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Fortress Asia: Is a Powerful New Trade Bloc Forming?

By Michael Schuman

The Great Recession hasn't been great for free trade. As unemployment rose and consumer demand dried up throughout much of the world, governments have been more focused on protecting their own industries and workers than making the compromises necessary to promote international commerce. The U.S., typically an enthusiastic trade promoter, included "Buy American" clauses in its stimulus package and propped up its flailing auto industry with handouts that in better times would have been criticized as unfair subsidies.

Although a meeting of ministers in New Delhi in early September promised to restart long-stalled World Trade Organization negotiations aimed at reaching a new, global consensus on freer trade, wide differences remain between the developed and developing world that make a final deal difficult.

Yet against this dim backdrop, the part of the world that was hit hardest by the trade crash — Asia — has been actively opening up its regional markets. According to the Asian Development Bank, the number of free-trade agreements (FTAs) signed by Asian countries has grown from just three in 2000 to 56 by the end of August. Nineteen of those FTAs have been made among 16 major Asian economies, a trend that could help Asia become a powerful trading bloc on par with the one created by the North American Free Trade Agreement. "Asian integration is sort of a dream, but it is much more realistic than it was before," says Ganeshan Wignaraja, an Asia Development Bank economist. "There is a move toward making a better business environment in Asia. The momentum is quite strong." ([See pictures of the global financial crisis.](#))

That can be seen clearly in the continuing stream of agreements tying together regional powers. In August, India inked two FTAs in a week, with South Korea and the 10-member Association of Southeast Asian Nations (ASEAN). Meanwhile, ASEAN and China are expected to bring most of the final tariff reductions of an FTA signed in 2004 into full effect in 2010. More deals are likely to come. Taiwan President Ma Ying-jeou has made his No.1 policy priority reaching a "comprehensive economic framework" with China that would reduce tariffs on Taiwan goods entering the Chinese market. Yukio Hatoyama, likely the next prime minister of Japan, has stressed the need for greater integration in Asia, even proposing the establishment of a euro-style common currency.

Although this trend has been in place for several years, the drive to lower trade barriers has taken on fresh urgency amid the recession. Fears of an extended slump in spending by U.S. consumers — primary buyers of Asia's manufactured goods — have prompted policymakers to look to China, India and other countries in the region as customers for exports. "This whole notion of being able to export yourself [into] a recovery and aiming at the U.S. market I think is not possible anymore," Malaysia Prime Minister Najib Razak told CNN in August. "So we do need to configure a new economic model." As manufacturing networks in the region become more intertwined — and as Asian consumers become wealthier and freer spending — trade within Asia is now seen as critical to future economic expansion. Asia's nascent recovery has shown the potentially huge benefits. Intra-regional trade last year made up 57% of total Asia trade, up from just 37% in 1980. "In the past Asia produced for America and Europe," Philippines President Gloria Arroyo said in a recent CNBC interview. "Now, Asia is producing for Asia."

Of course, Asia is still dependent on sales to the West. But regional free-trade agreements could reduce the region's exposure to the U.S. by giving Asian companies preferential treatment in selling to Asian companies and consumers. These benefits could come with downsides for the world as a whole, however. Companies in countries left out of the trade pacts — for example, the U.S. — could face competitive disadvantages when trying to tap fast-growing Asian markets. This, in turn, could have a negative impact on efforts to rebalance excessive debt and deficits in the U.S. and excessive savings in Asia. Bilateral FTAs "create a non-level playing field with advantages for Asian countries," says Eswar Prasad, professor of trade policy at Cornell University in Ithaca, New York. "If the most dynamically growing part of the global economy gives the U.S. restricted access, that has an impact on the whole rebalancing movement."

Some analysts also worry that intra-Asian trade pacts could hinder WTO trade negotiations. Asia's FTAs are a clear expression of how frustrated Asian governments have become with the WTO process — with fewer parties at the table, bilateral agreements have proven easier to attain than a sweeping, global consensus. But "the world will not be better off if we separate into different trading blocs," says Edward Leung, chief economist at the Hong Kong Trade Development Council.

Richard Baldwin, professor of international economics at the Graduate Institute in Geneva, believes that Asia will remain heavily reliant on demand from the West for years to come. Tariffs in Asia have already come down so significantly, he says, that the additional benefits of FTAs don't give Asian firms that much of an edge over foreign rivals. "So far the margins of preference are low and so the degree of discrimination is low," he says. Some analysts also see clear limits to how closely Asian nations are willing to tie themselves together. Continued political and economic rivalries, especially between the big economies of north Asia (China, South Korea and Japan), place high hurdles in the path of a true Asia trade bloc. "The notion that there is going to be a 'Fortress Asia' is really not correct," says Vinod Aggarwal, director of the APEC Study Center at the University of California-Berkeley.

Still, the attraction of the benefits from greater regional integration could prove powerful enough to eventually

overcome the roadblocks. ADB's Wignaraja foresees Asia becoming a NAFTA-style free-trading zone within the next 10 years. "In Asia, the only thing everyone agrees upon is business," he says. "In the end, pragmatism will prevail." If so, the world economy will never be the same.

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