

Policy Recommendation for South Korea's Middle Power Diplomacy: Finance

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In international politics, financial and monetary relations are the nucleus and backbone of the international economic order(s). As such, they are an arena of competition and cooperation that involves power, interests, and ideas among great powers. From the late 19th century to the early 20th century, both capital liberalization and the gold standard were inseparable from the hegemony of Great Britain. Similarly, the establishment and demise of the Bretton Woods System and the surge of neoliberalism as the organizing principle for financial and monetary order all materialized within the framework of competition and cooperation among great powers, such as the United States and the G-7.

A core function of institutionalization is the process of rule-making and rule-transformation. The politics of global standards is a case in point. At the same time, a rule accompanies a ruler and the ruled. The trinity of the Bretton Woods system—the International Monetary Fund (IMF), the World Bank, and the World Trade Organization (WTO)—just demonstrates the relationship between the ruler and the ruled through rules. Rule-setters set the terms on which future interactions among members take place. They are the authors of the rules of the game. By contrast, rule-takers' main policy goal is to adapt themselves to the changing international financial and monetary order(s). Put differently, weak powers' policy preference reflects constrained choices with little or a relatively narrow range of policy autonomy.

The start of the 21st century shows that the world has changed and so has Korea. The world economic order is at a crucial crossroad of transformation. Korea, previously a rule-taker as a catching-up state at best, is taking an important step toward being potentially a rule-setter. The fact that Korea today is a member of the G-20, the consultative body for



the world economic order created in 2009, is one example of such transition. In the history of the world economy, the next ten years can be noted as a period of epochal change, ushering in the great transformation of the world economic order. The 2008 global crisis calls for changes to be made in the international financial and monetary order at both a global and regional level.

How can Korea, which is not a great power in any meaningful sense, effectively carry out the role of a rule-setter, encompassing the world and East Asia in this major transformational period? More concretely, how can Korea secure such policy goals as exchange rates stability, financial market developments, and financial stability without at the same time losing its policy autonomy? Would there be any way for Korea to project its policy preferences onto the emerging global and East Asian regional finance and monetary order? In light of both the 1997 and 2008 financial crises that shook up the Korean economy and threatened to turn it upside down, the importance of financial diplomacy cannot be overstated to Korean policy makers.

Policy Recommendations

1. Macro Strategy: Korea Should Pursue Multilateral Linkages of Regional and Global Levels

I argue that multilateralism, particularly multilateralism linking regional and global dynamics, should be the cornerstone of Korean financial and monetary diplomacy. Being a middle power that is far more limited in projecting its policy preference on the international arena than a great power is, Korea should not only employ multilateralism as a policy tool. Korea should also pursue it as a goal in itself, if Korea is to be a rule-setter in the changing international and regional economic order(s). To be specific, Korea's multilateralism should be a mixed strategy of regional and global linkage. By this it means that the best way to maximize Korea's policy influence is to take a two-step approach (not mutually exclusive), attempting to exercise a global clout that derives from solidifying regional multilateralism. This is a bottom-up strategy that flows from regional to global processes.



2. Korea Should Act as a Broker in Regional Rule Setting Processes

In developing and designing regional financial and monetary arrangements in East Asia, Korea should build trust and mutual experience in policy cooperation and coordination with China and Japan. Korea should actively take the role of an honest broker in these regional rule-making processes. In so doing, Korea can consolidate the patterns of cooperation among regional powers. These patterns of cooperation would, then, translate into the regional source of Korea's global influence. In short, Korea can do much more in shaping the global financial and monetary order(s) than what its middle power position may allow it to do by choosing to embrace East Asia. A strategy of regional and global linkage opens up more possibilities for Korea to implement and reflect its policy preferences in comparison to other strategies. Of course, there may be a limit as to how far a middle power can go in initiating a multilateral approach and designing an institutional framework. Nonetheless, it can effectively take advantage of the multilateral framework already established, as the extant literature on multilateralism suggests.

3. Micro Strategy: Korea Should Make and Utilize Policy Network Processes

Consolidating financial cooperation in East Asia is a significant stepping stone toward this endeavor. As discussed earlier, the ASEAN+3(the APT) has institutionalized financial cooperation in no trivial way since the Asian financial crisis of 1997-8; however, there remain many challenges yet to be met before the institutional consolidation and stabilization of financial cooperation finally takes place. In this process of institutional consolidation, each member country's political will as well as mutual trust through communication and cooperation is indispensable. One can glean from the existing literature three main structural constraints in the way of robust institutional cooperation in East Asia. They are leadership competition between Japan and China; sovereignty sensitivity among regional countries; and finally heterogeneity in political institution, domestic economic structure, and core values among the countries (Lincoln 2004).

As such, the key to success for Korea's financial diplomacy is to find the ways in which Korea can stretch these constraints for nurturing patterns of sustainable cooperation. In other words, Korea needs detailed, micro strategies to help materialize the macro-vision of the bottom-up multilateral linkage. Korea's micro strategies should be carefully designed in combining Korea's political and economic position and expertise in East Asia with thoughtful analysis of political dynamics within the APT. What can be Korea's micro strategies that curtail the structural constraints at the maximum?



In this regard, Sohn's (2012) work is very useful in helping analytically think through the construction of such micro strategies. Sohn suggests three strategies to employ in mitigating against the aforementioned structural constraints facing East Asia (Sohn 2012, 9-16). Although Sohn offers three strategies in general without targeting a particular country within the APT, one can draw a great deal of the implications borne out of his analysis for Korea.

4a. Principled Minimalism and Host Regulation

The first strategy is 'Principled Minimalism and Host Regulation'. This strategy aims to create patterns of cooperation by taking into account power imbalance, sovereignty sensitivity, differences in domestic politics and economic structures among the APT countries. There are two key features in applying this strategy to actual practices of institutional building/consolidation. One is for the APT to focus initially on working out the most agreeable principles (regulations and rules). This is the case of 'Principled Minimalism'. The other is that domestic application of agreed principles is entrusted to individual countries based on their capabilities. In this scheme, each country sets the pace of its own adjustments to changing regional economic and political conditions without external imposition. This is the case of 'Host Regulation'. Taken together, the APT can develop the practice of working together with relatively easy issues while not worrying about external pressure-driven implementation.

4b. Decomposition and Issue Linkage Strategy

Decomposition refers to breaking down into multiple stages the complicated bargaining and negotiation processes of institutional cooperation. In the context of the APT, these processes include the efforts to establish the Asian Monetary Fund, to harmonize Asian bond market standardized measures, and to work on the creation of an East Asian common currency. 'Issue Linkage' is a strategy to smooth out negotiation processes by enhancing fairness in distribution of benefits among the APT countries. The upshot of this strategy is to link relevant issues with side payments to minimize distributional conflicts of negotiation parties.

4c. Activating "Informal Intermediaries"

This strategy is concerned with agenda setting, co-development of policy ideas, and construction of robust policy networks. More concretely, it aims to take advantage of revitalizing both Track 1.5 Diplomacy and Track 2 Diplomacy for these goals. Track 1.5 Diplomacy



increases interactions and exchanges of policy ideas among government agents, scholars, and professionals. Track 2 Diplomacy helps the formation of non-governmental policy network, which might be able to provide bipartisan perspectives on critical issues and debates in a way facilitating cooperation. The combination of Track 1.5 and Track 2 Diplomacy can help narrow down differences between the APT countries' stances in institutionalizing East Asian financial cooperation in addition to proposing creative policy ideas. Various formal and informal policy channels can ameliorate the side effects of policy proposal competition. For example, China and Japan, the two regional leadership rivals, may react negatively toward each other's policy proposals regardless of their policy contents. In cases like this, informal meetings for policy proposal discussions can provide leeway for building mutual trust and sharing policy visions (Depersonalizing effects).

5. Korea Should Employ an Approach that Incorporates all Three Aforementioned Strategies in Sequential Order

In general, these strategies are not exclusive of, but are linked to each other. As such, they can be used in various combinations. A closer examination of them further suggests that one way to best design the combination is to package them in a sequential order. For example, 'Principled Minimalism and Host Regulation' is linked to defining and achieving policy goals. 'Decomposition and Issue Linkage' is a strategy for negotiation processes. And finally, 'Informal Intermediaries' is supposed to be used for setting agendas for policy discussion. Given the fact that policymaking normally runs from agenda setting through negotiation to defining and implementing policy goals, agenda setting is the first in moving the chain. As such, Korea should take the lead in 'Informal Intermediaries' strategy, which in turn sets the tone for the other two processes. This way of grounding the entire process of institutional cooperation would provide Korea with opportunities to shape the direction on which the APT takes in building regional financial cooperation.

Furthermore, this sequential order-based strategy with focus on 'Informal Intermediary' fits in with Korea's major diplomatic goal in East Asia. That is, Korea wants to locate itself as an honest broker between China and Japan, the two great powers vying for regional leadership. Of course, Korea's active East Asian financial diplomacy alone cannot guarantee the success of institutionalizing East Asian financial and monetary cooperation. However, the absence or lack of East Asia's common position on major global financial and monetary issues only confirms the timidity of East Asia in global politics. As such, consolidating East Asia's position on major issues through the three strategies is undoubtedly important. Korea should spearhead the making of 'East Asian position' as the linchpin of its linkage diplomacy



for global influence. As discussed above, the first step toward such a goal is to form and lead East Asian policy network in the spirit of ‘Informal Intermediaries’.

6. Korea Must Form an Effective Policy Network in the Region with Korea at the Center

How can then Korea effectively form policy networks in the region and use it? Relatively weak on a military, economic, and material basis, how can Korea effectively carry out a multilateral linkage strategy? A needed increase in Korea’s economic and military capability and policymakers’ top-notch negotiation skills cannot be ignored as background prerequisites. Yet, in the long run, the ability to creatively formulate problem-solving policy ideas is critical in nurturing a policy network to be organized around Korea in the region.

Multilateralism, in which the interactions among countries take the form of repeated games, operates on a long-term time horizon. For this reason, multilateralism is conducive to creating an internal policy network among like-minded representatives from member countries that share policy visions beyond borders. A professional policy network shows tendency to work on policy ideas and long-term visions rather than calculation of short-term gains and losses. As such, Korea can offset its ‘power shortage’ problem in East Asia and stand at the center of institutional cooperation by constructing itself as a policy entrepreneur. This is particularly pertinent to such policy areas as finance and money where high level of expertise and professional experiences are required for policy developments.

7. Korea Should Invest in Creating a Local Epistemic Community Needed for Establishing Policy Networks in the Field

In order for Korea to be an effective leader in developing policy networks, first and foremost, the government has to find ways to educate, secure, and organize professionals and diplomatic figures in the field of international finance and money. Indeed, financial and monetary areas are structured in a cyclical and interactive way that the decisions of the government (or public sector) in turn impact the market and vice versa. Therefore, it is deemed necessary to create a policy team through which government officials in relevant ministries regularly exchange views and share information with researchers, professors, and business professionals. Government officials can provide information on other governments’ policy preferences that they have collected from intergovernmental negotiations; researchers can develop and spread new policy ideas through various academic exchanges, including informal and formal Track 2 meetings at regional and global levels; and business professionals can communicate with



government officials about market evaluation of and responses to government policies that would affect financial and monetary market. Korea lacks professional human resources in financial and monetary affairs by far in comparison to the U.S., Europe, and Japan. As such, Korea should effectively and efficiently manage its usable human resources at a full throttle. This domestic epistemic community would become a firm basis for projecting regional and global policy visions.

8. Korea Should Invest in Upgrading the Skills of Its Government Officials Who Are Involved in Financial and Monetary Diplomacy

In a similar vein, the government should bring up a group of talented government officials to be in charge of financial and monetary diplomacy for the long run. The importance of this issue was, for example, noted by those officials who were involved in preparing and managing the G-20 Seoul meeting; these officials faced grave challenges during IMF reform negotiation due to the lack of expert knowledge and necessary negotiation skills on IMF quarter and monitoring structure (Kim and Park, 2012). Selecting and nurturing these officials educationally and professionally not only fulfill the greater level of expertise demanded by financial and monetary diplomacy. It also ensures the development of veteran leadership in building and expanding policy networks. A veteran policymaker, who builds his/her professional career in multilateral diplomacy in a particular area, would be able to command his/her personal as well as institutional networks to shape a regional financial policy with his/her experience and reputation. Conversely, it is extremely difficult to expect a veteran leadership when government officials in charge of, say, the Chiang Mai Initiative, change at every finance minister's meeting. Policy consistency is less likely to be sustained when government representatives come and go.

9. Korea Should Help to Construct an East Asian Regional Epistemic Community

Korea should put strenuous efforts in constructing an East Asian regional epistemic community on finance and monetary affairs. This is an investment scheme for building regional expert networks to be tapped into for years to come. The government, universities, think tanks, and concerned business enterprises can work together to strengthen seminars and academic conferences on institutionalization of regional and global financial and monetary cooperation. The study of the institutional evolution of the EU in comparative regionalism perspectives would be worth investing considerable energy and time to envision the future of East Asia.

In addition to inviting foreign speakers who are currently influential, attention and sup-



port should be given to young leaders of the next generation to make East Asian cooperation more robust and sustainable. For this, an integrated management system of regional human resources can be developed and shared among relevant parties (ministries, universities and think tanks, and concerned business enterprises) to best utilize the stock of experts and professionals while avoiding one-time or isolated events.■



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Yong Wook Lee is an Associate Professor in the Department of Political Science and International Relations at Korea University, Seoul, Korea. He is an author, editor, and translator of six books, including “The Japanese Challenge to the American Neoliberal World Order: Identity, Meaning, and Foreign Policy” (Stanford University Press, 2008), and “China’s Rise and Regional Integration in East Asia: Hegemony or Community?” (Routledge, 2014). Lee’s works also appeared in various academic journals, such as *International Studies Quarterly*, *Review of International Political Economy*, and *Review of International Studies*. He is currently finishing up a book on East Asian financial regionalism. Lee received Ph.D. in international relations at the University of Southern California in 2003.

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