

East Asia's Counterweight Strategy:

Asian Financial Cooperation and Evolving International Monetary Order

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Introduction

International monetary order is changing, and East Asia is an important cause. The structure of economic power and parameters of interactions that have characterized the Group of Seven (G7)-dominated global financial governance over the last half century are being fundamentally affected by, among other factors, East Asia's growing economic and financial power, rising political influence, and, more importantly, increasing regional financial cooperation. In recent years, clear progress has been made in East Asia's collective efforts to create new regional financial cooperative mechanisms. The main forum for such efforts became one comprised exclusively of *East Asian* countries, notably excluding the United States. The Association for Southeast Asian Nations (ASEAN) member countries, China, Japan, and South Korea (the ASEAN+3) have been attempting to transform the bilateral swap arrangements under the Chiang Mai Initiative (CMI) into a multilateral arrangement. The

multilateralization of the CMI is perceived by many Asia watchers as a significant step toward the creation of an Asian Monetary Fund (AMF), an Asian version of the International Monetary Fund (IMF). East Asian countries also have sought to develop a vibrant regional bond market. The emergence of Asia's own regional bond market driven by the Asian Bond Fund (and Market) Initiative would possibly complement and constrain the U.S. and Europe-centered global capital markets. Moreover, even the creation of a single Asian currency is now more vigorously studied by East Asian governments. Such dramatic changes have been caused by regional actors' low-key, accommodating, and prudent approaches to regional financial cooperation. East Asian countries search for "counterweight" strategies that will allow them to avoid overdependence even as they maintain cooperative relations with the G7-centered global financial institutions (e.g. the IMF).¹ East Asian countries do not intend to directly challenge the United States and Europe, given the overwhelming significance of cooperation with the two economic powers to achieve common goals. When East Asia's policy preference diverges significantly from the United States and Europe, however, East Asian countries want to bolster their policy position and bargaining power vis-à-vis

¹ On the concept of "counterweight strategy" with some modifications, I benefit from Saori Katada's work on U.S.-Japan economic relations. Saori Katada, "Japan's Counterweight Strategy: U.S.-Japan Cooperation and Competition in International Finance, in Ellis S. Krauss and T.J. Pempel (eds.) *Beyond Bilateralism-U.S. Japan Relations in the New Asia-Pacific* (Stanford University Press 2004).

the non-Asian economic powers by developing and using regional alternatives. This pattern of East Asia's counterweight strategy is taking form at the very time that the international financial architecture is profoundly evolving. G7-centered decisionmaking characterized the post-World War II international financial architecture, namely, the Bretton Woods system. G7 members directly or through the IMF made most of the decisions on global financial governance, with the Bank for International Settlements (BIS), the Organization for Economic Cooperation and Development (OECD), and the World Bank playing supporting roles.² The traditional role of this architecture is now being called into question. An increasing number of developing countries have questioned the legitimacy and effectiveness of the relatively exclusive decisionmaking structure of global financial governance particularly after the 1997-98 Asian financial crisis. East Asia thus is calling for substantial IMF reform at the global level while pursuing new financial multilateralism at the regional level. In the context of these complex dynamics, counterweight strategy is a notable pattern of East Asia's interaction with the rest of the world in international finance. This paper offers a careful assessment of East Asia's new behavior and linkage with global financial governance in the early

² Eric Helleiner, *States and the Reemergence of Global Finance* (Ithaca, N.Y.: Cornell University Press, 1994); Louis W. Pauly, *Who Elected the Bankers: Surveillance and Control in the World Economy* (Ithaca, N.Y.: Cornell University Press, 1997); and Susan Strange, *Mad Money: When Markets Outgrow Governments* (Manchester: Manchester University Press, 1998).

twenty-first century. What motivated the emergence of Asian financial arrangements such as the Chiang Mai Initiative (CMI) and the Asian Bond Fund Initiative (ABFI)? What are the nature and purpose of the CMI and the ABFI? What would determine the future trajectory of the Asian financial cooperation and East Asia's counterweight strategy?

The sources of Asian financial cooperation

With their rapid economic ascent, East Asian countries became increasingly aware that their individual and collective positions within the global economy are not fairly reflected in existing international institutions.³ For instance, East Asia's quota share and corresponding voting power in the IMF do not represent its relative importance in the world economy. East Asia has about 13% of the total quota but this is much less than its shares of GDP (24%), PPP-based GDP (25%), trade (16%), reserves (28%) and population (33%).⁴ The 1997-98 Asian financial crisis brought to the fore East Asia's relative positions vis-à-vis the Western countries in the IMF, which deeply intervened

³ Anthony Rowley, "IMF may give merging nations more say", *The Business times* (Singapore), October 9 2000, pp. 1-2.

⁴ David P. Rapkin and Jonathan R. Strand, "Is East Asia under-represented in the International Monetary Fund?" *International Relations of the Asia-Pacific*, Volume 3 (2003), pp.15.

the economic policymaking of the region's crisis-hit countries. From the East Asian perspectives, their ability to influence the IMF conditionality and resist the IMF policies perceived as counterproductive, is significantly constrained by their limited quota shares and voting power in the IMF. The dissatisfaction with the IMF's performance in the Asian financial crisis⁵ and the discontent with the under-representation of East Asia in the G7-centered international financial institutions left two primary policy options with East Asian countries: global and regional ones. They can seek substantial reforms of the global institutions or (and) pursue the creation of regional alternative institutions.

However, East Asian countries confront a deep uncertainty about the evolution of both global and regional financial institutions. At the global level, the prospects for serious reforms in the G7-centered global financial institutions have been still remote in the eyes of many Asian policy makers. Although the G7 had finally begun to engage more expansively in dialogue with the rest of the world through the Financial Stability Forum (FSF) and the Group-20 (G-20) following the Asian financial crisis, such adjustments have not met the expectation of East Asian countries.⁶ In the views of many Asian

⁵ Richard Higgott, "The Asian economic crisis: a study in the politics of resentment", *New Political Economy*, Vol. 3, pp. 333-356, and Robert Wade and Frank Veneroso, "The Asian crisis: the high debt model vs. the Wall Street-Treasury-IMF complex", *New Left Review*, March-April, pp. 3-23.

⁶ Injoo Sohn, "Asian Financial Cooperation: the Problem of Legitimacy in Global Financial Governance," *Global Governance: A Review of Multilateralism and International Organizations*, November (11:4), 2005.

developing countries, the FSF featured heavy G7 representation; the new FSF excluded key emerging Asian economies such as China, Indonesia, South Korea, Malaysia, and Thailand. Although the G-20 included three non-G7-Asian countries (China, South Korea, and Indonesia), unlike the G7, the G-20 remained a nondecisionmaking body. The involvement of several Asian countries therefore would make little difference in the actual decisionmaking process of global financial governance. Moreover, the FSF and the G-20 tended to emphasize the *domestic* aspects of the reforms (in developing countries in particular), as opposed to the *international* aspects of the reforms (such as hedge funds, transnational capital flows, and offshore financial centers), which might entail painful adjustment for the G7 as well as non-G7 countries. Such a perceived unfair sharing of adjustment costs and benefits also contributed to reinforcing East Asia's discontent and skepticism that fundamental changes to the G7-centered global financial institutions are out of reach. At the regional level, skepticism about the feasibility and desirability of Asia's efforts to create more cohesive arrangements or institutions have prevailed both within and outside of the region.⁷ A series of potential

⁷ For the heated debates over the desirability and feasibility of the recent Asian financial cooperation, for example, see C. Randall Henning, *East Asian Financial Cooperation* (Washington DC: Institute for International Economics, 2002); Yung Chul Park, "Beyond the Chiang Mai Initiative: Rationale and Need for Decision-Making Body and Extended Regional Surveillance under the ASEAN+3 Framework," available online at <http://soback.kornet.net/~ycpark/pub/00bc.pdf> (accessed 1 September 2003); and Barry Eichengreen, "What to Do with the Chiang Mai Initiative," *Asian Economic Papers*,

political and economic hurdles seemed to shadow the future of Asian financial cooperation (this point will be discussed later in more detail). The ambiguity and uncertainty inherent in changing global institutions and creating regional institutions has become a central driver of current East Asia policy. Against this background, East Asian countries have pursued the risk-averse counterweight strategy, which intends to create new regional financial arrangements and thereby avoid overdependence while sustaining collaborative relations with the G7-dominated global financial institutions.

Two cases of East Asian financial cooperation

The early twenty first century witnesses the increased efforts of East Asian governments to promote financial integration at the regional level. Such collective actions aim to both reduce the region's vulnerabilities to a future financial crisis and improve the allocation of savings. A series of initiatives have been launched to increase regional self-sufficiency, ranging from information sharing to financial swap arrangements and regional bond market. This section examines the main purpose and nature of the two

(Washington DC: The Center for Strategic and International Studies, winter 2003), available online at LexisNexis, (accessed 29 July 2003).

prominent regional cooperative mechanisms: the Chiang Mai Initiative and the Asian Bond Fund Initiative.

The Chiang Mai Initiative (CMI)

The CMI is designed to provide liquidity support for member countries that experience short-run balance-of-payment deficits, with the purpose of preventing an extreme crisis or systemic failure in a country and subsequent regional contagion, such as the kind that occurred in the 1997-98 Asian financial crisis. Since 2001, 16 bilateral currency swap arrangements have been negotiated and concluded among ASEAN+3 countries. As of May 2005, the size of the CMI stood at U.S. \$ 36.5 billion. Each agreement enables parties to borrow the equivalent of \$1-3 billion in foreign exchange reserves from partners. The swap arrangements are effective for 90 days, renewable for up to two years.

The initial amounts (U.S. \$ 36.5 billion) involved under the CMI appeared relatively small and inadequate for single-handedly preventing speculative attacks. Such skepticism is understandable, given the huge amounts of foreign exchange reserves held by ASEAN+3 countries as a whole (which amount to U.S. \$ 1.8 trillion), as well as, the emergency assistance required by the crisis-hit countries in the 1997 crisis, since

Thailand alone requested U.S. \$ 17.2 billion. With such small amounts involved, one might expect that assistance via the CMI would have to be supplemented by the IMF and/or additional packages of aid negotiated at the time of crisis.

Recognizing such a weakness, in May 2005, East Asian countries decided to double the amount of emergency funds to be provided to crisis-hit nations to some U.S. \$ 80 billion (the second stage of the CMI) while noting exact size could be decided by bilateral negotiations. In accordance to the second stage of the CMI, for instance, Japan and Singapore signed a U.S. \$ 4 billion second currency swap arrangement in November 2005. Likewise, Japan and South Korea agreed on a U.S. \$ 15 billion second currency swap arrangement in February 2006. Similarly, China also doubled currency swap deal with Indonesia from U.S. \$ 2 billion to U.S. \$ 4 billion in May 2006. As of May 2006, the size of the CMI amounted to U.S. \$ 75 billion. The recent ongoing efforts to increase the size of the CMI show a clear consensus shared by East Asian countries that the dependence on an IMF or US-determined solution to financial crisis in the region is insufficient; East Asia pursues a regional option, as well as, the existing global one, to build defenses against future speculative attack.

Another notable feature of the initial CMI is its linkage with the IMF. The initial CMI required its member countries drawing more than 10 percent from the funds in the CMI

to accept an IMF conditionality. This means that East Asia's *preemptive* measure to reduce exchange rate volatility prior to a full-fledged crisis is hindered. In general, IMF programs are not negotiated until crisis has already occurred. Ten percent of the swap lines are too small to prevent a significant attack. Some participating countries, particularly Malaysia, opposed the linkage of the CMI with IMF conditionality. Meanwhile, other members such as China and Japan argued for the importance of forging a cooperative relationship with the IMF at an early stage of the CMI development to make it more credible. After all, East Asian countries agreed to accept the linkage of the CMI to the IMF as a temporary arrangement until a formal surveillance mechanism is put in place. This compromise can be explained by two factors. First, the IMF possesses better institutionalized surveillance mechanisms that the ASEAN+3 lacks. The IMF conducts annual review of member country economies via Article 4 consultations, as well as, assessments of financial sector vulnerability through the Financial Sector Assessment Program. For some East Asian countries, it would be ineffective and inappropriate to lend funds to countries whose operations were not under this type of regular surveillance. Linking the CMI to the IMF can ensure that funds lent had a better chance of being repaid, even if ASEAN+3 remained critical of

IMF conditionality per se.⁸ In addition to the “efficiency (or functional)” consideration, the logic of interstate “power” structure helped East Asian countries to take an accommodating and prudent approach to the CMI. Many of East Asian countries worried that the United States and European Union would oppose a new Asian financial framework which lacks any IMF linkage as in the case of the aborted Asian Monetary Fund plan in 1997. Given the limited, albeit growing, political power of East Asian grouping vis-à-vis the U.S. and EU, East Asian countries needed to water down the independent nature of the CMI at the initial stage of regional financial integration.

At May 2001 ASEAN+3 Finance Ministers Meeting in Honolulu, member countries agreed to review the issues of the IMF linkage with the CMI after three years had passed, leaving room for possible revision of the linkage requirement. In May 2005, the finance ministers of East Asian governments agreed to double the size of the emergency funds that could be withdrawn without IMF conditionality from 10 percent to 20 percent. This revision represents the incremental approach taken by East Asian countries in loosening their adherence to the IMF conditionality. Whether or not the CMI eliminates their IMF linkage in the near future, such a regional liquidity fund clearly intends to complement the role of the IMF in crisis management in the long term. At the moment,

⁸ Jennifer Amyx, “A Regional Bond Market for East Asia?” *The Australian National University’s Pacific Economic Papers*, No. 342, 2004, pp.6-7.

the IMF linkage made the CMI look more inclusive (as opposed to exclusive), thereby help to deflect suspicions and criticism from non-Asian economic powers. In this sense, the CMI reflects East Asia's strategic behavior to counter the risk of its overdependence on the IMF even as they maintain collaborative relations with the IMF and other G-7 centered global financial institutions.

More progress has been made in boosting the CMI recently. ASEAN+3 countries have been increasingly seeking to transform the CMI into a single multilateral framework since 2005. To this end, collective decision-making procedure for the CMI activation was adopted. All swap providing countries can simultaneously and promptly provide liquidity support to any parties involved in bilateral swap arrangements at times of emergency. In May 2006, East Asian countries also agreed to set up a "new task force" to further study various possible options towards CMI multilateralization (or Post-CMI).

Moreover, one can find that more concrete steps are being taken by East Asia toward the creation of an independent regional surveillance mechanism, which is crucial for the rise of the CMI with a regionally tailored conditionality that would fairly reflect Asian circumstances. For example, in May 2006 the ASEAN+3 nations declared to launch the Group of Experts (GOE) and the Technical Working Group on Economic and Financial

Monitoring (ETWG) to explore the ways for further strengthening surveillance capacity in East Asia. The GOE, composed of several regional professional experts, would serve as an independent economic assessment vehicle for this region. The ETWG would play an important role in developing and spreading the Early Warning System to facilitate early detection of irregularities. These new efforts would significantly contribute to enhancing East Asia's surveillance capacity, thus increasing the effectiveness of the CMI.

Asian Bond Fund Initiative (ABFI)

Asian Bond Fund Initiative (ABFI) added to the momentum of Asian financial cooperation. The ABF, along with the CMI, promised prospects that would contribute to changing the international financial landscape. In June 2003, The Executives' Meeting of East Asia Pacific Central Banks (EMEAP), the region's central bankers association – which includes representatives from Thailand, Indonesia, Malaysia, Singapore, the Philippines, China, Hong Kong, South Korea, Japan, Australia and New Zealand – announced the creation of the Asian Bond Fund (ABF) with an initial size of about U.S. \$ 1 billion. This first stage of the ABF invested in a basket of U.S. dollar denominated bonds issued by Asian sovereign and quasi-sovereign issuers in EMEAP economies.

Building on the success of ABF1, the EMEAP launched the second stage of the Asian Bond Fund (ABF2) in July 2005. The ABF2 invested in *local*-currency bonds issued by sovereign and quasi-sovereign issuers in the eight EMEAP markets. EMEAP members have invested a total of U.S. \$ 2 billion of seed money in ABF2. ABF2 comprises nine component funds: a Pan-Asian Bond Index Fund (PAIF) and eight single-market funds.

The rationale for broadening and deepening regional bond markets can be two-fold. First, the establishment of the Asian Bond Fund (ABF) ultimately aims to bring back the huge amount of Asian foreign reserves that were traditionally saved in Europe or in the U.S. to be used in bond investments throughout Asia. In the past decades, much of Asian savings were channeled into international bond markets in the U.S. or Europe due in part to the underdevelopment of Asian regional bond market. A growing number of Asian policy makers were becoming unhappy about the fact that the wealth of East Asia has been used (in the form of U.S. treasury bond) to finance the swelling US current account deficit, rather than to create greater prosperity for the region. In his speech advocating substantial regional bond market expansions, Hong Kong Monetary Authority Chief Executive Joseph Yam argued that “the cost of capital for enterprises in Asia would be lower, if there was a deep and well-functioning corporate bond market in the region to tap the considerable pool of savings, much of which now flows instead to

industrial countries.”⁹ Such concerns urged Asian governments to accelerate plans for a regional Asian bond market as a counterweight to bond markets in the west.¹⁰

Secondly, the ABFI intends to shield the region from the external vulnerabilities by building more robust and diversified local capital markets. The dominant view of those supporting Asian bond market expansion is that the Asian financial crisis would have been less severe if local bond markets had been more developed and financial intermediation in the crisis-affected countries had not been so heavily concentrated on banks.¹¹

While the ABFI has the potential to challenge the dominance of the U.S. and EU in the global capital markets, the recent emphasis many Asian leaders have placed on the Asian-Bond-Eurobond linkage and the creation of a Euro Bond Market in Asia helped to mobilize EU support for the idea of an Asian Bond Market. In line with Asian-European financial cooperation, for example, eleven Central Bank governors from the

⁹ Hong Kong Monetary Authority Chief Executive Joseph Yam, “A case for financial integration in Asia,” February 24th 2006 (Available at <http://aric.adb.org/asianbond/EOS.htm>).

¹⁰ In theory, the creation of a vibrant Asian bond market could have significant implications for the United States, since Japan and China ranks as the largest two foreign holders of the U.S. Treasury bonds. If the Japanese and Chinese governments shift away from US Treasury bonds and into Asian bonds, the impact could be considerable – particularly if US government debt continues to grow.

¹¹ Paul Lejot, Douglas Arner, Liu Qiao, Mylene Chan, and Marshall Mays, “Asia's debt capital markets appraisal and agenda for policy reform,” *Hong Kong Institute of Economics and Business Strategy Working Paper*, No. 1072, October 2003.

Executives' Meeting of East Asia-Pacific (EMEAP), the president of the European Central Bank, and twelve governors from the Eurosystem National Central Banks held a joint high-level seminar in Singapore in July 2004. The purpose of the seminar was to exchange views on issues that are relevant to both Europe and the East Asia-Pacific region, and to consolidate relations between EMEAP and the Eurosystem.

Overall, the ABF creates another counterweight enabling East Asia to go beyond the IMF (or the U.S.) support in finance for development and crisis management. East Asian countries now obtain means through which they can push forward their agenda independent of the G7-dominated international institutions, but without antagonizing G7 and endangering their relationship with the IMF.

Challenges and prospects

This section highlights and assesses some of the forces that might frustrate or facilitate Asian financial cooperation and relevant East Asia's counterweight strategy. First, in terms of structural economic conditions, East Asia faces both favorable and unfavorable environments. On the bright side of economic conditions, intensifying financial globalization provided a common economic enemy, namely, financial contagion effect, to East Asia. Following their bitter experience of the Asian financial crisis, East Asian

countries have more clearly recognized the common goals of preventing a future financial crisis and ensuring economic security in an increasingly interdependent global economy. In the views of East Asian countries, unilateral response would be no longer effective enough to protect their own economies from future international financial turmoil given the interdependent nature of financial globalization; the unilateral strategy of holding a very large stock of foreign exchange reserves to deal with large but infrequent capital flight is an extremely expensive strategy. Accordingly, Asian policy makers widely recognized that a regional pooling of foreign exchange reserves might be cost-effective means to pursue their common ends of reducing the instability of trans-border capital movements.

While such a functional need exists, however, regional economic diversity might hamper regional cooperation. The differences in economic size, development stage, and domestic regulation can possibly complicate Asia's collective action in regional financial cooperation.¹² Apparently such economic obstacles and challenges might slow the pace of regional cooperation. It is, however, an overstatement that such economic

¹² Another economic (and potentially political) challenge concerns the issue of conditionality in loans from the Chiang Mai Initiative (CMI). Who would determine the conditions on borrowers when the CMI is transformed into a full-fledged multilateral arrangement, independent of the IMF? Will there be a technical secretariat that imposes conditions? Will decisions be made by weighted voting in accord with the contributions of member countries or one-country-one-vote? These issues need to be resolved before the CMI can substitute the IMF. I am indebted to Ariel Buria on this point.

hurdles can determine the *direction* of Asian financial cooperation. Regional financial cooperation is foremost a *political* process as in the case of European monetary union. The political will of Asian policy makers would ultimately determine the final outcome of the regional cooperation. Put it differently, economic conditions alone do not point to any particular policy outcome, either success or failure in the realm of Asian financial cooperation. Given the ambiguous effects of regional economic conditions on the future trajectory of Asian financial cooperation, East Asian countries would continue to see regional multilateralism as a viable supplement or alternative to global multilateralism while simultaneously seeking to shape the existing international institutions in their favor. Such a counterweight strategy is more likely to remain intact for some year to come despite (and because of) the regional economic conditions.

A second key factor that might significantly affect Asia's cooperative efforts is interstate political dynamics. The potential rivalry between China and Japan for regional hegemony, and political tensions between Japan and its Northeast Asian neighbors over history issues and disputed islets are good examples in point. This is a significant political challenge facing East Asia. Yet it is misreading to characterize such geopolitical rivalry as insurmountable obstacles that are destined to frustrate Asian financial cooperation. In recent years, regional financial cooperation has been largely

insulated from diplomatic and political competitions among countries in the region. This situation can be dubbed as “hot economics and cold politics.” Despite the frosty political relations between Japan and its Northeast Asian neighbors, the three economic powerhouses of the region, China, Japan, South Korea, have managed to keep intergovernmental financial cooperation on track.¹³ At the trilateral finance ministers’ meeting on the sideline of the Asian Development Bank’s annual conference in May 2006, the Northeast Asian trio agreed to make more progress in regional financial cooperation including the feasibility study of Asian currency unit, and reached a consensus on the reform of the International Monetary Fund (IMF). Likewise, in February 2006 when Japan and South Korea agreed on second U.S. \$ 15 currency swap accord under the CMI, South Korean finance minister Han Duck-soo stated that “the fact that we [South Korea and Japan] are able to create a cooperative policy network has deep historical meaning...We hope this meeting will help the two countries understand each other better and create an atmosphere where we can overcome past problems.”¹⁴

¹³ For recent trilateral cooperation among Japan, China, and South Korea, see Hidetaka Yoshimatsu, “From Distrust to Mutual Interests?: Emerging Cooperation in Northeast Asia,” *East Asia: An International Quarterly*, Vol. 22 Issue 4, Winter 2005, pp18-38.

¹⁴ “Japan, South Korea agree to \$15 billion currency swap,” *Bloomberg*, February 4, 2006. <http://aric.adb.org/default1.asp?handler=infocus&switch=73> (accessed on July 17, 2006)

On a related point, it should be also noted here that it would be difficult to expect the rise of either China-centered or Japan-centered regional monetary hierarchy in the near or medium term. On the surface, China and Japan, the two major economic powers in the region, seem to enjoy sufficient economic leverage to influence the Asian financial cooperative initiatives. Yet in terms of soft power such as financial management skills and know-how (as opposed to hard power), the two countries do not stand out as well equipped to lead the regional financial cooperation, in particular, the Asian Bond Fund Initiative. Despite China's growing foreign currency reserves, China has few appealing knowledge, ideology, and vision for Asian financial cooperation. This significantly decreases the chances of China becoming a singular pole in Asian financial system. While many Asian countries see that Japan can make substantive contribution on the development of Asian financial cooperation, Japan is not well positioned to lead all dimensions of the infrastructure building endeavor. For instance, Japan lacks its own credible ratings agencies, one of key infrastructure for a well-functioning bond market. Furthermore, Japan only very recently – in 1998 – set up a full-fledged asset management corporation to tackle its banking sector's non-performing loans (South Korea, meanwhile, possesses the most capable and technically sophisticated asset

management corporation in the region, Korea Asset Management Cooperation).¹⁵ The least likely scenario of the emergence of one-country-dominant regional hierarchy in international finance helps to reduce the suspicions of the region's small countries about the zero-sum consequence (hegemon gains most) of Asian financial cooperation. There is also another incentive for small Asian countries to voice their support for financial multilateralism in the region. Small Asian countries may value the predictability in the two regional powers' rule-governed behavior in a multilateral setting, even though those multilateral rules favor the strong. Big states cannot do just anything they want within multilateral arrangements. They should often restrain themselves and play by multilateral rules out of self-interest. This can also contribute to little states' support for regional multilateralism. In short, like the region's economic conditions, Asia's geopolitical dynamics alone cannot direct the fate of regional financial cooperation. From the geopolitical perspectives, it is fair to say that it remains unknown whether the region's political dynamics would serve as a blessing or curse for Asian financial cooperation. Such uncertainties would also contribute to making East Asia's counterweight strategy relevant and reasonable at this point.

Thirdly, the reactions from the United States and Europe are also significant

¹⁵ On this point, Jennifer Amyx (2004: 21) argues that "issue-specific capabilities can – and often do – differ significantly from aggregate economic capacities."

influences on the future trajectory of Asian financial cooperation. Their reactions have been supportive or at least receptive. This is in contrast to their anxiety and opposition to the 1997 Japanese proposal for the creation of the AMF. Europe showed support for the establishment of an Asian bond market at the Fifth ASEM Finance Ministers Meeting in July 2003. The U.S. also explicitly voiced support for greater monetary integration in East Asia. The U.S. Treasury Undersecretary for International Affairs, Tim Adams said in June 2006, “We're supportive of financial and economic integration [in Asia] as long as it's done in an open and inclusive manner... There was a perception that somehow the U.S. opposed monetary and economic integration in the region... That is simply not true. We are very supportive.”¹⁶

The absence of external opposition to the Asian financial cooperative initiatives reflects perceptions that the newly emerging Asian financial institutions will neither eclipse the functions of other multilateral institutions nor significantly undermine the activities of other bond markets in the near future. As discussed above, such perceptions are attributable to the CMI's linkage with the IMF and East Asia's emphasis on the Asian Bond-Eurobond linkage. This also suggests that East Asia's counterweight

¹⁶ Robert Schroeder, “US backs stronger Asian economic ties,” *Market Watch*, June 19 2006 [from Asian Regional Information Center <http://aric.adb.org/default2.asp?handler=econews&switch=2&s=6&p=5>]

strategy have been so far effective: East Asia has made considerable progress in establishing regional supplements (or potential alternatives) while not creating a major fissure in their relationship with key actors outside the region. Such positive feedback is more likely to add to the momentum of East Asia's incremental and low-profile counterweight strategy in the foreseeable future.

Fourth, the outcome of the ongoing IMF reform would considerably affect the future development of the Asian financial cooperation and Asian counterweight strategy. East Asian countries are now becoming more active advocates of the IMF reform. One of significant challenges for multilateralism is to revise rules that accommodate changing power disparity and accepted by others including both the weak and the strong. Interstate power configuration can often change faster than international institutions. If multilateral institutions become only means for the declining or reigning powers to use to influence the rising powers, the rising powers would resist multilateral rules, thus making multilateralism ineffective.¹⁷ In this respect, the IMF should take measures to accommodate East Asia's growing economic power to make the IMF effective and legitimate. The IMF began to signal its intention to change the voting quota of the IMF,

¹⁷ For a more detailed discussion of the mutual impacts of efficacy and power, see Martha Finnemore, "Fights about rules: the role of efficacy and power in changing multilateralism," *Review of International Studies* (2005), 31, pp. 197-199.

reflecting changing distribution of world economic power.¹⁸ However, it is still unclear whether the IMF reform would result in substantive changes or cosmetic changes. Some skeptics speculate that the G7 try to close a deal on a minimal change to the representation of the IMF before the upcoming IMF and World Bank annual meetings in Singapore.¹⁹ The conservative tendencies of status quo powers and the bureaucratic inertia of existing international institutions would considerably constrain the pace and scope of the IMF reforms. Until and unless substantial adjustments are made to fairly reflect East Asia's growing economic power in the IMF and other Bretton Woods institutions, East Asian countries are less likely to lose political motivation to seek an Asian alternative through its counterweight strategy.

¹⁸ "IMF to give more weight to Asian vote", *Financial Times*, June 7, 2006.

¹⁹ The U.S. and other G7 member countries have been discussing the idea of increasing the quota share of key developing countries such as China, South Korea, Mexico, and Turkey. As of the summer of 2006, however, such a move confronts a big political hurdle due in part to the politicization of the IMF reform by the U.S. Congress. The U.S. government is reluctant to allow China to increase its quota share in the IMF because of the strong opposition from the U.S. Congress. Many critics in the US Congress argue that China should play by the rules in the world economy and particularly China should make its foreign exchange rate policy more flexible given the huge accumulation of its trade surplus and foreign reserves. Unless China makes considerable changes in its foreign economic policy, the U.S. government would not gain enough domestic support to allow China to deserve the increased quota share in the IMF. There is an increasing concern that such a controversy over China might postpone or stop the whole process of the ongoing IMF quota reform. The dilemma facing the IMF is that if the IMF reform does not proceed as planned, many developing countries are more likely to walk away from the IMF, making the IMF irrelevant and ineffective in global financial governance.

Conclusion-Policy Implications

Since the 1997-98 Asian financial crisis, East Asia has pursued greater regional cooperation and pushed for greater influence within the Bretton Woods institutions. While calling for the reform of the IMF, policy makers in East Asia have made more substantial progress in the regional initiatives such as the CMI and the ABFI than skeptics might initially anticipate. The more eye-catching agreement in recent regional cooperation is about the idea of a regional currency unit. In May 2006, East Asian governments decided to study the idea of an Asian Currency Unit (ACU), a first step on the long road to an Asian Euro. According to Asian Development Bank (ADB) president Haruhiko Kuroda, ACU is a theoretical currency unit made up of a basket of Asian currencies that would not be traded and would serve simply as an index of Asian exchange rates relative to each other. Although Mr. Kuroda and other advocates describe ACU in typically low-key manner out of concerns about possible suspicion and opposition from other regions, it has echoes of the European Currency Unit (ECU) which led eventually to the Euro.²⁰

It remains an open question whether Asia's common currency is desirable on the economic grounds and what the roadmap should be like when East Asian countries one

²⁰ Anthony Rowley, "The unfolding of Asia's monetary 'grand design'," *The Business Times*, 20 April, 2006.

day reach the conclusion that it is both desirable and feasible.²¹ Yet one of the significant implications of the idea of ACU is that policy makers in East Asia are continuously willing to work together for increasing financial cooperation and keep their minds open to all new ideas, be it an Asian currency or something more suitable for Asia.

Moreover, the CMI, the ABFI, and ACU clearly reflect the logic of East Asia's counterweight strategy. That is, to develop its own regional supplements (or potential alternatives), thereby better positioning regional actors in the evolution of the IMF and other Bretton Woods institutions without antagonizing key players outside the region. The logic of this counterweight strategy is understandable; it enables East Asia to sustain its extensive and beneficial relations with the G7-centered institutions while addressing uncertainty about evolving international monetary order. Policy makers in East Asia are hedging their economic bets about the uncertain prospects of both the creation of regional institutions and the reform of global institutions.

It remains to be seen what the U.S. and its G7 allies may do in the face of East Asian

²¹ For the skepticism about the desirability and feasibility about an Asian Currency Unit appearing in a recent meeting organized by the IMF and the Monetary Authority of Singapore (MAS), see "Common currency not on the cards for Asia," *Agence France Presse*, May 25 2006, and Hsiao Chink Tang, "An Asian Monetary Union?" *Centre for Applied Macroeconomic Analysis Working Paper*, Australian National University (April 2006), available at (<http://aric.adb.org/default7.asp?handler=forum&switch=83&s=116>) Accessed on July 14 2006.

collective action on regional financial arrangements. The U.S. seems to lack a clear strategy of what Asian monetary order it desires. The U.S. should not view East Asian-only arrangements negatively just because it is not a member. Instead, it needs to actively support Asian regional cooperation to signal U.S. interest in Asia and promote positive norms of global financial governance. Such a strategy would generate the perception that the U. S. is working on behalf of Asian interests, thus boosting the legitimacy of the U.S. presence and influence in the region. The U.S. is already a member of many regional economic organizations such as Asia Pacific Economic Cooperation and the Asian Development Bank, and does not have to belong to every organization to exert influence. Key U.S. allies even in the Asians-only groupings may be able to voice U.S. interests. The pragmatic and receptive stance of the U.S. and its G7 allies on East Asia's moderate and prudent counterweight strategy would contribute to maintaining East Asia's cooperative behavior in global financial governance, and facilitating the peaceful evolution of international monetary order in the 21st century.