic interests, "significantly undermining the global competitiveness of US exporters."¹⁵ The estimated 8.7 million overseas Americans, many of whom reside and work in the Indo-Pacific region, are de facto emissaries for American economic interests abroad and creators of domestic jobs. Yet FATCA has been hurting them. If a U.S. company aims to develop exports, through either sales representatives or subsidiaries, it needs foreign bank accounts to facilitate various legal transactions. FATCA, misguidedly, has created an enormous regulatory burden for the financial institutions needed to help U.S. companies and individuals attempting to penetrate foreign markets with U.S. products and services. In line with President Trump's February 2017 Executive Order 13772 Core Principles (d), which stipulates "enable American companies to be competitive with foreign firms in domestic and foreign markets,"¹⁶ the Administration should take steps to repeal FATCA.

14. Ibid.

15. Demetri Sevastopulo and Barney Jopson, "U.S. Expats Given Hope of Lower Tax Bills," *Financial Times*, October 25, 2017, <https://www.ft.com/content/4909d804-b9a1-11e7-8c12-5661783e5589> (accessed August 15, 2018).

16. The President, "Presidential Documents, Executive Order 13772 of February 3, 2017, Core Principles for Regulating the United States Financial System," *Federal Register*, Vol. 82, No. 25 (February 8, 2017), <http://republicansoverseas.com/wp-content/uploads/Trump-EO-13772-on-Financial-Regulations.pdf> (accessed August 15, 2018).

■ **Resume the Trade and Investment Framework Agreement (TIFA) talk with Taiwan and pursue a bilateral free trade agreement with this invaluable U.S. ally.** Taiwan is an important free-market democracy in the Indo-Pacific region and an active member of the World Trade Organization. Disappointingly, the United States and Taiwan have no broad trade pact to date. All that exists is the TIFA—basically an agreement to meet on a regular basis to discuss and work toward resolving outstanding trade differences. It is typically held at the Deputy Secretary level by the United States Trade Representative. However, a TIFA meeting is long overdue, as there has been no meeting since October 2016. The U.S./Taiwan relationship deserves far better than that.

Time to Build an Enduring Economic Freedom Partnership with the Indo-Pacific

America is an economic superpower in the Indo-Pacific region. However, to maintain its position, the U.S. must encourage the free flow of capital, goods, services, and ideas around the region. Implementing such forward-looking policies would generate and reinforce the economic dynamism and innovation

that will lead to an expanded network of free markets and greater economic ties to the region. In what must be a long-term, strategic effort, the U.S. needs to marshal its resources and continue its committed engagement to meet the challenges confronting the Indo-Pacific region.

Consistent with the National Security Strategy that President Trump announced in December 2017, the President's 2018 Trade Policy Agenda unambiguously recognizes that economic prosperity at home is necessary for American power and influence abroad.¹⁷

Indeed, it is fitting that advancing economic freedom is part of America's broad national security strategy. A strong economy undergirds a strong national defense, and a vibrant economy is an imperative source of U.S. military strength. Economic security driven by the advancement of economic freedom at home and abroad, not by the proliferation of protectionism, truly enhances national security, which in turn buttresses greater economic dynamism. The time for the Trump Administration to act on that is now.

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17. Office of the United States Trade Representative, "The President's 2018 Trade Policy Agenda," April 2018, <https://ustr.gov/sites/default/files/files/Press/Reports/2018/AR/2018%20Annual%20Report%201.pdf> (accessed August 15, 2018).