Korea Economic Institute of America

ACADEMIC PAPER SERIES

KEI
KOREA ECONOMIC INSTITUTE OF AMERICA | 한미경제연구소

SEPTEMBER 13, 2017

East Asia's Regional Financial Governance: Assessing Korea's Centrality

By Ramon Pacheco Pardo

Abstract

In the aftermath of the Global Financial Crisis, the multi-layered international financial governance regime has been strengthened. In East Asia, this regime includes an ASEAN+3 regional layer designed to complement – rather than replace – the global layer. This regional layer has three goals: crisis prevention, crisis management and resolution, and market strengthening. The Chiang Mai Initiative Multilateralization (CMIM), ASEAN+3 Macroeconomic Research Office (AMRO), and Economic Review and Policy Dialogue (ERPD) are the key institutions in the areas of crisis prevention, management, and resolution. South Korea has become increasingly central to this regional financial governance regime over the past few years. Seoul was crucial to the setting up of CMIM, holds top management positions in AMRO, and is involved in the ERPD dialogue process. Three key reasons explain Korea's centrality. To begin with, the growing role of financial markets in Korea's domestic economy has made Seoul aware of the need to have a strong regional safety net to offset the negative effects of financial openness. Furthermore, Korea sees itself as a middle power and has therefore become more involved in international governance – particularly at the regional level. Finally, Seoul has been a keen supporter of East Asian regionalism at a time when ASEAN centrality has been weakening. Korean centrality has allowed Seoul to act as a balancer between China and Japan, be perceived as a neutral actor, and bridge the gap between developed and developing countries. At a time when East Asian regional financial governance is being questioned, Korea's centrality serves as a catalyst for its enduring relevance.

***Key Words:** Financial governance, financial markets, middle power, Korean centrality, ASEAN+3*

Introduction

The Global Financial Crisis (GFC) was the culmination of several financial crises around the world since the 1970s. Contrasting previous crises, however, its origin in the U.S. and large impact on developed Western countries led to decisive, coordinated global action, including the strengthening of the multi-layered international financial governance regime. The G20, Financial Stability Board (FSB), International Monetary Fund (IMF), and Basel Committee on Banking Supervision (BCBS) have all become more central to crisis prevention and resolution. These and other institutions have led to real cooperation among countries seeking to avert a new GFC.

The multi-layered finance regime also includes a regional tier. East Asia is home to the most sophisticated and comprehensive regional layer, barring the EU. Originating in the aftermath of the East Asian Financial Crisis (EAFC) of 1997 and strengthened after the GFC, ASEAN+3 countries (the ten ASEAN members plus China, South Korea, and Japan) have launched a number of initiatives aimed at three goals: crisis prevention, crisis management and resolution, and market strengthening.[1] Thus, today the Chiang Mai Initiative Multilateralization (CMIM), ASEAN+3 Macroeconomic Research Office (AMRO), Economic Review and Policy Dialogue (ERPD), Asian Bond Markets Initiative (ABMI), and Credit Guarantee and Investment Facility (CGIF) form an institutional network aimed at preventing a repeat of the EAFC.

Korea[2] was one of the countries most affected by the EAFC. Until the GFC and subsequent Eurozone Sovereign Debt Crisis, it held the record as the largest-ever recipient of an IMF bailout. Like many other countries receiving help from the IMF, Korea was critical of the bailout. The IMF was accused of exacerbating

Ramon Pacheco Pardo is Senior Lecturer in International Relations at King's College London and Co-director of the London Asia Pacific Centre for Social Science. The views expressed are solely those of the author and do not necessarily reflect the views of any organizations he is affiliated with. This paper is the ninety-first in KEI's Academic Paper Series. As part of this program, KEI commissions and distributes approximately ten papers per year on original subjects of current interest to over 5,000 Korea watchers, government officials, think tank experts, and scholars around the United States and the world. At the end of the year, these papers are compiled and published in KEI's On Korea volume. For more information, please visit www.keia.org/aps_on_korea

Korea Economic Institute of America
1800 K Street, NW Suite 1010
Washington, DC 20006
www.keia.org

the crisis through its conditionality, impinging on the country's sovereignty, and opening the door to foreign takeovers of Korean banks and firms.[3] Unsurprisingly, Korea was an enthusiastic advocate for the launch of ASEAN+3 institutions designed to reduce future reliance on the IMF. The view from Seoul seemed to be that an East Asian institutional framework would better prevent contagion across the region and be less intrusive on Korean sovereignty were it to be activated.

Twenty years after the EAFC, Korea remains a strong advocate of East Asian regional financial governance. Seoul did not resort to ASEAN+3 initiatives during the GFC, instead preferring to make use of its own foreign exchange reserves and a $30 billion bilateral swap arrangement between the Bank of Korea and the Federal Reserve.[4] However, this was related to the perceived inadequacy of the Chiang Mai Initiative (CMI) that preceded CMIM due primarily to its small size. Indeed, successive governments have sought to make Korea central to ASEAN+3 initiatives in the aftermath of the GFC. Unlike the post-EAFC years, today Seoul is a central player in regional financial governance.

This paper will analyze the reasons propelling Korea towards centrality in East Asia's regional financial governance, as well as why Seoul's centrality is crucial to said governance. The focus will be on crisis prevention and resolution, since these are the two areas in which institutionalization is strongest and therefore government views and actions can be better gauged. The paper will first summarize the evolution of East Asia's crisis prevention and resolution mechanisms – namely the developments leading to CMIM, AMRO, and ERPD. It will then analyze in detail three key reasons why Korea has sought to become central to financial governance in East Asia. The paper will then explain why Korean centrality is crucial for ASEAN+3 financial governance and for it to remain relevant, thanks to its balancer and bridge roles.

Development of East Asia's Financial Governance

Over the past twenty years, ASEAN+3 countries have developed a comprehensive regional financial governance mechanism to complement – rather than replace – global governance institutions. Prior to the EAFC, the five original ASEAN members had established the ASEAN Swap Arrangement (ASA). Launched in 1977 by the five original members of ASEAN, ASA was not activated during the EAFC because its small size made it inadequate.[5] However, this experience originally made ASEAN the de facto leader in the early development of a regional financial safety net. Japan's proposal for an Asian Monetary Fund was rejected, China had yet to attain the economic power or centrality to the region to take a leading role, and Korea was still recovering from its crisis. ASEAN was thus able to take the lead in shaping the ASEAN+3 financial governance mechanism.

The key element of East Asia's incipient financial safety net was the CMI. Established in 2000, the initiative consisted of a network of what eventually became sixteen bilateral swap arrangements among ASEAN+3 countries amounting to $84 billion. CMI could have been activated in a crisis, but it remained unused during the GFC. To an extent, this was the result of East Asian countries opting for their own bailout packages while also using bilateral swap arrangements with other parties if necessary – most notably the United States.[6] Yet it was also the result of the relatively small size of CMI. During the EAFC, Korea and Indonesia had received $57 billion and $23 billion from the IMF, respectively. None of the bilateral swaps included in CMI were close to these figures.

The other element of the post-EAFC early regional financial safety net was ERPD. Launched in 1999, the dialogue originally was a surveillance or monitoring mechanism. In annual finance ministers meetings and biannual finance minister and central bank deputies meetings, economic conditions – both domestically and across the region – potential vulnerabilities, and policy recommendations to deal with them were discussed. In 2005, ERPD was integrated into the CMI framework due to potential need for liquidity-short countries to undergo strict surveillance and comply with conditionality.[7] Building on the "ASEAN Way", ERPD was characterized by dialogue and non-interference in domestic affairs. Thus, it can be argued that the ERPD was useful to symbolize regional cooperation but had little practical effect in its first few years.

In the years following the GFC, East Asia's regional financial governance architecture has been significantly enhanced. CMIM replaced CMI in 2010. As of 2017, it is a $240 billion self-managed reserve pool managed by a single contract. While it continued to serve as a crisis management and resolution facility, a precautionary line for crisis prevention purposes was also introduced in 2014.[8] Up to 30 per cent of each country's drawing quota is de-linked from the IMF; access to the rest requires an agreement with the IMF, even though there are plans to increase the de-linked portion to at least 40 percent.[9] The link to the IMF has been maintained due to a lack of trust among some of the countries in the region, which explains why plans to increase the de-linked portion have been on hold for several years.

Meanwhile, surveillance has been significantly improved. AMRO was launched in 2011 as the CMIM's macroeconomic surveillance unit. It was converted to a legal international organization in 2016, becoming the first ASEAN+3 supranational institution. During peace or non-crisis periods, its main task is to prepare quarterly macroeconomic and financial reports on the ASEAN+3 region as well as individual countries party to CMIM. In 2017, AMRO started to make its annual regional economic outlook report public.[10] This has enhanced transparency and is a significant step for ASEAN+3 countries less accustomed to public scrutiny. It should be noted that AMRO has conducted several joint seminars with the IMF, reinforcing the complementarity between ASEAN+3 regional governance and global governance.

As for the ERPD, there has been some progress. Starting from 2012, finance ministers have been joined by central bank governors in their annual meetings. This is relevant insofar as central banks have a comparative advantage in macroeconomic and financial surveillance, and would have a critical role to play were CMIM to be activated and disbursements to be made.[11] The ERPD also receives the support of AMRO through its quarterly and other reports. Therefore, even though the ERPD could still be strengthened were it to include financial regulators, engage with the FSB or meet more regularly, it can be said that its surveillance capacity has been strengthened following the GFC.

Korea and East Asia's Financial Governance

Seoul has been supportive of East Asia's regional financial governance since its inception. Dating back to the Kim Dae-jung administration that assumed office in February 1998 – shortly after Korea and the IMF agreed to the country's bailout package – successive Korean governments have sought to strengthen the regional financial safety net. In the aftermath of the GFC, this support has translated into Seoul taking a leading role in the strengthening of this safety net that has supported its institutionalization.[12] Concurrently, Seoul has also become more active in the global financial safety net.[13] Nonetheless, it has had a bigger impact on the regional layer, in which Korea's economic and diplomatic clout is obviously stronger.

There are three key reasons why Korea has sought to play a central role in East Asia's financial governance: an increasing reliance on financial markets as the role of the banking sector in fostering economic growth declines; Korea's self-perception and increasing activity as a middle-power; and unwavering support for ASEAN+3 integration concurrent to the decline of ASEAN centrality.

Growing role of financial markets in the domestic economy

Korea's contemporary, high-tech economy is very capital-intensive. The development model based on stringent controls over credit allocation by the banking sector no longer works for the modern economy. From the 1960s until the 1980s, it served the purpose of catch-up growth. By the 1990s, this model of credit allocation had become inadequate. Seoul thus started a very swift and aggressive capital liberalization process, leading to a hot money-induced bubble that resulted in the 1997 crisis.[14] Following the crisis, successive Korean governments initiated a more cautious financial liberalization process.[15] As a result, financial markets are increasingly central to the Korean economy.

Korea's move towards a market-based credit allocation model is necessary and unlikely to be reversed. To begin with, the economy is dominated by capital-intensive industries such as electronics, shipbuilding, automotive or machinery. New growth engines such as robotics, biotechnology or telecommunication also require large investments. In addition, Korea has actively sought to foster entrepreneurship and start-ups since the late 1990s. The Park Geun-hye government made this a centerpiece of its economic strategy with the "Creative Economy" plan.[16] President Moon Jae-in has indicated that he will continue to support entrepreneurs.[17] Start-ups tend to have difficulties in accessing bank credit, relying on financial markets in their early stages. To this end and among other measures, Seoul launched KONEX in July 2013 – a stock exchange specifically for start-ups and SMEs.[18]

Furthermore, the EAFC acted as a catalyst for Korea to seek better-quality foreign direct investment, as a means not only to limit the impact of hot money but also to weaken the links between government, the banking sector, and *chaebols*. The Foreign Investment Promotion Act of September 1998, amended and adapted several times since, has been the main conduit to achieve this goal.[19] Korea has significantly boosted overseas investment since the act was first passed.[20] Meanwhile, Korea has also become increasingly attractive for portfolio investors. The KOSPI index hit new record highs in July 2017.[21] This was the result of foreign ownership of KOSPI stocks reaching all-time highs – over one third are now owned by non-Korean investors.[22] Despite the Park Geun-hye impeachment process, foreign investors showed faith in Korea's financial sector due to its increasing competitiveness and openness. There is no indication that this trend will be reversed under Moon Jae-in.

The growing role of financial markets in the Korean economy might be welcomed news for an increasingly diverse economy, but it comes with associated risks such as credit or asset bubbles. The IMF and foreign investors blamed the 1997 crisis on an alleged lack of sophistication among emerging East Asian economies.[23] They were considered unable to manage capital account liberalization and financial inflows in the same way that more mature markets could. The GFC put an end to the idea that developed countries have graduated from financial crises. Even the biggest and most sophisticated financial market in the world – the U.S. – is susceptible to a bubble in a particular sector bursting and affecting the whole economy. In fact, recurrent financial crises have been a feature of the world economy since the end of the Bretton Woods system.[24]

A strong regional financial safety net is one of the means to reduce the risks associated with capital account openness and increasing financial interconnectedness.[25] CMIM is a source of emergency liquidity: Korea has ready access to $38.4 billion – 30 per cent of which is available without the need of an agreement with the IMF.[26] Even though Korea is the third largest contributor and unlikely to draw from this facility, the fact that the country has access to it would also be helpful to calm investors in the event of a crisis.

Moreover, and equally important, AMRO and CMIM are useful to prevent a crisis elsewhere in the region and to prevent contagion in case one takes place. The EAFC began in Thailand before spreading to other countries in the region – including Korea. AMRO is tasked with monitoring economic conditions in each ASEAN+3 country as well as at the regional level.[27] This should be helpful for crisis prevention, allowing Korea to understand regional macroeconomic trends as they develop.[28] The CMIM precautionary line would be equally useful if an East Asian country were on the brink of suffering liquidity shortages. Meanwhile, the initiative's credit lines would be of use if a crisis had already hit a country in the region. From a Korean perspective, avoiding contagion in an increasingly integrated region is an important reason for supporting the ASEAN+3 financial safety net.[29]

Self-perception and increasingly active role as a middle power

Korea sees itself as a middle power. Throughout the Cold War and until the end of the Kim Dae-jung government, Korea's foreign policy was very much focused on inter-Korean relations and closely followed American priorities. The Roh Moo-hyun government moved away from this narrow focus and decisively introduced a middle power agenda. This had a regional focus, seeking to make Korea a balancer between China and Japan while putting the country at the center of Northeast Asian security cooperation. The Lee Myung-bak government later launched an ambitious middle power agenda. His administration sought to make Korea a global player, serving as a bridge between developed and developing countries while becoming an agenda-setter in areas such as development assistance. The Park Geun-hye government might have been more reluctant to openly promote Korea's middle power agenda, but her government sought to position Korea between China and the U.S. and supported the MIKTA grouping.[30] Park also launched the Northeast Asia Peace and Cooperation Initiative – or NAPCI – again positioning Korea at the center of a regional security regime. In his inauguration speech, Moon Jae-in also talked about a Northeast Asian peace regime.[31]

> **"Implementation of international agreements is necessary for Korea to be seen as a responsible stakeholder in international affairs."**

Financial governance is one of the areas in which Korea has sought to project its middle power status.[32] Most notably, the Lee government lobbied for Korea to host the first G20 summit outside of a Western country, which it did in November 2010. Fitting its self-perception as a bridge between developed and developing countries, the Lee government moved the G20 agenda away from a narrower focus on post-GFC recovery to also include development issues and global imbalances in the agenda. More generally, Korea has been very supportive of the G20 and has successfully acted as a mediator and coordinator among members with different views.[33] Korea sees the G20 as an opportunity to reinforce its credentials as a middle power involved in agenda-setting.

Less talked-about but equally important in terms of projecting itself as a middle power, Korea joined the BCBS in March 2009.[34] Differently from the G20, Korea does not have an agenda-setter or even mediator role in the BCBS.[35] This is understandable, considering that other members such as the U.S. or Western European countries have more developed financial systems and much longer experience in this committee. Nonetheless, Korea is deemed to be largely compliant with the Basel III accord on capital adequacy.[36] This is the third iteration of the original Basel accord, designed to prevent a bank from collapsing and a financial crisis from happening through a set of minimum capital requirements. Implementation of international agreements is necessary for Korea to be seen as a responsible stakeholder in international affairs. Seoul is thus keen to be part of BCBS to have first-hand knowledge of new trends in financial governance.[37]

It is in East Asia, however, that Korea has taken a more active role in financial governance. Most notably, Seoul has sought to present itself as a middle point between China and Japan on the one hand and ASEAN on the other, acting as an honest broker and bridge builder.[38] This is clearest in CMIM. There were disagreements between China and Japan regarding their respective financial contributions, and between these two de-facto lenders and the de-factor borrowers in ASEAN. Korea was instrumental in the equitable allocation of contribution and borrowing ratios, while also ensuring that voting power was also fairly distributed.[39] This role fits Korea well insofar it has no regional financial domination ambitions. China and Japan might be in competition to become the dominant financial player in the region,[40] but Korea is not. Also, ASEAN countries hold suspicions about Chinese and Japanese intentions, which is not the case with Korea.[41]

For Seoul, taking a leading role in regional financial governance serves a second purpose in terms of its projection as a middle power. The Lee government was interested in IMF reform, and indeed played an important mediation role as the voting power of Korea and other non-Western countries was increased in the 2010 quota reform.[42] Yet, this change has been insufficient to grant Seoul a meaningful say in IMF decisions. In sharp contrast, Korea has played an instrumental role in CMIM. Similarly, Seoul plays a leading role in AMRO and was instrumental in the organization legally becoming an international institution.[43] Also, at least one of the senior management roles and several group head positions are de facto held by Korean officials,[44] placing Korea at the center of the organization's strategic direction. Since Korea does not seem determined to take the directorship of AMRO – thus far only held by Chinese or Japanese nationals – it can again be an honest broker and bridge builder, which would be more difficult to do if Seoul had greater aspirations.

Support for ASEAN+3 institutionalization concurrent to the weakening of ASEAN centrality

The creation of ASEAN+3 was the direct result of the EAFC, as previously stated. Members launched this cooperation mechanism due to two factors related to this crisis. The first factor was the contagion of the crisis from Thailand to the rest of the region. This prompted East Asian countries to establish ASEAN+3 institutions as support mechanisms to strengthen their financial sectors, prevent future crises, and solve any crisis that might hit the region.[45] The second factor was displeasure with the way in which the IMF handled the crisis, as well as with the stringent conditionality attached to its bailout packages. ASEAN+3 institutions were thus set up to prevent future reliance on the IMF and the associated stigma of accessing IMF credit lines.[46]

Successive Korean governments have also supported ASEAN+3 institutionalization due to growing trade and financial regionalization. Following China's entry into the WTO, a Sino-centric regional trade network has emerged. Trade in intermediate goods for final assembly and export from China has boomed, creating strong economic links across East Asia.[47] Even though intra-regional financial flows are not as integrated as trade links, investment from Korea and other developed countries in the region into the five largest ASEAN states and China is steadily growing.[48] The result of growing trade and investment integration is that the economies of the region are becoming more intertwined. They have become more dependent on each other than they were when the EAFC took place.

Conscious of this growing integration, Seoul is aware that there is a need for regional financial institutions that can help to prevent a loss in confidence towards the region. Trade and investment interconnectedness means that markets losing faith in one East Asian country could affect the others – as the Global Financial Crisis showed, intra-East Asia crisis contagion results from trade and investment links.[49] ASEAN+3 institutions are helpful in this respect. These institutions have an important signaling effect, indicating that countries in the region are working together to make sure that trade and investment does not suffer from a sudden stop.

One other reason why Korea is supportive of ASEAN+3 institutionalization that should not be dismissed is its cost-effectiveness.[50] China and Japan are not only the two largest economies in the region, but also the largest holders of foreign exchange reserves in the world. This grants them the significant advantage of not being reliant on outside support to prevent a financial crisis. Even though it is a large holder of reserves, the Korean government is aware that these would probably not be sufficient to fend off a crisis like the AFC.

For a large but not world-leading economy such as Korea, the pooling of resources together with China and Japan serves as an extra safety layer in case there are signs of a crisis. CMIM contributions are pledged rather than paid-in,[51] which indicates that if Korea – or any other ASEAN+3 country – was hit by a crisis it could potentially receive pledged capital without having to pay in or by only paying in a smaller amount than pledged. The up to $38.4 billion Seoul can borrow from the CMIM is the same amount it pledges to the institution, yet the fact that it can draw on Chinese and Japanese contributions to CMIM if needed that makes it cost-effective.

Korea's unwavering support for ASEAN+3 institutionalization is particularly relevant in the context of weakening ASEAN centrality. This concept, which placed ASEAN at the center of regional initiatives, was key to the launch of ASEAN+3 institutions. It was ASEAN that came up with the idea of the first (informal) ASEAN+3 meeting, held in Kuala Lumpur in December 1997 during the early stages of the EAFC.[52] In addition, CMI can be seen as an upgrading of ASA by incorporating China, Japan, and Korea into the network of pre-existing bilateral swap arrangements. Furthermore, ASEAN centrality was already in the process of being cemented as a result of the ASEAN Free Trade Area signed in 1992 and the launch of the ASEAN Regional Forum in 1994. It would be further strengthened with ASEAN trade agreements signed with China in 2002, Korea in 2004, and Japan in 2005.[53] By the mid-2000s, ASEAN centrality was key to financial cooperation, security dialogue, and trade agreements in East Asia. Great powers were supportive of this centrality, given the perception of ASEAN as a neutral organization.

This centrality, however, has been eroding over the past few years due to capacity constraints and internal divisions. To begin with, capacity constraints have eroded confidence in ASEAN.[54] This has become most obvious in the area of trade. A possible ASEAN+3 FTA has now been replaced by negotiations of an ASEAN+6 Regional Comprehensive Economic Partnership (RCEP). China has taken the lead in RCEP negotiations, which Japan has also sought to shape following the decision by the US withdraw from the Trans-Pacific Partnership (TPP).[55] Another reason behind the erosion of ASEAN centrality is internal divisions among its members.[56] Up until the mid-2000s, ASEAN members were showing remarkable unity in their foreign economic policy. The trade agreements with China, Japan, and Korea best exemplify this. This unity, however, has weakened over the past few years, affecting economic matters.

Focusing on regional financial governance, ASEAN centrality is further eroded for the simple reason that ASEAN members are potential borrowers rather than lenders.[57] The preponderance of nationals from China, Japan and Korea in AMRO senior management underscores this reality: the largest get to shape the conditions of the arrangement. Finally, ASEAN centrality in regional financial governance has also been eroded by the independent roles of Singapore and Indonesia in the G20. While it is true that the ASEAN chairman has been a guest of G20 meetings in the past, this was not the case during the last meeting in Hamburg.[58] Thus, ASEAN does not have a central voice in global financial governance in the same way that China, Japan, Korea, and Indonesia – all G20 members – as well as Singapore – a perennial representative of the Global Governance Group – do, which affects its position at the regional level.

Assessing the Importance of Korea's Centrality to East Asia's Regional Financial Governance

There is an ongoing debate regarding the importance of regional financial governance in East Asia. China, especially, and Japan have been building separate networks of bilateral currency swap agreements within the region and beyond through the People's Bank of China and the Bank of Japan, respectively. These arrangements sit outside the CMIM framework and thus are without its safeguards. This suggests Sino-Japanese competition could be the region's lender of last resort, which would undermine CMIM.[59] Meanwhile, Beijing has a clear strategy to support renminbi internationalization by setting up offshore currency centers across East Asia and the world.[60] These centers could potentially further erode regional financial governance if they made the renminbi a de facto regional currency, thus effectively giving Beijing's financial governance institutions the leading role in the resolution of any future crisis.

This debate, however, does not neglect the continuing relevance of East Asia's regional financial governance and, concomitantly, the role of Korea herein. The region's financial governance mechanisms are designed to complement their global counterparts, as explained above. Likewise, ASEAN+3 institutions are not meant to replace domestic mechanisms developed by each country – including bilateral swap arrangements among central banks.[61] AMRO, CMIM and RCEP are thus part of a multi-layered global financial governance regime in which the different layers reinforce each other. Cases in point include the surveillance role of AMRO and the precautionary line of CMIM, which are an important component of the region's toolkit to prevent future crises.

In this context, Korea's centrality to East Asia's regional financial governance is crucial for its continuation and operation. Seoul plays the role of balancer between Beijing and Tokyo. As explained above, Seoul was a key driver behind agreements on financial contributions, contribution and borrowing ratios, and voting rights in CMIM. Korea was also central to AMRO legally becoming an international institution. As ASEAN has become more disunited and its centrality to regional financial governance has weakened, Korea has stepped in as an honest broker capable of balancing the demands and needs of the two great regional powers.[62] Without Seoul's centrality, it is not unthinkable that East Asian financial governance could unravel – with ASEAN countries dividing themselves between the protective umbrellas of either China or Japan.

Meanwhile, Korea – in contrast to China and Japan – is perceived across Southeast Asia as a neutral actor with no geopolitical ambitions.[63] This perception can be extended to the area of regional financial governance. Korea has not shown any inclination to develop its own network of bilateral swap arrangements in a way that could be seen as detrimental to regional financial governance. Thus, Seoul can credibly present itself as a mediator between competing views of regional financial governance without having ulterior motives. Since ASEAN can no longer play this role due to internal divisions and capacity constraints, Korea has become ever-more important in this respect.

Furthermore, Korea is also relevant for East Asia's regional financial governance because of its position as a bridge between developed and developing countries.[64] Across Southeast Asia, Korea is seen as an economic and development model in a way that Japan and China – much larger economies – are not.[65] Having been hit by the EAFC during its own capital account opening up process, Seoul can present itself as an example to liberalizing Southeast Asian economies regarding what to do and not do. This includes the importance and usefulness of certain elements of the ASEAN+3 financial governance framework such as regular surveillance by AMRO, consultation through ERPD or potential liquidity provision by CMIM. These regional mechanisms were not available to Korea, and could have been helpful in preventing contagion during the EAFC or in solving the crisis with less pain.

Conclusions

As East Asia's regional financial governance architecture grows and strengthens, Korea is seeking to become increasingly central to its institutionalization. Crisis prevention and resolution is a clear case in point. Seoul was key to the evolution of CMI into CMIM and the creation of AMRO. It remains a significant player in the operation of both institutions and debates about their future development. Moreover, it seems that Korea's role is supported by other ASEAN+3 members. The country does not have regional leadership ambitions and has sought to play a balancing role. Both are welcome in a region often portrayed as ripe for competition, when not conflict.

There are three main factors why Korea has sought to become central to financial regionalism in ASEAN+3. Firstly, the growing role of financial markets in Korea's economy and, as a result, the possibility of instability that they bring with them. Secondly, Seoul's self-perception as a middle power since Roh's presidency, coupled with a behavior concomitant with this self-image. Thirdly, Korea's unapologetic and uninterrupted support for ASEAN+3 institutionalization – in the context of weakening ASEAN centrality. These factors are likely to continue to underpin and support Korea's bid for centrality in East Asia's regional financial governance. As a result, we can expect Seoul to remain central to financial regionalism in the coming years to the benefit of ASEAN+3 states.

Endnotes

[1] Ramon Pacheco Pardo and Pradumna B. Rana, “Complementarity between Regional and Global Financial Governance Institutes: The Case of ASEAN+3 and the Global Financial Safety Net,” *Global Governance: A Review of Multilateralism and International Organizations* 21:3 (2015), 413-433.

[2] Throughout this paper, Korea will be used to refer to South Korea.

[3] Elizabeth Thurbon, *Developmental Mindset: The Revival of Financial Activism in South Korea* (Ithaca: Cornell University Press, 2016).

[4] Pacheco Pardo and Rana, 2015.

[5] Ibid.

[6] Jayant Menon and Hal Hill, “Does East Asia Have a Working Financial Safety Net?,” *Asian Economic Journal* 28:1 (2014), 1-17.

[7] Masahiro Kawai, “From the Chiang Mai Initiative to an Asian Monetary Fund”, *ADBI Working Paper* 527, May 2015.

[8] ASEAN+3 Macroeconomic Research Office, *Overview of The Chiang Mai Initiative Multilateralization (CMIM)*, April 2016, http://www.amro-asia.org/overview-of-cmim/ (accessed July 17, 2017).

[9] ASEAN+3 Macroeconomic Research Office, *Keynote Speech by Dr Junhong Chang, AMRO Director, at the 6th Asia Research Forum CMIM-Asian Multilateralism and Cooperation*, July 1, 2016, http://www.amro-asia.org/keynote-speech-by-dr-junhong-chang-amro-director-at-the-6th-asia-research-forum-cmim-asian-multilateralism-and-cooperation/ (accessed July 17, 2017).

[10] ASEAN+3 Macroeconomic Research Office, About *AMRO*, http://www.amro-asia.org/about-amro/ (accessed on July 17, 2017).

[11] Kawai, 2015.

[12] Yong Wook Lee, “Korea’s Strategy for Regional and Global Financial Governance: From Rule Taker to Rule Setter?,” *EAI MPDI Working Paper*, September 2014.

[13] It should be noted that Korea has also strengthened its domestic safety net, based on two pillars. The first includes forex reserves of S378.4 billion as of June 2017 – one of the world’s ten largest amounts. This allowed the Lee Myung-bak government to implement the world’s second largest stimulus package as a percentage of GDP when the GFC struck. The second pillar is a network of bilateral swap arrangements between the Bank of Korea and other central banks including the Federal Reserve and the People’s Bank of China. As already stated, the Bank of Korea activated a $30 billion swap with the Federal Reserve during the GFC.

[14] Thurbon, 2016.

[15] This is reflected in the Chinn-Ito index of financial openness. For more information, see Menzie D. Chinn and Hiro Ito, “What Matters for Financial Development? Capital Controls, Institutions, and Interactions,” *Journal of Development Economics* 81:1 (2006), 163-192.

[16] Park Geun-hye, *Opening a New Era of Hope*, February 25, 2013.

[17] Moon Jae-in, *Remarks by President Moon Jae-in at the First Session of the 12th G20 Summit in Hamburg*, Germany, July 7, 2017.

[18] Simon Mundy, “South Korea Launches Third Stock Market”, *Financial Times*, July 1, 2013.

[19] The National Assembly of the Republic of Korea, *Foreign Investment Promotion Act*, September 16, 1998, last amended January 27, 1016.

[20] OECD, *FDI Financial Flows – By Partner Country*, http://stats.oecd.org/Index.aspx?QueryId=64194 (accessed July 17, 2017).

[21] Yoon Ja-young, “KOSPI Soars to Record High,” *Korea Times*, July 17, 2017.

[22] Song Jung-a, “Foreign Investors Find the Right Kind of Turmoil in South Korea,” *Financial Times*, March 21, 2017.

[23] Giancarlo Corsetti, Paolo Pesenti and Nouriel Roubini, “What Caused the Asian Currency and Financial Crisis?,” *Japan and the World Economy* 11:3 (1999), 305-373.

[24] Carmen Reinhart and Kenneth Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009).

[25] Telephone interview with KIEP Senior Research Fellow, June 14, 2017, London.

[26] ASEAN+3 Macroeconomic Research Office, *Key Points of the CMIM Agreement*, April 2016, http://www.amro-asia.org/key-points-of-the-cmim-agreement/ (accessed July 17, 2017).

[27] ASEAN+3 Macroeconomic Research Office, *Overview of The Chiang Mai Initiative Multilateralization (CMIM)*.

[28] Email interview with Korea Ministry of Strategy and Finance official, June 12, 2017, London.

[29] Email interview with Korea Ministry of Strategy and Finance official, June 12, 2017, London; telephone interview with KIEP Senior Research Fellow, June 14, 2017, London.

[30] Sung-Mi Kim, “South Korea’s Middle Power Diplomacy: Changes and Challenges,” *Chatham House Research Paper*, June 2016.

[31] Moon Jae-in, *Inaugural Address*, May 10, 2017.

[32] Email interview with Korea Ministry of Strategy and Finance official, June 12, 2017, London.

[33] G. John Ikenberry and Jongryn Mo, *The Rise of Korean Leadership: Emerging Powers and International Order* (New York: Palgrave Macmillan, 2013).

[34] Bank for International Settlements, “Expansion of Membership Announced by the Basel Committee,” *Bank for International Settlements*, March 13, 2009.

[35] Email interview with Korea University professor, July 14, 2017, London.

[36] Bank for International Settlements, *Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III Risk-based Capital Regulations – Korea* (Basel: Bank for International Settlements, 2016).

[37] Email interview with Korea Ministry of Strategy and Finance official, June 12, 2017, London.

[38] Lee, 2014.

[39] Interview with RSIS professor, June 17, 2017, Hong Kong; email interview with Korea University professor, July 14, 2017, London.

[40] Ramon Pacheco Pardo, "China, Japan, and Economic Security Competition (and Cooperation) in the Asia-Pacific," in Jeffrey Reeves, Jeffrey Hornung and Kerry Lynn Nankivell, *Chinese-Japanese Competition and the East Asian Security Complex* (New York: Routledge, 2017), 71-85.

[41] Interview with RSIS professor, June 17, 2017, Hong Kong.

[42] Ikenberry and Mo, 2013.

[43] Email interview with Korea University professor, July, 14 2017, London.

[44] ASEAN+3 Macroeconomic Research Office, *Senior Management*, http://www.amro-asia.org/about-amro/#_management (accessed July 17, 2017).

[45] Pacheco Pardo and Rana, 2015.

[46] Ibid.

[47] Asian Development Bank, *Asian Economic Integration Report 2016: What Drives Foreign Direct Investment in Asia and the Pacific?* (Manila: Asian Development Bank, 2016).

[48] Ibid.

[49] Mireya Solis, "Global Economic Crisis: Boon or Bust for East Asian Trade Integration?," *The Pacific Review* 24:3 (2011), 311-336.

[50] International Monetary Fund, *Adequacy of the Global Financial Safety Net* (Washington, DC: International Monetary Fund, 2016).

[51] ASEAN+3 Macroeconomic Research Office, *Key Points of the CMIM Agreement*.

[52] Richard Stubbs, "ASEAN Plus Three: Emerging East Asian Regionalism?," Asian Survey 42:3 (2002), 440-455.

[53] For a discussion of ASEAN-led East Asian cooperation in the 1990s and early 2000s, see Alice D. Ba, *(Re)Negotiating East and Southeast Asia: Region, Regionalism, and the Association of Southeast Asian Nations* (Stanford: Stanford University Press, 2009).

[54] Singapore Institute of International Affairs, *ASEAN Centrality in the Regional Architecture* (Singapore: Singapore Institute of International Affairs, 2015).

[55] Robin Harding, Tom Mitchell and Michael Peel, "China and Japan Vie for Control of Asia Trade Deal", *Financial Times*, March 14, 2017.

[56] Singapore Institute of International Affairs, 2015.

[57] Kaewkamol Karen Pitakdumrongkit, *Negotiating Financial Agreement in East Asia: Surviving the Turbulence* (London: Routledge, 2015).

[58] Pia Ranada, "Snubbed? ASEAN Chairman Duterte Wasn't Invited to G20 Summit," Rappler, July 10, 2017.

[59] William W. Grimes, "East Asian Financial Regionalism: Why Economic Enhancements Undermine Political Sustainability", *Contemporary Politics* 21:2 (2015), 145-160.

[60] Pacheco Pardo, 2017.

[61] Pacheco Pardo and Rana, 2015.

[62] Pitakdumrongkit, 2015.

[63] Sarah Teo, Bhubhindar Singh and See Seng Tan, "Southeast Asian Perspectives on South Korea's Middle Power Engagement Activities", *Asian Survey* 56:3 (2013), 555-580.

[64] Kim, 2016.

[65] Teo et al., 2013.

KEI KOREA ECONOMIC INSTITUTE OF AMERICA | 한 미 경 제 연 구 소

1800 K St. NW, Suite 1010 | Washington, DC 20006
T.202.464.1982 | F.202.464.1987 | www.keia.org