The New Rules: What the Global Economy Needs from Asia

Thomas P.M. Barnett | 17 Aug 2009

We hear a lot of talk nowadays about the structural imbalance in global trade: namely, the West needs to spend less and export more (Germany excluded) and the East needs to export less and spend more (China especially). What we don't talk about much are the structural deficits that currently stand in the way of rising Asia's collective ascension to the role of established third pillar of global order. Instead, we place too much hope on China's unique abilities to scale that mountain on its own, while simultaneously fearing that Beijing's resulting ambitions will ultimately prove globally destabilizing.

Ever since Richard Nixon detached the dollar's value from gold and plunged the West into an era of floating exchange rates, major industrial powers have been forced, every decade or so, to collude on engineering tectonic shifts in the value of key currencies -- most notably the dollar. The famous 1985 "Plaza accord," so named for the New York City hotel where negotiations took place, initiated a depreciation of the overvalued dollar, and 10 years later a "reverse Plaza accord" did the exact opposite.

But with the euro's emergence in 1999, several prominent European currencies were combined to generate a serious competitor to the dollar's role as primary global reserve currency. Debuting at roughly 18 percent of total global reserves, the euro has expanded its share to 27 percent while the dollar has dropped from 71 percent to 64 percent. The success of this balancing role can be seen in the fact that the dollar value, in relation to the euro, fluctuated rather dramatically over the past 10 years (ranging from $0.80 to $1.60) without causing undue perturbations in the global financial system.

But the euro's emergence wasn't enough to discipline the U.S. market, or more specifically Washington policymakers, who have long abused the dollar's global reserve status to get away with massive deficit spending. And with China's subsequent mercantilist strategy of piling up huge dollar reserves rather than allowing its own currency (yuan) to appreciate (thus insulating it from Asian Flu-like shocks), it took supreme advantage of America's unstated grand strategy of encouraging Asia's peaceful rise through export-driven growth.

By becoming the assembler-of-last-resort in global production chains, China consolidated Asia's trade surplus with America, thus winning all that final-sale cash. However, because China upheld Asia's implicit bargain with Washington by shoveling a good share of that surplus back into U.S. debt markets, America's continuing role as global military Leviathan -- and dominant military presence in Asia -- was effectively subsidized by its alleged "near-peer competitor."

While it's hard to argue with the success of America's strategy, as Asia now enjoys -- for the first time in modern history -- the simultaneous rise/strength of China, India, Korea and Japan, it's likewise obvious that these structural imbalances are no longer sustainable. America is far too leveraged financially and militarily, while "rising" China is beginning to regret outsourcing the management of its burgeoning currency and security risk-portfolios to a decidedly erratic and undisciplined Washington.

And yet, here's where it gets desperately tricky for Beijing to step up on its own and assume the mantle of the East's primary balancer against America's many excesses. With its hundreds of millions of impoverished rural citizens, China could easily use another decade (or two) of free-riding within an American-led global system. Unlike a similarly positioned "rising" America at the beginning of the 19th century, Beijing has neither the spare resources nor the strategic confidence to play a global policing role commensurate with its rapidly expanding worldwide economic networks. And to the extent it tries, it will logically trigger highly undesirable balancing responses from both the United States and its regional rivals.

On the economic side of the ledger, China's movement toward a convertible currency is inevitable, but that entails the frightening scenario of losing its export dominance through currency appreciation, thus forcing Beijing's leaders to rely -- prematurely in their minds -- on boosting domestic consumption to retain the income growth trajectory that determines the regime's legitimacy among the people. For now, China's leadership of the global recovery is accomplished overwhelmingly through public investment, but to boost consumption, Beijing will have to address public concerns over a lack of adequate health care and pension systems, two fears that drive China's stunningly high personal savings rate.

Toss in China's increasingly brittle environmental situation and rapidly aging demographic profile, and we're not talking about a government given to innovative global leadership.

A good example? Beijing's somewhat fantastic proposal to expand the International Monetary Fund's Special Drawing Rights (i.e., lines of credit among IMF members) into a full-fledged global reserve currency that replaces the dollar, thus attempting to shift China's currency risk back to the West, which presumably would rescue the IMF in the event of an SDR crash. As a recent Cato Institute paper argues, this approach would simply turn the IMF into another issuer of dangerously "collateralized debt obligations" -- further globalizing a bad Western practice instead of stemming it.

Ideally, a third global reserve currency would arise in the East, one that was based on a "basket" (weighted average) that included -- at the very least -- Japan's yen, Korea's won, and China's convertible yuan. If such an "asia" could command a quarter share of global reserves, it would, along with the euro, be capable of disciplining a still leading dollar.

But look at how the euro came about: built on top of a European Union, which itself was built atop a Europe-wide security alliance -- NATO. (Heck, even pioneering "multinational" America had to go through its Civil War to justify creating its own union-wide paper currency -- the "greenback" dollar in 1862.) Asia is nowhere close to either multinational construct, and yet the world clearly needs -- now -- the seemingly distant currency product such integration efforts would logically yield.

In the absence of such efforts, the West is thus left with pinning its hopes on China, which, true to form, desperately seeks to pass the buck -- as it were -- to the IMF.

America's grand strategy of encouraging Asia's peaceful rise while maintaining U.S. regional military dominance is partly to blame for this situation. By emphasizing America's strong bilateral security ties with the region's major powers, save China, it has prevented any chance for regional security integration that would naturally support similar economic integration. In the end, America successfully financed and "securitized" Asia's collective rise while simultaneously preventing its regional integration. As a result, what the world now needs from Asia, it cannot easily provide -- either collectively or on the shoulders of "rising" China alone.

This global economic crisis simply arrived too early, as crises are wont to do.

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Photo: From left, Chinese foreign minister Yang Jiechi, Japanese foreign minister Masahiko Komura, and South Korean foreign and trade minister Yu Myung-Hwan after the tripartite China-Japan-South Korea Foreign Ministers Meeting in Tokyo, June 14, 2008 (Chinese government photo).