FOREIGN AFFAIRS
Published by the Council on Foreign Relations

February 2, 2015
SNAPSHOT

The New Asian Order

And How the United States Fits In

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In November 2012, I found myself at the Trident Hotel in Mumbai—one of a tiny handful of Americans attending a forum, sponsored by prominent Indian and Chinese business organizations, on Asian financial integration.

There is something a bit unsettling about being nearly the only American at a discussion of financial order held not on the Potomac, East, Hudson, or Thames, but near the banks of the Mithi River. And surely there is something deeply symbolic about a forlorn group of Americans listening to power brokers from China, India, Japan, and elsewhere discuss how to remake the financial order on a pan-Asian basis. After all, the United States has dominated global finance in the postwar era, which is a byproduct of the unique role of the U.S. dollar, the United States' weight in global institutions, and the best-in-class status of so many U.S. financial services firms, among other factors.

Yet Americans should not be so surprised. Heavy symbolism aside, such meetings are the outgrowth of trends that date at least to the Asian financial crisis of the late 1990s. Indeed, they are not new, nor were they invented by Beijing—although China, it is true, has sought to leverage them to its advantage. They will remain a lasting feature of political and economic reality in Asia. And they are almost certain to pose a growing competitive challenge to U.S. leadership in the Pacific.

Washington should not shy away from this competition. The United States can and should adapt and compete. But doing so will require, first, a clear understanding of the depths and origins of change in Asia. Put simply, the United States cannot succeed, in either geopolitics or business, unless it properly understands the sources of its competition in the first place.

NEW ASIA, O□□ I□EAS

It has become fashionable to ascribe efforts to build a pan-Asian economic and institutional order to rising Chinese assertiveness or, more precisely, to Chinese ambition. And that is a simple and straightforward enough narrative.

But it is just one part of the story. In fact, contemporary Asian regionalism—the desire to forge at least some cohesion out of the region's enormous diversity—has found e□pression not just in China but across Asia and over many decades.

Take postwar Japan. Tokyo has been a close U.S. ally and has a strong trans-Pacific identity. Some in Japan and the United States argue that the two countries should lead a regionwide counter-response to China's supposedly □new□ pan-Asianism. But although both countries are deeply ambivalent about Beijing's intentions, it is worth recalling that Japan and its bureaucracy have long incubated a variety of pan-Asian ideas and ideologies, especially with respect to monetary integration. It was Japanese officials who, in 199□, proposed the establishment of an Asian Monetary Fund, a proposal that helped give rise to today's Chiang Mai Initiative, which involves bilateral currency swaps among Southeast and Northeast Asian countries.

And Japan is not alone.

As I have argued with Robert Manning □1□, the 199□□9□ financial crisis left a searing legacy on many Asian countries. From Indonesia to Thailand, the United States was widely perceived to be disconnected and aloof, dictating clich□d solutions to skeptical Asians. Those perceptions were reinforced when, after bailing out Me□ico in 199□, Washington refused to do the same for Thailand just three years later.

In response, Asians began to grope for their own solutions, more often than not on an intraregional basis. Their responses included various ideas and proposals, and many of them e□cluded the United States□Asia-only currency swaps such as Chiang Mai, Asia-only trade and investment pacts, regional bond funds, and so on.

These ideas built on e□isting concepts and frameworks. Often, they relied on the region's principal multilateral entity, the Association of Southeast Asian Nations □ASEAN□ One e□ample is the Regional Comprehensive Economic Partnership □RCEP□, which is the principal competitor to Washington's preferred trade pact, the Trans-Pacific Partnership □TPP□ RCEP includes the members of ASEAN plus si□ more regional powers—Australia, China, India, Japan, South □orea, and New □ealand—but not the United States.

So too with other pacts and institutions□among others, the East Asia Summit, which Washington belatedly joined, and the ASEAN Economic Community. Even the on-again, off-again trilateral process among China, Japan, and South □orea got a boost on the margins of a 200□ pan-Asian summit in Bali □2□, five years after the crisis.

NEW ASIA . . . NEW □AME

In the 1990s, to be sure, Washington could simply crush this incipient regionalism, working in tandem with □-□ partners. But the 1990s were a different time. The new pan-Asianism poses a tougher challenge, in part because the conte□t has changed.

For one thing, although the United States looms very large in the global economy, it is, in relative terms, not as large as it was in 200□, much less in 199□ The 200□ financial crisis bookended a tumultuous decade□it came almost precisely ten years after the Asian crisis and added fuel to Asian debates about overreliance on Western economies by dampening growth in the West, long the region's traditional export market.

As Asia emerged from the 200□ crisis, debates intensified about the utility of an intraregional hedge, or cushion, against continued or future volatility in the West. Meanwhile, many of the same countries have emphasized moving away from exports toward domestic, intraregional, and emerging market demand. This is true of China, whose fixed asset investment and export-led growth model is running out of steam, but is evident elsewhere, too—for example, in South Korea, which has been hit by a combination of yen depreciation and volatility in its traditional export markets.

Second, Asia's relationship to the world economy has changed dramatically. For decades, □-□ countries beat a path to Asia's door. But the other foot now wears the shoe□ many Western economies increasingly rely on Asian consumers. So Asian countries today are much more than traders. They are builders, lenders, investors, and, in some areas, a growth engine.

For illustration, consider the United States□ American demand for Asian goods has powered export-led sectors since at least the 19□0s, from Japanese and Korean microelectronics to Thai rubber and Vietnamese textiles. But Asians have become major consumers of all things American, including corn and soybeans (for their animal feed), pork (for their tables), and natural gas (for their power plants).

Third, Asia is now a source of capital, not just a capital recipient. Financial markets form wherever capital is concentrated, and increasingly, Asians are buying stakes in Asian companies, but also in companies in the United States and Europe. These purchases have scrambled the calculus in many countries, as Chinese, Japanese, and Korean money flows across Asia, Straits bankers finance deals in India, and Indian corporate money looks for opportunities overseas.

Just take Kazakhstan, a charter member of the new Beijing-backed Asian Infrastructure Investment Bank (AIIB). It is a country whose economic elite has long looked to London and points westward to raise capital. But as the country's former central bank governor, Grigori Marchenko, has bluntly put it, Kazakhstani financial and industrial interests are diversifying by looking east, because that is where the money is □□.

Fourth, Asia's emerging powers—India and China—are less content to live in perpetuity with an architecture largely built by the West. In 2000, China's nominal GDP was just $1.2 trillion□ by 201□, it was $10 trillion. India's GDP in 2000 was □□□ billion□ in 201□, it had surpassed $2 trillion. Countries with economies that have grown ten times larger are, not surprisingly, unwilling to merely settle for institutional arrangements that prevailed a decade ago.

Much has been made of Beijing's efforts to establish new institutions, but New Delhi, too, has joined the AIIB as a charter member, while lending rhetorical and some substantive support to the BRICS summit, bank, and contingency reserve. This has taken place even as Indian ambivalence about China has grown and even as India continues to pursue revised quotas and shares in the Bretton Woods institutions that Washington prefers. China has likewise pursued a dual-track approach that simultaneously supports both new and established institutions—for instance, giving □□1 billion to the BRICS contingency fund in 201□ and □□□ billion to International Monetary Fund replenishment in 2012.

Finally, there is China, whose foreign and economic policies are converging in unprecedented ways. With □□ trillion in foreign exchange reserves—larger than the nominal GDPs of India, South Korea, and Thailand combined and equivalent in size to the world's fourth-largest economy—Beijing's abundance of capital has become an extension of its foreign policy. Beijing has pledged (and spent) staggering sums of money, leveraging state-backed financial vehicles for diplomatic and economic ends. In addition, China remains the world's largest manufacturer by gross value added and its largest trader, and it now possesses seven of the world's ten largest cargo ports.

But Beijing has more going for it than just its capital. Surrounded by rivals, China is often said to be a "victim" of its strategic geography, yet it benefits from very favorable economic geography: China abuts regions either that are capital starved (Central and South Asia) or where capital is abundant but requirements exceed the capacity of the Bretton Woods institutions and private lenders (Southeast Asia's need for some $1 trillion in infrastructure by 2020).

In time, Beijing could try to do in Asia what the United States has done globally—namely, to be the lender of last resort. The growing use of the renminbi for trade settlement may prove to be an interesting twofer: a tool that complements the building of financial architecture that serves Beijing's interests.

WHITHER WASHINGTON?

The United States has a long history, deep ties, and vital strategic and economic interests in the Pacific. But now it must face the pan-Asianism of the post-2008 world.

Washington's first problem is that it cannot simply reject every pan-Asian idea out of hand, however much it may resent its own exclusion from some rooms, conversations, and agreements. Indeed, the proliferation of Asia-only pacts and institutions over the last two decades has won support in more than a few Asian capitals, even in countries that are ambivalent about China's rise and among U.S. allies and partners.

A strategy of *nyet,* therefore, is almost certain to backfire. And Washington runs the risk of appearing hypocritical by insisting, for example, that it can have the North American Free Trade Agreement or seek a Free Trade Area of the Americas while telling Asian countries that they cannot pursue their own intraregional agreements. That is why some pan-Asian formations are inevitable (). They will move forward regardless of Washington's views and preferences, so the United States should approach some of what is happening—pan-Asian dialogue mechanisms, for example—much as it supports European institutions.

Beyond that, American policymakers must answer three questions:

The first is, which pan-Asian groups or pacts the United States can live with and which will undermine vital U.S. interests. The groups that merit vigilance are those that pursue functional agendas detrimental to U.S. security, prosperity, market opportunities, or values. And here, Washington must distinguish between what it must have and what it would merely like to have. For example, bloc-like trade agreements or the use of technology standards as a non-tariff barrier to trade could close off opportunities and frustrate U.S. efforts to build a more open economic architecture. By contrast, a pan-Asian infrastructure bank that finances bridges, roads, and rail links is not inherently exclusionary since U.S. firms also benefit from better infrastructure and Washington does not offer large-scale project finance. Those institutions and pacts that undermine vital interests will require a forceful tool kit, including opposition to partners' participation and the credible threat of reciprocal treatment. For those that do not, the price of opposition will likely exceed the cost of living with them, possibly working with them, and certainly seeking to shape them.

In either case, Washington needs strategic and tactical coherence. Currently, it has neither. For example, in its first term, the Obama administration argued that U.S. exclusion from the East Asia Summit, a group that is mostly a talk shop, threatened U.S. interests. So it encouraged Australia to join, urged allies to be more assertive, and ultimately joined the group itself. But with the AIIB—no mere talk shop but a vehicle that will finance billions in infrastructure—Washington has discouraged its allies from joining and held itself aloof. Washington has no apparent strategy for deciding where it must be present.

The second question is, which pan-Asian ideas merely supplement U.S.-preferred approaches and which aim to supplant them? This is, admittedly, a fine line, since big things can spring from small beginnings. But as a practical matter, the existing regional and global architecture will not remain frozen forever. In fact, Washington is itself an advocate of new and ad hoc groups, including "minilaterals" in Asia, such as trilaterals and quadrilaterals with its allies, and valuable new mechanisms such as the Proliferation Security Initiative. If the existing architecture were the acme of perfection, there would be no cause for innovation, including such examples of American-endorsed innovation. An Asian contingency reserve fund, and the AIIB, for that matter, most likely will merely supplement existing structures.

The third point is that Washington cannot beat something with nothing, so it has to take steps to up its own game. Here, TPP is perhaps the most glaring example. If an RCEP-like arrangement does indeed threaten U.S. interests, then that is all the more reason to put the full weight of the U.S. government behind TPP, and soon. U.S. President Barack Obama has at last called for Trade Promotion Authority, which he will need to seriously pursue TPP; the administration needs to work with Congress to bring TPP home.

Then there is AIIB: it is unsurprising that Washington has no wish to capitalize a Beijing-backed bank with still hazy governance, but there is no reason it should not ask for an observer arrangement. After all, Washington sponsored China for precisely such an arrangement in the Inter-American Development Bank. And if, as Washington claims, it is really the AIIB's lack of anticorruption and environmental standards that is of concern, then it makes more sense to try to work with the organization to shape new regulations than to remain aloof. Washington could surely encourage international financial institutions to help shape standards in these new pan-Asian institutions, much as the United States endorsed World Bank efforts to pursue such partnerships with new funds in the Middle East.

Above all, Washington needs to intensify its own economic diplomacy in Asia. The U.S. goal should be not simply to tack an economic component onto its rebalance, or pivot, to Asia, but to encourage a liberal, open, market-based economic order in the region. By that standard, TPP is a very necessary but by no means sufficient condition to meet U.S. goals. A broadened agenda would include bilateral investment treaties with China and India; creative public-private partnerships aimed at injecting the United States into infrastructure developments in Southeast Asia; and sectoral agreements, for example in services and technology-related sectors. Washington could do more in this vein with its allies Japan and South Korea. And Congress needs to put more weight behind reforms of international financial institutions, and soon; otherwise, even partners such as India may throw up their hands and seek alternatives, much as New Delhi has already done through its involvement with the BRICS institutions and the AIIB.

Of course, the United States will not cease to be a Pacific power. It is an essential strategic balancer, and its security-related role has been reinforced in recent years, as China's choices and actions unsettle neighbors from Japan to India to the Philippines. But as Asians increasingly rely on one another for trade, investment, and other economic public

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