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FORWARD DEPLOYMENT IN EAST ASIA AND THE PACIFIC:
A PRELIMINARY SURVEY

James P. Bell

January 1993

Prepared for
Office of the Under Secretary of Defense for Policy

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PREFACE

The Institute for Defense Analyses (IDA) has been tasked by the Assistant Secretary of Defense, International Security Affairs, to examine the economic benefits that accrue to the United States as a result of deploying military forces in East Asia and the Pacific. This paper responds to a requirement to identify types of benefits and a methodology for studying them. Preliminary research suggests that important benefits exist, but further study is needed to estimate their magnitude. It was prepared in partial fulfillment under task, Potential Economic Benefits of Forward Deployment of U.S. Forces in Asia.

This preliminary effort included a small workshop to brainstorm the topic. The panel of experts included Professor Bernard K. Gordon of the University of New Hampshire, Dr. Ellen L. Frost of the Institute for International Economics, W. Robert Warne and Robert G. Rich of the Korea Economic Institute of America, and James Clad of the Carnegie Endowment for International Peace. The author benefited greatly from these discussions. The views expressed in this paper, however, are those of the author and have not been endorsed by the panel members or the U.S. government. The author is also grateful to Professor Todd Sandler of Iowa State University for reviewing this paper and providing a valuable critique.

CONTENTS

PREFACE	iii
SUMMARY	S-1
I. INTRODUCTION	I-1
II. TYPES OF BENEFITS	II-1
A. Stable Environment for Trade and Investment	II-1
1. Background	II-1
2. Examples	II-3
a. Market Value of U.S. Investment	II-3
b. U.S. Export Growth	II-5
c. Exports by State	II-7
d. Economic Sanctions Imposed by the U.S.	II-9
e. U.S. Business Costs	II-10
B. Influence with Regional Governments	II-11
1. Background	II-11
2. Examples	II-12
a. Japanese Aid	II-12
b. East Asian Economic Group	II-16
c. Trade Negotiations	II-17
d. Telephone Contracts in Indonesia	II-17
e. Rebuilding of Kuwait	II-19
f. Trade Discrimination	II-19
g. Infrastructure Contracts in Taiwan	II-21
h. Diplomatic Pressure in Korea	II-21
i. Diplomatic Pressure in Japan	II-22
C. Base Support Spin-offs	II-23
1. Background	II-23
2. Examples	II-24
a. GTE in Japan	II-24
b. Weapons Maintenance Contractors	II-24
c. Construction Contractors	II-24

d. Freight Transportation.....	II-25
e. Commercial Airlines	II-25
f. Other Services	II-25
g. Base-Related Economic Aid	II-26
D. Allied Support to the U.S.	II-26
1. Background	II-26
2. Examples.....	II-26
a. Contributions for Gulf War	II-26
b. Suppliers for Defense Industry	II-27
c. High Technology Cooperation	II-28
E. Foreign Military Sales.....	II-28
III. RESEARCH APPROACHES	III-1
A. Questionnaires and Interviews	III-1
1. U.S. Embassies in East Asia and the Pacific	III-1
2. East Asia and Pacific Embassies in the U.S.	III-1
3. U.S. Investors in East Asia and Pacific	III-1
4. Base Support Contractors	III-2
5. Officials and Scholars	III-2
B. Analytical Studies	III-2
1. Stability and the Cost of Capital	III-2
2. Stability and Regional Growth	III-2
3. Regional Growth and U.S. Exports	III-2
4. Originating U.S. Locations for Exports	III-3
IV. CONCLUSION.....	IV-1

TABLES

1. Market Value and the Cost of Capital II-3
2. U.S. Exports to East Asia and Pacific..... II-5
3. Share of Official Development Assistance That Is Tied II-15
4. Containers Shipped from East/Gulf Ports..... II-25

FIGURES

1. Market Value of U.S. Investment II-4
2. Exports to East Asia and Pacific..... II-6
3. Exports by State to East Asia and Pacific..... II-8
4. Percent Share of 1991 Exports from Each State to East Asia and Pacific II-9



SUMMARY

The forward deployment of U.S. forces in East Asia and the Pacific is based on fundamental national interests and security requirements. The United States benefits economically because forward presence helps protect vital economic interests and incidentally creates profitable opportunities. It is important that these potential economic benefits be recognized when forward presence is evaluated since they serve to offset its obvious costs.

This paper is a preliminary effort to identify potential economic benefits for further study. Types of benefits are discussed, examples are presented, and directions for research are noted. While the examples suggest that benefits are plausible, definitive estimates of their value would require further research.¹

A. TYPES OF BENEFITS

1. Stable Environment for Trade and Investment

The U.S. presence in East Asia and the Pacific improves stability in the region and fosters prosperity by making the region a good place for U.S. firms to invest and a good market for U.S. exports. A military withdrawal by the United States would greatly damage the credibility of U.S. alliances and jeopardize regional stability. Instability, or its prospect, would hamper regional economic growth, reduce expected profits from U.S. investments, and reduce the demand for U.S. exports.

East Asia is rife with dormant hostilities, mutual suspicions, and bitter rivalries. Instability may be too mild a word to describe the result of an abrupt U.S. withdrawal. The U.S. stake in the region is now so large that a serious threat to stability would subtract billions of dollars from the market value of U.S. investments. U.S. exports to the region are so great that a small reduction in regional economic growth rates can eliminate billions of dollars in U.S. exports.

¹ This paper considers gross benefits, i.e., positive economic impacts on U.S. citizens. No attempt is made to assess negative impacts or net benefits.

2. Influence with Regional Governments

The presence of U.S. troops in East Asia and the Pacific also contributes to the political influence of the United States in the region. Allied and friendly governments are eager to preserve security relationships with the U.S. and want to cooperate where they can. This, together with the importance of the U.S. market, strengthens the hand of the United States in trade negotiations and enables it to intervene with regional governments on behalf of U.S. companies seeking investment approvals, import licenses, and government contracts. The end results are more profitable investments and greater exports.

As Japan and other regional economies have grown, competition has increased and the relative economic influence of the United States has weakened. There is a threat of discrimination favoring regional companies over U.S. companies, but forward presence strengthens the ability of the United States to counter this threat and preserve competitive access to regional markets. Further, the U.S.-Japan alliance gives the United States a potentially valuable opportunity to influence the behavior of its most serious economic rival. Because of its desire to strengthen that relationship, Japan can be induced to temper its strong competitive instincts in certain cases.

3. Base Support Spin-offs

Providing support to forward bases, equipment, and personnel gives U.S. companies certain economies of scale in entering local markets to serve foreign customers. Support contracts help cover start-up costs and familiarize contractors with local market conditions. U.S. personnel also provide a customer base for U.S. firms serving local markets. The pay-off is in profitable investments and increased exports.

4. Allied Support to the U.S.

U.S. allies in East Asia and the Pacific provide valuable support that benefits the U.S. defense effort worldwide. This support includes supplying American defense contractors, cooperating in defense research and development, and contributing to U.S. activities in other theaters (e.g., Desert Storm). The pay-off is in lower defense budgets for the United States.

5. Foreign Military Sales

Forward deployment increases sales of military equipment by U.S. producers. Allies buy American equipment in order to strengthen their relationships and improve interoperability with the United States. Forward bases, military training, and joint

exercises familiarize local buyers with U.S. equipment. The pay-off is in increased export sales and economies of scale for the defense industry.

Forward U.S. presence also enables Japan to respect its self-imposed ban on arms exports. Without that ban, Japan would surely be a formidable competitor for military sales worldwide.

B. FURTHER RESEARCH

Future study should concentrate on the first four types of benefits. In gross dollar terms, the largest benefits are attributable to stability. In competitive terms, the most important benefits result from influence with regional governments. Whereas the benefits of stability are shared by the United States and its ally-competitors, the use of influence can be targeted to benefit the U.S. specifically, at the expense of those competitors. The third type of benefit, spin-off effects, is important because it entails the clearest cause-and-effect relationship between forward presence and economic benefit. The fourth type, allied contributions, will be particularly significant as the U.S. participates in multilateral security actions in the future.

Under the fifth type, foreign military sales, benefits are substantial and the cause-and-effect relationship is clear. However, the impact of *forward deployment on military sales* is already well known.

Research on the first type, the benefits of stability, would be analytical, requiring the collection and analysis of economic data. Academic sources should be consulted to evaluate assumptions on relevant economic relationships. Research on the remaining types would require contact with businessmen and government officials. Both questionnaires and interviews should be employed.

I. INTRODUCTION

The United States has fundamental geopolitical interests in East Asia and the Pacific that require a forward military presence. Most importantly, the U.S. wishes to preclude the emergence of a single dominant power that could pose a threat to the U.S. itself. In addition, the global position of the United States requires secure lines of communication through East Asia, for example, to the Persian Gulf.¹

U.S. scholars and policymakers in the post-Cold War era often speak of the increased importance of economic objectives in defining national security. For example, some suggest that the U.S. place greater emphasis on industrial intelligence, targeting economic competitors as well as potential military adversaries. Even the size and deployment of U.S. military forces may be judged in terms of their impact on the economy. It is asked, for example, whether defense expenditures weaken the U.S. by absorbing resources that could otherwise be used for productive investments. And it is argued that the U.S. shield allows its economic competitors to invest resources they would otherwise need for defense.

This paper identifies economic benefits that may result from the forward deployment of U.S. forces in East Asia and the Pacific. Potential benefits include the protection of vital economic interests as well as the incidental creation of profitable opportunities.² These benefits can be viewed as an offset to the obvious costs of forward deployment. It is important that potential benefits be recognized when security strategy for the region is considered.

The following sections discuss the various types of benefits that may result and consider methods by which their value could be estimated. This should be considered an exploratory effort.

-
- 1 An additional, long-standing objective has been to keep the region open for U.S. business pursuits. In the 19th century, for example, the U.S. employed gunboat diplomacy on occasion to open markets in Japan and Korea.
 - 2 Forward deployment protects economic interests in the United States itself as well as in East Asia and the Pacific. Indeed, forward deployment may reduce the cost of defending the U.S. See Robert Ayanian, *Force Deployment and the Production of Security*, "Defense Economics," Vol. 3, No. 2, pp. 99-112.

II. TYPES OF BENEFITS

A. STABLE ENVIRONMENT FOR TRADE AND INVESTMENT

1. Background

The stabilizing U.S. presence in East Asia has made a major contribution to the prosperity of the region and hence of the U.S. The U.S. presence has restrained underlying rivalries and permitted regional governments to concentrate on economic development. Development, in turn, has enhanced the stability of the regional economies. Prosperity and stability have made East Asia a valued host to U.S. investment and an important market for U.S. exports.

U.S. withdrawal from the region could be destabilizing. Regional governments would have to make other arrangements for their security as old rivalries and new threats emerged. It is easy to imagine an arms race and a struggle for influence by regional powers. Chances would increase for regional wars and externally supported insurgencies. Regional stability that did not depend on the U.S. might eventually emerge, but the intervening period would be dangerous.

Belief in the stabilizing impact of the U.S. presence is widely shared among regional leaders. For example, Japanese Prime Minister Miyazawa and South Korean President Roh Tae Woo—

... agreed that a continued active United States role is indispensable to stability in the region, and voiced the expectation that the coming new United States Administration will not change this policy.¹

It is not difficult to find historical examples of the stabilizing influence of the U.S. presence. Would South Korea even exist, let alone be an economic power, if the United States had not guaranteed its security for 40 years? Would Taiwan hold the largest foreign currency reserves in the world if the United States had not deterred an invasion from the mainland?

¹ *The New York Times*, November 9, 1992, p. A6.

Unfortunately, recent experience in the Philippines exemplifies the economic consequences of instability and shows that even a large U.S. presence is not sufficient to guarantee stability and prosperity. Foreign and domestic investors have avoided the Philippines due to changing governments, guerrilla warfare, coup attempts, and increasing lawlessness.² Nevertheless, while stability has eluded the Philippines in recent years, until the 1970s that country was among the more stable in East Asia and attracted the largest share of U.S. investment.³

In the future, a prolonged period of instability could damage regional economies in a number of ways. Emerging hostilities could halt progress toward economic integration within the region as governments placed a higher priority on autonomy for security reasons.⁴ Instead, governments might resort to economic sanctions and retaliatory economic measures. Increased defense spending could lead to higher taxes and reduced public investment in infrastructure. Business regulatory environments could change as new governments came to power. Actual fighting could lead to physical destruction and disrupt supplies and markets. Economic growth would decline as private investors reacted to increased uncertainty and risk. Lower growth in local markets would slow sales by local factories and reduce the demand for imports. The desirability of East Asia as a place to produce for export would decrease.

U.S. businesses in East Asia would share the suffering of locally owned companies.⁵ Increased instability would reduce the profitability of existing U.S. investments in East Asia. The market price of U.S.-owned factories in the region would decrease as potential buyers and creditors demanded higher returns to compensate for

2 Japanese investors were particularly frightened by the 1986 kidnapping of a Mitsui Company executive. Currently, investors from Taiwan and Hong Kong are being deterred by a wave of kidnappings of ethnic Chinese. See *Far Eastern Economic Review*, October 8, 1992, p. 22.

3 See Dennis J. Incarnation, *Rivals Beyond Trade*, Cornell University Press, 1992, p. 156.

4 The impact of hostility on integration was illustrated when South Korea recently recognized China and broke diplomatic relations with Taiwan. In retaliation, Taiwan announced a complete withdrawal of trade preferences and an ending of rights for South Korea's airlines. See *Far Eastern Economic Review*, September 3, 1992, p. 10.

5 U.S. businesses would also lose any special protection that forward deployment provides against anti-American terrorism or expropriation of investments.

increased risk.⁶ Slower growth would also decrease exports from U.S. factories to East Asia and reduce jobs in the affected industries.⁷

2. Examples

a. Market Value of U.S. Investment

The importance of U.S. investment and the magnitude of potential losses resulting from an unstable environment can be illustrated by a simple example. As of 1989, Americans held majority ownership in companies in East Asia and the Pacific with assets of \$141 billion. Net income for these companies was \$10.4 billion.⁸ The market value of these firms can be estimated by calculating the net present value of the income they produce. Assuming a 12% cost of capital and a 20-year life, total market value would amount to \$77.5 billion.

Now, if instability increased the risk of doing business in the region, prospective financiers would demand a higher rate of return. The market value of U.S. investments would decrease as shown on Table 1.

Table 1. Market Value and the Cost of Capital
(\$ Billion)

Cost of Capital (%)	Market Value	Cumulative Loss
12	77.5	
13	72.8	- 4.7
14	68.7	- 8.8
15	64.9	-12.6

6 For example, the scheduled reversion of Hong Kong to China's control in 1997 has raised the cost of borrowing for even blue chip companies. See *Interavia*, July 1991, p. 68, for a discussion of the impact on the Mass Transit Railway and Cathay Pacific. More recently, a Chinese official threatened to scrap the 1984 agreement that guaranteed a capitalist Hong Kong for 50 years, causing the Hong Kong stock market to drop 3 percent in one day. See *The New York Times*, November 18, 1992, p. A1.

7 A regional arms race might increase demand for U.S. weapons. On the other hand, it could lead to increased weapons production and exports within the region (e.g., by Japan) that would erode U.S. dominance in arms sales.

8 U.S. Department of Commerce, *U.S. Direct Investment Abroad: 1989 Benchmark Survey*, Table 20, October 1991.

For example, an increase in the cost of capital from 12% to 13% would result in a \$4.7 billion reduction in market value. An increase from 12% to 15% would reduce market value by \$12.6 billion. As illustrated in Figure 1, the potential loss would be even greater for larger increases.

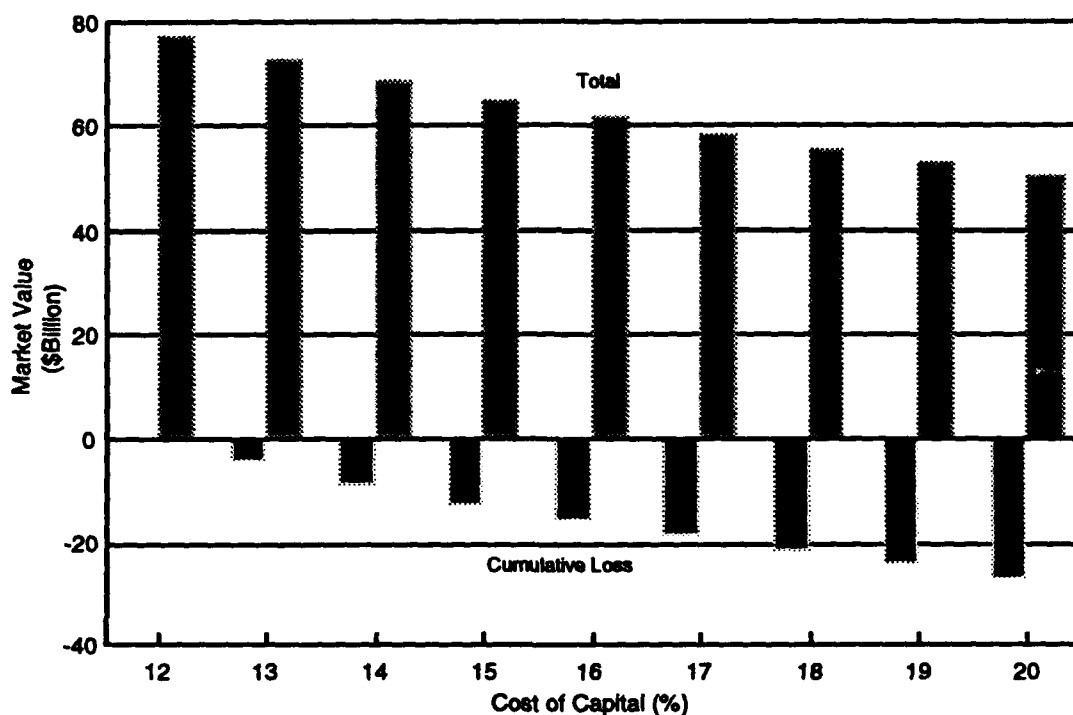


Figure 1. Market Value of U.S. Investment

It should be noted that the losses discussed here are paper losses. They would be realized only as companies sold their Asian factories, as individuals sold their stock, as company loans were refinanced, and as the feared results of instability came true.

This example suggests that potential losses to U.S. investors would be substantial. However, more accurate estimates would require additional study for the following reasons:

- The way in which regional stability affects the cost of capital should be defined and quantified.
- Losses would be borne, in part, by minority owners from other countries.
- An assumption of no growth in net income is unrealistic.
- The analysis is dependent on the values assumed for the initial cost of capital and the expected life of the investment.

b. U.S. Export Growth

If instability led to slower growth in East Asia and the Pacific, U.S. exports to the region would grow more slowly as well. A simple example will illustrate the potential magnitude of this effect.

In 1990, U.S. exports to the region amounted to \$122.5 billion. Exports for the succeeding 10 years can be projected by assuming that they would grow at the same rate as regional gross domestic product (GDP).⁹ The potential impact of instability can then be illustrated by showing how different regional growth rates would affect U.S. exports.

After one year, assuming regional GDP growth of 5%, U.S. exports would increase to \$128.6 billion. However, if instability reduced the growth rate to 4%, U.S. exports would be only \$127.4 billion. That is, lower GDP growth would have reduced exports by \$1.2 billion. As indicated in Table 2, export losses would increase to \$18.1 billion per year after 10 years. Losses would average \$8.8 billion per year, with a cumulative total of \$87.8 billion over the entire period.

**Table 2. U.S. Exports to East Asia and Pacific
(\$ Billion)**

Time Period	U.S. Exports		Loss
	@ 5%	@ 4%	
Year 0	122.5	122.5	-0.0
Year 1	128.6	127.4	-1.2
Year 2	135.0	132.5	-2.5
Year 3	141.8	137.8	-4.0
Year 4	148.9	143.3	-5.6
Year 5	156.3	149.0	-7.3
Year 6	164.1	155.0	-9.1
Year 7	172.3	161.2	-11.1
Year 8	180.9	167.6	-13.3
Year 9	189.9	174.3	-15.6
Year 10	199.4	181.3	-18.1
Total	1,617.2	1,529.4	-87.8
Average	161.7	152.9	-8.8

⁹ This is a conservative assumption since the increasing wealth and openness of the region should enable U.S. exports to grow even faster.

As illustrated in Figure 2, larger reductions in regional GDP growth rates would result in larger U.S. export losses. For example, if regional instability reduced growth rates from 5% to 0%, U.S. exports would be reduced by an average of \$39.2 billion per year.

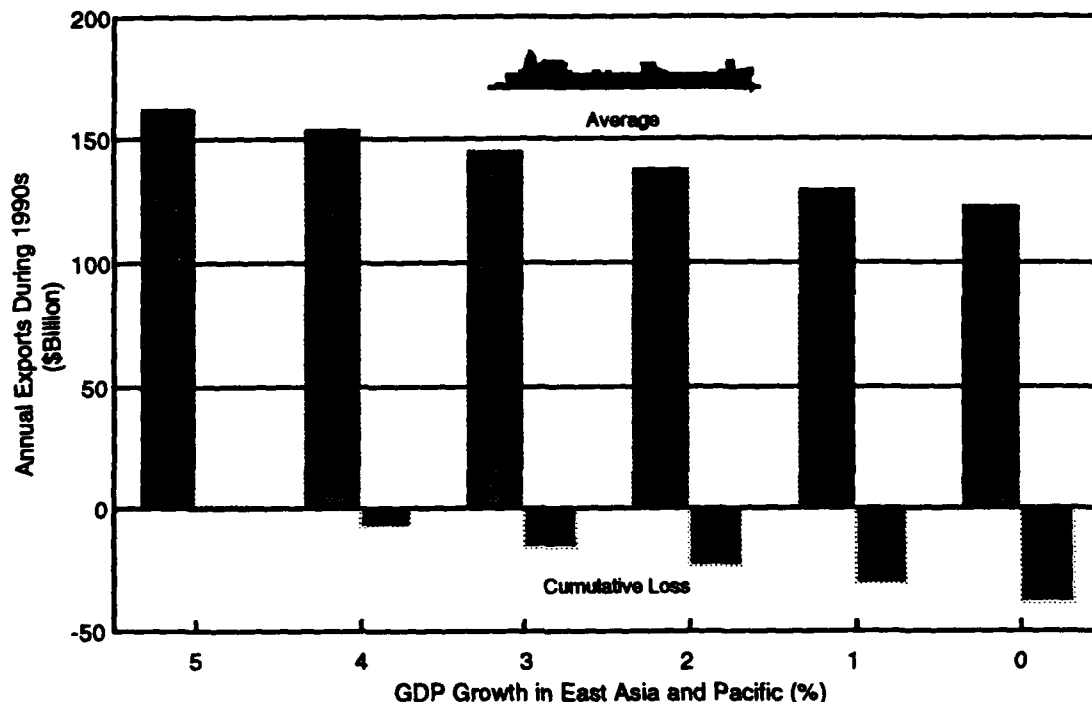


Figure 2. Exports to East Asia and Pacific

Reduced export growth would affect the well being of the U.S. in several ways. Jobs in export-related industries would be lost and would probably be replaced with jobs in lower-paying sectors.¹⁰ The net loss in jobs would average 127,000 if lost exports averaged \$8.8 billion per year.¹¹ Profits would be reduced as capital and other resources were shifted to less productive uses.

This example indicates that small changes in the rates of regional growth would have a major impact on U.S. exports. However, the example should be refined in a number of ways:

-
- 10 The U.S. Trade Representative, Carla Hills, has said that "... export-related jobs pay 17 percent more than the national average. ..." See *The New York Times*, October 7, 1992, p. D17.
 - 11 In *Exports from Manufacturing Establishments*, the Bureau of the Census reported that 1987 direct exports of \$193.6 billion were directly or indirectly associated with 2.8 million jobs, or 14,463 jobs for each \$1 billion in exports.

- The link between instability and growth rates should be explored based on historical incidents.
- Likely growth rates under continued stability should be determined for the region as a whole and for individual economies.
- The responsiveness of U.S. exports to changes in regional GDP should be estimated based on historical data.
- The *net* impact of export changes on national income in the U.S. should be estimated.
- The present value of lost export earnings should be assessed based on appropriate discount rates.

c. Exports by State

Communication of potential trade impacts would be more effective if the analysis were conducted at the local level, i.e., by city, state, or Congressional district. Suitably detailed data is scarce, but it is possible to examine trade relationships at the state level.

Figure 3, for example, depicts the value of 1991 exports to East Asia and the Pacific from each state with more than \$1 billion in shipments. Fully half of the states meet this criterion. Figure 4 indicates the percent share of each state's exports that were shipped to East Asia and the Pacific. As might be expected, the East Asian market is particularly important to states west of the Mississippi River, accounting for an average of 37.5% of their exports. What is more surprising is that East Asia also has a substantial share of exports from states located east of the Mississippi River, averaging 21.1%. This illustrates that the economic importance of East Asia to the U.S. is widely based.

Considerable data are available for further analyses at the state level. For example, the types of commodities shipped to each country in East Asia can be identified. However, suitable data are not readily available for analyses at the city or Congressional district level.¹²

Unfortunately, there are difficulties in interpreting the available data. Figures 3 and 4, for example, are based on data from a program entitled State of Origin of Exports prepared for the Commerce Department by the Massachusetts Institute for Social and Economic Research (MISER). The MISER data identify the state from which a product

¹² The Bureau of the Census can conduct surveys by special request to obtain data for local areas of interest. However, such surveys may cost millions of dollars and take years to complete.

began its export journey and the country to which it was first shipped. If a product is exported by a wholesaler located in a different state than its manufacturer, the MISER data assume that the export journey began from the wholesaler's location. Thus, states with a concentration of wholesalers, e.g., near major ports, may report export shipments that substantially exceed export production.¹³ Similarly, the MISER data do not identify the final destination for products that are shipped to one country and then re-exported to different countries.

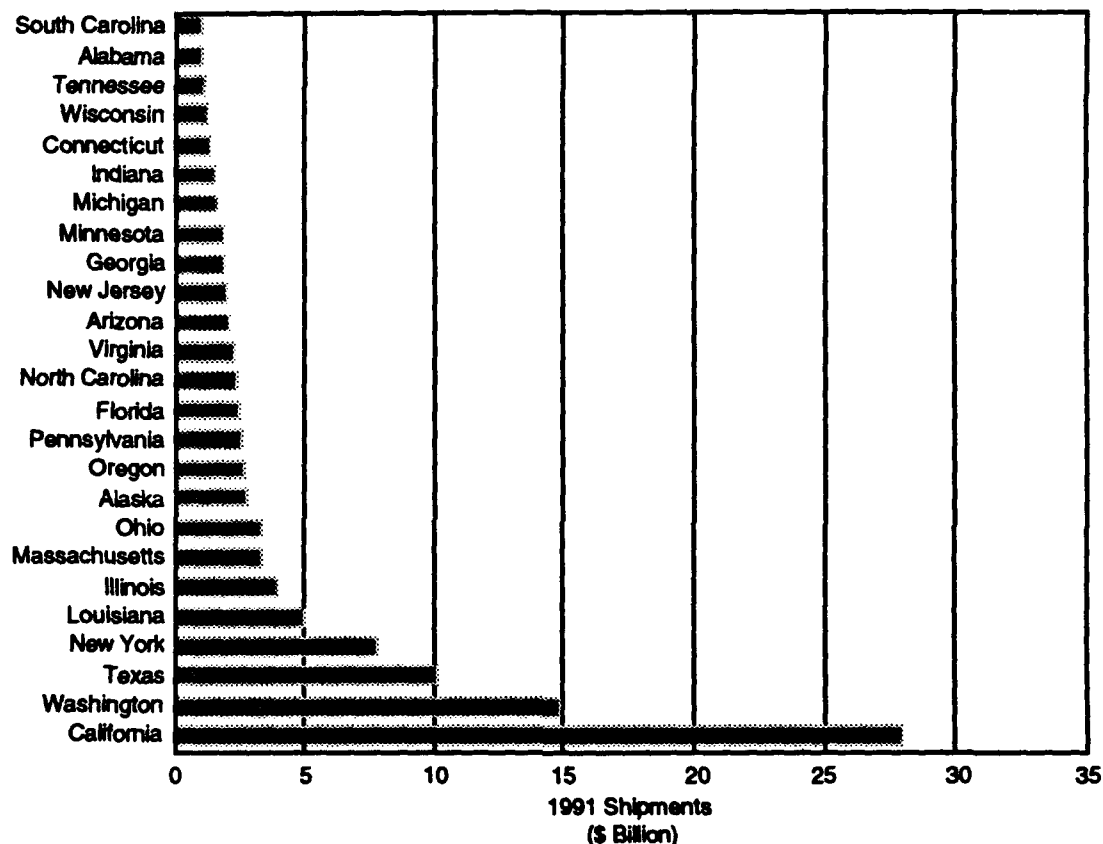


Figure 3. Exports by State to East Asia and Pacific

Other sources provide detailed data on exports and related employment by state of production but do not identify the countries to which exports are shipped. Data from these sources could be used in conjunction with the MISER directional data to estimate production and employment effects by destination country. However, such estimates would be based on broad averages and could be misleading.

¹³ Reported agricultural exports from Louisiana, for example, greatly exceed what is grown in that state.

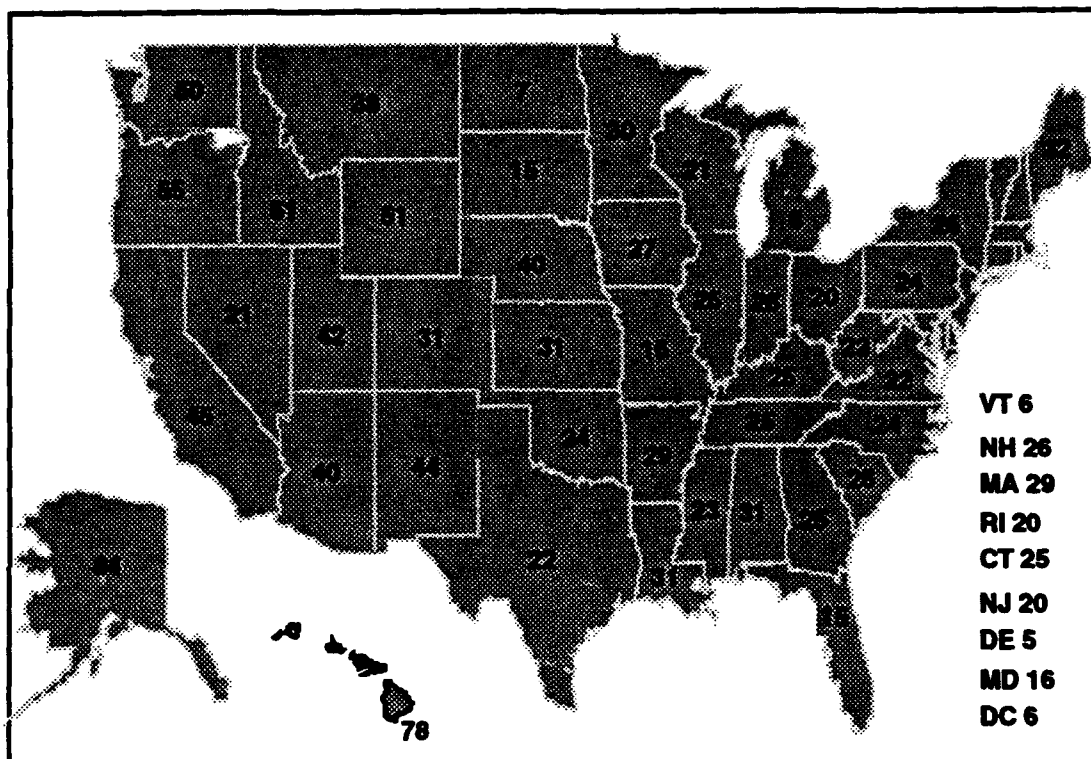


Figure 4. Percent Share of 1991 Exports from Each State to East Asia and Pacific

d. Economic Sanctions Imposed by the U.S.

In an effort to influence the behavior of other governments, the U.S. has often implemented trade sanctions and other policies that have led to reduced U.S. exports. Arguably, the incidence of such sanctions would increase if the United States were to *withdraw its forces from the region*. On the one hand, in a less stable environment, local governments would take more actions that the U.S. would find objectionable. On the other hand, without military leverage, the U.S. would have to rely more heavily on economic options to influence events.

One current example is the embargo the U.S. retains on trade and investment in Vietnam. While this embargo originated during the Vietnam War, Vietnam's 1978 invasion of Cambodia certainly prolonged it.¹⁴ Reductions in U.S. aid to the repressive government

14 The U.S. has prohibited unlicensed financial transactions and exports and has opposed financial assistance by multilateral agencies. Recently, the United States has slightly eased some of these restrictions. See *The U.S.-Japan Economic Relationship in East and Southeast Asia*, The Center for Strategic and International Studies, 1992, p. 191. (Hereinafter referred to as *The U.S.-Japan Economic Relationship*.)

of Myanmar (Burma) have reduced the potential for exports to that country. The shooting of civilians by the Indonesian army in East Timor similarly caused the Netherlands (but not the U.S.) to suspend aid. China's repression of dissent in 1989 provoked the embargo of selected items and the withholding of multilateral loans. Security-related controls on high-technology exports to potentially hostile countries (e.g., China) also exist.

A future need to impose economic sanctions on a major trading partner such as South Korea, Japan, or Taiwan would be very costly for the United States. Further, sanctions against one of these economies might prove necessary even if overall relations remain good. For example, in the 1970s, the U.S. imposed economic sanctions against both South Korea and Taiwan in order to discourage potential nuclear proliferation.¹⁵

Examples of trade sanctions in other parts of the world include the 1980 U.S. embargo on wheat sales to the Soviet Union following its invasion of Afghanistan in 1979. When the Soviets orchestrated martial law in Poland in 1981, the U.S. banned the export of equipment for a natural gas pipeline from the Soviet Union to Western Europe.

If East Asia were changing in ways that the United States did not like, it is easy to imagine an increase in these types of sanctions. They could be avoided only if the U.S. were to ignore the evolving security situation in the region.

Further study could develop estimates of the impact potential sanctions would have on U.S. exports. Existing case studies of actual sanctions would provide a foundation for this effort.

e. U.S. Business Costs

The stabilizing U.S. presence in East Asia and the Pacific directly reduces certain business costs. For example, by patrolling the sea lanes from the U.S. to East Asia and beyond, the U.S. reduces the risks associated with sea transportation. Related insurance costs would surely be higher if U.S. withdrawal led to instability.

Instability might also lead to incidents that would interrupt the supply of raw materials, thereby raising prices for American businesses operating in the region as well as in the United States itself. For example, an interruption in the flow of oil to Japan from or through Southeast Asia would raise prices as shortages developed within the region. Prices in the United States might also be affected as Japan sought alternative sources of supply.

¹⁵ See, for example, Gary Clyde Hufbauer et al., *Economic Sanctions Reconsidered*, Institute for International Economics, December 1990.

B. INFLUENCE WITH REGIONAL GOVERNMENTS

1. Background

The U.S. military presence in East Asia and the Pacific enhances the influence of the United States with regional governments. Together with the economic importance of the United States to the region, forward presence gives the U.S. important leverage in ensuring a benign environment for U.S. business.

Regional governments substantially influence the openness of local markets. They impose and remove tariffs that raise the cost of items that could be imported by their economies. They impose quotas that limit the amount of such imports. They require and only selectively issue import licenses for particular products. They regulate quality and safety standards that imports must meet. They control the ability of foreign companies to conduct business and invest in local industries. They restrict foreign bidding for government procurement contracts and select the winners.

Most Asian governments take an active role in managing the development of their economies, certainly more so than in the United States. Governments orchestrate development by channeling funds into target industries, often via government-owned enterprises. Development plans also shape the regulations that affect imports and foreign investment.

The decision processes of Asian governments tend to be less transparent than those in the United States. Decisions affecting particular businesses are made behind closed doors and often need not be justified in terms of published legal criteria.¹⁶ This "Asian" approach is characterized by long-term relationships, mutual favors, and bureaucratic leverage. In some countries, corruption among government officials is pervasive.

Further, the United States is not the only economic player—or even the dominant one—in the region. In many local economies, investment from Japan exceeds that from the United States. Japan's importance as a market for regional exports is substantial and increasing. Hong Kong, Taiwan, and South Korea also rival the United States as investors in several host countries.

U.S. influence with regional governments is thus critical to opening markets for U.S. exports and investments. However, U.S. economic influence alone is not enough.

¹⁶ See, for example, *The U.S.-Japan Economic Relationship*, p. 60.

A credible security role is essential in cases where we have less economic influence than our competitors.

By selectively using its influence, the United States can fight local discrimination that favors its competitors and thereby promote free trade and nondiscriminatory access. In some cases, local governments even discriminate in favor of the United States, at the expense of our competitors.

Foreign governments sometimes unilaterally safeguard U.S. interests in order to strengthen bilateral relations. In other cases, the United States actively intervenes to protect its interests. Such intervention may involve the President, his trade negotiators, personal emissaries, and embassy staffers. For example, for FY 1992 there were 113 embassy staff positions in Japan, and 41 in Korea, with economic, commercial, or agricultural specialties. These individuals, and the ambassadors themselves, intervened with the host governments to protect American interests in general and on behalf of particular companies.¹⁷ Our forward military presence makes it more likely that host governments will take U.S. officials seriously.¹⁸

2. Examples

a. Japanese Aid

Japan plays the dominant role in providing foreign aid to East Asia and the Pacific. Its dominance gives it political influence that could be used to the detriment of U.S. economic interests. More importantly, Japan's aid gives its businesses access to lucrative contracts and advantages in entering local markets. However, U.S. security relationships in the region give it the ability, in part, to offset Japan's advantages by influencing regional governments, including Japan's.

17 General Accounting Office, *Overseas Staffing: U.S. Economic, Commercial, and Agricultural Staffing in Japan and Korea*, NSIAD-92-162, April, 1992, p. 10. (Hereinafter referred to as *Overseas Staffing*) In this report, American companies complain that embassy staffing is insufficient and that larger businesses receive more attention. Nevertheless, they observe an increase in embassy interest in commercial matters in recent years, perhaps because this role has been given greater priority by the State Department in Washington. They note that, when the embassies do intervene, they "provide a tremendous amount of influence to help U.S. companies."

18 In earlier years, U.S. embassies were reputed to be unhelpful to U.S. businesses. Under President Bush, the State Department has placed greater emphasis on providing commercial support. The new attitude is perhaps captured by the following words ascribed to U.S. Ambassador to South Korea Donald Gregg: "The fruits of the cold war lie in our ability to trade." See *Newsweek*, November 23, 1992, p. 45.

Japan's bilateral economic aid to Asia averaged \$4.2 billion per year from 1984 to 1987.¹⁹ U.S. aid during the same period averaged only \$570 million, much of which represented compensation for former bases in the Philippines. Overall, Japan's aid accounted for 62.2% of the bilateral aid given in Asia by members of the Organization for Economic Cooperation and Development (OECD).²⁰ Japan's dominance is even more complete in particular countries. In China, for example, Japan currently provides 60% of aid from OECD countries while the U.S. provides none.²¹ Certainly, Japan can expect a certain amount of influence and preferential treatment in return for its generosity.

More concretely, Japan's aid program provides strong direct benefits to Japanese companies. Japan allocates a substantial portion of its aid to major infrastructure projects, e.g., energy, transportation, and telecommunications. In 1989, economic infrastructure accounted for 31.7% of Japan's worldwide aid, compared with 4.7% for the U.S. and 20.5% for all OECD donors.²² It should be expected that Japanese companies would have an advantage in obtaining lucrative construction and equipment contracts for large projects financed with Japanese aid. Initial contracts provide strategic advantages in obtaining future contracts in local markets. Japanese aid also finances projects that uniquely benefit Japanese firms in particular countries. Aid is a powerful economic tool for Japan.

Japan's pursuit of unilateral economic advantage is tempered, however, by its political objectives and by U.S. pressure. Japan has a keen interest in peace, stability, and prosperity among its regional neighbors. To some extent, Japan cooperates with the United States in maintaining stability, using its economic aid to complement the military role of the U.S. Japan's cooperation also reinforces its alliance with the U.S.

Japan's pursuit of regional stability through aid often conflicts with U.S. objectives, e.g., human rights and the resolution of missing-in-action (MIA) cases. Japan nevertheless tries to be seen as cooperating with the United States, and that gives the U.S. some leverage. For example, following the killings in Tiananmen Square in June 1989, Japan froze for one year negotiations on new aid to China. Existing aid projects were nevertheless allowed to go forward. By August 1991, Japan agreed to provide \$5.4 billion from 1990 to 1995 for infrastructure projects. Deference to U.S. sensitivities explains why Japan held off new commitments for a year.²³ The potential economic advantage to the

19 *The U.S.-Japan Economic Relationship*, p. 65.

20 *Ibid.*, p. 163.

21 *Ibid.*, p. 132.

22 *Ibid.*, p.127. See also Anne O. Krueger et al., *Aid and Development*, The Johns Hopkins University Press, 1989, p. 100.

23 *The U.S.-Japan Economic Relationship*, pp. 194, 210.

U.S. is that, during a period in which U.S. firms were reluctant to move forward due to uncertainty in China, Japanese firms also were given a reason to hesitate.

Japan's cooperation with U.S. sanctions against Vietnam provides a stronger example. Even after Vietnam's 1978 invasion of Cambodia, Japan was hesitant to cut off its aid to Vietnam. However, when the Soviets invaded Afghanistan, Japan felt compelled to demonstrate its solidarity with the West. Responding to U.S. pressure, Japan cut off aid to Vietnam in February 1980.²⁴ Since then, Japan has given only humanitarian aid, and its large companies have refrained from investing in Vietnam.²⁵ Now, as the U.S. begins to ease its embargo, Japanese big business is eager to move into Vietnam, to avoid losing out to competitors from Singapore and Taiwan. On November 6, 1992, Japan resumed official aid to Vietnam by granting a \$380 million concessional loan.²⁶ By cooperating with U.S. sanctions against Vietnam, Japan prevented its own firms from gaining a long-term advantage there over U.S. firms who were held back by U.S. law. If the U.S. lifts its sanctions soon, its firms can capitalize on this potential advantage.

As a result of pressure from the United States and other aid donors, Japan has dramatically reduced the proportion of its aid that is officially "tied." Most donor countries tie a portion of their aid, requiring that it be spent to buy goods and services from the donor country. As illustrated on Table 3, Japan has reduced from 74% to 59% the proportion of its bilateral aid that is tied, leaving it slightly above the OECD average.²⁷ More importantly, Japan increased from 8% to 49% the proportion of its aid contributed through (and untied by) multilateral agencies. As a result, only 30% of Japan's total aid was tied in 1986, compared with 49% for the U.S. and 45% for the average OECD country.

24 Ibid., pp. 213-222.

25 For example, Honda withdrew from plans to build a motorbike factory in Vietnam because of opposition in the U.S. Congress. Nevertheless, in 1988 Japan was Vietnam's largest trading partner, trailing only the Soviet Union.

26 *Far Eastern Economic Review*, November 19, 1992, p. 14.

27 Table 3 is based on *Aid and Development*, p. 74.

Table 3. Share of Official Development Assistance That Is Tied (percent)

Aid Component	1976	1986
Japan		
Bilateral	74	59
Total	68	30
United States		
Bilateral	82	57
Total	78	49
OECD Average		
Bilateral	63	54
Total	66	45

If these statistics can be believed, the untying of Japanese aid is a great benefit to U.S. companies, particularly in East Asia where Japan concentrates its aid. U.S. companies now have a greater opportunity to bid for contracts financed by Japanese aid. This is critically important in poor countries such as China and Vietnam that will rely disproportionately on Japanese financing.

There are other cases of U.S.-Japan aid cooperation that may reduce Japanese commercial advantages. For example, the U.S. and Japan still hold equal shares in the Asian Development Bank (ADB) even though Japan's financial contribution has increased.^{28 29} This gives the U.S. some leverage to ensure that U.S. firms can participate in projects financed by the ADB. Similarly, Japan agreed to become a major participant in the Multilateral Assistance Initiative (MAI) to provide aid to the Philippines, reportedly because Japan wanted to appear helpful to the U.S. and to promote its own economic and security interests.³⁰ Cooperation through the MAI may allow the United States to influence how Japanese aid is allocated. Through the OECD, the U.S. and Japan also cooperate to establish rules of competition, for example, that limit the use of concessional aid credits to help companies win commercial bids.

Of course, U.S. and Japanese companies remain serious competitors in East Asia, and Japan's dominance as an aid donor gives its firms a dramatic advantage. The regional military role of the United States, however, gives the U.S. some political influence with

28 A story of doubtful origin circulates regarding a meeting at the ADB to discuss an increase in voting rights for Japan. Supposedly, the delegates were given a tour of a U.S. aircraft carrier at nearby Subic Bay and asked how many votes that was worth.

29 See *The U.S.-Japan Economic Relationship*, p. 134.

30 Ibid., p. 128.

which to counter Japan's economic clout. These examples suggest ways in which that influence may have helped, even though cooperation between the U.S. and Japan is incomplete.³¹

b. East Asian Economic Group

Prime Minister Mahathir of Malaysia has proposed an East Asian Economic Group (EAEG) that would include East Asia and Japan but exclude the U.S., Australia, and New Zealand. The EAEG would promote economic cooperation and free trade and would help to counter any increase in protectionism in North America and Europe. The United States has opposed an EAEG, in part, because it could become an economic bloc and limit U.S. access to markets in Japan and the rest of East Asia.

The U.S. has allegedly applied considerable diplomatic pressure on its allies to oppose the formation of an EAEG. Early in 1992, for example, "Secretary of State Baker reminded Koreans that it was Americans, not Malaysians, who spilt blood in the defense of Korea."³² Malaysia also blamed U.S. pressure for Indonesia's resistance to the EAEG.

Japanese officials reportedly have said that they would not support an exclusive regional group like the EAEG, in part, because it could jeopardize Japan's defense relationship with the United States. It seems doubtful whether the American public would accept the idea of defending a Japan that belonged to an exclusive economic group that discriminated against the U.S. Of course, the U.S. discriminates against Japan through the existing U.S.-Canada free trade agreement (FTA) and the recently negotiated FTA for North America (NAFTA).³³ Similarly, the U.S. public has supported the North Atlantic Treaty Organization (NATO) even though the European Community discriminates against the United States.

While it is difficult to document diplomatic pressures, it is clear that the United States has opposed the EAEG, that allies such as Japan and Korea have not supported it, and that its formation appears to be stymied. This may well be an example of a benefit to U.S. economic interests resulting from our defense relationships.

³¹ If the U.S. withdrew militarily from the region, it might retain influence by increasing economic aid. This would be difficult, however, if the purpose of withdrawal was to reduce costs.

³² See *Far Eastern Economic Review*, April 9, 1992, p.11.

³³ These agreements do not raise new barriers against imports from Japan. However, they do provide for preferential treatment for imports from member countries.

c. Trade Negotiations

Security relations with East Asia may also be useful in preventing trade disputes from evolving into trade wars. For example, trade negotiations with Japan and Korea are conducted under the umbrella of U.S. security commitments to those countries. The need to retain good overall relations imposes discipline on both sides, prodding negotiators to find a solution. Japanese or Korean negotiators may be able to justify to their own people the concessions they make by pointing to the security commitment. Without this kind of discipline, Japan and Korea would be more likely to retaliate in kind when the U.S. imposes punitive tariffs on their exports.

Korea, for example, had a substantial trade surplus with the United States in the late 1980s. This has now been eliminated, in part, because Korea is opening its markets under U.S. pressure.

d. Telephone Contracts in Indonesia

In November 1990, Indonesia awarded contracts for telephone switching equipment to AT&T of the United States and NEC of Japan.³⁴ Each contract provided capacity for 350,000 lines; awards were \$103 million for AT&T and \$73 million for NEC. More importantly, with these awards the winners will have the inside track when Indonesia awards future contracts for equipment and spare parts. The negotiations that preceded these awards illustrate the need for influence in East Asia and the ability of the U.S. government to wield it.

Bidding took place over a period of 2 years, originally involving 11 companies. The process was chaotic to say the least. In October 1989, NEC was the low bidder, underpricing AT&T by \$32 million. However, AT&T's bid included the soft financing demanded by Indonesia, with a maximum interest rate of 3.5% and a minimum term of 25 years, while NEC's bid did not. In November 1989, NEC submitted a new bid that did include the required soft financing terms. In January 1990, AT&T submitted its own new bid that undercut NEC's price by only \$883.

The U.S. and Japanese governments put enormous pressure on Indonesia to make sure the process did not discriminate against their respective companies. Observers in Indonesia inferred a link between the negotiations and a January 1990 visit by a Japanese

³⁴ This discussion is based primarily on *Far Eastern Economic Review*, January 24, 1991, pp. 40-41.

aid team to review Indonesia's 1990 request for official aid. Whether a link was intended or not, Indonesia could not be expected to overlook the fact that Japan was its principal aid donor.

In February 1990, sensing that the Japanese would win, U.S. officials counterattacked. The Indonesians were contacted by Secretary of State James Baker, his deputy Lawrence Eagleburger, U.S. Trade Representative Carla Hills, Secretary of Commerce Robert Mossbacher, and Vice President Dan Quayle. Finally, President Bush appealed directly to President Suharto for fair play. The pressure was strong enough that Indonesian officials and newspapers complained of "conspicuous arm-twisting."

In the end, Indonesia restructured the proposed contract and reopened the bidding. In November 1990, both AT&T and NEC were awarded contracts for 350,000 lines. Originally, Indonesia had intended to award only one contract for 350,000 lines.

In this process, the United States pressured Japan as well as Indonesia. The U.S. insisted that Japan play by fair, OECD rules of competition. Indeed, NEC cited those rules in explaining why it did not initially offer soft financing terms. AT&T, of course, offered soft financing despite the rules. Both the U.S. and the Japanese governments were involved in supporting the subsidized credits.³⁵ In their final bids, credits exceeded contract awards by \$90 million for AT&T and \$97 million for NEC.

The political nature of government contracting in Indonesia is also illustrated by the local contractors with which AT&T and NEC were teamed. The partner company for AT&T is owned 75% by Suharto's eldest daughter and 25% by the brother of the Minister for Research and Technology. NEC's partners include two organizations partially owned by Suharto's sons.

It is clear from this story that bidding for government contracts in East Asia is a cutthroat process, requiring both political and economic leverage. Arguably, AT&T would have lost if the United States had not been able to counteract Japan's powerful influence as an aid donor, investor, and customer. U.S. influence can be attributed in part to the importance of the U.S. market to Indonesia and to U.S. government support for soft financing terms. However, an important component of U.S. influence is its military presence in the region. For example, Indonesia might want to encourage a continued U.S.

35 Because of the strategic nature of the contracts, the U.S. government departed from its previous policy. The Export-Import Bank and the U.S. Agency for International Development jointly provided funding to help AT&T meet the requirement for concessional financing. See *The U.S.-Japan Economic Relationship*, p. 88.

presence as a counterweight to Japanese domination. And Japan might temper its competitive instincts in deference to the U.S.-Japan security alliance.

e. Rebuilding of Kuwait

Although Kuwait is not part of East Asia, its recent agreement to purchase 236 M1-A2 battle tanks from the U.S. provides a stark example of the economic leverage that can flow from a defense relationship. This purchase can be attributed both to Kuwait's gratitude for the U.S. role during the Gulf War and to its need for future protection as illustrated by its September 1991 10-year defense agreement with the United States.

Following the Gulf War, Kuwait has consciously directed contracts under its massive, \$25 billion rebuilding effort to its wartime allies. The U.S. is receiving a large share of these contracts. Annual U.S. exports, for example, have increased from \$855 million before the war to \$2-3 billion now.³⁶ Boeing 747s, Chevrolet Caprices, construction rigs, and oil field equipment are selling particularly well.

Kuwait had planned to purchase tanks from the British in recognition of their contribution to Kuwait's defense. However, the U.S. engaged in a strenuous lobbying campaign with the royal family, involving President Bush, Vice President Quayle, and Defense Secretary Cheney. The results of this effort were aptly summed up by a member of the British Parliament, David Clelland:

It's quite clear this decision is a political decision. It's timed to give President Bush the fill-up he needs. That's what it's about. It's nothing to do with technicalities.³⁷

Purchase of the tanks and related items may cost Kuwait \$4 billion and will help preserve 5,900 jobs in Michigan and Ohio. This example shows that our allies value their security relationships with the United States, giving the U.S. a certain economic leverage.

f. Trade Discrimination

Official discrimination against the economic interests of particular countries is not uncommon in East Asia. At present, such discrimination is often directed against Japan. If the U.S. were to lose influence, however, it might be victimized more frequently.

³⁶ *Business Week*, February 17, 1992.

³⁷ *The New York Times*, October 13, 1992, p. A20. While the technical merits of the competing tanks can be debated, the British had been expected to win based on political considerations.

South Korea, for example, retained restrictions on certain Japanese imports even as it was liberalizing the restrictions for other countries.³⁸ South Korea also discriminated against Japan in providing intellectual property protection to the United States and the European Community.³⁹ South Korea bans the import of Japanese autos.⁴⁰

Taiwan also has a history of trade discrimination favoring the U.S. in products ranging from agricultural commodities to automobiles. For example, Japan is not allowed to export automobiles or related capital equipment to Taiwan. The U.S. is allowed to export motor vehicles, and General Motors is now establishing dealerships to sell its new Saturn car.⁴¹ Major competitors for the Saturn are expected to include Mitsubishi Eclipses and Toyota Corollas *made in the U.S.A.* Taiwan also uses its complex import licensing system and recently adopted incentive programs to discriminate against Japanese imports.⁴²

Taiwan's trade discrimination can be explained by a number of factors. Favoritism toward the United States is the result of previous defense and aid ties⁴³ as well as the continuing importance of the U.S. market and of a political relationship with the U.S. that still has military overtones. Discrimination against Japan is due to historical antagonism toward Taiwan's previous colonial master as well as a present fear of Japanese competition and domination.

The "Buy Britain Last" campaign in Malaysia provides another example of the need for diplomatic influence in order to preclude economic discrimination in East Asia. This campaign was initiated after tuition charges were raised for Malaysian students studying in the U.K.⁴⁴ The Malaysian government boycotted British goods except when they had no good alternative. This boycott was allowed to continue until Malaysia's Prime Minister Mahathir and the U.K.'s Prime Minister Thatcher met in 1984.

It is hoped that the U.S. retains sufficient influence to prevent a "Buy America Last" campaign. American opposition to Mahathir's proposed East Asian Economic Group, for example, could tempt Malaysia to start such a campaign.⁴⁵ Malaysia recently interfered with the sale of apples from Washington state, questioning claims about their

38 See *Business Week*, July 29, 1991.

39 See *Far Eastern Economic Review*, June 18, 1992, p. 81.

40 *Ibid.*, November 12, 1992, p. 70.

41 High taxes, a 30% tariff, and unappealing models have limited U.S. exports. A Saturn, for example, will sell for \$22,800 in Taiwan versus \$8,395 in the United States.

42 See *The U.S.-Japan Economic Relationship*, pp. 62-63.

43 *Ibid.*, p. 82.

44 See *Far Eastern Economic Review*, June 18, 1992, p. 74.

45 *Ibid.*, April 9, 1992, p. 11.

redness and forcing commercials to be withdrawn from local television stations. The U.S. Embassy defended the redness of the apples.

g. Infrastructure Contracts in Taiwan

Taiwan's 6-year national development plan envisions a massive, \$300 billion program to develop the island's infrastructure. Of this amount, \$100 billion in construction and equipment contracts will be open for bidding by foreign companies. Lucrative contracts will be awarded for railways, refineries, power plants, schools, housing, medical facilities, water treatment plants, and sewage systems.

The government of Taiwan must rely primarily on its economic power in pursuing diplomatic gains and national interests. Political considerations will thus be important in determining the allocation of contract awards. Because the U.S. military presence in the region is critically important for Taiwan, it should be expected that the U.S. will receive at least its fair share of contracts.

Recent actions by the U.S. government have helped to strengthen relations with Taiwan. A delegation of the President's Export Council visited Taiwan early this year.⁴⁶ Then, in a dramatic reversal of earlier policy, President Bush announced the sale of 150 F-16s to Taiwan. Now, U.S. Trade Representative Carla A. Hills plans to visit Taiwan in early December for a conference. That will be the first official trip by a Cabinet-rank official since diplomatic relations were severed in 1978.⁴⁷

It is too soon to count potential contract awards as economic benefits. It seems probable, however, that future study will confirm the utility of U.S. political influence in this case.

h. Diplomatic Pressure in Korea

In January 1990, the Finance Ministry of South Korea approved the construction of a DuPont titanium dioxide plant. DuPont expected to invest \$77.6 million for an 80% interest in the joint venture that would build the facility.⁴⁸ Acceptance of the plant was controversial, in part, because of the potential impact of associated industrial waste on the environment. There are reports that Taiwan rejected the plant for environmental reasons

46 "U.S. Mission Seeks Role in Taiwan's Development," *Journal of Commerce*, February 19, 1992, p. 4A.

47 See *The New York Times*, November 20, 1992, p. A12.

48 See *The Korea Economic Daily*, January 20, 1990.

and that South Korea accepted it because of U.S. government pressure.⁴⁹ The facts should be investigated further. However, this could be an example of the U.S. government's ability to influence South Korean government decisions on behalf of U.S. business. Following are other examples:

- In order to export candy to Korea, a U.S. company needed copyright protection and approval for the ingredients of its product from the Korean government. Embassy staffers intervened with the Korean government on behalf of the company. Mars candy bars are now available in Seoul.
- Faced with a recent trade deficit, Korea instituted an anti-import campaign that threatened to reduce imports from the United States. New guidelines to importers increased import prices dramatically. Tax inspectors harassed purchasers of foreign goods. The U.S. lodged fierce protests and the Koreans started backing down. In December 1990, the Minister of Trade and Industry was fired, and all officials in the ministry's U.S. trade section were transferred.⁵⁰
- An attempt was made to force foreign companies to sell 30% of their stock at administered prices on the Korean stock exchange. In effect, Korea would have confiscated part of the value of these companies. The embassy took strong action to stop this campaign.⁵¹
- U.S. Ambassador Donald Gregg helped U.S. architects gain a contract from the Korean government to design a new airport terminal. He reportedly applied hard-sell pressure on the Koreans.⁵²

These examples illustrate the need for continuous intervention in order to protect American economic interests. While any country with an embassy can intervene, only a country with strong diplomatic influence can expect to intervene successfully.

i. Diplomatic Pressure in Japan

U.S. trade negotiators have pushed hard to give U.S. firms access to construction contracts in Japan. Embassy officials aided U.S. companies in obtaining over \$200 million out of the \$2.3 billion in construction contracts for the airport and other projects near

49 See Walden Bello and Stephanie Rosenfeld, *Dragons in Distress*, Institute for Food and Development Policy, 1990, p. 101.

50 See *Business Week*, July 29, 1991.

51 See General Accounting Office, *Overseas Staffing*, pp. 5, 8.

52 See *Newsweek*, November 23, 1992, p. 46.

Osaka. Similar help will be needed, for example, to ensure access to contracts for construction related to the 1998 Winter Olympics in Japan.⁵³

Embassy officials also helped American International Group (AIG) obtain a concession to sell travel insurance at Tokyo's busy Narita airport. When it appeared that a Japanese company would gain the concession, U.S. Ambassador Michael Armacost phoned the prime minister's office on AIG's behalf. As a result, the Japanese company was persuaded to share a booth with AIG.⁵⁴

One legacy of the post-war U.S. occupation of Japan is very favorable access to Tokyo for U.S. airlines. The U.S. position is a major irritant to competing airlines in Southeast Asia, whose Tokyo connections are much poorer. The United States has reportedly used pressure in negotiating airline route structures with other regional governments. Further study might well reveal that defense relationships with the U.S. were an important consideration in these negotiations.

C. BASE SUPPORT SPIN-OFFS

1. Background

Providing support for U.S. bases in East Asia and the Pacific has aided many U.S. contractors in developing other business in the region. In some cases, base support contracts have covered start-up costs, making entry into the local market affordable. Contracts with U.S. bases have familiarized firms with local markets and enabled them to develop the skills and reputations necessary to enter those markets.⁵⁵

In other cases, American businesses have entered the region on their own to provide services to U.S. personnel. Again, this core of American customers helped to defray the costs of entering local markets. Indeed, by spreading American culture, U.S. personnel helped to popularize American products.⁵⁶

53 See General Accounting Office, *Overseas Staffing*, April 1992, p. 8.

54 See *Newsweek*, November 23, 1992, p. 45.

55 In FY 1989, DoD contract obligations in East Asia and the Pacific amounted to \$1.2 billion. See General Accounting Office, *Military Presence: U.S. Personnel in the Pacific Theater*, NSIAD-91-192, August 1991, p. 146.

56 In addition to military personnel, a substantial number of military dependents bring American consumer habits to the region. In 1990, for example, there were 8 dependents for every 10 military personnel in the area. See *U.S. Personnel in the Pacific Theater*, p. 27.

Eliminating U.S. forward bases would hurt these U.S.-owned businesses.⁵⁷ Loss of base contracts would drop some contractors below the minimum scale necessary to survive in local markets. Potential new contractors would lose the opportunity to enter Asian markets. Companies that serve Americans in the region would find their customer base reduced.

2. Examples

a. GTE in Japan

The Hawaiian Telephone Company unit of GTE has recently been awarded a contract to provide operations and maintenance support for the telecommunications transmission systems owned by the U.S. government in Japan. These systems interconnect U.S. bases there. In October 1992, Hawaiian Telephone Company replaced Nippon Electric Company as the provider of these services.

The spin-off effects of this contract are not known. The potential is substantial, however, since the contract will give Hawaiian Telephone Company a presence throughout Japan and since Japan is making some moves to open its telecommunications industry.

b. Weapons Maintenance Contractors

Maintenance support for advanced weapon systems is often provided by U.S. contractors. These same companies, e.g., GE and Westinghouse, provide support for U.S. equipment purchased by host nations and also have extensive civilian operations in the region. Further study may reveal that forward presence has played an important role in helping such companies to enter local markets.

c. Construction Contractors

Major U.S. construction firms are active in East Asia and the Pacific. They played an important role in base construction and in providing support during the Vietnam War. Further study may reveal that forward presence has played an important role in allowing such companies to enter local markets.

⁵⁷ While the military organizations and U.S. personnel would continue to demand services if they were withdrawn to the U.S., the viability of businesses serving foreign customers would be brought into question.

d. Freight Transportation

The transportation of supplies to U.S. bases provides an important source of business for U.S. ocean carriers. Worldwide, the Defense Department spends \$600 million for commercial ocean transportation.⁵⁸ Preferences for the use of U.S. carriers are important in helping to preserve the U.S. merchant marine in view of its high cost structure.

A wide variety of supplies are shipped. Table 4 indicates some of the major items shipped to bases worldwide.

Table 4. Containers Shipped from East/Gulf Ports

Commodity	Number	Share (%)
Food	2,716	33.6
Fuels and Chemicals	1,217	15.1
Vehicles and Parts	936	11.6
Other	3,204	39.7
Total	8,073	100.0

e. Commercial Airlines

Commercial airlines benefit from military and business travel related to overseas bases. This is evident to anyone who utilizes U.S. airlines to fly to South Korea or the Philippines. This support helps U.S. airlines maintain high load factors and convenient schedules that enable it to compete with regional carriers for local business. It will be interesting, for example, to see how U.S. withdrawal from its bases in the Philippines will affect scheduled flights there.

f. Other Services

American companies provide many services to American personnel stationed overseas. Some examples include banking, fast food franchises, long distance calls, and popular music. American companies have an advantage in providing some services where suitable local services are not yet available or where local demand has not been developed.

⁵⁸ See General Accounting Office, *DoD Commercial Transportation*, NSIAD-92-61, December 1991, pp. 8, 18.

Service to Americans has popularized American products and helped in the development of local markets for American services and exports.

g. Base-Related Economic Aid

A substantial portion of economic aid given by the United States must be used to buy American products. Economic aid given in compensation for basing rights in the Philippines thus increased U.S. exports. With the U.S. withdrawal from its Philippine bases, aid has been reduced. Exports will suffer accordingly.

D. ALLIED SUPPORT TO THE U.S.

1. Background

The defense efforts of the United States are supported economically by our allies in East Asia and the Pacific. This support constitutes an important benefit of forward deployment.

Certainly, Japan and Korea provide substantial host nation support to offset the costs of stationing U.S. forces in their countries. For example, by 1995, Japan will be contributing \$3.95 billion per year, which represents 54% of the cost of stationing forces there. Korea may contribute as much as \$900 million by 1995.⁵⁹

Host nation support reduces the cost of forward deployment. While this is an economic benefit, it applies narrowly and could be considered a condition rather than an independent result of forward deployment.⁶⁰ There are other benefits, however, that accrue more generally to the U.S. defense effort in other regions. Some examples are discussed below.

2. Examples

a. Contributions for Gulf War

Japan and Korea made substantial financial contributions to the U.S. to help defray the costs of the Gulf War. While Japan's contribution escalated in hesitant stages, it eventually totaled \$10.1 billion. This included over \$9.4 billion in cash and the balance in

⁵⁹ See Department of Defense, *A Strategic Framework for the Asian Pacific Rim: Report to Congress 1992*, pp. 25-6. Excluding U.S. salaries, Japan's contribution will cover 74% of stationing costs.

⁶⁰ That is, in a comparison of costs and benefits, host nation support should probably be classified as a reduction in cost rather than a benefit.

goods and services, of which more than \$350 million were purchased from American suppliers. Korea contributed at least \$251 million, including \$150 million in cash.⁶¹ Both countries also made significant contributions to other participants and victims of the Gulf War.

These contributions can be viewed as economic benefits resulting from our security relationships with Japan and Korea. They may have contributed because of gratitude or a sense of moral responsibility. They certainly contributed because they could not afford to be seen by the American public as unreliable allies and thereby jeopardize their U.S. ties.⁶² Not coincidentally, high officials from the Department of Defense were on the team that solicited these funds.⁶³

The Gulf War would have been fought without these contributions and even if there were no U.S. commitment to the security of Japan and Korea. Vital U.S. interests were at stake in the Middle East. Thus, the contributions can be seen as clear benefits resulting from forward presence in East Asia.

b. Suppliers for Defense Industry

U.S. manufacturers have become dependent on Japanese suppliers for certain state-of-the-art products. These include types of semiconductor manufacturing equipment and materials, semiconductor packaging, and related flat-panel display products.⁶⁴ The extent of such dependencies is likely to increase in the future.

The production of weapon systems in the U.S. is often improved by sourcing parts and components overseas. Foreign suppliers may offer advantages with respect to cost, quality, technology, performance, and delivery time. Foreign sourcing gives defense producers access to a larger industrial base and reflects the increasing global interdependence of the civilian economy. However, foreign sourcing can be dangerous if it leads to U.S. dependence on overseas suppliers to meet our needs, particularly if those firms are located in unreliable countries

61 General Accounting Office, *Operations Desert Shield/Storm: Foreign Government and Individual Contributions to the Department of Defense*, NSIAD-92-144, May 1992, pp. 20-5.

62 The Japanese had mixed feelings about the war. Some feared that military intervention itself would threaten vital oil supplies.

63 General Accounting Office, *Persian Gulf: Allied Burden Sharing Efforts*, NSIAD-92-71, December 1991, p. 2.

64 See General Accounting Office, *Industrial Base: Significance of DoD's Foreign Dependence*, NSIAD-91-93, January 1991, and General Accounting Office, *U.S. Business Access to Certain Foreign State-of-the-Art Technology*, NSIAD-91-278, September 1991.

It is critically important that U.S. defense producers have reliable access to state-of-the-art suppliers. However, it would be expensive and perhaps impractical to insist that all advanced inputs be produced domestically. The U.S.-Japan defense relationship increases the reliability of Japan as a supplier of advanced products. Japan is unlikely to curtail supplies even if it disagrees with security actions the U.S. is taking. By enhancing Japan's reliability, our security presence thus reduces the cost of defense procurement.

c. High Technology Cooperation

Collaboration with Japan in the development of advanced dual-use technologies would reduce costs for the United States. Potential savings will become increasingly important as Japan matches or exceeds the U.S. in more fields.

The U.S. and Japan signed an agreement in 1983 that established a Science and Technology Forum to facilitate cooperation between the U.S. Department of Defense and the Japan Defense Agency. A 1988 memorandum of understanding provided for technology sharing and cooperative development of Japan's FSX fighter. More recently, the U.S. and Japan signed a memorandum of understanding on the cooperative development of technologies for the hypervelocity ducted rocket engine for strategic defense.

It is debatable how important the benefits to the U.S. from high-technology cooperation have been to date. Nevertheless, the potential future benefits are substantial.

E. FOREIGN MILITARY SALES

One of the most obvious economic impacts of forward presence is that it promotes the sale of American weapons. Forward basing and joint operations and training familiarize local military leaders with the capabilities of U.S. equipment. Weapon sales are also aided by local needs for interoperability with U.S. forces and, in some cases, the availability of military aid. In addition, the U.S. uses the leverage it gains from security arrangements to pressure its allies to purchase U.S. technology (e.g., the FSX program in Japan).

Weapon sales are important because they generate short-run jobs, exports, and profits. Such sales also improve the long-run health of the defense industry and may help companies survive despite planned decreases in procurement by the U.S. military.

Further, the U.S.-Japan alliance enables Japan to continue its longstanding refusal to export weapons. Without the alliance, Japan might find it necessary to build up its own

defense capabilities. Japan might turn to weapons exports in order to achieve scale economies in production and as a means of extending its influence in the region. Japan's defense industry might well become a formidable global competitor, to the detriment of the U.S. industry.

III. RESEARCH APPROACHES

Chapter II has identified a number of potential economic benefits resulting from forward deployment. It is clear that such benefits could be significant, but it would nevertheless be premature at this point to estimate their overall magnitude. Further, the significance and validity of many of the examples cited is yet unknown. Additional research is necessary.

One line of research would be to contact the businessmen and officials who are knowledgeable about East Asia and the Pacific. Through questionnaires and interviews, specific credible examples of economic benefits could be documented.

A second line of research would be to analyze available economic data. This approach could yield macro-level estimates of the magnitude of economic benefits.

A. QUESTIONNAIRES AND INTERVIEWS

1. U.S. Embassies in East Asia and the Pacific

Economic and other embassy officials should know when U.S. influence has been exerted on behalf of American business interests. They should be aware of efforts by our competitors to gain advantages at our expense. Examples could be elicited via questionnaire. Promising cases could be followed up in depth with the companies or officials involved.

2. East Asia and Pacific Embassies in the U.S.

Defense attaches and economic officials at embassies in Washington, D.C., should be aware of efforts made by their governments to encourage the United States to continue its forward presence. These officials could be interviewed to obtain examples of related economic concessions and benefits.

3. U.S. Investors in East Asia and Pacific

U.S. companies doing business in the region should have definite opinions about the impact of forward presence. They and their associations could be interviewed to

determine how security issues impact their investment decisions and financial arrangements. U.S. banks that are active in the region would be particularly useful.

4. Base Support Contractors

U.S. companies that have provided support to forward bases in the region should know whether those activities helped them gain other business in local markets. These contractors could be identified and solicited via questionnaire. Responses could be tabulated to provide a general sense of the magnitude of this type of spin-off business. Interesting cases could be followed up via interview.

5. Officials and Scholars

It is important to obtain a general, macro-level perspective on the importance of economic relations with East Asia and the Pacific and of the role played by forward presence. Academicians and government officials should be interviewed in the U.S. as well as in the region.

B. ANALYTICAL STUDIES

1. Stability and the Cost of Capital

The relationship between stability and the cost of capital should be studied. Using available data and econometric techniques, the degree to which the cost of capital is affected when various indicators of stability change could be estimated. These results could be used to estimate the potential impact of instability on the market value of U.S. investments in East Asia and the Pacific.

2. Stability and Regional Growth

The relationship between stability and the growth of national income should be studied. Quantitative techniques and available data on East Asia as well as other regions could be used to examine economic growth during historical periods of instability. The results could be used to develop plausible assumptions on how a U.S. withdrawal and consequent instability would affect regional income growth.

3. Regional Growth and U.S. Exports

The responsiveness of U.S. exports to changes in regional income growth should be studied. Existing econometric forecasting models could be used to estimate the impact

of income growth on U.S. exports to particular countries and the region as a whole. The results could be used to estimate how U.S. exports would be affected if alternative manifestations of regional instability reduced regional growth rates.

4. Originating U.S. Locations for Exports

The geographical distribution of U.S. production for export to East Asia should be studied. Available detailed data could be used to estimate the concentration, importance, and employment impact of exports from particular states.

IV. CONCLUSION

This paper has discussed five types of benefits that may accrue to the United States as a result of the forward deployment of military forces in East Asia and the Pacific, namely:

- Stable Environment for Trade and Investment
- Influence with Regional Governments
- Base Support Spin-offs
- Allied Support to the U.S.
- Foreign Military Sales

The examples presented suggest that important benefits exist under each of these categories. Further study is needed, however, to validate the examples and evaluate the magnitude of these benefits.

Future study should concentrate on the first four types of benefits. In gross dollar terms, the largest benefits accrue under the benefits of stability. In competitive terms, the most important benefits result from influence with regional governments. Whereas the benefits of stability are shared by the United States and its ally-competitors, the use of influence can be targeted to benefit the U.S. specifically, at the expense of those competitors. The third type of benefit, spin-off effects, is important because it entails the clearest cause-and-effect relationship between forward presence and economic benefit. The fourth type, allied contributions, will be particularly significant as the U.S. participates in multilateral security actions in the future.

Under the fifth type, foreign military sales, benefits are substantial and the cause-and effect relationship is clear. However, the impact of forward deployment on military sales is already well known.

Research on the first type, the benefits of stability, would be analytical, requiring the collection and analysis of economic data. Academic sources should be consulted to evaluate assumptions on relevant economic relationships. Research on the remaining types would require contact with businessmen and government officials. Both questionnaires and interviews should be employed.

