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# Korea's Domestic Policies and Their Influence on Asia

# The Dollar's Influence in East Asia: Benevolent or Overbearing?

## A Comparative Answer in the U.S. Economic Aid and the Dollar Standard

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There is no doubt that the United States has been a dominant economic power in the world. U.S. troops are deployed in the various corners of the world, and their military presence is often a strong force in propping up the status quo or a peaceful co-existence, possibly and hopefully more peaceful than otherwise. The U.S. has held an important role in the international system as a military power. But also in an economic sense, the U.S. has been a dominant leader. As a major consumer market and an investor, U.S. influence on the global economy is significant to say the least. This is especially true in East Asia. Through military alliance and economic aid, the U.S. crafted close relationships with East Asian countries and influenced their domestic policymaking. For example, as a provider of military and economic stability, the U.S. wielded much influence on domestic macroeconomic policies of Korea and Taiwan during the early industrialization years of 1950s-60s. The economic aid came with conditions, and Korea and Taiwan complied. Although explicit economic aid stopped in the late 1960s, other forms of assistance, for example loans, grants and technology transfers continued, and more importantly security alliances remained strong. The U.S. still holds much influence over Korea and Taiwan, as a military ally and a major trade partner. In the present day, Korea and Taiwan closely peg their currencies to the U.S. dollar and hold large currency reserves in dollars. As a result, macroeconomic stability of Korea and Taiwan depends largely on the stability of the dollar. In this way, the dollar's influence on Korea and Taiwan is quite significant. Similar to but also different from the way that Korea and Taiwan depended on U.S. economic aid, they again depend on the dollar to anchor economic stability.

This paper examines the two types of dollar influence, economic aid and currency pegging, and assesses how the influence has been benevolent or overbearing on the receiving countries. The dollar's influence has been benevolent in the sense that it afforded stability, convenience and a closer relationship with the U.S. On the other hand, the dollar's influence has also been overbearing in that it reduced the political autonomy over domestic macroeconomic management and exposed Korea and Taiwan to the risks of external economic shocks and fluctuations.

## Power and Economic Hierarchy in Theory

Power can be conceptually defined as the ability to influence the outcome of events. It can be empirically studied with proxy variables of gross domestic product, defense spending, etc. Benjamin Cohen suggests that a government is "powerful to the extent that it can effectively pressure or coerce outsiders … exercise leverage or enforce compliance in pursuit of state objectives." Alternatively, a state is also "powerful to the extent that it is able to exercise effective independence in the formulation and implementation of policy – to act freely, insulated from outside pressure, to promote key national goals."[1] A useful synonym for the latter definition of power would be autonomy or sovereignty. In an increasingly, economically interconnected world, it becomes harder to maintain economic autonomy. Countries that have large deficits may have to decrease spending or devalue their currencies, and sacrifice economic growth or job security. Countries that run surpluses may experience unwanted inflation or exchange rate appreciation and suffer the loss of international competitiveness. Politically, it is preferable to avoid making domestic sacrifices to maintain external economic balance. If possible, countries would rather avoid making adjustments themselves but hope that others would. "For most states, therefore, the foundation of monetary power is the capacity to avoid the burden of adjustment required by payments imbalance" and maintain their autonomy.[2] According to Keohane and Nye, power derives from "patterns of asymmetrical interdependence between actors in the issue-areas in which they are involved with one another."[3] An answer to the question, "who needs whom more?" would demonstrate who holds control, or has power, over whom. Power can be both "relational" and "structural," where relational power can coerce an action or compliance from the weak, and structural power can "shape and determine the structures of the global political economy,...decide how things will be done, [and] shape frameworks within which states relate to each other."[4]

Similar to power, hierarchy is a "relational conception of authority."[5] States hold various positions of authority in international relations, and depending on their positions, states can be either dominant or subordinate relative to others. A dominant state possesses some form or kind of authority over a subordinate state. The dominant state can "use its commanding power position to gain acquiescence and participation [from the subordinate state] in a mutually acceptable order." [6] The subordinate states would benefit from the provided social order, but in exchange would give up "a measure of autonomy" or sovereignty. And "in this conception, authority is not law, but a contract."[7] In the context of East Asia, the U.S. undertook the responsibility of providing military and economic security to Korea and Taiwan, and in exchange gained leverage over the two governments.

Economic hierarchy can be measured by (1) how closely a currency is pegged to the dollar, ranging from not at all (i.e. free floating) to absolutely (i.e. dollarization) and (2) how much a state trades with the dominant state compared to others.[8] Exchange rate regime is significant in measuring economic hierarchy, since it represents how the price of national currency is set in relation to other currencies. Currency is not only a medium of exchange but also a symbol of national unity and governmental authority. The ability to determine the exchange rate translates to the authority to determine the unit of the country's value. As manager of the currency, a government will be particularly sensitive to the fact that a fall in the value of the currency might be limited, but could also gather momentum and lead to collapse."[9] Because monetary stability is a significant political agenda for all states, they "can and have used international monetary relations as an instrument of coercive power."[10] Dominant states can exercise international monetary power by manipulating currency, exploiting monetary dependence or creating systematic disruptions. Countries become monetarily dependent when they adopt "the home currency" as their own, peg their currencies to it, or use it for international transactions.

Currency pegging can take place in the form of absolute, crawl or soft pegging. It means countries would set a range of currency rates against an "anchor" currency and allow their dominant currencies to fluctuate only within that range. As a result, "with regard to the target countries, the home country gains an important degree of control over their economic destiny."[11] Monetary dependence can occur in an even more direct way, when home economies provide foreign aid to target economies. Foreign aid can "become vital for a particular government's operating budget, or provide necessary foreign exchange to pay for imports," and states can "allow themselves to become heavily dependent on continued aid."[12] A case in point would be East Asia, particularly Korea and Taiwan. Korea and Taiwan relied on the U.S. economic aid to sustain their government and help complete their development plans. And over time, Korea and Taiwan also became susceptible to U.S. influence over their economic destiny when they closely pegged their currencies to the dollar and used it for their international transactions. Korea and Taiwan allow their currencies to float within a certain range with the dollar as the anchor currency. They do this by setting their currency values against a basket, in which the U.S. dollar has a heavy weight.

## U.S. Aid with Conditionality: Economically Benevolent but Politically Controlling

In the 1950s, during the height of Cold War politics, the United States provided ample economic aid to non-Communist countries in the West and Asia to compete against the Communist bloc, mainly the Soviet Union and its satellite countries. The U.S. was concerned for the wellbeing of the countries located at the "fault lines of post-Second World War global politics, abutting communist Asia," with the rationale being that if they were wealthy, they would not fall to the Communist bloc.[13] Geopolitically located in close proximity to the Soviet Union and China, Korea and Taiwan were positioned to benefit from the U.S. agenda. Massive amounts of economic aid helped revitalize war-devastated Korea and industrialize non-Communist Taiwan.

Korea was a key beneficiary of its geopolitical location. From 1953 to 1958, Korea received a staggering $270 million worth of economic aid per year, which amounted to $12 per capita and 15% of its gross national product. In addition, the U.S. dispatched separate military aid in weaponry, personnel and technology.[14] Under the Mutual Security Act, the U.S. dispensed a total of $4,364 million to Korea in aid, loans and grants from 1953 to 1961.[15] U.S. aid financed almost 70% of Korea's total imports from overseas.[16] The imports ranged widely from energy, raw materials and intermediate goods to consumer products. The input of U.S. dollars helped Korea recover from the devastation of the Korean War. Three years of fierce fighting on domestic soil exhausted the civilians and destroyed much of the fertile land. Korea needed to industrialize and develop, and this capital was provided by the U.S.

However, Syngman Rhee, the South Korean president at the time took advantage of the situation and strategically manipulated domestic monetary policies to maximize aid benefits. He artificially lowered interest rates, overvalued exchange rates and financed the budget deficits with loans from central banks.[17] Also, because the aid was granted to the government to distribute internally, the Rhee administration used it to grant favors to those who were politically close to Rhee. In fact, many small and medium sized textile and other industrial firms that were favored by Rhee and his political cronies receive subsidized loans and tax exemptions and frequently received government contracts.[18] These practices of crony capitalism shaped the character of Korea's government-business relations and continued through the later development years. To some extent, close government-business ties continued until the 1990s when the financial crisis erupted.

Nonetheless, the injection of U.S. dollars stimulated the Korea economy. However, the U.S. did not overlook the corrupt process of aid distribution and pressed for reforms. Certainly, the Rhee administration granted unfair favors for political campaign, and that warranted calls for reform. However, U.S. pressures for reforms targeted not just the distribution of aid, but also the general direction of domestic monetary policies. The U.S. requested to establish a Combined Economic Board to pressure for higher taxes, smaller government expenditures and devalued exchange rates.[19] Also, the U.S. pressured the Korean government to privatize formerly Japanese properties. The U.S. threatened to cut its aid commitments if these reforms did not take place.[20] The Korean government had to reform, even when it was politically unpopular to do so because the pressures were politically overbearing.

U.S. pressures continued into the Park Jung Hee regime. The U.S. pressed Park to carry out budgetary and monetary discipline and devalue the won. In 1962, the director of the U.S. Agency of International Development, in charge of overseas economic aid, unilaterally suspended aid disbursements to Korea to force the Park regime to tighten its spending.[21] Aid leverage was often exercised. In 1964, the U.S. held back food aid to push the Korean government to devalue the won. Due to the famine and food shortages, ongoing from the previous year, the Korean government was in dire need of food aid. The government succumbed and devalued the won by almost 50%.[22] The U.S. knew that the Korean government was "extremely vulnerable to changes in aid levels," so it would comply with U.S. demands.[23] Korea was subject to frequent interventions in economic policy making to the extent its economic sovereignty could be questioned. Even after the aid stopped in the mid 1960s, U.S. interventions in Korea's policy making continued with their military alliance.[24] Also, until the 1980s, the U.S., under the Foreign Assistance Act, provided Korea with $8,681 million worth of other forms of economic assistance, such as loans and grants. [25]

The U.S. directly and coercively exercised its aid leverage to force policy changes. The policy changes were aligned with long term, economic logic based on the traditional liberal market theory. The overarching objective was to help Korea grow as a sound, efficient, independent and liberal economy, since Korea would eventually have to reduce its dependence on foreign aid. The aid financed industrialization and its accompanying conditions provided an impetus to further development. There were also U.S. pressures to adopt export promotion strategies that would help the Korean economy become more independent.[26] Exports became an important source of foreign exchange revenue for Korea, so the strategy worked. The dollar's influence resulted in positive economic development. Perhaps the aid leverage was a necessary tool to teach the young and inexperienced economy how to industrialize and grow. However, while the dollar's influence benefited Korea economically, it was politically overbearing and controlling. The aid leverage overpowered the domestic political will. Whether the domestic government was effective or not on its own, it was nonetheless susceptible to external pressures for changes in domestic macroeconomic management. Its sovereignty was compromised. The power of aid leverage reduced the Korean government's autonomy.

Similar to Korea, Taiwan also received massive amounts of U.S. aid which was economically beneficial but politically controlling. Taiwan, just a strait away from Communist People's Republic of China, was another beneficiary of Cold War geopolitics. In order to contain Communism, the U.S. disbursed massive economic and military aids to strengthen the Nationalist regime in Taiwan from 1954. Under the Mutual Security Act, the U.S. dispensed a total of $3,039 million to Taiwan between 1953 and 1961.[27] Throughout the 1950s, economic aid amounted to about 6% of the gross national product and 40% of the gross investment. A large share of the economic aid, about 38%, financed imports of intermediate goods, including cotton, yarn, ores, metals, and fertilizer.[28] In addition to raw material imports, technical assistance from American engineering firms greatly benefited the Taiwanese textile industry.[29] U.S. aid was also used to import consumer goods and food products as well as machinery and tools necessary for industrialization. In total, the U.S. financed about 35 to 40% of Taiwan's imports.[30]

These injections of U.S. dollars helped stabilize the Taiwanese economy and assure its survival against the constant threat of Mainland China. U.S. aid also helped the Taiwanese government execute land reforms and liberal economic reforms, control inflation and, at the same time, maintain a large military. Throughout this process, the Taiwanese government used this economic aid to solidify its domestic political legitimacy, especially to claim political power over native islanders. U.S. aid helped the Chinese Nationalist government exercise leverage over the economy.[31] Hence the economic aid from the U.S. was strategically important to Taiwan domestically, and the government formed the Council on U.S. Aid to better manage the aid and communicate with U.S. officials.[32] K.Y. Yin, the head of the Taiwanese industrial development commission, articulated that Taiwan will pursue industrialization, so that it can develop an "independent and self-sustaining economy…and reduce its dependence on American aid."[33] The Taiwanese government utilized the aid to pursue technology transfers in military, textile, electronic and avionic industries.

Both Taiwanese government and the United States Agency of International Development (USAID) supported and funded technology transfers. A case in point was the first-ever technology transfer agreement with a Japanese firm. In 1953, Tatung, a Taiwanese firm, reached an agreement with a Japanese firm to produce electric watt-hour meters with locally made components. It was a type of outsourcing agreement, but the Japanese firm agreed to train Taiwanese engineers to learn the manufacturing technology.[34] Also, Taiwan utilized USAID resources to pursue similar production agreements with U.S. companies.[35] Building on these business partnerships, Taiwan was able to recruit foreign direct investments from both the US and Japan.

As much as the economic aid was helpful to Taiwan, and as willingly as the Taiwanese government received it to carry out their agenda, the aid also came with conditions. Explicitly and implicitly, American economic and military advisors influenced the domestic economic policies in Taiwan. For example, the USAID proposed a program that stipulated liberalization of exchange rate controls, privatization of government enterprises and contraction of government spending. In responding to the proposal, Taiwanese leadership carried out liberal economic reforms, justifying their positions as they were under U.S. pressures.[36] Another motivation for the U.S. to push for the USAID program was to reduce Taiwanese military spending, which consumed a significant portion of the government expenditure. In the 1950s and early 1960s, the Taiwanese government allotted as much as 75% of its total central government expenditure for "defense and diplomacy," but mostly defense. Military expenditures averaged about 10% of GNP from the 1950s to the late 1970s.[37] These large defense expenditures were fueled by tensions with Mainland China. However, it was in the U.S.'s interest to deter Nationalist aggressions against Mainland China, because in the case of military confrontations, U.S. troops would be drawn in to fight.[38] In return for Taiwan's compliance with the USAID program to reduce military spending, the U.S. offered to extend a loan in the amount of $30 million. Ultimately, one third of this loan was cancelled due to the non-compliance to the suggested limits on military spending.[39]

In addition to economic and military policies, U.S. aid leverage extended its influence to social policies as well. American advisors pressed the Taiwanese government to reduce discrimination against native Taiwanese islanders when distributing government resources.[40] U.S. influence on domestic policymaking declined as the official economic aid stopped in 1965. However, as military aid continued until the 1970s, the U.S. still held significant leverage over Taiwan.[41] Also, until the 1980s, the U.S., under the Foreign Assistance Act, provided Taiwan with an additional $2,205 million worth of loans and grants.[42]

For both Korea and Taiwan, the injection of U.S. dollars provided much needed financing for industrialization. But help did not come free. The "relational" power of the dollar coerced the Korean and Taiwanese governments to practice fiscal discipline and implement liberal economic policies. In a domestic setting, the "structural power" of the dollar determined the path of economic development.[43] In the 1950s-60s, the U.S. economic hierarchy in East Asia was clearly evident.

Although economic aid has stopped, the U.S. is still a dominant force in East Asia. The U.S.-Korea military alliance positions a U.S. military base at the heart of the capital city. Both Korea and Taiwan prioritize a close relationship with the U.S. The U.S. is still a major importer of Korean and Taiwanese goods. At the same time, the current U.S. influence is not as tangible as it was in the 1950s. The U.S. no longer holds joint authority over economic planning boards or dictates domestic government expenditures. The U.S. influence has become more subtle in the present day. By virtue of the U.S. being a large consumer market and the dollar being an international base currency, the U.S. now allows the market dynamics to confirm its economic hierarchy. Although not as directly as before, the dollar is still an authoritative driving force in the East Asian economy. These days, the dollar wields a significant "structural" power as an anchor currency.

## Pegging to the Dollar: Economically Convenient yet Risky, Politically Favorable Nonetheless

Adopting the dollar as an anchor currency has mixed effects on economic stability in East Asia. On one hand, the dollar standard provides exchange rate stability and transactional convenience. On the other hand, the currencies that are largely pegged to the dollar are vulnerable to extraneous currency fluctuations and financial crises that involve the dollar. On the political front, the dollar standard is favorable because governments can maintain exchange rate stability for the benefit of domestic economic agents as well as trading partners. Theoretically, the optimal way to guarantee stabilization would be to create an "Asian euro," a regional currency unit.[44] There could be material benefits to having an anchor currency within Asia. However, currency integration is a politically as well as economically cumbersome process. Different political interests and economic positions also complicate the process, so that adopting the Japanese yen or Chinese yuan standard would be unacceptable, especially to Japan and China. Next to the "Asian euro" or an Asian anchor currency option, using the dollar as the key currency would be the best political solution for now.[45]

In East Asia, the dollar standard has been quite successful in providing exchange rate stability. Especially for major exporters like Korea and Taiwan that conduct a high volume of transactions with the U.S., closely pegging to the U.S. dollar is convenient. Because the U.S. is a large market for Korean and Taiwanese products and a high proportion of international trade activities are invoiced in dollars, having a stable exchange rate against the U.S. dollar ensures stability as well as convenience in trade activities. Also, it helps lower the risk of currency mismatch for foreign loans. East Asian countries are perpetually exposed to the risks of dual mismatches of currency and maturity, due to their inability to "use domestic currencies to borrow abroad or to borrow long term," termed as the "original sin."[46] For these stability benefits, Korea and Taiwan maintain their currencies in a narrow range of fluctuations against the dollar. Rather than relying on market dynamics, these countries match their currencies against a currency basket in which the dollar has a heavy weight. From 1994 to 1997, the dollar weight in the Korean won exchange regime currency basket was as high as 97% and for the New Taiwan dollar as high as 98%.[47] After a brief period of free float during the financial crisis, the dollar weight for the Korean won and the New Taiwan dollar became dominant again. From 1999 to 2003, the dollar weight for Korean won reached 85%, still high albeit lower than the pre-crisis level. The dollar weight for the New Taiwan dollar reached 94%, also lower but very close to the pre-crisis level.[48]

Not only Korea and Taiwan, but also other developing countries in East Asia such as Malaysia and Thailand, match their currencies closely against the dollar. Therefore, the collective dollar anchor in Asia at large provides further stability in the region.[49] A stable link to the U.S. dollar "harmonizes nominal currency values, thus removing exchange rate variation within the region as a possible threat to relative competitive positions."[50] The "collective macroeconomic consequences of all East Asian countries opting individually to peg to the U.S. dollar, if only softly, enlarges the effective zone of stable prices far beyond each country's direct trade with the U.S."[51]

Pegging, whether soft or hard, to the dollar means submission to a dollar bloc, and it provides external benefits to the participating countries and internal benefits to the U.S. "Against the outside world, the area can provide insulation as well as the potential for the mobilization and coordination of resources."[52] As long as the value of the dollar remains stable with the management by the U.S. Federal Reserve Bank, using the dollar as the anchor currency can have a stabilizing effect in East Asia. At the same time, the U.S. becomes more powerful as the leader of the dollar bloc. As the participating countries in the dollar bloc would prefer to "shift [their] preferences … toward harmony with those of the home state," in the process, "power accrues to leader states, [in this case the U.S.] both directly and indirectly."[53]

Although pegging to the dollar has stabilizing benefits, it is not without risks. Even when pegged to the dollar, domestic currencies are vulnerable to extraneous exchange rate fluctuations between the U.S. dollar and other major currencies such as the euro, yen or sterling. Also, because exchange rates are fixed, banks and other financial intermediaries can fall into moral hazard as they may prefer to gamble rather than to hedge their bets in the foreign exchange.[54] Banks may over-borrow in dollar or yen and make loans in the domestic currency at high interest rates. The easy availability of foreign capital can lead to overexposure to dollars and overinvestment in high risk assets and equities.[55] This is precisely what happened in the early 1990s. During the Asian financial crisis, pegging to the dollar created a false sense of security of the Thai's baht stability. Excessive foreign loans in dollars were invested into high risk and speculative assets with low returns. Thailand, Indonesia and Korea were heavily dependent on foreign loans, and their foreign exchange reserves were insufficient to cover their liabilities.[56] The nominal exchange rate artificially pegged to the dollar betrayed the real exchange rate backed by dollar assets in the foreign exchange reserves. So, if not managed carefully, pegging to a single anchor currency can be economically risky. Also, for a regional concern, fluctuations of nominal exchange rates can lead to sharp variations of international competitiveness, since the domestic price level would be relatively sticky.[57]

There are also risks with the dollar's instability. The stability of the dollar is the prerequisite for its stabilizing effect in East Asia. If the dollar becomes unstable, pegging to the dollar and holding large reserves in dollars can significantly destabilize East Asian economies.[58] Massive trade deficits and financial crises involving the U.S. can lower the value of the dollar, and consequently undermine the economic stability and strength of East Asian countries, especially that of China which holds trillions of dollars in its reserves.[59] A case in point would be the recent global financial crisis. A number of variables and factors were at play, but the epicenter of the crisis is traced to the U.S. The volatility of the U.S. economy sent ripple effects to East Asian economies that export to the U.S. and receive investments from U.S. based multinational corporations. East Asian economies were vulnerable to the economic shocks and damaging effects that originated with no relation to their own domestic policies or conditions. The vulnerability to these risks is not only an economic concern but also a matter of political autonomy.

Reliance on the dollar standard and susceptibility to dollar fluctuations limits the state's power to control its currency power within its borders. In particular, the domestic government is limited in its capacity to autonomously formulate and implement domestic macroeconomic policies. Due to "the mutual incompatibility of exchange rate stability, capital mobility and autonomy of national monetary policy," termed as the "unholy trinity," countries can have only two out of the three conditions.[60] "In theory, by maintaining comprehensive and effective capital controls, states can largely escape this dilemma, but in practice, setting macroeconomic policies to assure domestic price stability implies a loss of control over the exchange rate, and vice versa."[61] The dilemma is how to manage the two prices: "(1) The price (and variability of the price) of money in the home market (i.e. the inflation rate) [and] (2) The price (and variability of the price) of money outside the home market (the exchange rate).[62] In order to ensure that their currency is relatively stable against dollar, the Korean and Taiwanese central banks raise interest rates to control their money supplies.

Together with other East Asian countries who softly peg their currencies to the dollar, Korea and Taiwan are forced to coordinate their economic policies. "Members in a currency area, [in this case the dollar bloc] must coordinate their economic policies, at the very least to those policies that would affect reserve positions, but usually more."[63] With a growing volume of intra-Asia trade, especially with China who maintains a hard peg to the dollar, the coordination of economic policies among Asian countries is especially important. As such, the dollar as an anchor currency in East Asia compels compliance with the U.S. macroeconomic policies and harmony among other East Asian countries. In this sense, the dollar standard wields a structural power over the East Asian economic system. The dollar standard shapes the structure of Asian economies by determining a suitable range of exchange rates. The dollar also continues to be the prevailing currency for intraregional transactions.

## Conclusion: the Inevitable Tradeoff between Stability and Autonomy

The tradeoff between stability and autonomy is a classic dilemma in international relations, especially in the context of hierarchical relationships. "Relational authority is inherently strategic. Both ruler and ruled are integral to the contract: the former must produce an acceptable social order; the latter must consent to the former's authority."[64] During the developmental years, U.S. economic aid provided economic stability for Korea and Taiwan, both encompassed with security threats from North Korea and China. In return, Korean and Taiwanese governments yielded to U.S. pressures to reform their economic and other policies. Nowadays, the dollar weight provides exchange rate stability for Korea and Taiwan. In return, the Korean and Taiwanese central banks are sensitive to fluctuations in U.S. exchange rates. At the same time, being linked to the the dollar presents economic risks associated with U.S. deficits and foreign debt. Nonetheless, the dollar provides an economic order to East Asia, and the recipients of the dollar's influence consent to its authority. As the dollar standard translates to some risks of vulnerability, it also signifies some loss of political autonomy. However, the "degree of vulnerability is to a certain extent a state choice."[65] In a way, East Asian economies adopt the dollar standard out of volition and for its benefits.

Significant for East Asia, especially Korea and Taiwan, is trade. The U.S. is a major consumer of Korean and Taiwanese products. The sheer size of the U.S. market is leverage for the U.S. Convenience for trade transactions and stability of trade relations were important considerations in closely matching their domestic currencies to the dollar. Together with trade relations, the link to the U.S. dollar is a proxy measure for U.S. hegemony, or economic hierarchy in East Asia. While U.S. influence over East Asia's economy is still significant, it is bound to be challenged in the near future. Inter-Asian trade continues to rise steadily, and China is a major trade partner for Korea and Taiwan. Trading with China is quickly surpassing that with the U.S. Still, the argument could be made that China is only the world's assembly or manufacturing house and the ultimate destination of the exports is the U.S. market. But the Chinese domestic market is growing rapidly too. It will not be long before China becomes the largest consumer market for all sorts of products from consumables to high luxury items. As trade with China and/or other Asian countries increase, the importance of the U.S. market would fade in importance in the relative sense.

While U.S. dominance was visibly apparent in the dollar deposits and military presence in the 1950s, it is now more behind the scenes in international currency markets. While U.S. visibility has decreased, the strength of the U.S.'s influence did not necessarily decrease. A vast, high volume of currency reserves are still held in dollars, and international loans and investment transactions also occur in dollars. The U.S. Federal Reserve is still the ultimate source of liquidity assistance and currency swaps. When the U.S. economy undergoes financial volatility, the real economy of East Asia suffers.

Enmeshed in the economic hierarchy with the U.S. as the dominant state, East Asian countries are vulnerable if the U.S. cannot deliver. The rationale for the hierarchy was that the ruler would “produce an acceptable social order,” in this case economic stability.[66] On the condition that states could rely on the dominant state for stability, the states forgo a measure of their sovereignty. Whether the U.S. can successfully and continuously provide an acceptable economic order, and whether U.S. hegemony is benevolent or overbearing to East Asia remains to be seen. The tradeoff between economic stability and political autonomy, as well as the management of vulnerability to risks and benefits of financial globalization will have to be weighed carefully. With the growing interconnections in both economic and political spheres of influence, how to hedge against U.S. risk is the ultimate challenge that encumbers Korea and Taiwan.

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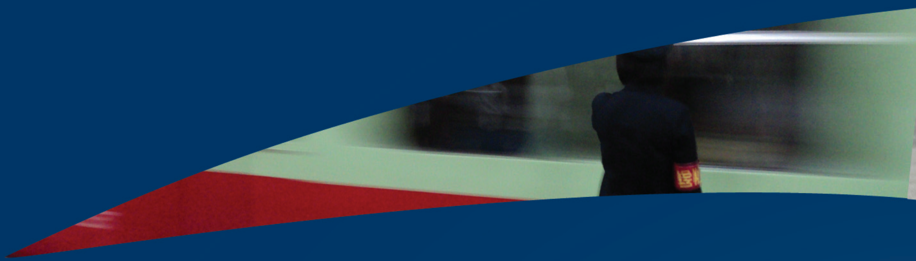

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