

Security Still Trumps Finance in East Asia

By Benjamin J. Cohen

While much has been written about moves in East Asia toward financial integration, security tensions and the lack of a common identity have made such efforts largely symbolic, argues Benjamin J. Cohen, a specialist in international monetary and financial relations.

Over time, however, even modest steps toward financial regionalism can help resolve security issues — if there is sufficient political will to overcome historical differences.

WHAT DRIVES THE RELATIONSHIP between regional finance and security in East Asia? Financial co-operation in the region, long promoted in principle, is constrained in practice by underlying security tensions. Yet, over time, tentative steps toward closer monetary and financial relations can have the effect of moderating regional security strains as governments become more accustomed to working with each other and interests become more closely intertwined. Efforts to promote financial regionalism can be expected to persist, but in the absence of a fundamental shift in regional politics, tangible achievements will most likely remain modest for a long time to come.

THE CHIANG MAI INITIATIVE

To date, East Asia's most notable financial accomplishment has been the Chiang Mai Initiative (CMI), launched in May 2000 by ASEAN+3, the 10 members of the Association of Southeast Asian Nations plus China, Japan and South Korea. Conceived in the wake of the 1997 Asian financial crisis, the CMI established a basis for mutual liquidity assistance in the form of a network of bilateral swap arrangements (BSAs). At its peak, the swap network attained a nominal size of some \$60 billion. And then, early last year, under the label Chiang Mai Initiative Multilateralization (CMIM), resources were doubled to \$120 billion and pooled to enhance the amounts that any single country might draw when in need.

Great hopes have been placed in this mechanism as the foundation for closer financial and monetary relations in the region. Of particular importance, it is said, is the commitment under

the CMIM to a new joint decision-making process. As the common pool supersedes bilateral swaps, access to loans will be decided by a majority vote — in principle, a giant step toward regional financial integration.

In practice, however, there seems rather less here than meets the eye. The total amount of money involved, while a substantial increase from the existing BSA network, is still trivial in relation to potential need. Moreover, governance of the system will continue to be based on the East Asian tradition of consensus, minimizing any compromise of national sovereignty. Governments continue to operate more or less autonomously, tailoring their monetary and exchange-rate policies to their individual preferences. Payment financing is still dependent, first and foremost, on national reserves held in central banks.

Overall, therefore, one has the impression that the CMIM is largely of symbolic value, and that it signals little more than a minimal spirit of comity. Its practical impact has not been dramatic, and more than a decade after its debut, no participating country has yet drawn a single loan from the CMI/CMIM.

EXPLAINING THE RECORD

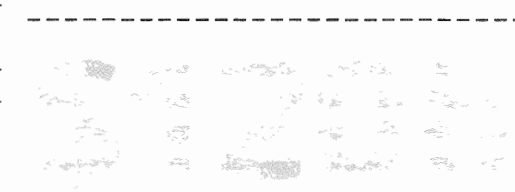
What explains the modesty of the record to date? Most discussions focus on economics, highlighting structural and institutional differences among the economies of the region. But none of these barriers is necessarily insurmountable, given sufficient will. The real problem is political. Security tensions — anxieties over possible threats or conflicts — lead governments to seek to preserve as much room for maneuver as possible. For all the talk of financial regionalism in East Asia, little real progress is possible without a significant moderation of underlying rivalries and animosities.

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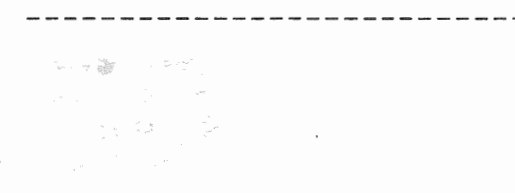
The Chiang Mai Initiative: Still a Work in Progress



The foreign-exchange reserves of the ASEAN + 3 nations at the start of 2010, according to Bloomberg.



The amount of pooled foreign exchange reserves available for those ASEAN + 3 states under the Chiang Mai Initiative Multilateralization.



The total so far borrowed since the start of the Chiang Mai Initiative process in 2000.

community or enduring common interest. There are the sensitive unresolved issues of Taiwan and the divided Korean Peninsula. And there is the continuing rivalry between China and Japan, both of which aspire to regional leadership. With so much at stake, governments are understandably reluctant to commit to far-reaching financial reforms that might limit their autonomy.

Financial co-operation of any sort involves a degree of commitment that is naturally antithetical to the preferences of sovereign nations. Two requisites stand out. One is the presence of a powerful state or combination of powerful states committed to using their influence to keep the joint effort functioning effectively on terms agreeable to all. The other is the presence of a broad constellation of related ties and commitments sufficient to make the sacrifice of sovereignty, whatever the costs, basically acceptable to each partner. History suggests that one or the other of these two conditions is necessary to sustain the commitment among governments.

The problem for East Asia is that neither of these critical conditions really exists. On the one hand, there is a dearth of coherent leadership. Between Japan and China, for example, there is a distinct lack of comity — the formal courtesies that states extend to one another in matters of law — that makes it difficult for East Asia's two giants to jointly lead the way. The lack of trust between them is fraught with bitterness and mutual suspicion. Neither country is willing to commit to any collective initiative that might cede a greater measure of influence or prestige to the other.

On the other hand, there is a lack of genuine regional solidarity. Put simply, East Asia lacks any sense of common identity. Other than geography, little binds the countries of the area together, while many factors work to keep them apart. These include deep differences of language, religion, ideology and social organization as well as the stubborn

legacies of World War II and the Cold War. For all their protestations of amity, the region's governments remain distrustful of one another.

Should we be surprised, then, that the results of financial regionalism have until now been so unimpressive? The needed conditions have been most conspicuous by their absence. The lack of political will is by no means an accident.

ATTITUDES COULD CHANGE

Political will is not written in stone, however. Attitudes can change. In particular, we cannot dismiss the possibility of reverse causation. While security tensions may cause East Asians to hesitate today, tomorrow could be different. Over time, tentative steps toward financial co-operation could have the effect of moderating regional strains, by socializing policy-makers to the benefits of co-operation. Governments might reconsider their security concerns, thus paving the way for additional financial initiatives in a kind of self-reinforcing "virtuous circle."

In practice, socialization tends to occur naturally when co-operation between states becomes institutionalized in initiatives like the CMI/CMIM. The more that policy-makers learn to work together, finding joint solutions to common problems, the less reason they find to cling to ancient suspicions. Gradually, bitterness and fear can yield to an accumulation of the mutual trust needed for more far-reaching initiatives.

That some kind of socialization has been taking place in East Asia can hardly be questioned. Indeed, how could attitudes not be affected, given the frequency of meetings across the region dealing with one financial issue or another? Some positive influence must be at work, quietly building a sense of common destiny. On its own, however, socialization is unlikely to be decisive, precisely because it is such a gradual process. Some trigger is needed to overcome resistance to change. The most obvious

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candidate to play that role is an unexpected crisis of some kind, such as the Asian financial collapse of 1997-1998 or today's global recession.

THE BENEFITS OF CRISIS

Scholars of international relations have long noted the potentially positive role of crises. Many have pointed to the Chinese symbol for crisis, *wei ji* (危机), which combines the words for danger and opportunity (although *ji* is usually better translated as "crucial point"). Crises can raise the appeal of co-operation, at least temporarily, leading to the institutionalization of initiatives such as Chiang Mai. Such initiatives cannot go beyond limits set by broad security concerns. But once some degree of co-operation is institutionalized, a basis for building mutual trust is established that, over time, can serve to ease historical suspicions, setting the stage for yet more financial initiatives down the road.

The dynamic has certainly seemed to be at work in East Asia — at least so far. Crisis, we know, clearly played a role a decade ago in first stimulating interest in financial regionalism. Likewise, the shock of the global financial meltdown that started in 2007-08 plainly provided the impetus needed to complete the multilateralization of the CMI in 2010. In both instances,

the perceived threat was serious enough to prod governments into action.

Can we expect this pattern to be repeated again? Obviously, there is no certainty about the process. For one thing, it relies on the recurrence of events whose frequency and timing is by definition unknowable. Furthermore, even in the midst of a period of distress, the reach of any new financial commitments will be strictly circumscribed by larger security concerns, which in a threatening world are naturally accorded a higher priority by governments. Through the effects of socialization, initiatives like the CMI/CMIM could help to reduce barriers to further co-operation in the future. But the process will at best be both episodic and excruciatingly slow. In the absence of a truly fundamental transformation of East Asian politics, cumulative accomplishments in regional finance will most likely remain modest for a long time to come.

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