doi: 10.1111/j.1748-3131.2009.01121.x *Asian Economic Policy Review* (2009) 4, 181–199

American Economic Relations with Asia

Marcus NOLAND[1,2]†

[1]Peterson Institute for International Economics and [2]East-West Center

The USA and Asia have an enormous stake in each others' continuing prosperity. This outcome is linked to the preservation of the open international economic order, which in turn faces challenges at both the interstate diplomatic level and at the domestic political level. The global financial crisis is probably the worst since the Great Depression and the domestic politics makes it increasingly difficult to formulate a constructive trade policy. In the absence of adequate reform at the global level, the alternative could be further fragmentation into competing regional blocs. Asia holds the key, combining both dissatisfaction with existing global arrangements with the resources to reconstitute, at least at the regional level, an alternative set of institutions and practices. How Asia responds, acting to strengthen reformed global institutions or undermine them in favor of regional alternatives, will partly depend on the policies of the dominant global power, the USA.

Key words: Asia, financial crisis, globalization, regionalism, USA

JEL codes: F5, F02, F13, F33

1. Introduction

That the USA and Asia have an enormous stake in their shared prosperity should go without saying: trans-Pacific economic integration is deep, and US leadership for more than one half century has supported the maintenance of a liberal global trade and financial system, the enabling framework in which Asia has experienced its spectacular development.

Looking forward, however, the relationship faces major challenges. In the short run, the global financial crisis, with its epicenter in the US, will have both a direct impact on Asian economic performance through trade and financial channels, as well as a longer-run impact on this event's impact through induced policy changes in the US, regionally and globally. These developments in turn feed into the increasingly difficult long-term challenges of managing globalization and maintaining the open international economic order which has served American and Asian interests.

Asia, with a large number of economies of widely varying sizes and income levels, encompasses enormous diversity. One implication is that while the process of growing regional trade and investment ties are forging a stronger regional identity than one that existed in the past, the national interests of Asian countries diverge on many specific policy issues, creating some paradoxical challenges for American policymakers: Asia's

Paper prepared for the Asia Economic Policy Review conference Tokyo, 18 April. I would like to thank Jennifer Lee for research assistance and conference participants for comments on an earlier draft.

†Correspondence: Marcus Noland, Peterson Institute for International Economics, and East-West Center, 1750 Massachusetts Avenue, NW, Washington, DC 20036, USA. Email: mnoland@petersoninstitute.org

heterogeneity militates against defining US economic policy in regional terms, yet the emergence in Asia of regional institutions and initiatives requires a US policy response. The USA will host the Asia–Pacific Economic Cooperation (APEC) forum in 2011, forcing Asian regional issues onto the agenda of the current Administration.

For the most part, the US policy agenda toward Asia does not revolve around regional issues, however. Instead, it is largely derivative of American global economic concerns. Likewise, from the standpoint of most Asian governments, the issues of greatest salience in their relationship with the USA are either bilateral in nature, or are the bilateral manifestation of issues of global concern. Some of the critical items on the US economic agenda with Asia – establishing a viable policy on sovereign wealth funds, the Korea–US Free Trade Agreement (KORUS), and the future of the Doha Development Round of multilateral trade negotiations under the auspices of the World Trade Organization (WTO), to name three – may or may not be specifically "Asian" per se.

The ability of the USA and Asia to work together to sustain an open system of international economic relations face challenges at both the inter-state diplomatic level and at the domestic political level. The Obama Administration, in particular, faces two specific challenges in organizing American economic diplomacy toward Asia. The global financial crisis is probably the worst since the Great Depression and the domestic political environment which makes it increasingly difficult to formulate a constructive trade policy.

The relationship between the USA and Asia will be the single biggest determinant in the evolution of the global economic system. Accelerated fragmentation of the global economy is a distinct possibility. Asia is key, combining both dissatisfaction with existing global arrangements with the resources to reconstitute, at least at the regional level, an alternative set of institutions and practices. How Asia handles this situation, acting to strengthen reformed global institutions or undermine them in favor of regional alternatives, will partly turn on the policies of the dominant global power, the USA.

2. The Global Financial Crisis

The International Monetary Fund (IMF) predicts that global financial output will fall by 1.3% in 2009, making it the worst year since the Great Depression (IMF 2009a). The origins of the current financial crisis reside primarily in developments in US financial markets. The development of highly complex financial instruments, many related to the securitization of mortgage lending, was abetted by unusually low interest rates as a result of a variety of factors including the Asian savings glut, and a bias toward monetary ease under the Greenspan Fed, which both facilitated borrowing in the first instance or primary sense, as well as encouraging excessive leverage among secondary market participants (Taylor, 2009).

The ratings agencies and regulators were asleep at the switch. In particular, the regulatory system of the USA was revealed to be fragmented and inadequate, particularly with respect to the so-called "second banking system" comprised of non-bank financial institutions such as hedge funds. Abundant liquidity and regulatory lassitude enabled criminal frauds on a grand scale, of which the Madoff and Stanford scandals are the leading indicators. Similar developments occurred in parallel elsewhere around the globe, particularly in the UK.

The crisis was propagated internationally through open capital markets exposing pre-existing weaknesses in financial sectors and participants outside the USA, and once the crisis got underway, rising interest rates exposed weaknesses in other segments of the US financial market, such as consumer lending and commercial real estate in the USA. Crisis response in the USA has been forceful (at least as measured by expenditures), but inconsistent and ad hoc, complicated by the electoral calendar in the USA and the political transition from the Bush Administration to the Obama Administration.

Benchmarking against past banking crises, US economy could continue shrinking into 2010, followed by slow recovery, and eventual increases in asset prices and employment, with housing prices taking the longest time to recover (Reinhart & Rogoff, 2008), though others have predicted a more rapid recovery (Bernanke, 2009; Mussa, 2009). While trying to calculate losses ex ante in the midst of a crisis is a mug's game, the IMF estimates that current gross financial losses are \$4.1 trillion, with losses on US assets \$2.2 trillion or 15% of current gross domestic product (GDP). These estimates have risen as the crisis has unfolded (IMF, 2009b), putting them into the same league as those experienced by Japan, Korea, and Taiwan during their crises in the 1990s. Boone and Johnson (2009) have ventured that ultimate taxpayer costs will be on the order of \$1 trillion. There is some thought that the crisis will actually prove more severe and protracted in Europe.

Some Asian countries have benefitted substantially from the rapid growth of consumption in the USA since 1994, which coincided with their interests in running current account surpluses and accumulating reserves as a form of self-insurance following the 1997–1998 Asian Financial Crisis. In 2007, China's current account surplus as a share of GDP reached a historically unprecedented 11 percent, and is forecast to remain an extraordinary 10% through 2009 (IMF, 2009a), and during the early stages of the current episode, there was wishful thinking about "decoupling," the notion that Asia would be able to maintain its growth rates, even as the USA and Europe slowed.

Rather than "decoupling," Asia appears to be experiencing "re-coupling" or "reverse coupling" with a vengeance. There are multiple channels through which this is occurring. The most obvious is through the "real" channel, as a combination of slowdown in the USA and Europe and depreciation of the US dollar leads to a substantial, sustained increase in US net exports. This adjustment is already beginning to occur, and is happening much more abruptly than generally anticipated. One upside for most of Asia associated with this weakening of global growth has been the fall in commodity prices, the price of oil in particular, and the improvement in terms of trade has acted as a kind of automatic stabilizer, cushioning the external shock. But it is unlikely that the USA will be able to continue as the "consumer of last resort" and the IMF predicts that the region will not experience a sustained recovery until mid-2010 and that it cannot rely on China to pull it out of its slump (Burton, 2009). To revive growth, Asian countries will have to increase domestic demand in the context of an unwinding of the massive global imbalances.

Beyond the real effects, Asian economies will suffer losses based on their degree of exposure to troubled markets. Shocks felt through this financial channel may have secondary real side implications as well. The re-equilibration of financial flows has resulted in exchange rate adjustments, including an appreciation of the Japanese yen, associated with a reversal of the carry-trade. Over the course of 2008, the Korean won depreciated more than 40% against the Japanese yen, for example. This shift in competitiveness could have additional knock-on implications; it is conceivable that Korean auto firms could experience an increase in market share at the expense of Japanese assemblers in the shrinking US market, complicating the passage of the KORUS free trade agreement (FTA), for example.

A key issue is how China will contribute to greater stability in international economic relations. Chinese officials have become more assertive in their pronouncements on international economic issues, criticizing US economic policies, and calling for a new reserve currency based on the IMF's Special Drawing Rights (SDRs). Whatever the reserve currency, an outstanding issue is whether and how China will increase the flexibility of exchange rate determination and how this might affect the movements of other Asian currencies against the yuan. The bilateral trade imbalance between the USA and China ballooned to $266 billion in 2008, accounting for one-third of USA's global trade deficit of nearly $800 billion. In the long run, China will experience significant real appreciation generated by its rising productivity in its traded goods sector, the current account surplus will diminish, and exchange rate policy will move toward a more genuine float. But getting to this outcome will be politically contentious, and the Obama Administration will face Congressional pressure on the Chinese currency issue.

The crisis is likely to prove to be a watershed event and have a longer-term effect on Asia through what might be called the policy channel. In response to the crisis, the USA is currently re-regulating its financial sector on an ad hoc basis, reversing the trend toward financial market deregulation begun during the Carter Administration in the 1970s. At some point, US authorities will attempt to move beyond improvisation and undertake a concerted regulatory overhaul. A key issue is whether such interventions would adversely affect US economic performance, possibly contributing to a decline in the relative importance of the USA in the global economy and reducing American diplomatic relevance. If inexpertly done, this move could both impair the competitiveness of the US economy as well as reduce the attractiveness of the US financial sector. Both developments would be bad for Asia.

Enhanced regulation would also change the ideological context of international policy formation both bilaterally and through multilateral institutions for financial sector liberalization generally, and external liberalization specifically. Less pressure for financial market liberalization on Asian countries would emanate from multilateral organizations such as the IMF, World Bank, and Asian Development Bank (ADB). With a lag, this shift would presumably be reflected in the US trade negotiation agenda: with less confidence in unfettered financial market operation, and US policy swinging back toward regulation, US demands for Asian countries to liberalize their financial markets and grant US service providers greater access would eventually attenuate or become less effective. This tendency is already manifest in the April 2009 G-20 Leaders Statement which made "strengthening financial supervision and regulation" a key component of their recovery and reform plan (Leaders of the Group of Twenty, 2009).

Heightened interest in the regulation of sovereign wealth funds (SWFs) will be of immediate relevance to Asian sovereign investors. The IMF is facilitating a dialog on identifying best practices for SWFs; the Organisation for Economic Cooperation and Development is running a counterpart operation for SWF investment recipient countries. In March 2008, the USA, United Arab Emirates, and Singapore, homes of some of the oldest SWFs, announced a code of conduct, which they hope will gain adherents and form the basis for a global standard. The IMF's International Working Group (which includes Australia, China, Korea, New Zealand, Singapore, and the USA among its members) issued a set of voluntary principles in October 2008.

3. Longer-term Challenges

Globalization is built on the twin supports of technological innovations and supportive institutions that facilitate the global diffusion of those technological innovations. Following two world wars and the Great Depression, which brought an earlier "Golden Age" of globalization to a close, the noncommunist world, led by the USA, began to reassemble the pieces of a liberal trading order: a key currency system based on the US dollar and supportive multilateral institutions, including the General Agreement on Tariffs and Trade (GATT) and its eventual successor, the WTO, as well as other multilateral institutions, such as the World Bank and the IMF in the financial sphere. This order's sustainability is in doubt, however.

Globalization creates winners and losers, begetting social tensions that must be managed at both the national and international levels. At the national level, for example, in the USA, the public is split largely along educational lines – those with only a high school education or less fear globalization, while those with some post–high school education tend to view it benignly (Blonigen, 2008). While it is possible that this difference in outlook is a result of the ignorance of less-educated people, their assessment may also reflect a rational appraisal of the impact of globalization on their earnings and relative status. In the USA, it appears that married females, who for social reasons have less geographical mobility, experience particularly large lifetime earning losses associated with trade-related job displacement (Kletzer, 2001). Similar political tendencies are evident in Asia. In Asia, polling conducted between November 2008 and February 2009 suggests a growing dissatisfaction with the status quo, both with respect to international and national economic systems (BBC Poll, 2009).[1]

Hence, the status quo faces at least two sources of potential vulnerability. The first challenge is at the diplomatic level. Globalization thrives on order. The issue today is that the objections to globalization on current terms by a growing number of systemically important participants may degrade the existing commercial regime significantly without constituting a consensus sufficient either to reform the existing system or construct a coherent alternative.

In this respect Asia is key; in the decade since the 1997–1998 crisis, Asian disappointment with "Washington" – both the US government and the Washington-based World Bank and IMF – has encouraged a push for both greater influence within these institutions as well as more robust regional institutions and arrangements. Rightly or wrongly, many Asians regard the Fund's performance during this episode as incompetent, if not malicious. In the aftermath of the crisis, the Asians in effect said "never again," building up colossal foreign exchange reserves as a form of self-insurance while exploring reinvigorated Asian regional financial initiatives. What sets Asia apart from other regions of the world such as Latin America or Africa where governments may have similar dissatisfaction with the existing order, is that with roughly $4 trillion in official reserves, Asia has the financial resources to alter, reinforce, or undermine the existing order if the political will is there.

The second vulnerability is that systemically important governments will be unable to sustain an internal political consensus supportive of an open system. Of course these two challenges are interrelated – changes to rules may be politically controversial and acceptable in one polity but not another, so the sustainability of globalization at its current level will reflect both the interplay of interstate diplomacy and domestic politics. Management of these challenges is likely to be made more acute by the global financial crisis and the political stresses entailed, at least in the short run. Trade volumes declined in the second half of 2008, and the World Bank is predicting that trade will shrink in 2009, falling for the first time since 1982, and exhibiting its weakest performance since the Bank began keeping records in 1970 (World Bank, 2009).

4. Inter-state Issues: Complexity, Pluralism, and Legitimacy

Over the past 30 years, the USA has undergone a remarkable process of globalization. The share of merchandise trade in national income has nearly doubled to 23%, making the USA a more open economy than other large industrial countries such as Japan or Germany (excluding intra-EU transactions). The USA faces issues of how to prioritize its own efforts among multilateral, regional, and bilateral initiatives, and how to evaluate its interests vis-à-vis Asian regional initiatives.

4.1 Trade

The WTO is the centerpiece of US trade policy. All major Asian countries are members. The Doha Development Round, the organization's ongoing negotiations, has stalled for a variety of reasons: a complex negotiating agenda; the increasing assertiveness of a number of participants, notably China and India; political weakness in the traditional major powers which has made compromise, particularly on the central issue of agriculture, more difficult. On agriculture, Asia has no coherent regional interest. Some Asian countries such as Japan and South Korea number among the world's most inefficient and protected agricultural producers, while Australia, Indonesia, Malaysia, New Zealand, Pakistan, the Philippines, and Thailand are members of the Cairns Group of self-identified, nonsubsidizing agricultural exporters. Two developments over the last quarter century greatly complicated the negotiation process.

The first is that the successful conclusion of trade negotiations has been made more difficult as the substantive agenda has broadened and grown more complex. Changes in the underlying economy, including the rise of multinational firms with global production and sales operations, the shift in the developed countries toward a “post-industrial economy,” and the growth of tradable services, all contributed to a shift away from the old tariff-cutting paradigm of trade negotiations. As difficult as agreeing on tariff-cutting formulas may have seemed to the negotiators of the Kennedy or Tokyo Rounds, the conceptual complexity and political sensitivity of these efforts paled beside the emerging “behind the border” issues such as competition policy and intellectual property rights (IPR) protection, to say nothing of the hot-button “social agenda” of labor and environmental standards. The climate change–trade linkage is likely to rise in importance in coming years, further increasing political salience and complexity. The length of time needed to complete a round has steadily lengthened, with the Uruguay Round, which greatly broadened disciplines on services protection, introduced IPR obligations into the system, and established the WTO and its strengthened dispute settlement system, taking from 1986 to 1994 to conclude. Its successor, the Doha Development Round, launched in 2001, remains in suspended animation. (Ironically, the specific trigger for the most recent collapse of negotiations was a dispute over the very traditional issue of agricultural tariffs.) There are already calls to shift the negotiating agenda toward more uncharted territory or to deemphasize multilateral negotiations through the WTO (Crook, 2008; Mattoo & Subramanian, 2009).

At the same time that the trade agenda was expanding and impinging more on what had been purely domestic policy concerns, the set of diplomatically relevant negotiating parties was expanding. The GATT had effectively been a US–European Union (EU) condominium. Ironically the very successes of the Uruguay Round – the extended obligations, single undertaking, and strengthened dispute settlement – contained the seeds of the old paradigm’s destruction. In the past, practices such as “special and differential” treatment, which effectively absolved developing countries from most obligations, and the use of opt-in “codes” on issues such as government procurement, which allowed countries to take on differing levels of obligations, created automatic political safety valves for developing-country participants. The Uruguay Round’s single undertaking at once enhanced the obligations embodied in the system and their enforceability. At the same time, the technical and financial aid promised to developing countries to support taking on these heightened obligations was largely not forthcoming.

This experience left many developing-country governments embittered and skeptical of entering into new obligations through the WTO system. By the time of the Doha Development Round, launched in 2001, India, China, and other “new” players were demanding far greater influence on the negotiations than they had been accorded in the past and bringing with them distinct viewpoints on the role of international trade and the appropriate rules and procedures for its governance. Thus, increasing complexity and political sensitivity coincided with growing pluralism, presenting an obvious, and possibly insurmountable, challenge for policy management. After the July 2008 WTO ministerial bust-up in Geneva, whether the comatose negotiation can be revived is an open question.

4.2 Finance

The international financial institutions (IFIs) face interrelated challenges involving resources and governance. At the IMF, governance more closely reflects the political realities of the mid-20th century than of the 21st. Board representation is a function of quota allocations, in principle reflecting the importance of individual countries in the world economy, which sets the amount of foreign exchange countries make available for Fund use and notionally determine the level of borrowing for which a country is eligible. The USA, with a quota share of 17%, is the only member that can exercise sole veto power over Executive Board decisions under the 85% qualified-majority voting system. Over the past several years, the IMF Board has authorized two quota reallocations, which have increased the influence of countries such as China, Mexico, Turkey, and South Korea.

Yet Asia remains underweighted. (China's quota is less than that of France or the Benelux countries.) The trouble is that there is a zero-sum element to Board representation, and the two overweighted regions, Western Europe and Africa, are reluctant to see a diminution of their representation. Europe is key: African quotas are really too small to matter in terms of rebalancing, and in light of the influence that the Bretton Woods institutions wield in Africa, many would regard any reduction in Africa's modest influence within these institutions as fundamentally unfair and illegitimate, in any event. The USA, with a quota share of 17%, has allowed its own quota to decline (though not enough to imperil its sole veto power over Executive Board decisions under the 85% qualified majority voting system). To satisfy Asian desires, it might be possible to combine Western Europe into a single EU, or *Eurozone*, quota and reallocate to Asia and other under-represented areas the remaining quota freed by the aggregation of Europe into a single voting entity. Yet to accomplish this, Western European governments would have to be willing to sacrifice national prerogatives, and the USA might have to surrender its veto monopoly. Thus far, European intransigence has freed the USA from the necessity of confronting this challenge though influential voices within Europe recognize the inevitability of change (De Larosière *et al.*, 2009). As for Asia, there is no single dominant economy equivalent to the USA, nor the degree of formal regional integration like the EU or Eurozone, which could make accumulation into a single regional voice possible.[2]

The growing importance of countries beyond the small group of traditional powers was evident in the November 2008 meeting of the G-20 hosted by the US government in response to the global financial crisis. While the meeting accomplished little, it at least signaled the recognition that the "steering committee" for the world economy would have to be broadened beyond the G-7, including such Asia–Pacific countries as Australia, China, India, Indonesia, and Korea which are not G-7 members. The organization has formed four working groups: domestic financial regulation, international cooperation overseeing financial markets, the IMF, and the multilateral development banks. The Financial Stability Forum (upgraded at the April G-20 meeting to the Financial Stability Board) has been broadened to include China, India, Korea, and Indonesia. Likewise, the Basel Committee on Banking Supervision was recently expanded to include Australia, Japan, Korea, China, and India.

The challenges for the international financial system go beyond the "chairs and shares" issue; given the magnitude of challenges confronting the global economy, the IFIs appear to be under-resourced (Truman, 2009). At the April 2009 G-20 Leaders meeting, among other commitments, the group pledged to treble resources available to the IMF to $750 billion, to support a new SDR allocation of $250 billion, to support at least $100 billion of additional lending by the Multilateral Development Bank (MDBs), and to ensure $250 billion of support for trade finance. Individual countries made individual commitments, following the leadership of Japan which had stepped forward in February 2009, signing an agreement with the Fund to offer up to $100 billion in borrowing rights to temporarily supplement the Fund's resources. Goldstein (2009) recommends a "grand bargain" between industrial and emerging market economies which would trade enhanced insurance (obviating the need to run undervalued exchange rates to build reserves for self-insurance) for greater exchange rate surveillance.

Given this history, over the past decade, the Asians have focused on regional initiatives, though there is thought in some quarters, at least, that at the present juncture the regional initiatives may be distracting from more urgent tasks at the global level (Drysdale, 2009; Soesastro, 2009). In the financial sphere the most prominent of these regional efforts has been the Chiang Mai Initiative (CMI), a three-part cooperation framework instituting a network of bilateral medium-term foreign exchange credit arrangements among the central banks, undertaking regional macroeconomic surveillance, and committing to technical assistance, with the Japanese-led ADB effectively serving as the secretariat. In May 2009, ASEAN+3 Finance Ministers agreed to multilateralize the existing network of bilateral swap agreements and expand commitments to the level of $120 billion, with the Association of South-East Asian Nations (ASEAN) and non-ASEAN shares set at 20% and 80% respectively, and Japan and China (inclusive of Hong Kong) each committing $38.4 billion. Originally, full use of CMI funds had been conditioned on the borrower successfully concluding an agreement with the IMF, but the May 2009 finance ministers' announcement did not mention any such linkage. The finance ministers also endorsed the existing Asian Bonds Market Initiative and the establishment of a regional Credit Guarantee and Investment Mechanism.

The concern of some outside observers is that the CMI were to lend under loose or absent conditionality, the large pool of public money could fuel moral hazard and eventually contribute to the collapse of the globally oriented IMF. Indeed, under current arrangements, the finance some Asian countries could access through the CMI mechanism now exceeds their IMF quota. Yet with the Fund itself effectively abandoning conditionality with its short-term liquidity facility and new flexible credit line, it is likely that this linkage to the IMF in the use of CMI funds will be eventually abandoned altogether as intimated in the finance ministers' May 2009 statement. Asian countries possess roughly $4 trillion in official reserves, more than 50% of the world total. If the political will is there, Asia has the financial wherewithal to go its own way. The May 2009 announcement, specifying China and Japan equal shares in the CMI Multilaterization represents a step forward. In 1998, the USA opposed the creation of an Asian Monetary Fund. In 2009, it has taken a hands-off stance and frankly is not in much of a position to do otherwise.

5. Domestic Politics: Waning Mass and Elite Support

The difficulties of managing globalization at the international level are mirrored at the level of national politics, where there is evidence of waning support for globalization at both the mass and elite levels. In the late 1990s, high-level multilateral economic conclaves such as the annual G-7 heads of government meetings, the joint World Bank–IMF annual meetings, and WTO ministerials were usually accompanied by mass protests.

Public opinion survey data suggest that support for free markets is relatively ubiquitous, though there is some variation by region in the degree of enthusiasm for markets. Table 1 reports cross-national data on attitudes toward free markets, international economic organizations such as the WTO and the IFIs, and globalization taken from two surveys conducted by the Pew Global Attitudes Project (2003, 2008). In the first survey, the USA and East Asia (with the exception of Japan) are relatively supportive of markets, South Asia less so. Support declines, however, when respondents are asked about globalization or specific manifestations of globalization such as the multilateral economic organizations discussed in the preceding section. Support for globalization declines even further when one moves from economics to cultural issues. In short, the survey shows general comfort with markets, less comfort with international exchange, and discomfort with the social and cultural impact of globalization. Only the "market" and "not protect against foreign influences" questions were asked in the follow-up survey and while support declines across the board, the USA and East Asia exhibit relatively positive attitudes. If the lesson to be learned from the lack of Japanese support and the subsequent across-the-board fall in support for globalization is that poor economic performance makes people less tolerant and secure, then the current crisis does not auger well for the future.

The decline in support in the USA for globalization is confirmed by more specific polling data on trade agreements. The intrusion of international competition into a wider range of activities, and through the process of offshoring the introduction of international competition into previously sheltered, computer-savvy, middle class occupations in what were historically considered "non-tradable" activities, has raised the political salience of trade issues in the USA. A 2008 poll by the Pew Research Center for the People and the Press concluded that "Americans express increasingly negative opinions toward the World Trade Organization (WTO) and free trade agreements (FTAs) such as the North American Free Trade Agreement (NAFTA). In the current survey, a 48% plurality says that free trade agreements are a bad thing for the country, compared with 35% of the public who call them a good thing. Last November [i.e. 2007], opinion about free trade's impact on the country was evenly split; for the previous decade, modest pluralities said that free trade agreements were good for the country . . . There is now a broad agreement that free trade negatively affects wages, jobs, and economic growth in America" (Pew Research Center for the People and the Press, 2008; section 4). The "Buy American" proposals considered as part of the stimulus package have broad bipartisan support: "Two thirds of Americans think such a requirement is a good idea because it keeps jobs in America, while just 24% see it as a bad idea because other countries might retaliate by not buying American

Table 1 Regional Pew Survey responses (percentage of people agreeing)

		2003	2007			2003
Supporting free markets	Global average	59.1	23.7	Globalization, good	Global average	57.8
	USA	66.5	37.5		USA	65.5
	Japan	43	35		Japan	53
	Korea	82	16		Korea	84
	China	70	31		China	76
	Vietnam	95	†		Vietnam	79
	Philippines	71	17		Philippines	63
	Indonesia	54	12		Indonesia	79
	Bangladesh	32	81		Bangladesh	63
	Pakistan	†	60		Pakistan	33
	India	44	76		India	45
Do not need to protect against foreign influence	Global average	63.8	23.2	International organizations (such as the World Bank, International Monetary Fund, and World Trade Organization), good	Global average	59.9
	USA	70	33		USA	62
	Japan	49	32		Japan	57
	Korea	72	28		Korea	58
	China	75	26		China	70
	Vietnam	†	†		Vietnam	85
	Philippines	†	†		Philippines	81
	Indonesia	45	11		Indonesia	48
	Bangladesh	8	12		Bangladesh	42
	Pakistan	6	9		Pakistan	23
	India	4	9		India	50

Source: Pew Global Attitudes Project (2003, 2007).
†data unavailable.

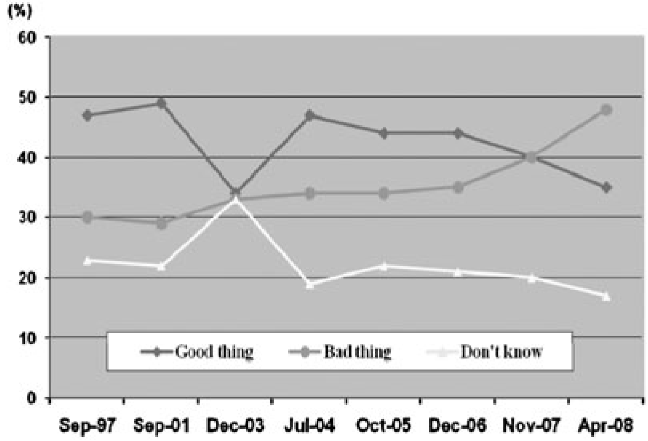

Figure 1 Opinions on impact of free trade agreements on the country.
Source: Pew Research Center for the People and the Press (2008).

products and services. Wide majorities of Democrats (70%), Republicans (66%) and independents (63%) all agree that it would be a good idea for the plan to require that spending be limited to U.S.-made goods and services" (Pew Research Center for the People and the Press, 2009; p. 2).

The Pew Center results of deteriorating popular support for trade are generally reinforced by the limited amount of time-series polling on the topic (Figure 1).[3] It is possible that this decline in support for trade represents a temporary dip rather than a permanent shift in attitudes; there is some evidence to suggest similar trade skepticism during the 1992 recession, which was followed by the congressional passage of NAFTA and the Uruguay Round agreement.

Given this popular skepticism, it is not surprising that political decision-makers have evinced trepidation. Trade policy has become increasingly partisan in the USA (see Destler, 2005; Layman *et al.*, 2006; Kupchan & Trubowitz, 2007), and while trade concerns were probably a minor contributor, the Democratic Party, the more trade-skeptical of the two major US political parties, won the White House in the 2008 elections with the election of Senator Barack Obama as president and increased its majority in both houses of the US Congress as well (Im & Sung, 2008; Pew Research Center for the People and the Press, 2008).[4] The 2008 Democratic Party statement on trade reaffirms the party's commitment to achieving a successful completion of the Doha Round and strengthening the rules-based multilateral system. But the document says very little about liberalization per se; instead, its focus is on emphasizing enforcement of foreign government obligations of existing agreements, including provisions on labor, environment, and safety standards in trade agreements, and combating currency manipulation. It says nothing about either FTAs that have been signed but await congressional ratification (Colombia, Korea, and Panama) or other potential regional initiatives with Asia and Latin America.

The early days of the Obama Administration have not been entirely reassuring in this regard. Although the Administration appears to be backing away from some problematic positions (such as the pledge to renegotiate NAFTA), its relatively supine response to backdoor protection via "Buy American" initiatives, and the lack of any positive agenda with respect to the FTAs pending ratification are troubling. One bright spot has been the signal that the USA is prepared to sign the ASEAN-sponsored Treaty of Amity and Cooperation.

Operationally, the near-term prospects for US trade liberalization at either the global or regional level have been dimmed by the expiration of "fast-track" negotiating authority. The "fast-track" procedure precommits the Congress to a simple up/down vote on implementing legislation – without amendment and within a specified time frame. Given increasingly fractious US trade politics, it is highly unlikely that – in the absence of such expedited procedures – trade accords with major partners could be successfully concluded and enacted. Nonetheless, if the Obama Administration wants to have a significant proactive trade policy, it will need to persuade the Congress to renew fast-track authority at least for the WTO negotiations, so that it can attempt to salvage the Doha Round. It will not be easy. US credibility has dealt a potentially fatal blow in April 2008 by the congressional decision to alter the fast-track rules ex post in the case of the US–Colombia FTA (Bergsten, 2008). Some in Congress argue that the Colombian case is unique and should not set a precedent for other fast-track cases, including pending consideration of the KORUS FTA. However, what matters in this context is not attitudes on Capitol Hill, but rather whether foreign governments will hold back in trade negotiations with the USA for fear that the negotiated deal will be reopened before a congressional ratification vote. In other words, US trading partners will be the ultimate arbiters of how badly the Congress has damaged US negotiating credibility.

6. Prognosis: Fragmentation?

At the November 2008 and April 2009 G-20 meetings on November 15, 2008 and April 2, 2009 (as well as at the November 2008 APEC forum summit), participants committed to a loose standstill, abjuring the introduction of new protections or derogations from existing liberalization commitments. A number of countries appear to be honoring the commitment in the breach, however: Director-General of the WTO reported that since the start of 2009, there has been "significant slippage" including the introduction of new tariff and nontariff barriers, as well as increased use of trade-remedy actions (Lamy, 2009; p. 1). An analysis by the World Bank came to similarly worrying conclusions (Gamberoni & Newfarmer, 2009). The fact that "eyes are watching" may inhibit the willingness for governments to reach for protectionist solutions; Elek (2009) reviews some "naming and shaming" options.

Apart from the resort to protection in the face of shrinking aggregate demand à la the 1930s, the longer-run issue is whether the WTO system has simply become too unwieldy to deliver much in terms of liberalization. The weaknesses of both the multilateral trade and financial institutions have provided impetus for regional and plurilateral initiatives in both the trade and financial fields. Accelerated fragmentation is a distinctly possible outcome.

Stasis at the WTO has encouraged preferential trade initiatives. APEC is the most prominent such scheme in Asia. Its membership established the goal of free trade in the region by 2020, with the developed countries of the group completely freeing their trade by 2010, but this commitment has foundered for a variety of reasons, including the lack of any enforcement mechanism. As a consequence, APEC has devolved more into a consultative organization to encourage trade and investment facilitation, and an opportunity for annual heads of government meetings.

As trade liberalization has stalled at the global and regional levels, action has naturally shifted toward more limited subregional and bilateral initiatives. The USA successfully concluded an FTA with Singapore, but negotiations with several other Asian countries including Malaysia, Sri Lanka, and Thailand have derailed. The USA, as a postindustrial economy, strongly emphasizes trans-border issues such as investment and services, which are more difficult to negotiate than more traditional bilateral measures such as tariffs, which are the focus of intra-Asian deals. The US penchant for loading labor standards and environmental concerns into these agreements creates a situation in which negotiating an FTA with the USA is more challenging than with other potential partners, particularly China.

It is unclear whether KORUS will ever be ratified. The US Congress has never failed to ratify a bilateral trade pact and failure to implement KORUS would be a terrible blow to US–Korea relations, US standing in Asia, and the US role in global trade policy. But despite President Obama's reassuring words to President Lee at the April 2009 G-20 meeting, confronting this situation is not at the top of the Obama Administration's agenda.

Preferential trade pacts among Asian countries have proliferated. ASEAN has positioned its own ASEAN FTA as the center of a hub-and-spoke system of Asian regionalism, creating a network of broadly comparable "10 + 1" agreements. From the standpoint of the USA, it faces growing numbers of potentially trade-diverting pacts in its fastest-growing export markets.

Researchers are just beginning to get a handle on how comprehensive are their provisions and how widely these preferences are actually used by firms engaged in cross-border trade and investment (Kawai & Wignaraja, 2009). One simulation model found that the USA could lose as much as $25 billion of annual exports solely from the static discriminatory effects of an East Asian Free Trade Area (Scollay & Gilbert, 2001) while other, dynamic, models concluded that real welfare loss would be lower (Jiang & McKibbin 2008; Lee *et al.*, 2009).

It is important to embed regional economic initiatives in broader geographic contexts, lest they subsequently turn inward and become closed blocs (Petri [2008] provides a more optimistic interpretation, albeit one which ignores the practical difficulties of knitting together multiple, inconsistent arrangements). In this regard, a survey of 262 Asian "strategic elites" generated an intriguing and nuanced set of results (Gill *et al.*, 2009). There was widespread support for an "East Asian Community," but less consensus on which countries should form that community. Among respondents from ASEAN+3 countries, significant majorities supported the inclusion of India (80%), the US (79%), and Australia (74%), while New Zealand and the EU failed to garner majority support. Yet despite their enthusiasm for community-building, the respondents expected unilateral, bilateral, and global arrangements to play a more important role in addressing a variety of challenges over the ensuing decade.

The Bush Administration responded to these developments by pushing the idea of the Free Trade Area of the Asia–Pacific, as well as the P*x*, a kind of coalition of the willing among APEC's more liberal members. However, the Obama Administration has suspended US participation in the P*x* talks. Were it to be made politically practical, the APEC-wide Free Trade Area for the Asia–Pacific would dominate the intra-Asia alternatives both diplomatically and economically, avoiding "drawing a line down the middle of the Pacific" and delivering greater increases in economic welfare.

Through the process of diverting trade from globally efficient producers to less efficient – though preferentially favored – producers in signatory countries, preferential agreements can potentially harm both signatories and third parties alike. The prospect of being adversely affected by discriminatory deals in Asia (especially those involving the large economies of Northeast Asia) might possibly constitute a "wake-up call" for the US Congress, forcing the USA to reassess its stance and adopt a more forthcoming posture. Korea, for example, has reached a tentative FTA deal with the EU.

7. Conclusions

The USA and Asia have an enormous stake in each others' continuing prosperity. This outcome is in turn linked to the preservation of the open international economic order. Yet the sustainability of this regime is by no means assured. While technological advances will presumably continue to reduce the costs of moving labor, capital, and goods across borders, the political prerequisites may not survive, victim of both inter-state and domestic politics. American leadership is impaired, discredited by its role as the epicenter of the global financial crisis, and an absence of constructive leadership may contribute to an erosion of adherence to systemic norms reminiscent of the system-fraying observed in the first decade of the 20th century as the first Golden Age of globalization came to a close.

US policy toward Asia is largely derivative of global issues and specific bilateral concerns. The specifically regional component in both the trade and financial fields could increase or decrease in importance depending on the evolution of institutions at the global level.

Addressing current macroeconomic and financial sector challenges is the top priority. Management of the international aspects of these issues appears to be shifting toward the G-20 which means enhanced influence for Asian countries, which, with the exception of Japan, were excluded from the G-7. The April 2009 G-20 meeting appeared to signal a broad consensus with respect to greater regulation of financial markets and institutions, increasing resources available to the international financial institutions, and improved governance of those institutions. An overarching challenge is how to achieve an economically and diplomatically sustainable consensus behind a set of institutions and practices which allow the unwinding of massive international imbalances, in effect a "grand bargain" which would reduce the need for self-insurance which politically can be interpreted as mercantilism. China is central to resolving this issue.

In the trade arena, three issues require prompt attention: the re-establishment of fast-track negotiating authority for the President, the resolution of the Doha Round impasse, and the passage of the KORUS FTA. The highest priority should be placed on passing KORUS, if only because the cost of failure to do so, in both economic and broader diplomatic terms, is so large. To make this trade policy agenda politically palatable, it will probably need to be coupled with a broader set of social safety net and education policies – desirable in their own right – to alleviate the American public's anxieties about global competition.

The Administration will also face a series of ongoing issues where the risks are longer-term in nature, and the common recommendation is "first, do no harm." This applies to regulation of financial markets in the USA, regulation of foreign investment in the USA, particularly by SWFs, and the multifaceted economic engagement with China, in its macroeconomic, financial, and trade and investment dimensions, which will be the most politically sensitive bilateral relationship for the foreseeable future.

Finally, in the area of least immediate domestic political sensitivity, the Administration will have to formulate a coherent strategy for responding to the emerging regional and subregional policy initiatives within Asia in both the financial and trade spheres. The evolution of these initiatives in turn will be affected by developments at the global level. With respect to finance, first priority should be on ensuring that the expanding regional initiatives are compatible with the broader global financial architecture, and secondly, on pursuing the specifics of the US policy agenda through institutions such as the ADB and the G-20. Analogously, in the trade area the emphasis should be on shaping the development of preferential schemes in ways that are compatible with broader global rules, and responding – by pre-emption, emulation, or countermeasures – preferential schemes that would harm US interests.

In the absence of adequate reform at the global level, the alternative could be further fragmentation into competing regional blocs. Asia holds the key, combining both dissatisfaction with existing global arrangements with the resources to reconstitute, at least at the regional level, an alternative set of institutions and practices. How Asia responds, acting to strengthen reformed global institutions or undermine them in favor of regional alternatives, will partly depend on the policies of the dominant global power, the USA. The most constructive course for the USA would be to re-emphasize global liberalization through the WTO and thereby reduce the value of preferential deals. Alternatively, the USA could play tit-for-tat: either by trying to match or join the Asian initiatives, or by further expanding its own web of preferential agreements. Either option assumes that the USA has the political capacity to liberalize trade.

Notes

1 The poll was conducted in six Asian countries: Australia, China, India, Indonesia, Japan, and the Philippines. Dissatisfaction with the international system was the highest in the Philippines (88%), with majorities supporting major changes in the international system in Australia (76%), China (75%), and Indonesia (62%). Majorities in the Philippines (92%), Indonesia (73%), and China (59%) also supported significant change in their domestic economic systems. Japan was the only country in the 24-country global sample in which majorities did not support major or minor changes in the international system and a majority only supported minor change at the domestic level.

2 Governance problems are evident with respect to the selection of senior leadership as well. By tradition, the president of the World Bank is an American, the managing director of the IMF a European, and the head of the ADB, Japanese, reflecting the political legacies of 1944 and, in the case of the ADB, the power of the purse. And despite some problematic choices, none of the incumbents appear willing to acquiesce to a reform of this anachronistic system, though the April 2009 G-20 Leaders statement contains encouraging language.

3 See also http://www.pollingreport.com/trade.htm

4 Democrats are considerably more trade-skeptical than Republicans, with solid majorities holding negative views. Republicans are essentially evenly split, 43% versus 42% in support of FTAs. Statistical modeling suggests that Democratic House members systematically are less inclined to vote for FTAs than their Republican counterparts. However, the sample period 2003–2006 was one in which the President was a Republican, and there is some evidence that the pattern of partisanship shifted on close votes, suggesting that Republican leaders may have been calibrating marginal votes carefully (all FTAs were passed). Whether this pattern of calibrating marginal votes will continue under a Democrat President and Congress remains to be seen. A recent attempt to remove the "Buy American" provision of the stimulus bill was defeated in the Senate 65-31 without a single Democrat voting in favor.

References

BBC Poll (2009). *Economic System Needs "Major Changes": Global Poll*. Accessed 4 April 2009. Available from URL: http://www.worldpublicopinion.org/pipa/pdf/mar09/BBCEcon_Mar09_rpt.pdf

Bergsten C.F. (2008). The Democrats' dangerous trade games. *The Wall Street Journal* 20 May, p. A23.

Bernanke B.S. (2009). *The Economic Outlook*. Testimony before the Joint Economic Committee of the U.S. Congress, Washington, DC, 5 May. Accessed 16 May 2009. Available from URL: http://www.federalreserve.gov/newsevents/testimony/bernanke20090505a.htm

Blonigen B. (2008). New evidence on the formation of trade policy preferences. National Bureau of Economic Research Working Paper no.14627, National Bureau of Economic Research, Cambridge, MA.

Boone P. & Johnson S. (2009). To save the banks we must stand up to the bankers. *Financial Times*. Accessed 27 January 2009. Available from URL: http://www.ft.com/cms/s/0/7f76fb22-ebb7-11dd-8838-0000779fd2ac.html?nclick_check=1

Burton J. (2009). IMF sees no recovery in Asia until 2010. *Financial Times*, 6 May. Accessed 26 October 2009. Available from URL: http://www.ft.com/cms/s/0/1246bcf6-3a25-11de-8a2d-00144feabdc0.html

Crook C. (2008). Obama has to lead the way on trade. *Financial Times*, 22 December. Accessed 26 October 2009. Available from URL: http://blogs.ft.com/crookblog/2008/12/obama-has-to-lead-the-way-on-trade/

De Larosière J., Balcerowicz L., Issing O. *et al.* (2009). The High-Level Group on Financial Supervision in the EU. Accessed 4 April 2009. Available from URL: http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf

Destler I.M. (2005). *American Trade Politics*, 4th ed. Institute for International Economics, Washington, DC.

Drysdale P. (2009). *East Asia's Moment of Truth*. Accessed 2 February 2009. Available from URL: http://www.eastasiaforum.org/2009/02/01/east-asias-moment-of-truth/

Elek A. (2009). *Sliding Back Towards Protectionism*. Accessed 23 February 2009. Available from URL: http://www.eastasiaforum.org/author/andrewelek/

Gamberoni E. & Newfarmer R. (2009). Trade protection: Incipient but worrisome trends. In: Baldwin R., Evenett S. (eds), *The Collapse of Global Trade, Murky Protectionism, and the Crisis: Recommendations for the G20*. VoxEU.org, Washington, DC. 49–54. Accessed 4 April 2009. Available from URL: http://voxeu.org/index.php?q=node/3183

Gill B., Green M., Tsuji K. & Watts W. (2009). *Strategic Views on Asian Regionalism: Survey Results and Analysis*. Center for Strategic and International Studies, Washington, DC.

Goldstein M. (2009). A grand bargain for the London G-20 Summit: Insurance and obeying the rules. *VoxEU.org*, 19 February. Accessed 20 February 2009. Available from URL: http://www.iie.com/publications/opeds/oped.cfm?ResearchID=1125

Im H. & Sung H. (2008). Empirical analyses of U.S. Congressional voting on recent FTA bills. Korea Institute for International Economic Policy Working Paper 08-08, Korea Institute for International Economic Policy, Korea.

International Monetary Fund (2009a). *World Economic Outlook – Crisis and Recovery, April 2009*. International Monetary Fund, Washington, DC. Available from URL: http://www.imf.org/external/pubs/ft/weo/2009/01/

International Monetary Fund (2009b). *Global Financial Stability Report Market Update, January 2009*. International Monetary Fund, Washington, DC. Available from URL: http://www.imf.org/External/Pubs/FT/fmu/eng/2009/01/index.htm

Jiang T. & McKibbin W. (2008). What does a free trade area of the Asia-Pacific mean to China. Centre for Applied Macroeconomic Analysis Working Paper 10/2008, The Australian National University.

Kawai M. & Wignaraja G. (2009). The Asian "noodle bowl": Is it serious business? ADBI Working Paper Series no. 136, Asian Development Bank Institute, Japan.

Kletzer L. (2001). *Job Loss from Imports: Measuring the Cost*. Institute for International Economics, Washington, DC.

Kupchan C.A. & Trubowitz P.L. (2007). Dead center: The demise of liberal internationalism in the United States. *International Security*, **32** (2), 7–44.

Lamy P. (2009). Report to the TPRB from the Director-General on the financial and economic crisis and trade-related developments. Accessed 4 April 2009. Available from URL: http://www.cera.org.ar/new-site/descargarArchivo.php?idioma_code=es&contenido_id=788&PHPSESSID=c3f602c81be116c37bafdcc05df52d46

Layman G.C., Carsey T.M. & Horowitz J.M. (2006). Party polarization in American politics: Characteristics, causes, and consequences. *Annual Review of Political Science*, **9**, 83–110.

Leaders of the Group of Twenty (2009). The global plan for recovery and reform 2 April 2009. Accessed 4 April 2009. Available from URL: http://www.londonsummit.gov.uk/resources/en/PDF/final-communique

Lee H., Owen R.F. & van der Mensbrugghe D. (2009). Regional integration in Asia and its effects on the EU and North America. *Journal of Asian Economics*, **20** (3), 240–245.

Mattoo A. & Subramanian A. (2009). From Doha to the next Bretton Woods. *Foreign Affairs*, **88** (1), 15–26.

Mussa M. (2009). Global economic prospects: L- or V-shaped recovery. Accessed 16 May 2009. Available from URL: http://www.petersoninstitute.org/publications/papers/transcript-20090407.pdf

Petri P.A. (2008). Mulittrack integration in East Asian trade: Noodle bowl or matrix? Asia Pacific Issues no. 86, East-West Center, Honolulu.

Pew Global Attitudes Project (2003). *Views of a Changing World*. Pew Research Center, Washington, DC.

Pew Global Attitudes Project (2007). *World Publics Welcome Global Trade – But Not Immigration*. Pew Research Center, Washington, DC.

Pew Global Attitudes Project (2008). *Global Public Opinion in the Bush Years (2001–2008)*. Pew Research Center, Washington, DC.

Pew Research Center for the People and the Press (2008). *Trade and Economy: Obama's Image Slips, His Lead over Clinton Disappears*. Pew Research Center for the People and the Press.

Pew Research Center for the People and the Press (2009). *Support for the Stimulus Plan Slips, But Obama Rides High. Accessed 20 February 2009*. Available from URL: http://people-press.org/report/490/obama-stimulus

Reinhart C.M. & Rogoff K.S. (2008). The aftermath of financial crises. Accessed 20 February 2009. Available from URL: http://www.economics.harvard.edu/faculty/rogoff/files/Aftermath.pdf

Scollay R. & Gilbert J.P. (2001). New regional trading arrangements in the Asia-Pacific? Policy Analyses in International Economics no. 63, Institute for International Economics, Washington, DC.

Soesastro H. (2009). East Asia, the G20 and global economic governance. Accessed 9 March 2009. Available from URL: http://www.eastasiaforum.org/2009/03/08/east-asia-the-g20-and-global-economic-governance/

Taylor J. (2009). *Getting Off Track*. Hoover Institution Press, Stanford, CA.

Truman E.M. (2009). IMF reform: An unfinished agenda. *VoxEU.org*, 28 January. Accessed 20 February 2009. Available from URL: http://www.iie.com/publications/opeds/oped.cfm?ResearchID=1106

World Bank (2009). *Global Economic Prospects: Commodities at the Crossroads*. The World Bank, Washington, DC.

