Financial cooperation among East and Southeast Asian countries has advanced significantly since the 1997-97 Asian financial crisis, taking expression in forms such as the Chiang Mai Initiative in the early 2000s and its multilateralization since. However, while Asian regional cooperation has been spurred by crises and has progressed, it faces an uncertain future in the face of intra-regional rivalries, global-level reform possibilities and the national priorities of countries in the region.

In this paper, we provide an assessment of the scope of Asian financial cooperation, its drivers and obstacles, and focus on China’s role but in the context of regional rivalry with Japan. While China is certainly not a unitary state and the domestic politics of regional cooperation are important, in this chapter we highlight intra-regional rivalries. The future of Asian regional cooperation is closely linked to how China-Japan relations unfold and whether ‘regional leadership’ contestation can be solved between them allowing for a more coherent and extensive regional financial architecture to develop.

In the next section, we outline the drivers for Asian regional cooperation focusing on the two financial crises – the Asian and the Global – which have provided the spur for the search for cooperative regional solutions. We also document the obstacles which are inherent to any regional financial cooperation initiatives and show how they are applicable to Asia. In Section III, we detail the extent of Asian financial cooperation and the measures that have been put in place as a result of the crises. Section IV discusses China’s role in these developments and illustrates how its perceptions of, and interests in, regional financial cooperation have changed over time as it has moved from passive observer to active participant in the various regional financial initiatives.

In this discussion, we will argue that intra-regional rivalry between China and Japan is one factor which will influence how regional cooperation evolves in the future. In Section V, we consider renminbi-yen rivalry as one example of this and examine the possibilities for closer Asian monetary cooperation, one of the aims of regional cooperation advanced by countries in the region. In our concluding section, we argue that while China has become a much more active participant in regional financial cooperation over the last 20 years, at the same time regional cooperation has now reached one its least important levels during this period, in part because of China’s own actions and in part because of the actions of
others. Continuing inter-regional rivalry is unlikely to provide an upturn any time soon in the absence of an exogenous shock.

We start by considering the drivers of, and obstacles to, regional financial cooperation in Asia

II. Asian financial cooperation: drivers and obstacles

The main drivers of financial cooperation in Asia are the financial crises which have hit the region, most obviously the Asian financial crisis (AFC) of 1997-98 and the global financial crisis (GFC) in 2008. The crises were, however, different in their causes and effects and, as a result, in the responses they elicited in the region. In the next section, we provide a detailed explanation of the contours of those responses. Here we provide a brief outline of the crises themselves as drivers of a regional response. In terms of its effect on regional cooperation, the most significant event was the AFC some two decades ago and which moved regional financial cooperation to a new level. The AFC has been well studied and we provide only a thumbnail sketch here.

The main driver for regional financial cooperation in the wake of the Asian financial crisis is what Higgott (1998) labelled 'the politics of resentment' as a result of the policies forced upon the region's affected countries by the IMF.¹ The crisis itself was triggered by the decision of the Thai central bank to float the baht on 2 July 1997.² The Thai government decided that it could no longer defend the currency, announced a managed float, and called upon the IMF for technical assistance. The 'contagion' spread to other countries in the region including the Philippines, Malaysia, Indonesia, South Korea, Hong Kong, and Vietnam. By the time the dust had settled, the IMF had instituted the largest bailout in its history with the US$ 54bn loan to South Korea. Indonesia received US$ 40bn, Thailand US$17.2bn and the Philippines US$1bn. While the facts of the crisis are well known, the causes of the crisis remain disputed. For some, the weakness of domestic financial institutions, their lack of regulation, and the general malaise of 'crony capitalism' was to blame. For others, as surveyed by MacLean (1999), the crisis had its roots in financial liberalization, exchange rates pegged to an appreciating U.S. dollar, and then financial panic that produced a dramatic reversal in capital flows to the region.

¹ Although we find the "politics of resentment" convenient as a label, we recognize it might give the impression of an irrational, overly emotional response. It is not our intention to give such an impression.

² The account of the Asian financial crisis provided here draws upon Bowles (2002).
It is clear that one of the critical actors in the drama - the IMF - saw the cause of the crisis as emanating from essentially domestic factors which required the tried and trusted methods associated with the stabilization and structural adjustment programmes which the IMF and World Bank had been applying to other developing countries since the early 1980s. As MacLean et al. (1999) noted, the IMF intervened in Asia both at the macroeconomic and structural levels. The policies recommended at the macroeconomic level were, by and large, the typical ones that characterized IMF interventions in the past. To stop currency depreciation and restore confidence, the IMF prescribed its traditional austerity medicine. This involved, first of all, a tight monetary policy, i.e. a sharp increase in interest rates.

In order to cover the costs of the financial bailout, the IMF also asked for the curtailment of government budgets (achieved mainly through the reduction of social programmes, the scrapping of large public infrastructure projects and the elimination of subsidies). These fiscal measures were criticized since none of the countries in question had been particularly profligate in their spending. In fact, since 1993, only Korea had run a budget deficit - equal to 0.1 per cent of GDP - and this only in 1996. Thailand and Indonesia had run average budget surpluses of 2.3 and 1.2 per cent of GDP respectively. Critics argued that the tightening of state budgets would inevitably worsen the recession brought about by the crisis and it did. The recognition that these policies were not bringing about the desired effects (exchange rates continued to slide, the outflow of capital worsened and output fell more than projected), and the perception that they might trigger social unrest, led the IMF to modify some aspects of its programme. However, the damage had been done.

The policies undertaken by the IMF at the structural level were especially criticized in Asia. Policies under his heading can be divided into two categories: (1) those designed to reform financial systems and (2) those aiming to open up the economies of the crisis countries. A perception became widely held in the region that the IMF was acting to protect the interests of Western lending institutions with policies under the first category and to open Asian markets for Western firms at the expense of Asian workers and the sovereignty of Asian countries with policies under the second category. As Bello (as quoted in Higgott 1998: 345) noted at the time 'never has the IMF's connection to its principal stockholder been displayed so prominently'.

IMF imposed austerity and U.S. friendly privatizations therefore fuelled the ‘politics of resentment’ and spurred a regional response as a way of providing some insulation and shelter for the countries of the
region from the volatility of global financial markets and from the strictures of the US-dominated IMF (Cho 2014; Choi 2013).  

The second crisis, the GFC, a decade later had its origins outside of the region and had a less dramatic impact upon it. The sub-prime mortgage crisis originated in the U.S. and took down some of the largest financial institutions in the world. This affected liquidity across globe, drove down interest rates, and slowed growth in the developed countries while, at least initially, growth continued in the developing world. In Asia this meant that major banks did not fail and developing Asia as a whole did not experience a major growth slowdown. The defensive drivers of regional monetary cooperation as insulation against vulnerability were therefore less of a factor in post-GFC than post-AFC. (Emmers and Ravenhill 2011). However, some economies were noticeably affected, in particular South Korea and Indonesia. These two economies faced currency flight and had to respond to it. As South Korea’s reserves dwindled and the won depreciated rapidly, the government successfully entered a swap agreement with the US Federal Reserve to the tune of $30bn and smaller swap agreements with the Bank of Japan (BoJ) and People’s Bank of China (PBOC) a few months later. Indonesia sought a bilateral swap agreement with the US Fed but was denied and relied upon financing from the World Bank, ADB, Australia and Japan. (Kawai 2015)  

While the GFC crisis has a limited direct impact on the region, the slow and incomplete recoveries of various Eurozone countries together with the sovereign debt crisis experienced since 2009 by Portugal, Ireland, Spain, Cyprus, and especially Greece, has contributed to increased awareness in East Asia about the risks to countries engaging in regional financial cooperation. Common currencies had been touted by economists as a way of stimulating regional trade (Rose, 2000) but the Eurozone fall-out from the GFC highlighted a darker side. As Wyplosz (2015: 4) has put it:

"Until the sovereign debt crisis, the process of European monetary integration was often seen as a possible blueprint for East Asia. Although the region’s political make-up meant that East Asia was unlikely to follow that route (Park and Wyplosz 2010), the perceived success of the euro was seen as an encouragement to deepen monetary coordination in the region. The sovereign debt crisis has radically changed that perception."

Furthermore, while neoliberalism was not abandoned in the face of its failure in the GFC (Crouch, Jessop), its credibility was significantly reduced. Added to this, the global political response to the GFC was to expand the G7 to the G20, thereby including key developing countries from Asia such as South

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3 Weisbrot (e.g., 2007) has documented that the IMF’s role in the Asian financial crisis set in motion a process in which the IMF has lost most of its power over middle-income countries in general, not just over East Asian countries.
Korea and China in elite-level global decision-making, and to place the reform of the IMF on the global governance agenda. As a result, the politics of resentment was not nearly so evident in the region post-GFC as it was post-AFC (Katada 2011) although the skepticism towards neoliberalism increased and the veracity of advice from leading Western powers certainly diminished.

In general then, the AFC was a bigger driver of regional financial cooperation than the GFC. In fact, it has been argued that while the response to the AFC was regional in character, the GFC relied primarily on national and global responses; national responses being in terms of large Keynesian-style macroeconomic intervention most evidently in China (Yang, 2015) and global responses being in terms of the changes to global governance through the establishment of the G20 and IMF reform. (Emmers and Ravenhill 2011; Katada 2011). Notwithstanding this, one national response – that of the U.S. – did have ripple effects in the region. This was the U.S. policy of “quantitative easing” which was seen in the region as a policy of dollar devaluation. This gave a spur to greater invoicing of trade in the region especially by China which sought to extend the use of the renminbi for its regional trade settlements where possible and thereby allow its exporters to avoid the costs of dollar depreciation/renminbi appreciation. Interest in the greater use of regional currencies was therefore one outcome of the GFC, a topic to which turn in more detail in Section IV. Furthermore, the rapid trade integration of the region continued thereby posing potential risks to payments balances and currency volatility which could form the basis for further regional financial cooperation in order to lessen those risks. (Iwata et al 2015).

The move to end quantitative easing in 2013 led what Kawai (2015) has called a “taper tantrum” rather than a full blown crisis. Indonesia was caught in this and saw the rupiah come under sustained attack showing that countries in the region were still vulnerable to externally-induced volatility.

While the drivers of regional financial cooperation are relatively easy to identify, with the AFC being the main one, this does not necessarily mean that such cooperation will occur. In Latin America, for example, another region which has experienced periodic financial crises both regional and global in origin, there has been very little in the form of regional financial cooperation, even compared to Asia. (Krapohl 2015). In fact, there are least five reasons why regional financial cooperation might be difficult to attain in practice.

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4 The consequences of policies of quantitative easing, including their consequences for exchange rates, are discussed, e.g., in MacLean 2015.
Sohn (2012: 592-593) describes them as follows. The first is sovereignty. For regional monetary and financial cooperation to advance requires that countries cede some sovereignty to regional bodies. With powerful countries such as China and Japan involved, relegating domestic interests to regional ones may prove difficult in the absence of large and clear advantages for doing so. (See also Cohen 2004). The presence of China and Japan in the region also raises the second problem, that of power rivalry. As we will explore further in later sections, rivalry between the two major regional powers may inhibit regional cooperation mechanisms. As Cho (2014: 92) notes "mere geographic proximity does not make China and Japan any less self-interested than the United States” suggesting that because China and Japan are geographically regional neighbours does not mean that they are less interested in pursuing their own narrow interests in the region than an extra-regional power. Thirdly, the region is structurally diverse with economies at widely different levels of economic development and income as well as in regulatory regimes and institutional capacities. Forging consensus and common policies which will benefit all is a challenge in the face of such diversity. A fourth challenge is that of collective action in a region where some countries may be tempted to defect and pursue their own exchange rate policies, for example, rather than join a regional initiative to stabilize the regions’ currencies against extra-regional ones. This is further exacerbated in a region with weak regional identity, the fifth major obstacle. While the ‘politics of resentment’ in the wake of the AFC provided an instance where regional identity was enhanced by the identification an ‘outside other’ (the IMF and US), there remain many intractable historical and territorial disputes between countries in the region which weaken regional identity.

Notwithstanding these obstacles, regional financial cooperation did emerge in the aftermath of the AFC and it is to the details of this that we now turn.

III) Asian financial cooperation: the story so far

In the immediate aftermath of the AFC, it was clear that greater financial cooperation among countries in the region would be beneficial in allowing the region to better protect itself from shocks and stabilize its constituent economies. To this end, Japan took the leadership role and proposed the formation of an Asian Monetary Fund (AMF) which could fill the role of a regional lender. Proposed in the wake of the Thai crisis, Japan initiated this call among the so-called “Friends of Thailand” group. The idea of an AMF was opposed by the U.S. and by the IMF as being a competitor to the latter. China did not respond to the Japanese initiative with Kawai (2015: 6 note 3) arguing on the basis of interview data that Japan
would have acted in defiance of the U.S. and IMF if China had come on board but China neither
accepted or rejected the proposal and it fell by the wayside.

Following the imposition of IMF medicine, interest in regional cooperation increased and the Chiang Mai
Initiative (CMI) was launched in 2000. It started a broad trend in regional financial cooperation which
has four main components. These are (i) emergency liquidity provision; (ii) development of regional
bond markets; (iii) improved surveillance and dialogue; and (iv) currency management (Grimes 2006;
Sohn 2013). We discuss each in turn concentrating in this section on emergency liquidity provision as it
is the component in which the most progress has been made.

The CMI had as its centre a series of bilateral currency swaps whereby member countries (ASEAN+3)
could draw upon funds from fellow members when needed. The failure of the AMF to get off the ground
did not take away the need for a regional response to financial vulnerability, it just changed the path to
it. The CMI was launched in May 2000 and the currency swaps were at first a modest $1bn between
ASEAN members. Over time the number of swaps and the totals involved grew significantly; by 2004 16
bilateral swap agreements were in place with totals of $36.5bn committed, a figure which grew to
$90bn by 2009. By that point Japan had committed nearly a half ($44bn) of the total with South Korea
second ($18.5bn) and China third ($16.5bn). (Kawai 2015). The inconveniencies and duplications of
bilateral swaps led to the CMI Multilateralization (CMIM) initiative. This had started to be negotiated as
early as 2006, was formally put in place in 2010 and has continued to evolve thereafter. The fund was
set at $120bn but one of the most sensitive issues was the amounts that each country would provide;
the Plus 3 countries all wanted to provide more and the negotiations on the quotas (and hence voting
shares) were delicate. Japan wanted to be the largest donor, China did not want be second to Japan and
South Korea wanted a large share in recognition of its developed country status. In the end a
compromise was reached under which Japan contributed 32%, China contributed 28.5% with Hong Kong
conributing an addition 3.5% (thereby totaling 32%), and South Korea 16%. All of the countries could
claim that their objectives had been met through by creatively including Hong Kong as a separate
contributor. While Japan had been by far the largest contributor to CMI, by the time it came to CMIM
China wanted parity. (Kawai 2015).

The debates over the size and contributing shares to CMI and CMIM notwithstanding, the sums involved
are not as large as they seem in the sense that only a portion can be released without an IMF agreement
in place with the borrowing country. This was initially set at 10%. The reason for this is (at least) twofold.
One reason is that such a linkage meant that the IMF and U.S. supported the initiative in contrast to
their earlier opposition to the AMF which they feared would have sidelined the IMF. This new formulation allowed the regional CMI to proceed in a way which very much involved the IMF. Secondly, to administer loans requires an institutional capacity to assess and regulate the conditions for securing such loans and monitor the implementation of any conditions attached to them. It has been argued that the countries of the region lacked this regional institutional structure and capacity with the result that delegating these functions to the IMF made sense. The ‘IMF link’ has been loosened over time with the percentage of funds released without IMF agreement increasing at first to 20% and now to 30%. At the same time, new structures have been put in place to increase the capacity of regional institutions to assess and monitor each other. Notable here are the creation of a new surveillance unit (the ASEAN+3 Macroeconomic Research Organization, AMRO) and the establishment of a new precautionary lending line. How far these changes move the region towards some genuine autonomy remains in doubt (See Grimes 2015; Sussangkarn 2011). Cho (2013: 55) argues that “monetary regionalism in East Asia still remains more of a glass half-empty than half-full” while Grimes (2015) argues that the CMIM is still fraught with internal divisions and rivalries between China and Japan. “Further complicating the picture”, he adds, “both China and Japan have recently established large bilateral swap lines outside of the CMIM framework with several of their ASEAN+3 partners, raising the question of whether CMIM is moving towards political irrelevance even as it has arrived at a high water mark in its institutional development.” (Grimes 2015: 145). Add to this the fact that both South Korea and Singapore turned to bilateral swaps with the US Fed in 2008 rather than triggering CMIM loans then it is certainly easy to see why there is skepticism. (Grimes 2011).

Other components of regional financial cooperation are the Asian Bond Fund (ABF) and efforts towards greater exchange rate coordination including the establishment of an Asian Currency Unit (ACU). The ABF arose out a meeting of the region’s central bankers in 2003 with an initial size of $1bn and “invested in a basket of dollar denominated bonds issued by Asian sovereign and quasi-sovereign issuers” in the region. (Sohn 2013b: 4) This was followed by a further $1bn issued in local currency bonds in 2005 (ibid. 5). The ABF’s aims are to allow more savings to be reinvested in the region instead of going to extra-regional markets (in US Treasury Bonds, for example) and to build more diversified regional local capital markets which can provide a degree of insulation against external vulnerabilities. The fourth component is the ACU, the study of which was officially agreed at a meeting of East Asian governments in 2006. (Sohn 2013b: 7). The idea of an ACU, with its implicit symbolic reference to the ECU, the forerunner of the euro, suggests a degree of long term regional monetary cooperation that belies current realities. The
prospects for greater cooperation on exchange rates are analysed in Section V below. Before coming to this, we first discuss China’s specific role in the emergence and development of financial regionalism.

IV) China’s evolving role

In the first moves towards Asian financial regionalism in the wake of the AFC, China largely sat on the sidelines. As noted above, Japan’s proposal for an AMF was unanswered by China, a position of “silent opposition” as Yang (2010: 608) calls it. China had its reasons for this. These included the fact that China was largely insulated from the contagion effects of the crisis due to its healthy external balance and, more importantly, its extensive capital controls. China was also engaged with the U.S. over the terms of WTO entry and was not prepared to jeopardize that engagement especially to support Japan, a point that U.S. officials were keen to point out to their Chinese counterparts urging them to be wary, as if such a warning were necessary, of ‘Japanese hegemony’ (ibid). Ironically, the politics of resentment against the IMF and US was felt more keenly in the capitalist countries of the region than in communist China. Furthermore, it has been argued that China had very little conception of East Asia as a ‘region’ in economic and security terms before 1999 (Tsai and Liu 2013: 552).

This position did not last long, however, and China actively participated in the CMI launched in 2000. As Jiang (2010: 606) notes, China’s participation was hampered by its domestic institutional structure with both the Ministry of Finance (MoF) and People’s Bank of China (PBoC) being involved in regional cooperation but with separate areas of responsibility; while the MoF represents China at the ASEAN+3 Finance Ministers’ Meetings the responsibility for exchange rate and reserve policy falls squarely with the PBoC. But these domestic institutional constraints notwithstanding, China became actively involved in the CMI in a change from its previous non-committal position. There are a number of reasons why this change occurred. Firstly, China’s suspicion of regional arrangements as potentially compromising its own autonomy and exposing itself to external influence was gradually reduced (Chan 2012: 204), especially in light of the ‘flexible’ nature of the CMI itself (Yang 2010: 609). A further part of the detail of the CMI was, as previously noted, the link to the IMF and this enabled China to participate without the fear of straining relations with the U.S. Furthermore, the AFC impressed upon the Chinese leadership the need to think more about the ‘region’ in economic and financial security terms. However, the biggest reason, according to Yang (2010) was China’s change in diplomatic strategy to that of assuming the role of a ‘responsible great power’. (See also Bowles 2002; Bowles and Wang 2006). This change of strategy, designed to enhance China’s regional and international image as well as increasing its claim to a greater
role in regional and international decision-making, saw China embark on a number of regional initiatives in the trade and financial cooperation areas.

It is important to note that this change in the position of China explains much of the impetus for regional financial cooperation since 2000. Japan, South Korea and ASEAN countries had already signaled their support for such cooperation in the aftermath of the AFC; but nothing came of it and nor was it likely to without the inclusion of China. Thus, China’s change of position to one of active participation was critical to the launch of regional financial initiatives in the 2000s. Furthermore, not only did China become active but, over time, also became more assertive in its regional leadership. The diplomatic finessing of the contribution and voting shares to CMIM have already been mentioned. In fact, CMIM was initially a Japanese proposal but China applied to undertake the study on regional reserve pooling (Yang 2010: 612). Rather than rejecting any proposal emanating from Japan, China now took the proposal and sought to lead it. The study was finally conducted by China and Thailand. The leadership of the newly created AMRO was also subject to diplomatic finesse with an official from China assuming the leadership in its first year and a Japanese nominee completing the second and third years of the initial term. (Chan 2012: 204).

This evolution signals a greater interest and involvement in regional financial cooperation, an evolution which includes qualitative change. Tsai and Liu (2013: 558-60) describe three post-AFC crisis phases as active participation under the status quo (1997-2002), seeking the role of regional agenda setter (2003-2009) and towards a balance or potential candidate for regional hegemon (post-2010). While this suggests a more linear path than is perhaps evident in the practice of regional financial cooperation, it does provide a useful summary of the changing nature and motives behind China’s regional engagements.

But to succeed in enhancing its role over time requires not just a motive – achieving responsible great power status – but also requires an increasing institutional recognition and capacity to achieve such goals. In this respect, Sohn (2008) provides an analysis of how China has played a greater role as a result of three factors: cognitive dissonance, feedback effects and transnational persuasion. Cognitive dissonance refers to the intense discussions and analysis of the AFC within China’s elite policy-making circles which served to highlight the causes and importance of financial security as necessary to national interests and political stability. Feedback effects indicate how policy-makers became more amenable to regional cooperation initiatives as their experience of such initiatives, especially the ASEAN Regional Forum proved positive. Transnational persuasion refers to the increased familiarity with the benefits of
regional cooperation as expressed by other member countries in the Asia-Europe Meeting and the ASEAN+3. For all these reasons, China moved to support Asian financial regionalism and saw it as one vehicle to achieve its goal of establishing itself as a responsible great power.

However, it should be noted that China did not rely only on the regional initiative to achieve this goal. In fact Sohn (2013b) argues that regional cooperation was part of a counterweight strategy which also saw China seeking an increasing role on the global stage and in multilateral organizations such as the IMF. Given the uncertainties of global reform, the regional initiatives gave China an alternative vehicle for achieving its goals; the regional and the global were therefore seen as reinforcing but also compensating levels on which to work with slow progress at the global level, for example, being countered by greater progress at the regional level.

It should also be noted that none of this should underestimate the role of purely national policy instruments as well; in the wake of the GFC China did embark on a massive national policy of demand-led stabilization, the world’s largest.

The three levels of national, regional and global are clearly relevant to discussion of the final component of financial cooperation, that of exchange rate management. This was one of the ambitions of regional cooperation, and one of the long term ultimate tests of the scope and success of such cooperation, but it is also the one with the least progress to date. We discuss it below.

V) The renminbi, regional currencies and China-Japan rivalries

Regional financial cooperation in the form of exchange rate management would mark a significant leap. If countries in the region were able to make this leap it would have the potential benefits of providing increased economic stability in the region, the minimization of exchange rate crises, and thereby provide a spur to increasing intra-regional trade. Such is the theory anyway, and it provides some of the economic rationale for moves in other regions of the world towards greater exchange rate coordination and single currencies, most obviously evident in Europe.

As Yang (2010: 615) notes “Japan has been the most active proponent of East Asian monetary cooperation and has come up with several plans for exchange rate coordination”. Included among these were the proposal in 1998 for a G-3 basket under which countries in the region would tie their currencies to a weighted basket of the US dollar, euro and the yen, a proposal which would move countries away from the dollar peg which many countries had utilized before the AFC (and which was
argued to be partly responsible for the crisis). Yang (2010: 615) argues that “Chinese policymakers and scholars alike have criticized this plan heavily on the grounds that it would not serve the original purpose of East Asian financial cooperation – to build an East Asian monetary regime that is independent of the US dollar – and that it would only strengthen the role of the yen in the region and cater to Japanese national interests”. In other words, it was more an extension of Japan’s long-held desire to internationalise the yen than to promote regional cooperation. The response from Japan was to propose an Asian Monetary Unit (AMU) based on 13 regional currencies, an idea that was taken up by the Asian Development Bank in the form an ACU in 2005. However, it was delayed in its announcement and quietly slipped off the agenda fairly quickly. Among the reasons for this were the lack of clarity over the function of the ACU, disputes over the weighting of currencies in the basket particularly between the yen and the renminbi, and Chinese officials’ views that greater exchange rate alignment would not serve its national interest. (Yang 2010: 616-17; see also Hassdorf 2011).

In any case, China embarked on its own currency initiative, the internationalization of the renminbi (See Bowles and Wang 2013, Prasad 2016). The impact of the GFC and the U.S. response of quantitative easing convinced the Chinese authorities that an expanded use of the renminbi in trade would be a benefit to its exporters and help to avoid the costs of dollar depreciation. This was especially encouraged for regional trade. The rapid increase in the use of the renminbi in trade since has led to investigation of whether a “renminbi bloc” is forming in the region with countries tying their currencies to the renminbi rather than the dollar (or the yen). This would represent the creation of a de facto regional monetary arrangement with the renminbi at its centre.

Whether a regional renminbi bloc has emerged is a contested question. Subramanian and Kessler (2013) boldly declared that a “renminbi bloc is here” based on examination of currency co-movements for 10 of the region’s currencies over a three year period. They find that 7 of the 10 currencies co-move more closely with the renminbi than with the dollar. Li (2013) also argues that a regional reminbi bloc is emerging (see also Eichengreen and Lombardi 2015). Others report different results. Kawai and Pontines (2014) find that the dollar remains the anchor currency for the region’s economies and although the importance of the renminbi has increased it has not eclipsed the dollar. The continued dominance of the dollar, albeit with the rising influence of the renminbi, is also reported by Hwang (2015) and Schnabi and Spantig (2016).

Regardless of whether the renminbi has replaced the dollar yet as the regional anchor currency, it is clear that its influence is increasing. The question is whether this makes further regional financial
cooperation more or less likely. Ma and McCauley (2011: 23) argue that the stability of regional currencies against each other, which would come with renminbi targeting, creates “favourable conditions for regional monetary cooperation”. Park and Song (2011), in contrast, argue that the emergence of a de facto renminbi bloc weakens the case for Asean+3 regional monetary-financial cooperation because neither Japan nor Korea could join the new bloc for political and economic reasons. Added to this, the incentive for China to engage in such cooperation is also reduced since it can achieve a degree of regional currency dominance and stability by pursuing its own currency internationalization initiatives which do not require ceding any monetary autonomy to regional bodies. A prerequisite of a formal regional exchange rate agreement would be the coordination of regional monetary policies. This would be very difficult in light of the diversity of economies in the region and, just as importantly, the unlikely event that China’s and Japan’s macroeconomic policies converge. China’s macro policies based on maintaining a “new normal” growth rate of around 6.5 per cent p.a. and gradually shifting to a greater role for domestic demand are unlikely to accommodate regional concerns. Similarly, Abenomics is a Japan-centred policy.

The exchange rate coordination component of regional financial cooperation therefore got off to a troubled start with Japan’s immediate post-AFC proposals, was launched in 2006 but was pretty much still-born, and has become an increasingly distant regional goal as the renminbi has risen in importance in the region, creating a de facto renminbi bloc already in the analysis of some, and reducing China’s incentive to be involved in regional currency cooperation when it has achieved much by acting unilaterally.

It is worth noting that the current enthusiasm for renminbi regionalization and internationalization in China and among commentators may be curbed, ironically as problems have arisen with Japan’s yen internationalization. In fact, the economic history of Japan over the past few decades may point to a strong reason for why China may be cautious about how far it promotes the internalization of the renminbi. At the time in the 1980s that Japan undertook various financial reforms with a view to promoting the use of the yen as an international currency, one of the counter-arguments, as noted in MacLean (1990), was that internalization of the yen would weaken the ability of the policy authorities to stabilize the yen’s value against other international currencies. In other words, reforms that would promote internalization of the yen would have the side effect of exposing the yen to swings in its value that could periodically undermine the effectiveness of Japanese domestic macroeconomic policies.
It has turned out that such concerns were well-founded. The liberalization of Japan’s financial markets carried out in connection with internationalization of the yen has made the yen periodically attractive as a “safe haven” currency. Often, as in the peso crisis of the mid-1990s, the demand for the yen as “safe haven” currency has resulted in strong yen appreciation just when yen appreciation was the very opposite of what macroeconomic policy-makers desired. In fact, these unwelcome episodes of sharp yen appreciation even created within Japan an unusual interest in Ronald McKinnon’s proposal for a revival of the gold standard. (See MacLean 2006).

Japan’s resort to quantitative easing, and more recently to negative nominal interest rates, should be viewed partly in this light. It is notable that the Swiss central bank also resorted to negative nominal interest rates at a time when the Swiss franc, also a “safe haven” currency, was under strong upward pressure.

An important consideration for China is that the monetary policy tools of quantitative easing and negative interest rates, while they apparently work in the right direction, are not powerful tools. As one journalist (Milner 2016) commented on the effects of negative interest rates on the value of the yen: “The currency, which has gained about 6 per cent against the U.S. dollar so far this year, continues to thwart policy makers’ intentions, because its safe-haven status trumps negative rates every time. Just ask the Swiss, who face similar headaches.”

Even so, if China were to step back from the rapid internationalization of the renminbi if it were to fear the same loss of macroeconomic control as Japan has experienced, it is still a long way from there to the creation of a regional currency instead.

VI) Conclusion

Asian regional financial cooperation has been spurred by two crises, the AFC and the GFC. China’s position has changed from that of neutrality to one of active engagement as it has seen regional financial engagement as a means of increasing its own economic security and enhancing its role as a responsible power. As a result China became a leading supporter of the CMIM, engaged in the ABF, and a joint-leader of the AMRO. The CMIM has made the most progress of any of the components of regional financial cooperation, and exchange rate coordination the least, notwithstanding Japan’s enthusiasm for the idea; China has been able to gain a greater regional role for the renminbi without relying on formal regional mechanisms.
There remains the question of how significant the cooperation measures implemented to date have actually been. Economically speaking, we view them as limited. The CMIM remains tied to the IMF and countries have shown that they have been more comfortable seeking bilateral loans with the US Fed and others than utilizing the CMIM anyway. All countries in the region have also acted independently in building up their own reserves. The ABF remains small in size and the AMRO has little function beyond information sharing. Formal exchange rate coordination has not gotten off the ground. Politically, the region experienced greater cohesion in the wake of the AFC than it did in the aftermath of the GFC when national policy responses were dominant. Furthermore, China’s involvement in the G20, its greater role in the IMF, and the renminbi joining the SDR basket, show Beijing advancing its international influence.

At the same time that China has shown the most enthusiasm for regional financial cooperation, therefore, the latter’s relevance is probably at its lowest point in the last two decades. This is in part because of China’s own actions (in promoting the regionalization/internationalization of the renminbi) and in part because of the actions of others (in not using the CMIM in response to the GFC and in the global level move to the G20). The prospects for the future do not look much better either. Any movement towards closer regional financial cooperation would require a lessening of China-Japan rivalry over regional leadership.

In this respect, the most common perception is likely that Japan is fighting a losing battle because China will continue to outgrow Japan by a large margin, and there are limits on how much Japan can leverage its alliance with the United States. While it does seem likely that China will continue to outgrow Japan by a large margin, there is always the risk that asset price bubbles in China could burst and plunge China into the type of macroeconomic quagmire that produced Japan’s so-called Lost Decade. But perhaps more important is the possibility that Japan will forge a strong alliance with India. Given the size of the Indian economy, and its growth potential, this could prove significant, and the forging of strong Japanese ties with India would fit with Japan’s approach of seeking allies for the cause of "shared values and democracy in Asia." Furthermore, Japan has thus far not signed on to China’s Asia Infrastructure Investment Bank (AIIB) fearing that the AIIB will enhance China’s regional power and supplant, or at least limit, the influence of the ADB in which Japan has greater influence and which has been an important vehicle for shaping the regional financial order. The plethora of trade arrangements, actual and potential, with their partially overlapping memberships, different promoters, and geopolitical

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5 For a sampling of economist’s views on this topic, see Lewis et al (2017).
6 See, e.g., Ministry of Foreign Affairs Japan (2016).
motives (including containment of China in the case of the TPP; see Bowles 2015), further indicate that the region remains fragmented politically as well as unlikely to find regional trade arrangements acting as a spur for closer regional financial cooperation.

Any new spur to regional financial cooperation is therefore likely to come in response to an exogenous shock, in much the same way as the AFC provided the initial impetus to the present round of regional financial cooperation. Here the actions of the Trump administration will be closely watched. Described by policy makers as “whiplash”, the policies of the U.S. administration are capable of changing drastically within days. From which country will pay for the U.S.-Mexico border wall to whether NAFTA will be abrogated or renegotiated, the administration has shown itself capable of remarkable U-turns. Included in this is China’s position as a “currency manipulator”, a refrain constantly heard on the campaign trail but apparently now abandoned. But one can never be sure. A U.S. misstep is quite capable of reinvigorating Asian regionalism, including in the area of financial cooperation.
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