

Smart Talk No. 4

Presenter

Marcus Noland

Moderator

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Discussants

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This product presents a policy-oriented summary of the Smart Talk.

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American Economic Policy Toward Asia

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The United States and East Asia have a common stake in each other's prosperity. There is an undeniably strong link, interaction, and dependency between the two. However, there is no clearly defined regional economic policy on East Asia either from the United States or among Asian states themselves. The paradox is that even though there is a growing Asian identity, the economic issues between America and East Asia are largely part of wider bilateral or global approaches.

This argument was put forward by Marcus Noland, Senior Fellow at the Peterson Institute for International Economics, during the East Asia Institute's 4th Smart Talk. With the current Global Economic Crisis, the issue of the United States' economic policy towards East Asia and the policies of the countries themselves are now more critical than ever before.

What are the economic policies of the United States to East Asia? What is the solution for resolving the Global Economic Crisis? Can Asian regionalism prove to be a solution to the crisis and lead to a recovery?

These were some of the questions raised at the 4th Smart Talk, which brought together a number of prominent Korean and international scholars with Dr. Marcus Noland to discuss the Global Financial Crisis and the economic policies of America and East Asia. Noland presented an overview of American economic policy to East Asia and offered policy recommendations against the backdrop of the Post-Crisis environment. The following

discussion allowed panelists to discuss some of these issues in depth, particularly emerging trends in the economic policies of the United States and Asia.

Presentation

The key strategic relationship between the United States and East Asia has short- and long-term issues that need to be addressed. While in the short-term there is the need to recover from the current Global Financial Crisis, in the long-term there are the trade issues related to sustaining an open global economy.

Short-Term Challenge: Global Financial Crisis

Before examining the economic policies of the United States or East Asia, the immediate short-term challenge of the unprecedented Global Financial Crisis needs to be better understood. The origin of the current crisis is regarded as having two causes, known as the micro and macro interpretations, which are interdependent. According to the micro story, the United States' housing market was at the epicenter of the crisis, a phenomenon that was encouraged by a macro situation of complacency and global imbalances. The resulting propagation that took place through the open markets caused widespread losses and exposed a number of other problems in U.S.

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consumer lending and commercial real estate.

The impact of the Global Financial Crisis on East Asia has been a reverse of the “decoupling” effect that some had expected of Asian countries. This “decoupling” effect is the separation of Asian economies from their dependency upon the U.S economy for growth. The impact of this reverse “decoupling” effect has manifested itself through three channels: the “real” channel, the financial channel, and the policy channel. In the “real” channel, trade has been majorly affected, particularly in exports to Europe and the United State. In some Asian countries, the rates of trade have fallen faster than Gross Domestic Product (GDP). However, the shock of this has been cushioned by the fall in commodity prices that has acted as a kind of counterbalance. In the financial channel, countries in East Asia might be adversely affected by their exposure to troubled markets. This kind of impact can also be felt in the “real” market.

Developments in the policy channel, which according to Noland is the most significant, could also have a major impact depending on the decisions made. The current process of nationalization and increased regulation in the United States will weaken its attempts to open up and liberalize markets in East Asia. So far, the level of regulation under the Obama administration has been surprisingly mild. It is, however, possible that if the economic situation worsens in the future, then this mild approach could dramatically change, bringing about further challenges in the future.

Long-Term Challenge: Maintaining an Open Global Economy

The long-term challenges of American policy toward East Asia are as complex as the short-term challenges manifested by the Global Fi-

ancial Crisis. There are two levels of addressing the need to maintain an open global economy and trade liberalization. The first is at the inter-state or diplomatic level, and the second is related to managing domestic politics.

Regarding the first area of inter-state challenges, increased complexity and pluralism, particularly due to an increase of “players,” have resulted in a crisis of legitimacy and democratic deficits within international financial institutions. With an increase in the importance of countries like Brazil, China, and India who were technically in the system but have now become more pronounced and assertive, as well as individual European countries showing an unwillingness to sacrifice their national prerogatives, it is increasingly difficult for such a diverse and large group of states to reach a consensus or agreement on crucial matters.

The International Monetary Fund (IMF) is a prime example of an international institution whose model is more representative of the world of 1944 than that of 2009. There have been attempts to reform the system, but governance issues remain. Western European countries, for example, have far too much dominance on the directorship of the IMF. However, with the current crisis there is now more than ever a profound need to institute some change in the IMF’s governance.

Coupled with this crisis of legitimacy is the domestic politics of globalization. There are a number of surveys that reflect the weakening support for economic and cultural globalization. This kind of popular reaction will manifest itself through policymakers’ decisions. A crucial example of this is the political situation in the United States, which in turn provides an important context on the long-term challenges. The Democratic Party has shown a tendency to be anti-globalization

primarily due to waning public support for open trade. This is very significant as the party currently controls the White House and both houses. Although President Obama has shown modest elements of protectionism, it is not yet clear where he stands on these issues. There are two ways of looking at this: either this is a tactical maneuver to gain political support for his health care bill, or Obama does indeed favor protectionism. At any rate, how the United States approaches globalization and trade liberalization will be an important aspect of any economic policy.

Solution to the Challenges: Asian Regionalism?

The countries of East Asia are in a very unique position. They now hold the resources to make changes in the international financial architecture. There are many possibilities for developing a more integrated approach, to go down the path of Asian regionalism as a response to the short- and long-term challenges mentioned above. However, certain facets prevent the emergence of an Asian solution. The Japan-China rivalry is a significant constraint and impediment to regionalism. Similarly, the strong reluctance among East Asian nations to give up their national sovereignty will also limit the efforts of Asian regionalism to be a supranational institution. In short, Noland argued that the financial muscle is there in respect of financial resources, but the political will is lacking.

The emergence in the importance of the G-20 may be able to not only resolve some current problems, but also discourage Asian countries from pursuing the regional option. With the upcoming G-20 summit in 2010 to be hosted by South Korea, we can expect Seoul to place a great deal of emphasis on that

institution.

Discussion

Regional Integration Vs Global Solution

The discussion focused on the approaches to the short- and long-term challenges that Noland addressed in his presentation. Noland had explained both the regional and global approaches to resolving these challenges, but had expressed favor for a global approach. In response, Seungjoo Lee pointed out some of the motivations behind the growing Asian regionalism. Lee explained that many of the international financial institutions have a great problem of democratic deficit, to the extent that Asian countries are increasingly dissatisfied with these institutions. As a result, they seek regional solutions, and turn to their own institutions and resources like the Chiang Mai Initiative (CMI).

Noland agreed with this analysis but stressed that a global solution is better in resolving the current challenges. As part of this global approach, he recommended using a system of balance to deal with the international financial institutions' democratic deficit. These institutions should not just be dominated by Western Europe, nor should they simply be handed over to India or China; there has to be a balance. At the same time, Noland acknowledged that regional solutions have their place in the current climate. From the United States' perspective and relevant to their policy, the problem is those that go against Washington's interests.

Byung-Yeon Kim noted Noland's concerns of Asian regionalism in the economic sector but believed that if East Asian countries cooperated more, there could be greater bene-

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fits for everyone. Other discussants, however, felt that talk of Asian regionalism as an approach to the challenges did not have much strength. Thomas Kalinowski questioned the notions of regionalism and particularly the so-called concept of “decoupling” by pointing out that East Asia is still greatly dependent on exports to Europe and the United States. Noland echoed this sentiment by stating that “delinking” does not make much sense when East Asia relies on Europe and the United States for final demand of its products. If East Asian nations are to offset this dependency, then Noland suggested that they would have to increase domestic consumption, particularly in China. He explained that between 1979 and 2002, China recorded high growth but with an equal balance; but since 2002, China has been experiencing “explosive growth” in trade surpluses.

Finally, Byung-Kook Kim questioned the response of countries, particularly in East Asia, to the short-term challenge of the Global Financial Crisis. Regarding Noland’s assessment of the micro and macro causes of the crisis, Kim believed that the causes and subsequent responses do not match. Whether through Asian regionalism or the G-20, Kim expressed concern that these responses were only addressing the effects of the crisis and not the causes. Noland agreed on some of these points, and further stated that the moves towards Asian regionalism are not an appropriate response to the current financial crisis; rather, they were about “fighting the last war” which was the Asian Financial Crisis of 1997. This is apparent in the narrow focus on building up large financial reserves, rather than on the financial restructuring that is needed to prevent a future crisis. The G-20, on the other hand, has the right agenda, but whether or not this agenda will translate into an appropriate

response is yet to be seen.

Bilateral Challenge I: The United States’ Approach to East Asia and the U.S.-China Dynamic

The policy of the United States to China is a very important part of its overall economic approach toward East Asia. There has been a great deal of debate on the G-2 and whether it could work as a solution to the Global Financial Crisis and other issues.

Byung-Yeon Kim wanted Noland to elaborate on the United States’ policy toward China and evaluate its success. In particular Kim reflected on some of the criticisms of the G-2 model, particularly Chinese skepticism regarding the notion of a G-2 and whether it could actually achieve anything.

Noland disagreed with this skepticism and stated that the United States’ policy toward China has been one of its greatest successes. Specifically, he believed that the United States had done well in embracing China and encouraging its integration into the world system in a constructive manner. The turning point, according to Noland, was in 2005 with then Deputy Secretary of State Robert Zoellick’s “responsible stakeholder” speech signaling a shift in how Washington would deal with Beijing. The G-2 was thus a positive step of moving towards a durable multilateral solution. It stands in contrast to 20th Century strategies toward a rising power, which were to isolate and contain an emerging power. Noland also emphasized that the G-2 was not as big a failure as has been made out, and that the G-2 has shown an immense depth of dialogue between the United States and China. In addition, efforts to address major global challenges such as climate change must involve China.

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Bilateral Challenge II: Moving Forward with the KORUS FTA

Yong Wook Lee asked Noland to comment on the KORUS FTA (Korea-United States Free Trade Agreement), one of the greatest challenges in the U.S.-Korea bilateral relationship. He believed that two factors will greatly impact this relationship—the first being the United States’ recovery from the Global Financial Crisis, and the other is ratification of the KORUS FTA by both Washington and Seoul.

In response, Noland explained that it is easier to pass trade liberalization when it is part of a macro-economic policy. According to Noland, there are two factors that will boost ratification of the KORUS FTA. The first is to push the FTA through Congress by making the case that the KORUS FTA will strengthen the alliance between the United States and South Korea. The second factor is to reinforce Korea’s current FTA negotiations with the European Union (EU) because any progress with the EU will be a clear example of what the United States will be missing out on. Therefore, progress on Korea’s FTA negotiations with the EU could serve as an incentive for Washington to pass the KORUS FTA in order to avoid being excluded from key agreements.

Conclusion

In general, the panelists of the Smart Talk concluded that there is no clearly defined East Asia regional economic policy by the United States, that Washington’s policies are more reflective of broader global and bilateral concerns. The short- and long-term challenges

outlined by Noland highlighted the global nature of the United States’ concerns. Difficulties arise in the approaches to cope with these challenges. The question of regionalism, particularly Asian regionalism as a potential solution, shows mixed results. While Noland argued that a global solution to the challenges is the best approach, some panelists felt that an Asian regional solution offered more hope, particularly as there was so little faith in the current international financial architecture. Although Noland generally accepted this suggestion, he also suggested that some of the democratic deficit problems can be resolved by reforming international financial institutions to create more balanced structures. With stronger institutions, a global approach becomes more feasible and manageable.

In this regard, East Asia holds many cards, such as its large sovereign wealth funds and growing regional trade. It has the financial resources to change the international structure and pursue a regional option. However, Noland noted that tensions and distrust between Asian countries themselves have hampered these efforts. He pointed out the interesting example of South Korea, who in early 2009 was facing serious financial challenges with its balance of payments. At the time, it could approach either the regional CMI fund for money or the Federal Reserve for a bilateral Fed Swap line. South Korea chose the option of going to the Federal Reserve, which raises questions about why Seoul chose that option. It also is indicative of the lack of faith in the regional institutions in East Asia among the states themselves.

In addition, Noland gave a few warnings about the future. Although East Asia has had a good run for the last 60 years, especially in terms of accumulating a great deal of wealth and strength, the demographics are against

the region with an aging population due to low birth rates. This presents a number of challenges that policymakers will need to address in the coming years. ■

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