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US Turn to Protectionism: How Should Asia Respond?

By Tomoo Kikuchi and Yohei Tanaka

Synopsis

The US turns to protectionism as it becomes less dependent on oil from the Middle East, aiming to reduce its government debt and revitalise its manufacturing industries. The world needs to step up to create a new inclusive economic and security order.

Commentary

WHILE GLOBALISATION fatigue seems to set in, protectionism is emerging. The question that needs to be asked is what is the trend underlying this phenomenon and how Asia should respond to it.

Since the World War II, free trade has been the cornerstone of the world economy. The establishment of the World Trade Organisation (WTO) in 1995 as well as numerous economic partnership and free trade agreements have promoted free trade based on the concept of comparative advantage. Institutionalisation of trade and advancement of information technology brought the world ever closer together.

'New Engine' Getting Old?

On the other hand, the postwar period required a new engine for the world economy to rebuild the nations devastated by the war. Meanwhile, Germany and Japan have revived their manufacturing industries running trade surplus against the United States, which they invested in US treasury securities.

The US was a major crude oil exporter until the 1970s. When oil production declined, the US became increasingly dependent on oil from the Middle East. In turn, the oil producing countries invested their trade surplus in the US treasury securities over the coming decades.

Awash with the US dollar, the Bretton Woods system became unsustainable by 1973 and led to the twin deficit during the Reagan administration during the 1980s. Still, the growth of financial markets backed by the US dollar continued to support the expanding international trade and world economy in the 1990s and 2000s.

US Turns to Protectionism

The recycling of the US dollar has run its course while major central banks have taken a series of monetary easing policies in response to the global financial crisis in 2008. The resulting low-interest rate environment and surging oil price encouraged investment into the oil industry, leading to the US shale revolution in 2011 and pushing its oil production above 1970 level.

The rise in the US oil production could contribute to reduction not only in trade deficit but also in the US treasury issuance, thus affecting the world. The US can now become self-sufficient in energy, reduce its debt issuance, and revive its manufacturing industry.

In other words, the US needs less free trade and more protectionism. However, free trade remains crucial for other countries, especially those which mainly export or import oil. This contradiction of benefits resulted in growing tension between policies of the US and its major trading partners.

However, it is not necessarily a bad thing. The US government debt burdens future generations and the reduction of it is a national mandate. On the other hand, major foreign US treasury securities holders such as China and Japan can reduce holdings of these assets that sometimes even incur negative returns in their own currency terms. The rest of the world can also become less affected by the US monetary policies.

Challenges to the World

These changes will create new challenges.

First, the rise of the US interest rate means repatriation of the dollar circulating in the world, leading to lower liquidity. Hence, the world needs to reduce its dependency on the dollar in trade and finance. Secondly, global supply chains need to adjust to the new US economy, which tries to revitalise manufacturing industries.

Third, most countries will see their export to the US decline as the US enters trade wars. These new challenges urge the world to adjust to a new form of international trade and to a multi-currency regime.

New wisdom and commitments are required to navigate the world economy to a new direction, which is difficult as we are bound by conventional wisdom. The hollowing out of the manufacturing industries in the US has made its society more vulnerable and allowed for racist sentiments to revive.

The feelings of despair in the Rust Belt were not shared by the elites in the East Coast,

who have promoted globalisation. Donald Trump listened to the people who felt left out. Contrary to being erratic or a racist, he may actually be gearing the US towards the new world.

How Should Asia Response?

Asia needs to adjust to the protectionism of the US by introducing appropriate and effective counter measures. More fundamentally, Asia must 1) rebuild international trade via promotion of regional integration and 2) reduce dependency on the dollar.

To promote regional integration, countries need to harmonise regulations and standards in trading, banking, and accounting to create larger markets. Free trade agreements such as Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP) should be advanced for Asia to remain competitive in global value chains and to replace the US to become the global consumer market.

To reduce the dollar dependency, a multi-currency clearing system must be introduced for energy trade, in particular, for crude oil and liquefied natural gas as currency and energy are the lifeblood of the economy. To strengthen the liquidity and effectiveness of the multi-currency regime, off-shore markets based on the Japanese yen and the Chinese yuan should be further developed.

Stock exchanges in the region should also be deregulated so that foreign companies can raise capital by tapping into excessive savings that corporate and household sectors have accumulated.

While the US military cuts back involvement in the Middle East and potentially in Asia, each region, in particular, the US allies, need to take up more responsibilities to establish a new security framework not relying solely on the US. When the US chooses to be “excluded,” the rest of the world should show leadership to create a new “inclusive” world order.

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