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The varieties of financial statecraft and middle powers: assessing South Korea's strategic involvement in regional financial cooperation

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Middle Powers and the Varieties of Financial Statecraft: Assessing South Korea's Strategic Involvement in Regional Financial Cooperation

Abstract

In recent years, the financial statecraft literature has expanded from a focus on great powers to encompass the behavior of emerging powers. While offering an important corrective, the literature does not yet adequately address the full variety of the emerging powers' strategies of financial statecraft. In particular, we argue that regional middle powers behave differently from regional great powers even when they have similar capacities at the global level. For instance, both India and South Korea are categorized as emerging powers in the financial statecraft literature and deploy regional strategies to reduce their financial vulnerability. Yet their financial statecraft strategies have clearly differed in practice. India has sought to challenge the global status quo and influence its neighbors, while South Korea has pursued more modest and defensive goals. Drawing on the middle power literature, we posit that certain behavioral characteristics attached to states based on their relative regional power explain such differences among the financial statecraft of emerging powers. To demonstrate the utility of this approach, we examine South Korea's financial statecraft in the Asia-Pacific region. We find that its position as a regional middle power effectively explains its patterns of bilateral and regional cooperation in the monetary sphere.

Keywords: financial statecraft, Chiang Mai Initiative Multilateralization, South Korea, middle powers, Bilateral Swap Arrangements, Regional Financial Arrangement

Introduction

Since the publication of Armijo and Katada's (2014, 2015) pioneering studies of the financial statecraft of emerging powers, there has been a growing attention to the ways in which non-traditional financial powers have sought to exercise power internationally. Financial statecraft refers to "the intentional use, by national governments, of a country's monetary or financial capabilities or conditions for the purpose of achieving ongoing foreign policy goals, whether political, economic, or financial." (Armijo & Katada 2015, p.43) Prior studies of financial statecraft had focused on the actions of the leading powers of the postwar era, including the United States, Europe, and Japan. With the relative decline of economic and financial dominance of these countries, the importance of studying the financial statecraft of the rest of the world is apparent.

Reasonably enough, much of the work on financial statecraft by non-traditional powers has focused on major rising powers, including China, India, and Brazil. Nonetheless, broadly categorizing these newly rising powers as emerging powers does not adequately explain the varieties of financial statecraft strategies employed by them. Understanding the motivation behind financial statecraft was not an issue when the financial statecraft literature was limited

to mainly discussing the interaction between great powers, since the behavioral characteristics of great powers have been able to explain why these states act in the way they do. (Wu & De Wei 2014; McDowell 2019; Lim et al. 2020) Yet the categorization of emerging powers encompasses a much wider variety of countries that are different in terms of both material and relative power. The strategical considerations that each country must make when engaging in financial statecraft ought to differ accordingly. For instance, why did India and Brazil choose to challenge the imbalance of the international monetary system, as Katada et al. (2017) argue, while South Korea has not, even though all three are disadvantaged by the global dollar system and are middle powers at the global level?

This paper clarifies this ambiguity by arguing that emerging powers practice financial statecraft based on their level of relative and material power and capacities¹ in their respective regions—i.e., regional hierarchies matter. As great powers within their regions, India and Brazil have the capacity and ambition to seek to lead regional initiatives, whereas Korea is as much a middle power within its region as it is globally. Accordingly, we elaborate a model of middle power financial statecraft in this paper.

We incorporate insights from the literatures on both middle powers and emerging power financial statecraft to build a coherent picture of middle power financial statecraft, and illustrate it with examples from South Korea (hereinafter, Korea), a regional middle power in East Asia. Unlike great powers or rising great powers, middle powers are not in a position either to enforce existing rules and organizations or to create new ones. They are constrained to operate within systems established and led by larger powers. Crucially, however, they may be in a position to improve their own positions within those systems and even to shape the systems and organizations advocated by larger powers at key moments.

We find evidence for the usefulness of applying the behavioral characteristics attributed to middle powers to explain the financial statecraft of a specific group of emerging powers. We examine the financial statecraft of Korea, a country that has been identified as a prototypical middle power by the existing literature, as evidence. Korea has been noticeably reticent in expanding its influence through bilateral channels, as we observe in its approach to bilateral swap arrangements (BSAs). In contrast, Korea has been proactive in expanding its influence through multilateral channels as we find in its engagement with the establishment and operation of the Chiang Mai Initiative Multilateralism (CMIM), East Asia's \$240 billion regional financial arrangement (RFA). Korea has played a critical role as a mediator and at times as a leader in advancing the RFA. These behaviors are common traits of middle powers, characterized by preference for multilateral processes and strength in niche policy areas. (Soward 1965; Cooper et al. 1994; Beeson & Higgott 2013; Teo 2017)

¹ "Capacity" is not just a proxy for overall economic power. Capacities also vary by issue and policy tool. For example, India is the world's third largest economy on a purchasing power parity (PPP) basis but has a closed capital account and only limited involvement in international financial standard-setting. Singapore, in contrast, is an important player in regional financial intermediation and in global financial standard-setting, but a small economy.

These findings are backed by in-depth interviews with Korean policy executives and elites, along with policy reports in the local language, to show that Korea not only sought to thicken its financial safety net through the CMIM but also sought to maximize its political influence within the multilateral platform to ultimately increase its currency's influence in the region. In contrast, we find that Korea's proactiveness in expanding its influence through multilateral financial cooperation has not extended to bilateral financial cooperation where its leverage was more limited. Based on these findings, we demonstrate how incorporating the findings of the middle power literature increases the explanatory power of theorizing on the financial statecraft of emerging powers, clarifying why and how states engage in financial statecraft.

The paper proceeds as follows: First, we conduct a more detailed review of the literature on the financial statecraft of emerging powers to specifically identify its gaps and this paper's contributions. Second, we identify the defining characteristics of a middle power based on existing literature and demonstrate how Korea operates as a middle power not only in trade and security issues, but also in the international monetary system. Third, we highlight Korea's passive attitude in advancing its financial influence in the region through bilateral channels, which is also characteristic of middle power behavior. Fourth, based on in-depth interviews and public accounts on Korea's involvement in and perception of the CMIM, we find strong evidence of Korea's proactive involvement in advancing its interests in the multilateral platform, a defining characteristic of middle power behavior. Through this, we demonstrate how Korea's relative power in the region, or its positioning as a regional middle power, strongly determines its engagement in regional financial cooperation. Finally, we identify caveats, suggestions for future research, and implications of the study.

What decipherers the financial statecraft of emerging powers? Gaps and solutions

Globalization has accelerated the build-up of complex interdependence in trade and finance among economies. Interdependence, however, often comes in asymmetric forms (Keohane & Nye 1973), allowing certain states to have larger economic influence over others. Capable states have proactively exploited this leverage to practice economic statecraft, generally defined by a state's use of instruments in the economic dimension such as imposing economic sanctions, trade barriers, and more to achieve foreign policy ends. (Baldwin 1989; Kirshner 1998; Blanchard & Ripsman 2015; Farrell & Newman 2019) Traditional studies of economic statecraft mostly focused on trade and other sanctions that had quantifiable impacts on the real economy and less on the financial dimension. (Hirschman 1980; Baldwin 1985; Steil & Litan 2008) Nevertheless, power asymmetries are at least as visible in financial dimensions as in trade (Eichengreen 1987; Mehrling 2013), creating room for the implementation of a wide variety of statecraft strategies that deserve a separate focus from those that affect the real economy.

Hence, studies have increasingly sought to separately identify the ways through which states convert their power advantages via the international monetary system. (Kirshner 1998; Steil

& Litan 2006; Andrews 2006; Halabi 2008; Grimes 2011; Armjio & Katada 2015; Cohen 2018; Farrell & Newman 2019) Steil & Litan (2006) identify such state behaviors as 'financial' statecraft, which exists as a subset of economic statecraft, where states seek to achieve foreign policy ends through financial means.

Since statecraft was conventionally understood to be a means of coercing a target state for policy ends, however, earlier studies generally considered only a hegemon or major powers that held significant levels of financial influence over others as being capable of practicing financial statecraft. (Steil & Litan 2006; Andrews 2006; Halabi 2008) Armjio & Katada (2015) offer an important corrective to this assumption, arguing that financial statecraft should refer not only to such offensive actions but also include defensive actions that are employed to reduce states' vulnerability to the offensive financial statecraft of other major states or even to aspects of the international monetary system itself that may jeopardize their policy autonomy. Numerous recent articles have therefore argued for an expanded view on financial statecraft and the states that practice it, shedding new analytical light onto the policies employed by emerging and developing economies as well as those of global powers. (Armjio & Katada 2015; Katada et al. 2017; Chey 2019; Obydenkova 2020)

While these works provide much needed insight in explaining the policy choices of emerging and developing economies through the lens of financial statecraft, they do not fully account for the variety of financial statecraft strategies employed by the states. In particular, they do not sufficiently address the strategies of non-great powers seeking to employ financial statecraft. This is a theoretically important gap: while traditional accounts of financial statecraft often speak directly to the literature on great power struggle and how it motivates the strategic choices of great powers, middle and/or regional powers are also agents under the expanded definition of financial statecraft, albeit with limited capacities.

Making this connection is empirically important, as existing studies do not provide sufficient explanations for why economies choose one strategy over others under similar circumstantial challenges. For instance, in Katada et al.'s pioneering work on emerging power financial statecraft (2014, 2015), the authors argue that the collective financial statecraft strategies employed by the BRICS economies are the result of their dissatisfaction with imbalances in the international monetary system. Given the power constraints they face when acting individually, Katada et al. (2017) argue that the BRICS economies opted for collective action in seeking to altering the existing system to their favor. This is a convincing argument. However, it does not explain why other emerging economies that are similarly disadvantaged by the imbalance of the international monetary system have not consistently opted for similar policies.

To answer this puzzle, we argue that looking at states' power within the global system is insufficient; rather, their power relative to other neighboring states is a strong determinant of the strategic choices they make in financial statecraft. States that can be categorized as middle powers at the global level may or may not be leading regional powers, and we argue that this distinction can also shape their motivations and strategies in financial statecraft. This

comports with the findings of numerous studies that the relative power of a state, in addition to its overall material power, is a strong determinant of its policy choices in multiple dimensions. (Cooper et al. 1994; Nolte 2010; Layne 2012; Teo 2017; among many others) For instance, although Brazil or South Africa have similar or smaller economic and military capacities to those of Korea, Australia, Canada, or Indonesia, they are classified as regional powers due to their relative preponderance within their respective regions. Regional powers demonstrate distinct differences in their foreign policy choices from other middle powers, marked by stronger motivation to shape the regional security and economic agenda by directly expanding their influence over states within their sphere of influence. (de Lima & Hirst 2006; Flesmes 2007; Prys 2014) It makes sense that this would hold for financial statecraft as well. Thus, India, Brazil, and South Africa, classified as regional powers, chose to pursue a more offensive financial statecraft strategy of challenging the system, seeking for redistribution and renewed recognition (Nel 2010; Stephen 2012), while Korea, classified as a middle power even within its region, opted for more defensive means to protect its autonomy even though it too is disadvantaged by the global dollar system. Integrating the insights of studies of the behavior of regional or middle powers into the literature on financial statecraft can explain why countries choose specific strategies among the identified ‘varieties of financial statecraft’. (Katada et al. 2017)

Distinguishing between regional powers and regional middle powers is both theoretically and empirically useful. While the category of ‘emerging powers’ potentially includes dozens of states, the spectrum of capacity among the states is strikingly wide. For instance, both China and Indonesia are categorized as emerging powers to the system in Armijo & Katada (2015), but there is a clear disparity between the two powers in terms of material and relative capacity. Since strategic options are constrained by capabilities, behavior of leading and middle powers should differ.

The issue of what constitutes an emerging power is less problematic in studies that focus solely on the financial statecraft of China, whose strategic motivations have been clearly linked to hegemonic struggles or great power contests, given China’s position as a potential challenger to the international monetary system and dollar hegemony. (Wu & De Wei 2014; McDowell 2019; Lim et al. 2020) The same applies to studies on Japan’s financial statecraft—both toward the US and the international monetary system, where its defensive financial statecraft reflected its global middle power status (Grimes 2013), and toward China, where it has acted as an incumbent power that is answering to the challenges posed by its rising neighbor and rival. (Grimes 2009, Katada & Sohn 2014; Mattlin & Gaens 2018; Chey 2018)

However, the term “emerging powers” is also used in reference to states with less influence, raising the question of how such power discrepancies lead to different financial statecraft strategies. The growing number of studies that assess the financial statecraft of the BRICS economies (Armijo & Roberts 2014; Katada et al. 2017; Roberts et al. 2018; Grabel 2019) do not provide a compelling explanation of why these economies (with the exception of China, which is aspiring to be a peer challenger to the United States) have chosen a more offensive

policy trajectory compared to other countries that face similar challenges and limited material capacity such as Korea. In other words, while the current literature on financial statecraft demonstrates that a wide variety of states are active users of financial statecraft, it does not sufficiently address how the resulting wider variety maps onto differing strategies. In this paper, we argue that states' status as middle or regional powers helps to explain the range of options available to them, as well as their motivations. We find strong evidence for this assertion, affirming the effect of relative power as well as material capabilities as a strong determinant of policy choices even in the financial dimension.

The behavioral characteristics of middle powers and their applicability to explaining the financial statecraft of emerging powers

The contribution of this paper lies not only in expanding our understanding of middle power behavior to financial affairs, but more importantly in improving our understanding of why certain emerging powers are motivated to engage in certain financial statecraft behavior. In other words, by incorporating the findings from the middle power diplomacy literature, we seek to improve the explanatory power of the literature on financial statecraft of emerging powers. Hence, the discussion of middle powers in this section is aimed at outlining the behavioral characteristics of middle powers based on existing studies and testing their usefulness in explaining the financial statecraft of a subset of emerging powers in the later sections.

A key insight of the middle power diplomacy literature is that middle powers are constrained by the rules and institutions in which they operate. For the most part, they must seek particularistic advantage within those institutions. Occasionally, they may be able to shape or alter the rules, but they can do so only in cooperation with other states—whether siding with a great power, leading a coalition of middle and/or lesser powers, or mediating between two great powers or coalitions. Thus, middle power financial statecraft is defensive in nature, prefers multilateral action over bilateral influence, and emphasizes coalition-building and mediation rather than leverage.

Categorizing states into groups characterized by a set of common behavioral qualities has been common practice in the study of international relations, as it establishes an analytical framework that can help empirically identify certain qualities of states that lead to a set of policy choices. (Rousseau & Garcia-Retamero 2007; Lake 2009) This endeavor, however, has also been challenging and contested as countless factors determine how states behave. This has especially been so in defining what constitutes middle powers, given their ambiguous position between great powers and smaller powers. (Robertson 2017) Still, scholars have repeatedly found evidence for commonalities among a group of states that share certain qualities, including a plethora of works that assess the role and behavior of middle powers in the international stage. (Chapnick 1999; Jordaan 2003; Ungerer 2007; Karim 2018, among others)

Studies classify states as middle powers based on three factors. (Soward 1965; Cooper et al. 1994; Beeson & Higgott 2013; Teo 2017) The first, or the positional, factor focuses mainly on material capacities, such as economic size, territorial size, population, and military capacities. (Emmers & Teo 2014; Gilley & O'Neil 2014) While this quantitative approach allows for a rough first cut for identifying middle powers, it offers only limited insights into how the states are actually behaving on the international stage. Hence, material capacity should be only one of the independent variables that determine how a state behaves. Cooper et al. (1994) focus on two other factors: the material capacity of a state relative to its geographical neighbors and normative qualities of states such as culture, ideology, or the path dependency of past policy trajectories that affect current policy choices.

This is where regional powers differ from middle powers within the broader category of emerging powers. While from a material capacity perspective, a regional power may potentially be less capable in global terms than a middle power, its relative strength in its regional landscape can lead to more proactive, or even aggressive, policies to shape regional power dynamics and policy agenda in its favor either to gain new or protect their existing influence. (Prys 2014) In this respect, middle powers can be classified as states that are located between great powers in terms of their material power, geographical location, and political or ideological systems. (Beeson & Higgott 2014) In general, such a positioning defines middle powers as holding enough power to secure their autonomy and exercise influence while still being limited by their weak power relative to their geographical neighbors.

Studies have found that such a power positioning leads to certain consistent characteristics of middle powers. First, the areas where middle powers demonstrate strength often consist of non-traditional security issue areas such as technology standards or other areas of soft power where they can take intellectual leadership. (Behringer 2013; Cooper et al. 1994) Middle powers can only exercise effective leadership in limited issue areas on the international stage, as stronger powers already occupy the leadership position in areas that directly relate to material capacity. This creates an incentive for middle powers to seek leadership in 'niche' areas. (Cooper 1997; Behringer 2013; Robertson 2017) Second, middle powers depend heavily on multilateral platforms and processes to achieve foreign policy ends. (Behringer 2013; Nossal & Stubbs 1997) This is because, while middle powers wield a sufficient level of power to protect their autonomy, their individual influence on the region or the international system is limited. As a result, middle powers favor multilateral processes. Multilateral processes and agreements not only have the benefit of binding great powers; they also offer venues where middle powers can use diplomacy and soft power tactics, in which they may hold comparative advantages, to shape favorable outcomes by building coalitions of support with other middle and lesser powers or play a mediating role between great powers. Hence, given the limitations in both relative and material capacity, middle powers rely on diplomacy, coalition building, and soft power to advance their interests, seeking to take leadership only in niche policy areas.

Based on Korea's relative and material power, multiple studies have characterized it as a middle power at the global level. (Robertson 2007; Shin 2015; Mo 2016; Karim 2018) Korea is

also a middle power within East Asia. In its economic and political capabilities, Korea is placed between China and Japan, the two great powers in the region, on the one hand and the smaller economies in Southeast Asia on the other. Behaviorally, Korea has demonstrated a clear preference for multilateral processes where possible in advancing its foreign policy interests and a demonstrated motivation to take intellectual leadership in the region as a bridge between developing and advanced economies. (Bretford et al. 2015)

This is not to say that middle powers only pursue multilateral processes. Strategies can differ per sector, depending on the country's relative power in the respective sector. (Breslin & Nesadurai 2023) That said, while Korea has repeatedly acted as a middle power in other policy areas such as trade (Teo, 2017; Sohn, 2019) and security (Lee, 2019; Lee, 2021; Abbondanza, 2022), its specific methods of advancing policy interests have varied widely depending on its relative positioning in each sector. For instance, while Korea is positioned as a middle power across many sectors, its relative influence in global trade has been more significant than in finance. Korea's presence in trade is regionally positioned as a middle power, due to its larger neighbors, but globally, Korea has been a major actor in both exports and imports. Korea was the fifth largest exporter and 11th largest importer in the world as of 2021. (WITS 2021) There is a clear difference, therefore, in Korea's material influence in trade compared to that in finance. These material differences have led to more proactive policies in trade, where Korea has sought for both multilateral and bilateral processes to maximize its interests.

As Sohn (2019) argues, Korea's non-participation in the Trans Pacific Partnership (TPP) was a strategic decision as a middle power to accommodate China's demands since Korea is highly dependent on trade with China and participating in a multilateral trade agreement that excluded China could expose it to considerable bilateral pressure, both economically and politically. Policymakers saw that bilateral processes may be more effective in advancing Korea's economic and political interests, especially given that Korea had signed bilateral free trade agreements with most of the member states of the TPP. (*Ibid*) Indeed, Korea's active pursuit of bilateral free trade agreements (FTAs) over the last two decades has been a defensive supplement to multilateral trade agreements, with Korea seeking both to lock in access to powerful partners like the United States and European Union and to ensure that its firms would not be disadvantaged relative to U.S., EU, and Japanese competitors in third countries. In other words, proactive participation in multilateral processes does not define whether a country is acting like a middle power; rather, multilateral platforms can often serve as an effective venue for middle powers to most effectively exercise their comparative advantages.

Hence, middle powers are constrained by rules and institutions in which they operate. For the most part, they must seek particularistic advantage within those institutions. Occasionally, they may be able to shape or alter the rules, but they can do so only in cooperation with other states—whether siding with a great power, leading a coalition of middle and/or lesser powers, or mediating between two great powers or coalitions. Thus, middle power financial statecraft is defensive in nature, prefers multilateral action over bilateral influence, and emphasizes

coalition-building and mediation rather than leverage.

We find that Korea's policy initiatives in the financial dimension are also in clear alignment with these expectations of middle power behavior. In particular, Korea has avoided advancing its financial interests through bilateral channels; instead, it has demonstrated a clear preference for multilateral processes and niche policy areas, where it holds advantages as a middle power.

Korea's contrasting financial statecraft in bilateral and multilateral process

As Armijo & Katada (2015) argue, financial statecraft comes in both offensive and defensive forms. An offensive financial statecraft strategy is coercive and is aimed at using the agent's financial influence over the target state to induce compliance or at changing the international monetary system to advance its own interests. Naturally, only states with considerable financial influence over the target state or power in the global system are expected to be able to implement such a strategy. On the other hand, defensive financial statecraft seeks to prevent such maneuvers by thickening the agent state's financial safety net or reducing its dependence on the target state or the international monetary system itself.

A middle power's financial statecraft is defensive in nature. As existing studies on financial statecraft implicitly demonstrate, however, that there are gradations to defensive financial statecraft strategies. For instance, Katada et al. (2017) argue that BRICS member states took collective action to protect their financial markets from the dollar dominance of the international monetary system. The authors categorize their policy choice as defensive financial statecraft since although they challenged the status quo of the international monetary system, the purpose of their challenge was defensive. In this respect, the financial statecraft of the BRICS economies is still defensive but is a more proactive way of achieving policy aims. BSAs that can be drawn on in a crisis (particularly dollar swaps) can also be seen as proactive in this sense, as they make the target state more dependent on the agent state.

On the other hand, more passive strategies involve endeavors that seek to enhance financial security without changing the status quo of the regional, or international monetary system. Such passive strategies would involve, among others, the accumulation of foreign reserves or circumventing reliance on the dollar by establishing local-currency BSAs for the purpose of settling trade balances in local currencies. These strategies thicken the agent state's financial safety net as they prepare the state's financial market against excessive external drains and dollar shortages but do not attempt to expand its financial influence, unlike the strategies employed by the BRICS economies. Hence 'passive' and 'proactive' defensive financial statecraft strategies share the same policy aims, but differ in terms of whether they challenge the status quo of the existing system. We demonstrate this difference more clearly in the table below.

Table 1: Varieties of defensive financial statecraft

[Table 1]

This section assesses the financial statecraft of Korea in the East Asian region to find that Korea has been attempting to defend its financial security by way of expansion of influence in multilateral platforms. Yet in stark contrast, Korea has clearly demonstrated a passive attitude to defend its financial security in bilateral processes. We find that this contrast serves as strong evidence for how the behavioral characteristics of middle powers can explain the strategic motivations behind the financial statecraft of non-great powers.

Korea's 'passive' defensive financial statecraft in bilateral processes

Korea has been noticeably reticent in implementing a more proactive defensive financial statecraft strategy in bilateral channels. This is surprising, as even when compared to the BRICS economies that have been implementing a more proactive strategy, Korea's financial safety net has been very robust after the traumatic experience of the Asian Financial Crisis. As figure 1 demonstrates, Korea's foreign exchange reserve volumes are at par with other BRICS economies. Korea has also been allowed ad hoc access to the Federal Reserve's dollar liquidity lines in past financial crises, which successfully protected Korea's capital markets by bringing confidence back to its market. This has afforded Korea a relatively high degree of protection from currency crises, which in principle should allow it to offer help to more vulnerable trading partners, increasing its political influence as well as supporting its economic interests. In other words, given Korea's robust financial security with its large-scale foreign reserves and backstop assurance from the Federal Reserve against crises, it is natural to anticipate more proactive defensive financial statecraft strategies from Korea in the region, especially considering the behaviors of BRICS economies.

Fig. 1: Korea's foreign exchange reserves volume including gold in comparison to BRICS economies excluding China in billion USD (1999-2020)

[Figure 1]

Nevertheless, again, Korea has been markedly reticent in implementing more proactive policies that would not only thicken its financial safety net but also expand its financial influence in the region in its bilateral channels. We point to two BSAs that Korea signed with its regional neighbors as evidence of this puzzling passivity: Korea's BSAs with Indonesia and Malaysia. We focus on BSAs as they have become an increasingly common tool of financial statecraft, making them a suitable instrument for assessing a state's financial statecraft strategies. (McDowell 2019) BSAs denominated in local currencies can promote trade settlements to be made in local currencies and potentially reduce the foreign exchange risks

coming from using the dollar as a trade medium. A country that is recording chronic trade deficits with a given trading partner may therefore benefit from establishing a BSA with the trading partner as increased settlements through local currencies can allow obligations to be paid in the country's own currency instead of the dollar. However, they are unlikely to require either country to risk BSA funds in a bailout, since none of the local currencies involved would be financially useful in a crisis; rather, the BSAs would be most useful in preventing bilateral trade disruptions. (Perks et al. 2022) All of this points to more passive use of BSAs for defensive financial statecraft.

A more proactive use of BSAs, on the other hand, would involve arrangements where a state signs arrangements to enhance the financial security of partner states, which would in turn enhance its own financial security. Such a strategy would also ultimately involve the expansion of the agent state's financial influence, as in the BRICS economies' strategies (Katada et al. 2017), as those enjoying enhanced protection would become more financially reliant on the agent state, making it a proactive tool of financial statecraft. Japan's network of dollar-yen denominated BSAs with Southeast Asian economies and India's dollar-rupee denominated BSAs with the South Asian Association for Regional Cooperation (SAARC) are some of the examples of such proactive defensive financial statecraft. Given the intimate economic and financial relations each country shares with its regional partners, insuring their financial markets against crises through providing dollar credit lines essentially also protects Japan and India's own financial markets. This is evidently a step beyond passively protecting its own financial markets as it thickens financial security through the expansion of influence.

Korea's BSA activity in the Asia-Pacific region may appear to indicate that Korea has been implementing such proactive defensive financial statecraft strategies. As noted above, Korea already has established a robust financial safety net. It has also concluded a local currency denominated BSA with Malaysia equivalent to 4.7 billion dollars and a 10 billion dollar-equivalent BSA with Indonesia. At first glance, this seems to suggest that Korea is employing a proactive strategy similar to those of India or Japan. However, while these numbers may seem significant given Korea's relative economic size to its neighbors as Table 2 indicates, a closer look behind Korea's BSAs with these countries demonstrates that Korea's BSAs have been driven by inward-looking, passively defensive intentions.

Table 2: CJK BSAs with ASEAN Countries (in billion \$) as of 2020

[Table 2]

As Figure 2 demonstrates, Indonesia and Malaysia have been the only trading partners with which Korea has been recording a chronic trade deficit among the major ASEAN member states with convertible currencies. BSAs with these economies reduce the risk to Korea of being unable to secure essential commodities if it runs short of dollars. In other words, Korea's BSAs with its Southeast Asian partners were primarily aimed at thickening its own financial safety net, rather than increasing its financial influence in the region. Such tendencies are

more clearly demonstrated in how the BSA negotiations were commenced. Indonesia was first to request a swap line in 2013 to Korea but Indonesia's initial request was that the swap line be doubly denominated in the dollar following the model of the BSAs that it had signed with Japan. However, despite Korea's apparently robust financial safety net, Korean policymakers showed little interest in expanding its financial influence on Indonesia through this opportunity. (Jeon 2013) Rather, as reports on Korea's BSAs with Indonesia and Malaysia demonstrate, Korea instead saw the request as an opportunity to thicken its financial safety net by potentially allowing its trade deficits with the two countries to be paid back in its own currency. (Heo 2013)

Fig. 2: Korea's balance of payments with ASEAN-5 in 1,000 USD (2012-2021)

[Figure 2]

Such reticence in expanding its influence and taking regional leadership through bilateral channels can be explained by Korea's limitations in material capacity relative to its neighbors. As Table 2 demonstrates, Japan has already taken the role of the regional lender of last resort as it extended dollar-yen denominated BSAs to half of ASEAN member states, and China's regional trade volumes are too robust to allow space for the Korean currency to meaningfully expand its presence in the region through BSAs. Bilateral processes, therefore, were not an attractive channel to expand Korea's financial influence in the region.

The following section demonstrates, however, that in striking contrast to Korea's reticence in exercising and expanding its material influence through bilateral channels, Korea has clearly demonstrated eagerness to expand its influence in multilateral processes and has played a critical role in taking intellectual and technical leadership in developing the region's regional financial arrangement, the CMIM. This allowed it to secure voting rights and borrowing privileges that well exceed its relative economic weight among members, as described below. Such a preference for multilateral processes is in clear alignment with the expected behavior of a middle power. In other words, Korea's relative reticence in expanding its influence through bilateral channels compared to its BRICS counterparts can be explained by Korea's status as not being a preponderant power in the region. Its financial statecraft strategies follow the behavioral characteristics of a middle power, which are marked by a preference for multilateral processes, niche diplomacy, and a tendency to avoid direct competition for stronger material influence. The following section finds further empirical backing for these conjectures by drawing on primary evidence from in-depth interviews with Korean policy elites and executives to explain Korea's involvement in the developmental process of the CMIM and its current role.

Korea's 'proactive' financial statecraft in multilateral processes

The Asian Financial Crisis (AFC) of 1997-98 called into doubt the IMF's capacity and fitness to act as the lender of last resort against a rapidly globalizing international financial system. As a

result, the finance ministers of the ASEAN+3² economies gathered in Chiang Mai, Thailand and reached an agreement shortly after the crisis to establish a network of BSAs among the members to provide emergency liquidity to economies under financial distress in what was called the Chiang Mai Initiative (CMI). (Henning 2002)

Although heralded as a major regional initiative, CMI had a number of features that led to questions about its usefulness. First, BSAs were bilaterally negotiated and not standardized. This not only meant that they formed more of a patchwork than a uniform safety net, but also that it took considerable time to negotiate all the BSAs. The same was true when ASEAN+3 finance ministers agreed to double the size of the arrangement in 2005. (Grimes 2009) Indeed, the network of BSAs had not actually been completed by the time that the members agreed to “multilateralize” it in 2009. China especially lagged behind finalizing its BSAs with other member states, which was a serious flaw in that it (along with Japan) was expected to be one of two largest providers of funds. (Kawai 2015) CMI was also closely tied to the IMF through both the IMF link,³ which effectively delegated key decisions about disbursement to the IMF, and its reliance on the IMF for support in the disbursement process and ex post management of the loans. The IMF link in particular was of concern to CMI members, several of which had suffered under stringent IMF programs following the AFC.

To account for such concerns, a task force to push for the multilateralization of the BSA network was established in 2007, and an agreement to multilateralize the CMI was eventually reached in 2009 along with plans to establish a separate surveillance unit that would help de-link the newly established RFA further from the IMF. (Grimes 2011) The agreement significantly increased the funds available (from \$80 billion to \$120 billion; this was later doubled) and reduced the IMF link. At least as important for Korea, it also created a weighted contribution and voting system in which Korea locked in access to up to \$19.2 billion (later raised to \$38.4) and 14.77% voting share, as well as a new Precautionary Line that enabled provision of funds without stringent conditionality. The new CMIM made more funds available to Korea at more favorable terms, while also making it an important swing vote in funding decisions, which gave it structural power within the initiative.

In contrast to its reticent financial statecraft in bilateral channels, as demonstrated in the previous section, Korea played a key role in improving and leading the development of this regional cooperative effort. Korea had been the first to finalize all of its BSAs with members of the ASEAN+3 under the original CMI (see Kawai 2015) and it played a pivotal role in establishing and guiding the task force to multilateralize the CMI into a quota-based RFA. (Ferrier 2019) Building a functional RFA was an important focus of Korea’s financial statecraft after 1997. Interviews with Korean officials make clear that, from the outset, the government

² Association of Southeast Nations plus China, Japan, and Korea

³ The IMF link stipulated that only a small portion of funds (initially 10%, rising to 20% in 2005) could be mobilized unless a liquidity provision was done in coordination with the IMF, effectively tying use of CMI to an IMF bailout. For East Asian economies still traumatized by the 1997-98 financial crisis and resulting IMF packages, this made CMI essentially unusable.

saw diplomatic as well as economic security opportunities in the region's first formal financial cooperation initiative, Korea worked hard to expand its influence in this niche area through diplomacy and intellectual leadership.⁴

Interviews with BOK officials and Yoon Deokryong of the Ministry of Economy and Finance prove a coherent picture of Korea's objectives in CMI and CMIM. First, and rather straightforwardly, Korea sought to bolster its access to foreign reserves as a follow-up measure against the financial crisis the country had just experienced. Another, more important source of motivation for these policymakers, however, came from Korea's perception of the CMI as a potential platform to expand its currency's influence in the region. Yoon, being one of the key Korean policymakers at the time of the CMI's inauguration, envisioned that the CMI should go beyond its role as an emergency liquidity pool, to later be developed into a regional currency basket.

The creation of a regional currency was expected to further encourage settlements to be made in local currencies as it would be representative of a combination of currencies, which policymakers expected to increase exchange rate stability and increase the role of the won in external transactions.⁵ The hope was that Korea would be able to reduce its chronic reliance on the dollar and exposure to capital flight. Like other emerging economies in finance that have similar material power and positive political relationships with the US, Korea's defensive financial statecraft is essentially targeted at protecting its financial markets from the imbalanced structure of the international monetary system. (Mehrling 2017) As a middle power with a currency that was not used internationally, its ability to protect its markets through its own efforts were limited; thus, it focused on multilateral regional actions through CMI. Although Korea had similar, or even stronger financial fundamentals compared to regional powers with similar material power elsewhere in the world, Korea's defensive financial statecraft strategy has involved a strong preference for multilateral processes and reticence in directly competing for material influence—in contrast, for example, to India, which has sought to increase its neighbors' dependence on it by extending dollar swap lines to every South Asian economy.

Korea's proactiveness in this multilateral process could also be seen from the outset, in the speed with which Korea finalized its BSAs under the CMI. Prior to the CMI's multilateralization,

⁴ This section draws heavily on in-depth interviews conducted with Yoon Deokryong, a former policy advisor to the vice minister of the Korean Ministry of Economy and Finance, Bank of Korea's (BOK) financial cooperation department team, and two policy executives from the Korean National Research Council (NRC) in the summer of 2021. The interview with Yoon was aimed at identifying Korea's initial intentions in participating in the CMI as Yoon was a direct participant in devising Korea's policy for arrangement in the early 2000s. Interviews with the BOK were mainly aimed at understanding Korea's current perceptions on the now multilateralized CMI, along with how the bank officially perceived the CMI at the time of its inauguration. Finally, interviews with NRC executives sought to gain a general understanding on Korea's motivation behind its extensive technical cooperation with the financial arrangement and its surveillance institution.

⁵ A similar logic inspired Japanese policy makers who had advocated a regional currency basket and regional settlement as part of a strategy to make the yen the dominant regional currency. (Grimes 2009, ch. 4)

Korea was able to sign off the largest volume (\$23.5 billion) of BSAs, even compared to China (\$7 billion) and Japan (\$15.5 billion). (Kawai 2015, Table 1) Korea also signed substantial local-currency BSAs with China and Japan in 2005, although the BSA with Japan was subsequently allowed to lapse. Naturally, the CMI's expansions came incrementally, and Korean policymakers anticipated that being the first country to finalize the BSA signings would allow it at least momentarily to take a leadership position in designing the future development of the initiative.

Yoon states that this proved to be true and that the task force to plan for CMI's multilateralization process was established under Korea's intellectual leadership. (Ferrier 2019) Korea's strong preference for multilateral processes in advancing its foreign policy interests paid off, allowing it to secure a significantly greater role in the CMI's multilateralization process than the size of its economy and foreign exchange reserves would suggest. This approach constitutes a form of 'niche diplomacy.' (Cooper 1997) In particular, Korea was able to take advantage of its middle power status and multilateral strategy to fill a leadership vacuum left open by the power contest between Japan and China (Grimes 2015), leading to advantageous results, including a larger-than-expected voting share and access to funds. This was widely reported in the Korean press at the time as a victory for its financial diplomacy.

Yoon recalled that Korea's task force proposal, which sought to transform the CMI into a quota system, was also part of Korea's intentions to develop the CMI into a currency basket in the future. Such intentions can also be evidenced in the CMIM's structural design, where the voting powers of the RFA's member states are determined primarily by the size of their contribution. Korean policy makers anticipated that negotiating a larger contribution could lead not only to better representation in decisionmaking within the CMIM but also to a larger share for the Korean Won in an eventual currency basket, which could help to cushion the economy from currency fluctuations.

Based on such intentions, Korea was able to break through the political deadlock between China and Japan (Pitakdumrongkit 2015; Grimes 2015; Ferrier 2019) by forming a consensus to grant China and Japan equal levels of contribution and voting power, while securing for itself a contribution equal to half of theirs, which was significantly larger than its economic presence in the region. (see AMRO 2021) Korea also took account of the interests of the ASEAN member states, which were the most likely borrowers from CMIM, and which wanted to have a larger voice in how funds would be disbursed. The final compromise gave ASEAN as a bloc 28.41% voting power while only contributing 20% of committed funds. Korea effectively exploited its middle power position in the multilateral process to build consensus and secure important policy goals.

Korea also had an integral role in establishing the precautionary line for the CMIM (CMIM-PL), the need for which was made clear by Korea's dependence in the fall of 2008 on a dollar swap line with the New York Federal Reserve Bank to maintain dollar liquidity and prevent a possible currency crisis. (Yoon et al. 2020) The precautionary line is designed to avoid strict IMF conditionality on the disbursement of CMIM funds, although there remain questions as to the

circumstances under which it could be used. CMIM-PL has been seen by analysts to be a tool of liquidity management that would primarily affect Korea, insofar as other member states would be unlikely to qualify for it. (Grimes 2015) By pursuing its financial statecraft through a multilateral venue, Korea was able to build influence and structural power in a way that was impossible through bilateral means. Unlike Korea's inward-looking, defensive policies in terms of regional BSAs in the region, its policies towards the CMIM clearly go beyond passively thickening its financial safety net to proactively shaping its regional economic environment.

Interviews affirm this perspective. The BOK executives valued the CMIM as a potential source of emergency credit, but emphasized that the bank primarily sees the CMIM as a channel for advancing regional cooperation. And in fact, the CMIM is currently managed by the BOK's international cooperation department rather than by the departments that manage external volatility and the bank's liquidity portfolio, as might be expected if CMIM were seen as a crucial source of emergency liquidity. Similarly, Yoon stressed that Korean policymakers do not see the CMIM as an attractive reserve asset, given Korea's economic size and the limited amount of credit it can draw from the reserve pool, along with the complicated disbursement process and potential for sparking speculative attacks on the currency. In his view, the CMIM is truly a last resort against liquidity crises, rather than a credit line that can be drawn as needed.

This perspective is further supported by interviews with executives in the international cooperation department of the NRC, a national peak association that oversees the majority of Korea's official technical assistance programs. The NRC devoted considerable material efforts through the Korean Institute for International Economic Policy (KIEP), an affiliated organization of the NRC, to regularly deliver technical assistance to the task forces established to multilateralize the CMI and build a separate surveillance unit for the RFA. KIEP continues to work in partnership with the CMIM and its supporting surveillance unit (ASEAN+3 Macroeconomic Research Office, or AMRO), sharing data and technical knowhow. By providing data and intellectual support to these under-resourced organizations, Korea has been able to leverage its expertise and resources to influence regional cooperation.

Hence, while Korea's integral role in establishing CMIM-PL (Yoon et al. 2020) demonstrates that Korea also had inward-looking intentions in engaging with the CMIM, our interviews reveal that Korea has primarily perceived the CMIM to be a channel for regional cooperation and thus as a venue to expand its regional influence, rather than a key component of its financial safety net. Again, the emphasis on multilateral processes as a channel for financial statecraft marks a contrast strikingly with its apparent reticence in bilateral channels and with the policy responses of regional powers elsewhere that have similar material capacity.

Questioning the sustainability of Korea's financial statecraft through the CMIM

Despite its successes in shaping the establishment of CMIM and AMRO, however, Korea's intellectual leadership has been less apparent in the ensuing years. Korea was able to

momentarily fill in the leadership vacuum created by the political deadlock between China and Japan in designing the CMI as the unconsolidated structure of the CMI allowed Korea to momentarily occupy the leadership position by acting as a mediator among competing interests and steer decisions its favor. However, since the CMI multilateralized, such policy space seems to have greatly diminished under the continued political rivalry between Japan and China, as the structuralized design of the CMIM is now effectively locked in place. Hence, as Yoon argued in the interview, Korea has now relinquished much of its intellectual leadership to Japan, which has been increasing its enthusiasm for CMIM.

In other words, the CMIM is no longer a niche policy area that Korea can further exploit as a regional middle power. According to Yoon's accounts, although the idea of transforming the CMI into a regional currency basket was first officially proposed by Korea, Japan has been leading the intellectual discourse on this agenda.⁶ Japan's relative economic presence has declined to the point that it too, is now overrepresented in the CMIM. Hence, transforming the CMIM into a currency basket under the current quota structure would allow the Japanese yen to be overrepresented relative to the Chinese currency (assuming that a currency basket would be weighted by GDP or trade share without consideration to convertibility or global usage), thanks to China's much more rapid economic growth than Japan's since CMIM's establishment.

Evidence for Japan's enthusiasm for the establishment of a regional currency goes back to the 1990s. (Kwon 2001; Grimes 2009, ch. 4) As one example, the Japanese Research Institute of Economy, Trade & Industry (attached to the Ministry of Economy, Trade & Industry) has been regularly publishing monthly data since 2005 on the projected value of a regional currency basket, identified as the Asian Monetary Unit (AMU), which currently reflects the country-weights of the CMIM. (RIETI 2021) BOK officials note that Korea, in contrast, has chosen not to publish its own preferred currency basket values. Yoon also noted strong interests in this agenda from Japan in his encounters with Japanese officials as a policy advisor compared to Korean officials.

The recent discussions in the 2021 ASEAN+3 Finance Ministers' Meeting also demonstrate this push by Japan—for the first time in an annual official statement, the group noted that discussions on denominating the CMIM in both the dollar and the local currencies of the member states have seen noteworthy progress. Nevertheless, Korea's early investment in multilateral financial statecraft continues to pay off, as Korea has already secured a significant representation within the CMIM and helped to put in place the CMIM-PL. Moreover, Japan's preferences in terms of CMIM, AMRO, and AMU currently parallel those of Korea, and Korea's support will be crucial in moving those ideas forward. As long as Korea is able to place itself as a potential mediator between Japanese and Chinese interests, the opportunities to advance its interest through multilateral financial statecraft in CMIM go well beyond the level

⁶ Yoon's version contrasts with the accounts of Japanese officials and economists, who trace the idea back to the work of Japanese economists in the late 1990s. See Grimes 2009, ch. 4.

that its material power might suggest.

Conclusion

This paper investigates the way in which regional positioning, rather than just material power, shape the motivations and financial statecraft of non-great powers, a factor that has not been emphasized in existing studies. While the literature on financial statecraft has begun to broaden its perspective by analyzing the financial statecraft of less capable states (Armijo & Katada 2014, 2015), studies on why these states make the choices they do have mostly focused on circumstantial motivations (Katada et al. 2017), reducing their effectiveness in explaining why states make different choices despite similar circumstantial endowments. This contrasts with the traditional perspective on statecraft which mainly focuses on great powers, where corresponding studies have often spoken directly to the literature on great power struggle and how it motivates the strategic choices of major powers. (Grimes 2011, 2015; Chey 2017; Cohen 2018)

To fill this gap in the financial statecraft literature, this paper argues that the behavioral characteristics attached to states based on their relative power can serve as a powerful explanation for understanding the financial statecraft of emerging powers. This paper focuses on the important case of Korea's financial statecraft in the Asia-Pacific region. Korea has been commonly classified as a middle power in existing studies, and this paper argues that the behavioral characteristics attached to middle powers explain Korea's policy choices in the financial dimension. This explains why Korea has very different strategies from states with similar material capacities in other regions, such as India, Brazil, or South Africa. Korea's position as a regional middle power alters its options for financial statecraft in ways that parallel the predictions of the middle power literature in other issue areas.

In building this argument, we first observe Korea's relative reticence in expanding its financial influence through bilateral channels. In contrast, we demonstrate that Korea has been quite proactive in pursuing the goals of financial statecraft through multilateral processes. Interviews with Korean policy policymakers and officials confirm that the emphasis on multilateral mechanisms has been a conscious strategy. This finding carries both theoretical and empirical significance in that it offers a theoretical framework to explain the motivations behind the financial statecraft of lesser powers and not only advances our understanding of Korea's financial statecraft, which has been critically understudied compared to Korea's economic magnitude, but also helps better explain the development process and status quo of regional financial cooperation in the East Asian region by highlighting Korea's role in shaping, and at times leading regional cooperation.

More specifically, the paper contributes to three literatures. First, authors such as Armijo and Katada (2014, 2015) have broadened our understanding of financial statecraft by extending it to emerging powers and creating a set of analytical categories that capture the actions of states that are not great powers. We add to this literature by underscoring the importance of

relative regional power as well as overall material capabilities. Second, we extend the growing literature on middle power diplomacy to the financial realm. Finally, this work starts to fill in a major gap in the literature on Korean foreign economic policy, which has so far focused on trade, investment, and development aid. Financial statecraft has actually been quite important to Korea's external economic policy profile, and deserves further study. For future studies, we call for studies that further explore the varieties in the financial statecraft of non-great powers, such as minor or regional powers like we have done in this paper for middle powers.

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