

# Analysis of the Interactive Mechanism between Regional Monetary Cooperation and the Formation of a Multi-level Monetary World

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**Abstract:** Regional monetary cooperation, as an important path for the transformation of the international monetary system, has a deep interactive relationship with the formation of a multi-level monetary world. This article systematically analyzes the internal mechanism by which regional monetary cooperation promotes the evolution of a multi-level monetary system from three dimensions: theoretical logic, institutional construction, and practical constraints. Research shows that regional monetary cooperation provides an institutional basis for a multi-level monetary world by reducing transaction costs, diversifying systemic risks and reconfiguring the international monetary power structure. The competitive pressure in a multi-level currency world, in turn, promotes the deepening of regional currency cooperation. This interactive process reflects the inevitability of the transformation of the international monetary system from unipolar hegemony to multi-party governance.

**Keywords:** Regional Monetary Cooperation; A Multi-level Currency World; Optimal Currency Area Theory; Reconstruction of International Monetary Power

## 1. Introduction

Since the 21st century, the international monetary system has shown the dual characteristics of the loosening of unipolar hegemony and the initial emergence of a diversified pattern [1]. The Bretton Woods system dominated by the US dollar has exposed systemic flaws under the impact of deepening globalization and geopolitical changes: on the one hand, the United States maintains global demand through a "debt-currency" cycle, leading to an intensification of global imbalances [2]; On the other hand, the rise of emerging economies and the accelerated regional economic

integration have driven the international monetary power towards multi-polarization and dispersion [3]. Against this backdrop, regional monetary cooperation, as an intermediate form connecting national monetary sovereignty with the international monetary order, its interactive mechanism with the multi-level monetary world has become the key to understanding the transformation of the international monetary system [4].

Traditional studies mostly analyze the feasibility of regional monetary cooperation from the economic criteria of the optimal currency area theory (such as the liquidity of production factors and economic openness) [5], but they have insufficient consideration of non-economic factors such as political power and institutional competition. In recent years, scholars have gradually paid attention to the strategic attributes of regional monetary cooperation: it is not only the pursuit of economic efficiency, but also a strategic choice for the redistribution of international monetary power [6]. For instance, the establishment of the Eurozone has weakened the monopolistic position of the US dollar, while the internationalization of the RMB has promoted the use of regional currencies through the Belt and Road Initiative, further challenging the unipolar system [7]. However, existing research still lacks a systematic analysis of the "two-way interaction" mechanism formed by regional monetary cooperation and a multi-level monetary world, especially insufficient exploration of the dynamic correlation between institutional evolution, power reconfiguration and technological change.

## 2. The Theoretical Basis and Institutional Form of Regional Monetary Cooperation

### 2.1 The Evolution and Limitations of the Optimal Currency Zone Theory

The theory of the optimal currency area is an

important theoretical cornerstone of regional monetary cooperation. It was first proposed by the renowned economist Mundell in 1961. The core viewpoint of this theory lies in that by achieving the free flow of production factors within the region, an equilibrium state of the regional economy can be reached, thereby replacing the traditional exchange rate adjustment mechanism to maintain the stable operation of the economy [8]. This pioneering theory provides crucial direction guidance for the subsequent research and practice of regional monetary cooperation.

Since then, many scholars have conducted in-depth improvement and development of the theory of the optimal currency area. McKinnon expanded from the perspective of economic openness, emphasizing the significant impact of the degree of economic openness on the construction of currency areas. Krugman constructed the GG-LL model, further enriching the analytical dimensions of the theory and enabling the theory of the optimal currency area to gradually form a comprehensive analytical framework that includes economic standards, policy coordination, and institutional arrangements.

However, the traditional optimal currency area theory (OCA theory) is not without flaws and has three significant limitations. Firstly, this theory overly focuses on the aspect of economic efficiency, but to some extent neglects the key factor of political sovereignty cost. In actual regional currency cooperation, the transfer of currency issuance rights and other aspects often involve adjustments to a country's political sovereignty, and such costs cannot be underestimated. Secondly, the traditional OCA theory employs static analysis methods, making it difficult to precisely explain the dynamic evolution process of regional monetary cooperation in the temporal dimension. Regional monetary cooperation in reality is a constantly evolving process, influenced by the interaction of multiple factors. Thirdly, this theory obviously fails to take into account non-economic factors such as institutional competition and network externalities. These non-economic factors also play a significant role in current regional monetary cooperation and may even influence the direction and effectiveness of the cooperation.

After the 1990s, the new optimal currency area theory emerged, which incorporated new

elements such as private sector choice and institutional credibility into its analytical perspective. For instance, Krugman proposed that when the cost of intra-regional trade is lower than the cost of currency conversion, the benefits brought by a unified currency will exceed the sovereign losses resulting from the transfer of monetary sovereignty. This brand-new perspective provides a solid theoretical foundation for understanding the "self-actualization" mechanism of regional monetary cooperation. Specifically, in the initial stage, regional currency cooperation can attract more member states to join by reducing transaction costs, thereby creating a path dependence effect and promoting the continuous in-depth development of regional currency cooperation.

## **2.2 Institutional Forms and Levels of Regional Monetary Cooperation**

Regional monetary cooperation shows a gradual evolution feature from the primary to the advanced level in the practical process, and its institutional form can be clearly divided into three levels.

The first level is the crisis relief mechanism, represented by the Asian Monetary Fund (AMF). This mechanism mainly provides liquidity support to member countries facing short-term balance of payments imbalances by establishing regional foreign exchange reserve pools. It has non-institutional and bilateral characteristics, and is more often used to play an emergency role in times of crisis, helping member states relieve temporary financial pressure.

The second level is the exchange rate coordination mechanism, with the European Exchange Rate Mechanism (ERM) being a typical representative. This mechanism limits the fluctuation range of member states' currencies by setting exchange rate arrangements for target areas. To reap the benefits of exchange rate stability, member states need to give up some of the independence of their monetary policies, which imposes certain constraints on their monetary policy formulation.

The third level is a unified monetary union, and the Eurozone is a typical example of this advanced form. The unified currency union transfers the right to issue currency through legal contracts. This not only involves deep integration in the economic field but also deep adjustment and integration of fiscal and political

sovereignty. It is the highest form of regional currency cooperation.

The choice of different institutional forms is not made at will, but depends on multiple factors such as the economic homogeneity, political will and institutional capacity of member states. For instance, due to significant differences in economic cycles, East Asian countries tend to start with crisis rescue mechanisms in the early stage of regional monetary cooperation, gradually accumulating experience and enhancing mutual trust. Due to the strong complementarity of their economic structures and the solid foundation of political alliances, the EU countries have been able to directly promote a unified currency and achieve higher-level regional monetary cooperation.

### **3. The Economic Logic of Regional Currency Cooperation Promoting the Formation of a Multi-level Currency World**

#### **3.1 Reduce Transaction Costs and Network Externality Effects**

Regional currency cooperation significantly reduces the currency conversion costs of trade and investment within the region through unified currency or fixed exchange rate arrangements. According to the World Bank's estimation, the establishment of the Eurozone has reduced trade costs within the region by approximately 0.5% and promoted an average annual GDP growth of 0.2%. This cost-saving effect creates network externalities: as the cooperation area expands, the marginal benefits of new members joining increase, thereby attracting more countries to participate and forming a positive cycle of "cooperation-expansion-stronger cooperation".

Network externalities are also reflected in the use of international currencies. When a regional currency becomes the main pricing and settlement currency within the region, external countries will actively hold the currency as a reserve asset to reduce transaction risks, thereby enhancing their international status. For instance, since its launch in 1999, the euro's share of global foreign exchange reserves has risen from 18% to 25% by 2024, posing a substantial challenge to the monopoly of the US dollar.

#### **3.2 Diversify Systemic Risks and Enhance System Stability**

Under a unipolar currency system, systemic risks are highly concentrated in the central

currency-issuing country. The global financial crisis in 2008 exposed the vulnerability of the US dollar standard: the quantitative easing policy of the Federal Reserve led to a global liquidity glut, and emerging economies faced the dual risks of a sudden increase and sudden withdrawal of capital inflows. Regional currency cooperation reduces the impact of single currency fluctuations on the global economy by building a multi-currency anchor and diversifying risks across multiple regional centers.

The stability of a multi-level monetary system also stems from the "competitive stability" mechanism. When a regional currency abuses its issuance rights, market entities can turn to other stable currencies to form a balance against the central currency-issuing country. For instance, during the eurozone debt crisis in 2010, some international investors shifted their asset allocation towards RMB-denominated assets, objectively restricting the policy expansion of the euro.

#### **3.3 Reconstruct the International Monetary Power Structure**

International monetary power is essentially a combination of rule-making power and resource allocation power. Regional monetary cooperation reconstructs the monetary power structure through the following paths:

**Decentralization of rule-making power:** Regional monetary unions formulate internal financial regulatory standards (such as the EU's Capital Requirements Directive), weakening the rule-making dominance of global institutions like the International Monetary Fund (IMF).

**Diversification of reserve assets:** The internationalization of regional currencies has driven the global reserve assets to shift from the US dollar to a multi-polar pattern of "US dollar + euro + RMB". According to the IMF, in 2024, the proportion of non-US dollar currencies in global foreign exchange reserves reached 42%, an increase of 27 percentage points compared with 2000.

**Regionalization of crisis response mechanisms:** Regional monetary cooperation in establishing crisis relief funds independent of the IMF (such as the Chiang Mai Initiative Multilateralization mechanism) has weakened the United States' ability to exert policy influence through the IMF's conditional loans.

#### **4. The Reverse Shaping of Regional Monetary Cooperation by a Multi-level Currency World**

##### **4.1 Competitive Pressure Promotes Institutional Optimization**

In a multi-level currency world, regional currencies need to maintain their competitiveness through continuous institutional innovation. The Eurozone attempts to resolve the inherent contradiction between a unified currency and decentralized finance by establishing a banking union and unifying fiscal rules. The internationalization of the RMB has enhanced market confidence and institutional credibility through measures such as the "811 Exchange rate Reform" and its inclusion in the SDR currency basket. This kind of competition forces regional monetary cooperation to transform from crisis response to long-term institutional building.

##### **4.2 Redistribution of Power Drives Strategic Adjustment**

Under a multi-level monetary system, international monetary power has shifted from the United States to regional centers such as the European Union and China, leading to changes in the strategic goals of regional monetary cooperation. The European Union has consolidated the status of the euro by deepening the Economic and Monetary Union (EMU). China promotes the use of the RMB in trade and investment through the Belt and Road Initiative. The redistribution of power has also triggered geopolitical games. For instance, the United States' containment of challenges to the euro (such as the Kosovo War) and its vigilance against the internationalization of the RMB (such as the trade war) have further promoted the extension of regional monetary cooperation into a political alliance.

##### **4.3 Technological Changes Expand the Boundaries of Cooperation**

The development of digital currency technology has provided new tools for regional monetary cooperation. Central bank digital currencies (CBDCs) can reduce cross-border payment costs and enhance the attractiveness of regional currencies. For instance, the pilot program of China's digital RMB has covered multiple countries along the Belt and Road Initiative, providing technical support for the regionalization of the RMB. In addition,

distributed ledger technology (DLT) can enhance the transparency and efficiency of regional monetary cooperation, promoting the transformation of cooperation from inter-governmental agreements to market-driven ones.

#### **5. China's Strategic Choices for Participating in Regional Monetary Cooperation and the Construction of a Multi-level Monetary System**

##### **5.1 Path Selection for the Internationalization of the RMB**

The internationalization of the RMB should take into account both economic efficiency and institutional security. In the short term, the scale of use should be enhanced by expanding cross-border trade settlement and developing offshore markets (such as the Hong Kong RMB hub). In the medium term, it is necessary to improve the exchange rate formation mechanism and open up the capital market to enhance market confidence. In the long term, it is necessary to promote regional currency cooperation (such as the currency arrangement of the China-Japan-South Korea Free Trade Area) to create conditions for the RMB to become a regional anchor currency.

##### **5.2 Participate in the Institutional Innovation of Global Monetary Governance**

China can enhance its say in global monetary governance through the following approaches: First, promote the reform of the IMF quota to increase the voting rights of emerging economies; Secondly, under the framework of the G20, advocate a multilateral currency coordination mechanism to weaken the United States' monopoly on global liquidity management. Thirdly, explore a new international monetary system of "digital currency + Special Drawing Rights (SDR)" to provide public goods for a multi-level currency world.

##### **5.3 Balance Regional Cooperation with Sovereign Security**

Regional monetary cooperation involves monetary policy and the transfer of fiscal sovereignty, and it is necessary to seek a balance between efficiency and security. China can draw on the experience of the European Union and promote cooperation in stages: in the initial stage, mainly through crisis relief funds and bilateral

currency swaps; Establish a regional exchange rate coordination mechanism in the medium term; In the long term, higher forms of monetary cooperation should be considered when conditions are ripe. At the same time, it is necessary to enhance institutional resilience and reduce cooperation risks through domestic financial reforms (such as interest rate liberalization and prudent opening of the capital account).

## 6. Conclusion

Regional monetary cooperation and the formation of a multi-level monetary world are the dual manifestations of the transformation of the international monetary system. Through the interaction of economic logic and power politics, the two jointly promote the transformation of the system from unipolar hegemony to multi-party governance. Regional monetary cooperation provides an institutional foundation for a multi-level monetary world by reducing transaction costs, diversifying risks and reconfiguring the power structure. The competitive pressure and technological changes in a multi-level currency world, in turn, promote the deepening of regional currency cooperation and institutional innovation.

As a representative of emerging economies, China should strive for strategic initiative in a multi-level monetary system through the internationalization of the RMB, participation in global currency governance and balanced regional cooperation. Future research needs to further focus on new issues such as the impact of digital currencies on regional monetary cooperation and the interference of geopolitical conflicts on the cooperation process, providing more forward-looking theoretical support for the

reform of the international monetary system.

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