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An Analysis of the Strategic Positioning of Financial Diplomacy in a Global Context

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Abstract: The core of financial diplomacy is represented by how countries protect their financial goals, and being part of the process of regulating the world's financial system, as well as enhancing or strengthening the widening scope of this role due to an ever-changing financial landscape. With changes to the international system of regulating the world's financial markets, financial diplomacy has the mission of aligning/maintaining/controlling international rules for financial systems, stabilizing the global financial system, and enforcing/instituting restraints on international capital flows. Financial diplomacy is also a vital piece of creating regional and bilateral financial networks. By defining the strategic purpose of financial diplomacy, you can strengthen a country's financial infrastructure while creating a more equitable and fair financial system; both of these are important for a country's economic growth and development, and consistency across the globe for financial regulation and governance.

Keywords: Financial diplomacy; Strategic positioning; International financial governance; National interests

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1. Introduction

The integration of economies around the world is continuing to evolve. The present international monetary system is in a period of transformation, with each relationship between money, debt, and state-building around the world being different, and as a result of the unique circumstances and experiences of each nation. The rise of financial diplomacy represents an increasing means through which nations compete on a global level and gain respect for their sovereignty. Current mechanisms for international monetary and financial governance leave significant room for improvement, and the need for many emerging economies to increase their global voice has become critical. The evolving role of financial diplomacy will continue to strengthen within the global economy; therefore, greater emphasis must be placed on further study of financial diplomacy on a global scale, its relationship to global monetary and financial governance, and the nations' use of financial diplomacy to enhance global financial system stability and profitability.

2. The theoretical implications and developmental trajectory of financial diplomacy

2.1. The conceptual definition and core characteristics of financial diplomacy

Financial Diplomacy is the way countries interact with one another regarding international finance on an understanding basis and without hostility, through discussion, mutual communication, and cooperation, based primarily on their individual levels of financial evolution. While Traditional Diplomacy focuses mainly on interaction at the political level, Financial Diplomacy focuses primarily on the implementation of transnational financial cooperation as well as ensuring that the financial regulations that govern those interactions do not have negative consequences for either party. The three most important characteristics of Financial Diplomacy are: (1) Financial diplomacy is always based on the specific financial issues that each state is experiencing; (2) Financial diplomacy is dependent upon how successful it is to achieve the financial objectives of its nation as well as the goal of creating a stable international financial system; and (3) Financial diplomacy recognizes that the financial development processes that each nation has undertaken differ. Therefore, financial diplomacy needs to be flexible and recognize that there is no one solution for everyone. In particular, this characteristic differentiates financial diplomacy from traditional diplomacy because of the prominence of emerging market economies in financial diplomacy and the need for an equitable resolution to meet these nations' legitimate interests [1].

2.2. The theoretical foundation of financial diplomacy: A perspective from international political economy

The core theory of financial diplomacy is based on international political economy, which synthesizes the power games and the distribution of interests across countries with financial activities — this means breaking down the traditional boundaries between financial and diplomatic theories. Thus, from this perspective, financial diplomacy is one avenue by which a country can harmonize its political and economic interests via financial means, as opposed to solely through either economic exchanges or through diplomatic means. Financial diplomacy also has its theoretical underpinnings in balancing national interests unlike the older theories of international political economy that focused disproportionately on game-play among great powers. Because of the current international financial interdependence of countries, a financial disturbance in one nation can cause repercussive damages to another nation in the world; therefore, the ability to actually apply the two theories makes the theoretical foundation for financial diplomacy more applicable than other diplomatic methods. Ultimately, this process will also support the core principle of international political economy, but will also provide new knowledge of financial diplomacy due to the integration of these two theories, as they are parallel to the growth of international finance.

3. Analysis of the strategic positioning of financial diplomacy from an international perspective

3.1. As an institutional tool for safeguarding national financial interests

Financial diplomacy is an instrument of instituting protections for the financial interests of a nation through the integration of the protection of these interests into every aspect of the execution of cross-border financial transactions using standard agreements and procedures, providing an alternative to the traditional model of temporary negotiation and passive response. The government uses financial diplomacy as an institutional tool to achieve practical solutions to various issues in cross-border finance, such as rights protection in cross-border investments, ambiguity in currency settlements, and access to cross-border financial services. By using this tool, a country can establish permanent communication channels, define the parties' respective rights and responsibilities, identify any potential risks before they occur, and prevent future interest-related disputes. In addition, financial diplomacy replaces the short-term game mentality with a long-term focus on negotiating to achieve stability; this is accomplished by establishing specific details related to the protection of a nation's financial interests [2]. Therefore, a country can avoid financial disputes with other nations due to an aggressive determination to protect its own rights while also protecting its legitimate rights in its cross-border financial activities, and develop a more workable and stable method to protect its financial interests in its financial development activities.

3.2. As a platform for coordinating and jointly building international financial rules

The relationship between international financial rules and efficient international financial transactions is fundamental. Financial diplomacy provides the coordination/co-construction platform to address the historical "lead by the strong" dilemma of international financial rule construction. The platform is non-prescriptive and, instead, recognizes the actual differences in financial development of countries and creates equal opportunity for the emergence and operation of differing development and financial models. Therefore, the monopoly of the current international financial regulatory regime held by a very few financially developed nations will be eliminated. Emerging market nations will be able to introduce rules and recommendations that fit their level of development and financial requirements (i.e., have a voice in improving rules for inclusive finance and cross-border micro-payment systems). Established nations will also provide their maturity in both financial regulation and market operation; both will interact at an equal level of communication & understanding, create consensus that supports the present reality in global financial development, improve upon existing rules, and create mutual recognition of legitimate financial development needs in all member countries.

3.3. As a cooperative mechanism for global financial stability and crisis response

As global financial connections have become more significant, the response to a country's financial crisis is no longer feasible, as this way of dealing with a financial crisis will not work anymore. Financial diplomacy has led to the establishment of a cooperative approach to address financial risks, which will be a very different model than what we have seen recently, where individual nations were attempting to act independently. This new cooperation is based on standardization of working together as much as possible to mutually help each other in addressing the needs of countries for the prevention and management of financial risks, including through real-time sharing of information relating to financial institutions warning of risk exposure, tearing down communication barriers between countries, and building a combined group of countries to address the issues together rather than independently. This new structure will allow countries to share information and cooperate quickly on the development and adjustment of their financial policies when there are signs of cross-border financial problems in order to limit the spread of that financial problem, and, in contrast to the "passive response" of previous crisis management practices. This new model also seeks to provide an efficient global response to preventing and managing financial risks, regardless of the state of a country's ability to prevent and manage its own financial risks [3].

3.4. As a regulatory framework for cross-border capital flows and financial liberalization

Every country faces challenges in regulating and protecting cross-border capital flows on the path to financial openness. Financial diplomacy creates a management framework that harmonizes these two objectives in a balanced way, rather than thinking only in terms of extreme positions of "total closed control" or "totally open." This framework focuses on the regulation and guidance of capital flows based on the actual degree of financial openness and the maturity of countries' markets, as well as their ability to prevent and control risk. Hence, it provides flexibility in adjusting the various management methods (i.e., different management approaches for different countries), rather than using a "one-size-fits-all" approach. In areas with significant capital movement, such as cross-border investments or the settlement of international trade transactions, specific areas will be defined where there are reasonable limits to the inflow and outflow of capital; a standardized procedure for inflows and outflows of capital will be implemented; and an enhanced monitoring mechanism for detecting irregularities in capital flows will be developed. Thus, this will ensure the unfettered movement of legally obtained capital, the accommodation of countries' actual need for financial exchanges and economic growth, and the minimization of potentially destabilizing market fluctuations, financial risks, or other disruptions resulting from irregular flows of capital, thus creating a two-way balance between the two goals of financial openness and security protection [4].

4. Supporting conditions and practical challenges in implementing financial diplomacy strategies

4.1. The institutional foundation of domestic financial strength and regulatory systems

An improved institutional base of both the domestic financial system and its related regulatory structure is an essential and pivotal element in creating the necessary mechanisms to effectively and efficiently implement a financial diplomacy policy. Frequently, there is substantial misunderstanding by different countries engaged in promoting financial diplomacy; specifically, countries will place too much emphasis on conducting cooperation negotiations as a form of diplomacy while failing to properly consolidate their domestic financial systems. Depending on the cooperative agreements reached at the diplomatic level of many countries, there will likely be a significant challenge to the implementation of such agreements domestically, and in some instances, financial risks could spill over from one country into another. The major reasons for this happening relate to the relatively weak structure of the domestic financial market and the inadequate regulatory system. Financial regulatory systems in place should reflect and align with the ongoing development of the domestic finance market and should not blindly duplicate developed country regulatory structures. Therefore, a financial regulatory system should be established that permits flexibility and efficiency based on the characteristics of the domestic financial market. At the same time, the financial regulatory system must protect against financial transaction activity and allocate resources appropriately in a manner that permits an adequate level of risk. Improvements in the regulatory system must incorporate considerations of synergy, as barriers created through jurisdictional lines between various regulatory bodies must be eliminated; as regulatory gaps and/or redundancy in regulatory oversight must be addressed; therefore, providing a sound internal support structure for the conduct of financial diplomacy [5].

4.2. Building international financial influence and the capacity to shape the agenda

The construction of the international financial discourse power and ability to lead issues is directly related to the effectiveness of the implementation of the financial diplomacy strategy. There are many countries that have long been passive participants in the international financial field, where the core of their inability to play an active role stems from a lack of discourse power and issue-leading ability. The international financial discourse power is much more than simply having the "right to express an opinion"; it also extends to how "international financial issues" are created and set, how "rules" are interpreted and agreed upon, as well as the "building of consensus" at the international level. Currently, there are many countries that are participating in the international financial cooperation process; however, they find it difficult to lead the direction of these issues and must continue to follow the pace set by developed countries. The foundation for leading is based on the real world, as countries should not just focus on "overall leadership" in international finance. Instead, the individual country's financial development should be the basis for determining which financial issues will always provide the best possible opportunities for the country and globally, i.e., developing all means available to prevent and control cross-border financial risk and create an inclusive global financial system. When determining which issues should be addressed, a country can provide and share its financial development experience, develop practical and realistic agenda plans, then with time, more and more of the global community will recognize the validity of the country's position, and will in turn collaborate and cooperate with the emerging economies to elicit a major shift from the dominant position of the few to much broader participation in defining the global financial agenda and providing actual needs to the overwhelming majority of the world's nations.

4.3. Coordination and participation strategies within multilateral financial organizations

The role of multilateral finance institutions is very significant in implementing financial diplomacy strategies, and the effectiveness of financial diplomacy will be determined by how countries coordinate with one another and the level of participation they have within the multilateral finance institutions. Many countries, due to a lack of knowledge, find themselves in "passive participation and reckless consent" during their participation in the financial diplomacy process; this causes them to be less effective in playing their part as members of the multilateral finance institutions. Developing a country's participation and coordination strategy should consider its own financial development circumstances and needs, and cannot be modeled after another country or be in violation of the rules and guidelines of multilateral finance institutions. When a country is participating, it should not just follow the path of the developed world, but should engage actively in the core issues of the multilateral finance institutions and establish a specific cooperative agenda based on its own experience [6]. A country will want to find ways to jointly establish a strong alliance with countries that share similar interests using effective communication, collaboration, and consensus-building. In order to coordinate interests among all parties, the country must consider its own interests in addition to the multilateral interests of all parties and avoid conceding to one side or insisting on another without considering other options. Further, the strategy for participation should be flexible and should consider not only the short-term impact of participation but also look toward creating long-term solutions [7].

5. Conclusion

The framework for the method of conducting financial diplomacy: the cooperative and protective relationship that will exist between nations in developing their financial systems, has become increasingly important as international financial governance has evolved over many years; hence, financial diplomacy has become even more crucial as a means to successfully execute financial diplomacy and continues to support the overall development of domestic finance and the enhancement of international finance. The identification of the strategic significance of financial diplomacy and its associated development will offer each nation an opportunity to work cooperatively within the respective financial systems to accomplish cooperative projects globally; thus, financial diplomacy provides a significant contribution to promoting global financial stability, developing global trading rules and processes, and to creating connections and inter-relationships among nations throughout the world to facilitate ongoing transition of the overall global financial governance system.

Disclosure statement

The author declares no conflict of interest.

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