

The Future of the Chiang Mai Initiative: An Asian Monetary Fund?

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In September 1997, at the outset of the last global financial crisis, the Japanese Ministry of Finance proposed the creation of an Asian Monetary Fund. Although this particular proposal was scuttled, the idea of a common regional fund on which East Asian governments might draw in times of financial turmoil survives. The region's disaffection from the International Monetary Fund (IMF), stemming from the 1997–98 crisis, sustains this idea and a desire on the part of individual countries to self-insure with large holdings of foreign exchange reserves. East Asian governments and central banks have created a set of bilateral swap

arrangements (BSAs) dubbed the Chiang Mai Initiative (CMI) and are negotiating among themselves to build these BSAs into a more comprehensive facility. Some Asian officials hope that such a facility could underpin exchange rate cooperation and monetary integration in the region, although such proposals remain for the moment long-term visions.

The present financial crisis raises the prospect that some governments might draw on their BSAs under the CMI and increases the stakes in the CMI's possible future development into a comprehensive facility. This juncture thus represents a moment of truth for East Asia: Are these governments serious about financial cooperation? Can they overcome rivalries and make the difficult political decisions to advance it? Will they adhere to or break from international financial institutions such as the IMF?

Senior officials of East Asian governments and central banks will meet three times between February and May 2009 to consider, among other things, transforming the CMI from a network of BSAs into a collectively managed fund. These meetings take place under the aegis of ASEAN+3, the ten members of the Association of Southeast Asian Nations¹ plus China, Japan, and South Korea. Their 13 finance ministers will meet on February 22 prior to a meeting of the ASEAN heads of government beginning February 27 in Thailand. The finance ministers will then meet again in Bali, Indonesia, in early May. The three meetings straddle the next summit of the Group of Twenty (G-20) in London in early April. An ASEAN+3 agreement to create a common regional fund would realize some, though not all, of the features of the original Asian Monetary Fund proposal and significantly alter the global financial architecture. Whether the 13 governments are willing to cross that threshold, however, remains to be seen.

This policy brief (1) provides a brief primer on the CMI, (2) reviews the issues under discussion for its conversion into a common regional fund, and (3) offers recommendations to governments in East Asia and the rest of the world to enhance complementarity between financial regionalism and global institutions such as the IMF.

1. The 10 ASEAN members are Brunei, Cambodia, Indonesia, Laos, Malaysia, Burma/Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

Reviewing the CMI and possibilities for its regionalization is all the more timely in light of a notable increase in the number and relevance of other regional and bilateral financial arrangements. At the outset of their recent crises, for example, Iceland and Pakistan each appealed to reserve-rich countries in an unsuccessful effort to avoid resorting to the IMF. The European Union provided large shares of the financial packages for Hungary and Latvia. Russia has announced modest support for regional neighbors, and Ukrainian officials have asked Moscow to consider a large loan. In addition, since December 2007, the US Federal Reserve has opened swap agreements with 14 central banks including several in East Asia.² While these arrangements have so far avoided colliding with one another and with the IMF, the potential for conflict rises with the number and diversity of alternative financial facilities. The international community must address the respective roles of bilateral and regional facilities and global financial institutions, notably the IMF, and coordination among them (Henning 2002, 2008).

THE CHIANG MAI INITIATIVE

The CMI was launched at a meeting of ASEAN+3 finance ministers in Thailand in May 2000. They announced a broad set of objectives for financial cooperation, involving policy dialogue, monitoring of capital flows, and reform of international financial institutions. The finance ministers would also later add bond-market initiatives and regional bond funds to their agenda for regional cooperation. But at Chiang Mai their core objective was to establish a network of BSAs between Northeast and Southeast Asian members. As these BSAs were negotiated and concluded over the subsequent years, their number grew to 16—although the number in effect at any one time varies, as these arrangements lapse and are renegotiated and reinstated.³ ASEAN+3 finance ministers reviewed the CMI in 2004–05 and launched a “stage two,” roughly doubling the nominal size of the swaps among other things. Asian officials now place the total amount that can be mobilized under these BSAs at \$83 billion. Eliminating double-counting and removing arrangements that have mostly symbolic value, however, reduces the total to \$50 billion to \$60 billion. These arrangements nonetheless potentially mobilize funds that represent a multiple of the IMF quotas for Indonesia, Malaysia, the

Philippines, Thailand, and South Korea.⁴ Because they can be renewed up to seven times, these (three-month) “swaps” can provide not only short-term liquidity but also medium-term balance-of-payments financing.

The amounts that individual countries can access under these arrangements depend on the specific BSAs in place with Japan, China, and South Korea. In principle, Indonesia can borrow \$12 billion, Thailand and the Philippines \$9 billion each, and Malaysia \$6.5 billion under their arrangements with the three creditors. Prior to recent agreements (discussed below) South Korea could borrow from both its Northeast Asian partners, Japan and China, as well as from Southeast Asian countries, with whom it has two-way arrangements, for a grand total of \$23 billion.⁵

These amounts must be qualified by three observations, however, two of which suggest more limited access and one that suggests greater access. First, the 16 BSAs have specified terms and, therefore, will be in various states of expiration, renegotiation, and renewal at any one time. Second, under the BSAs, activation is not automatic on the request of the borrower. Activation also requires approval by the creditor, which, while perhaps expected, is not guaranteed and hinges critically on decisions of the IMF (discussed below). Third, the amounts, while modest, can nonetheless be raised relatively quickly in a crisis. While raising amounts available is not trivial, this particular matter can sometimes be renegotiated more easily once an agreement is in place than negotiating an entirely new agreement.

Recently, East Asian central banks have announced several new swap agreements outside the ambit of the CMI. In December 2008 the three countries in Northeast Asia announced (a) an increase in the size of one of the Japan-Korea swaps from the equivalent of \$3 billion to the equivalent of \$20 billion and (b) the establishment of a new China-Korea swap equivalent to roughly \$26 billion. In concluding these agreements, Japanese and Chinese officials appeared to be responding to the extension of a \$30 billion swap agreement to Korea by the US Federal Reserve.⁶ China subsequently also extended two local-currency

2. The Fed also maintains long-standing swap agreements with the Bank of Canada and Bank of Mexico.

3. The CMI rubric and BSAs are described in detail in Henning (2002). See Kawai and Houser (2007) for a useful update.

4. The development of the CMI and associated policy issues are debated in Henning (2002, 2006), Eichengreen (2002), Bergsten and Park (2002), de Brouwer (2004), Kuroda and Kawai (2004), Rajan and Sirigar (2004), Amyx (2005, 2008), Grimes (2006, 2009), among others.

5. See, for example, Kawai and Houser (2007) and the frequently cited diagram at the website of the Japanese Ministry of Finance, www.mof.go.jp/english/if/cmi_0707.pdf.

6. Bank of Japan, “The Bank of Japan and the Bank of Korea Announce an Increase in the Size of the Yen-Won Swap Arrangement” December 12, 2008, available at www.boj.or.jp; People’s Bank of China, “The People’s Bank of China and the Bank of Korea have agreed to establish a Swap Arrangement,” December 12, 2008, available at www.pbc.gov.cn; US Federal Reserve, “Federal Reserve, Banco Central do Brasil, Banco de Mexico, Bank of Korea, and

swap arrangements, one to Hong Kong equivalent to about \$34 billion and the other to Malaysia equivalent to about \$13.5 billion.⁷

While the new swaps increase the financing that recipients can make available to private banks facing short-term funding problems, they are not intended to be used for balance-of-payments financing. The intra-regional agreements are sometimes referred to as “sunshine swaps” for this reason. The local-currency nature of these swaps further limits their value to situations in which yen or renminbi liquidity is needed. Korea’s immediate concern in fall 2008, however, was to fund the dollar liabilities of Korean banks, though they might also have funding needs in Japanese yen. We should consider the new liquidity swaps and the CMI swaps to be separate facilities for these reasons. While these new swaps have large face value, help to underpin confidence, and are a potentially useful adjunct to the CMI, they should not be considered a substantial expansion of the CMI per se.

Five aspects of the evolution of the CMI and parallel trends and developments are useful for placing the present negotiations over a common fund in context.

First, the CMI was not by any means the only response of East Asian governments to the Asian financial crisis of 1997–98. They generally pursued multipronged strategies that included self-insurance via the accumulation of large reserves of US dollars and other foreign exchange. Undervaluation of their currencies and trade surpluses also conferred a sense of financial security on East Asian policymakers. One consequence was that East Asian governments collectively commanded the wherewithal to fight financial crises—if they were willing to commit some of their large reserve holdings to one another for this purpose.

Second, the CMI was not independent from the IMF. The 13 countries within the group debated the extent of the linkage at some length. All were cognizant of the region’s experience under IMF programs during the 1997–98 crisis and none wanted to repeat that experience. But the potential creditors within the group also perceived a need to attach conditions that the region was not yet capable of defining. A compromise was reached at the outset whereby 90 percent of the amounts available under the BSAs would be disbursed only if the borrower also agreed to an IMF program but that 10 percent could be disbursed prior to such a program, and the split would be reviewed. In 2005 the finance ministers agreed

to raise the amount disburseable without a Fund program to 20 percent.⁸ Conceived as such, the CMI is largely a “second” or “parallel line of defense” to IMF financing. Note, however, that the “IMF link” does not apply to the short-term liquidity swaps intended to help fund liabilities of financial institutions—such as the local-currency swaps among Japan, China, and South Korea—as opposed to medium-term balance-of-payments loans.

Third, ASEAN+3 also launched a regional surveillance mechanism called the Economic Review and Policy Dialogue. Many officials within the region hoped for the mechanism to evolve to the point of providing information and analysis that would permit the identification of financial and economic

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vulnerabilities among members and provide a foundation for regionally defined conditionality in the event that the BSAs were called upon. Japanese officials, among others, explicitly conditioned any reduction in the proportion of the BSAs linked to IMF programs to the strengthening of regional surveillance. But shaping policy conditionality is demanding, requiring excellent information and sophisticated analysis, and enforcing it requires political determination. By contrast, ASEAN+3 surveillance has strengthened only gradually and is not yet up to the task of setting appropriate conditions for medium-term balance-of-payments lending by the region.⁹ For this reason, any disbursements under the BSAs would still be largely conditioned on a Stand-By Arrangement with the IMF.

Fourth, East Asian governments evolved their arrangements with an eye to reforms within the IMF. In particular, they hoped to see changes to Fund facilities, policy conditionality, and governance, especially with respect to granting them larger quotas and thus voting rights in the Executive Board and Board of Governors. After a long negotiation, however, the results agreed to at the April 2008 meetings in Washington, still to be ratified, were modest in terms of increasing the quotas of the

Monetary Authority of Singapore announce the establishment of temporary reciprocal currency arrangements,” October 29, 2008, available at www.federalreserve.gov.

7. People’s Bank of China, “PBC and HKMA Signed Currency Swap Agreement,” January 20, 2009, available at www.pbc.gov.cn; “The People’s Bank of China and Bank Negara Malaysia established a Currency Swap Arrangement,” February 8, 2009, available at www.pbc.gov.cn.

8. The Joint Ministerial Statement of the 8th ASEAN+3 Finance Ministers’ Meeting, Istanbul, Turkey, May 4, 2005, available at www.aseansec.org.

9. Contributions on ASEAN+3 surveillance include Kawai and Houser (2007), Institute for International Monetary Affairs (2005) and Wang and Yoon (2002).

Fund and redistributing quotas and voting shares (see, among other treatments, Truman 2008). On the other hand, the Fund has extended new facilities and has reviewed conditionality. At this point, however, it does not seem likely that these changes will allay Asian misgivings about the IMF.

Finally, it is important to note that none of the BSAs have been activated as of this writing. Most of the period since the establishment of the CMI has been relatively benign. To our knowledge, none of the Southeast Asian countries have yet formally requested activation. ASEAN+3, therefore, enters the present crisis and embarks on intensive negotiations over “multilateralisation” with critical elements of these arrangements—decision making, coordination among the creditors, defining the terms, and coordination with the IMF—untested.

“MULTILATERALISATION” OF THE CMI

The members of ASEAN+3 refer to the creation of a common fund as a “multilateralisation” of the CMI, by which they mean collectivization on a regional basis. In this sense the term “multilateral” refers to something more than “bilateral” and less than “global.” I prefer to reserve the term “multilateral” to refer to the global level and to describe the IMF and World Bank as “multilateral institutions” but defer to Asian usage for the purposes of this policy brief. It is important to emphasize that, as this policy brief goes to press, there is no clear agreement on the part of the 13 governments to proceed with multilateralisation, but they are instead engaged in negotiations that could result in such an agreement.

The objective of multilateralising the CMI was first mentioned in the communiqués of the ASEAN+3 finance ministers at their Istanbul meeting in May 2005. After announcing the objectives of the second stage of the CMI—enhancement of surveillance, clarification of the activation process, adoption of common decision making, doubling the size of the swaps, and reducing the IMF link to 80 percent—the ministers declared, “To further enhance the CMI’s effectiveness, we tasked the Deputies to study the various possible routes towards multilateralizing the CMI.”¹⁰ At Hyderabad, India, in May 2006, the finance ministers “tasked the Deputies to set up a ‘new task force’ to further study various possible options towards an advanced framework of the regional liquidity support arrangement (CMI multilateralization or Post-CMI), based upon their exploration during the past year.”¹¹

10. The Joint Ministerial Statement of the 8th ASEAN+3 Finance Ministers’ Meeting, Istanbul, Turkey, May 4, 2005, paragraph 7, available at www.aseansec.org.

11. The Joint Ministerial Statement of the 9th ASEAN+3 Finance Ministers’ Meeting, Hyderabad, India, May 4, 2006, paragraph 6, available at

The ASEAN+3 finance ministers announced more substantial agreement on the matter at their 2007 meeting in Kyoto, Japan:

We noted the substantial progress made in the activities of the new Taskforce on CMI Multilateralisation. Proceeding with a step-by-step approach, we unanimously agreed in principle that a self-managed reserve pooling arrangement governed by a single contractual agreement is an appropriate form of multilateralisation. We recognised the consensus reached as a significant achievement towards an advanced framework of regional liquidity support mechanism. We instructed the Deputies to carry out further in-depth studies on the key elements of the multilateralisation of the CMI including surveillance, reserve eligibility, size of commitment, borrowing quota and activation mechanism. Meanwhile, we reiterated our commitment to maintain the two core objectives of the CMI, i.e., (i) to address short-term liquidity difficulties in the region and (ii) to supplement the existing international financial arrangements.¹²

The phrase “self-managed” qualifies “reserve” in the second sentence, meaning that the reserves would not in fact be physically collected in a common fund but would instead be held by national central banks and earmarked for that purpose. As the sentence also states, however, the disposition of those reserves would be common and subject to a single agreement, rather than a series of agreements such as the BSAs. The final sentence repeats a phrase that appears in all of the previous communiqués, a coded reference to the linked and unlinked portions of the swaps. Significantly, the same is to apply to any new common fund, although the 20-80 split might be revised.

Meeting in Madrid in May 2008, the finance ministers announced progress toward agreeing on “rigorous principles” governing a common fund and “key concepts” related to borrowing arrangements (discussed in the following section). They also declared that “it is indispensable to build a credible system in ASEAN+3 to monitor the economic and financial situation of member countries” and cited some specific measures toward that end.¹³

www.aseansec.org.

12. The Joint Ministerial Statement of the 10th ASEAN+3 Finance Ministers’ Meeting, Kyoto, Japan, May 5, 2007, paragraph 6, available at www.aseansec.org.

13. Joint Ministerial Statement of the 11th ASEAN Plus Three ASEAN Ministers Meeting, Madrid, Spain, May 4, 2008, paragraph 7, available at www.aseansec.org.

QUESTIONS SURROUNDING MULTILATERALISATION

Creating a common regional fund would require addressing questions of obligations, contributions, and rights of members as well as the size, governance, and borrowing arrangements—the same set of issues confronted by the architects of the Bretton Woods institutions. This section enumerates these key questions—providing a checklist for outsiders observing the evolution of these arrangements—and offers some preliminary answers.

What Exactly Would Be the Nature of Multilateralisation?

ASEAN+3 member states had considered pooling reserves into a single account that could be held, managed, and disbursed by a secretariat, as is the case with the IMF. Present discussions, however, center on whether to earmark reserves for a common fund and instead retain them in the accounts of national central banks and finance ministries. Officials engaged in these talks thus refer to the present proposal as a “self-managed reserve pooling arrangement” or an SRPA. Recently this term has been replaced in some statements by Chiang Mai Initiative Multilateralisation, or CMIM, but SRPA is more descriptive. Nonetheless, if the ASEAN+3 members were to take this step, these funds, while held separately, would be administered in common under a joint decision making process—a common fund in effect.

How Large Would the Fund Be?

Given that East Asian governments collectively hold the equivalent of roughly \$3.5 trillion in foreign exchange reserves, the region could clearly create a robust fund with just a small portion of its reserves. ASEAN+3 finance ministers previously declared that, if they agree to multilateralisation, their common fund would amount to \$80 billion.¹⁴ But in the face of the present crisis, several Asian officials have proposed that much larger amounts of reserves be dedicated to the fund.¹⁵ Meeting among themselves, the 10 ASEAN finance ministers appear to have agreed to propose that the previously agreed

number be raised by half, to \$120 billion.¹⁶ Although expectations are converging on that figure, the exact size remains a point of negotiation.

Which Countries Would Be Members?

As implied in the earlier discussion, the membership would be the 13 countries of ASEAN+3. But this question raises a couple of important points about the arrangement. First, such a fund would considerably broaden participation in regional financial facilities beyond the eight countries that presently have BSAs in place; it would include Laos, Cambodia, Vietnam, Burma/Myanmar, and Brunei in the process for the first time. Second, it is worth emphasizing that it would include Burma/Myanmar in particular, a country that has been deeply problematic but for which ASEAN officials hope participation in regional affairs could be rehabilitative.

What Would Be Members' Contributions?

ASEAN+3 would have to agree on the exact contribution of each member, and therefore their relative shares, before an accord is concluded. The Madrid communiqué announced that the three Northeast Asian members would contribute 80 percent while the 10 Southeast Asian members would contribute 20 percent of the common fund.¹⁷ However, ASEAN+3 has yet to decide on the allocation of contributions within these two groups. The shares of China and Japan are particularly important, because they will determine the relative influence of the two countries. The issue of which country would have the larger share, or whether the two would have equal shares, is probably the most important and difficult question facing ASEAN+3 negotiators.

How Would the Fund Be Governed?

This question can in turn be broken down into three subsidiary questions: In what institution, forum, or group will decisions be taken? Under what decision rule? With what weights to each member? Any common fund would require a collective body to make decisions on, for example, activation—the

14. Joint Ministerial Statement of the 11th ASEAN Plus Three ASEAN Ministers Meeting, Madrid, Spain, May 4, 2008, paragraph 8, available at www.aseansec.org.

15. Joyce Pangco Panares, “\$80-B Fund Approved By Asean, 3 Partners,” *Manila Standard*, October 25, 2008; “Thailand to propose \$350-bn Asian pool,” *Nation*, October 23, 2008.

16. Dario Agnote, “ASEAN plans to beef up pooled reserves to fight crisis,” *Kyodo News*, December 16, 2008; “ASEAN, regional partners likely to increase crisis funds—Indonesian minister,” *BBC Monitoring Asia Pacific*, December 15, 2008.

17. Joint Ministerial Statement of the 11th ASEAN Plus Three ASEAN Ministers Meeting Madrid, Spain, May 4, 2008, paragraph 8, available at www.aseansec.org.

functional equivalent of the Executive Boards of the IMF and World Bank. ASEAN+3 would have to agree not only on the balance between China and Japan but also on the balance between the potential creditors and debtors under the arrangement. There appears to be broad support among members for the principle of weighted voting, where each country wields votes in rough proportion to its contribution to the fund, and for taking decisions by a supermajority rather than by simple majority or unanimity. But the establishment of voting rather than unanimity and the weights, size of the majority, and scope of matters that would be subjected to voting remain to be decided. Agreement on a common fund could also founder on these sensitive institutional and political questions.

Will the Bilateral Swap Arrangements Be Retired?

Much of the public speculation about the future of the CMI assumes that its regionalization would substitute the common fund for the BSAs. This is not necessarily the case. Each pair of countries is likely to decide the fate of their bilateral swaps. Thus, while some might choose to retire, others might choose to renew or enlarge their BSAs even once a common fund becomes operational. Both potential lenders and borrowers have incentives to maintain multiple lines of finance: If ASEAN+3 cannot agree to use the fund collectively, country pairs might retain the option to activate bilateral swaps in a crisis. At this point, countries in the region might well place a higher value on flexibility than on solidarity. Coexistence of a common fund and BSAs could facilitate agreement on joint decision making by reducing the risk that adopting a supermajority or unanimity decision rule would block disbursements in a crisis.

On What Terms Would a Common Fund Lend to Its Members?

If a common fund were created, ASEAN+3 would have to set the terms on which it could be activated. Such terms fall into two basic categories: loan terms and policy conditionality. The former refers mainly to the amount, maturity, interest rate, and collateral arrangements for the loan. Under the rubric of the CMI, the terms of the BSAs have been reasonably well defined. Beyond the first 20 percent of the swap, borrowers could originally activate on a 90-day basis, renewable seven times, at increasing increments over Libor (Henning 2002, 20–21; see also Grimes 2009, 82). However, these terms are evolving and could well change under any common fund.

The second category refers to the policy adjustments, if any, that would be required of borrowers in exchange for activating the fund—including changes in fiscal and monetary

policies. Because the policy conditionality of the IMF proved to be the most contentious and resented aspect of the 1997–98 financial crisis, such conditions would be politically charged. Yet, the governments of the region must also be concerned about (a) moral hazard, (b) default, and (c) contagion within the region and for these reasons must consider whether policy conditions are required and, if so, what those should be in any given case. Those decisions can in principle be (a) outsourced by making disbursements from a common fund contingent on agreeing to an IMF program or (b) developed within the region by the managers and governing board of the fund.

Would the Common Fund Be Linked to the IMF?

The disbursements of any common fund created by ASEAN+3 would be linked to IMF program lending as would any disbursements under the BSAs. As discussed above, under the present BSAs, borrowers can draw up to 20 percent of their swaps prior to agreeing on an IMF program, including required policy adjustments, but would need such a program to access the remainder. Several of the potential borrowers would no doubt like to see this linkage reduced; the 13-member group is committed to reviewing the link periodically, and it could well be adjusted in the future. But the potential creditors, including especially Japan, have conditioned a softening of the link on improvements in regional surveillance and the institutional capacity to analyze members' needs and identify needed policy adjustments on a regional basis. Given the present state of surveillance within the region, as discussed above, the IMF link should be retained.

STANCE OF NON-ASIANS

The opposition of the US Treasury and the refusal of China to support the proposal famously scuttled the 1997 plan for the Asian Monetary Fund (Blustein 2001, 162–70). Several of the people then at Treasury are now senior officials in the Barack Obama administration, in particular Treasury Secretary Timothy F. Geithner and Director of the National Economic Council Lawrence H. Summers. Since 1997, however, several important changes have cast East Asian financial regionalism in a different light. The number of regional economic arrangements, both financial and trade, have continued to increase around the globe, with the United States itself instigating several of them. The CMI has evolved along conventional lines since its creation in 2000. East Asian countries have accumulated massive foreign exchange reserves, giving them the wherewithal to contribute to emergency financial packages. Meanwhile, the underrepresentation of large, fast-growing emerging-market countries persists

within the IMF, which has gone for about a decade without a general increase in quotas despite dramatic growth in the world economy and in financial vulnerability of many members.

The United States, Europe, and the rest of the world have an interest in ASEAN+3 advancing East Asian financial cooperation in ways that are consistent with their obligations in the IMF and coordinated with that institution. The lack of development of surveillance within ASEAN+3 means the IMF link would be maintained for the time being. It is worth noting that the European Union, whose surveillance and analytical capacities are well developed, has cooperated closely with the IMF in recent programs for Central and Eastern European countries. Provided that ASEAN+3 manages the bilateralised or multilateralised CMI in this way—a proviso that applies to other regional financial facilities as well—the rest of the world can accept these arrangements.

The Bill Clinton administration in its last years and the George W. Bush administration accepted the CMI. But it has been quite some time since US policymakers made a clear statement about their views on East Asian financial regionalism. They have nonetheless made several constructive contributions to economic and financial stability within the

In the absence of robust surveillance and analytical capacity in the region, East Asian governments must link any common fund they might create to the IMF.

region. First, the US Federal Reserve has put in place large facilities with 14 central banks to help provide dollar liquidity to foreign financial institutions when private markets seize up. These facilities, recently extended to October 2009, include arrangements with Japan, Singapore, and South Korea and were important in treating Korea's problems in the fall of 2008. Second, the United States cooperated with other members and the staff to introduce the Short-Term Liquidity Facility (SLF) and Exogenous Shocks Facility at the IMF.

PROSPECTS FOR AGREEMENT

Differences between Japan and China and between potential creditors and debtors could still block agreement. However, the systemic environment affects the calculus of these key actors regarding regional cooperation. As I argued during the first phase of the CMI (Henning 2002, 29–31), the source and severity of financial shocks and the response of the international community were likely to determine the path of East

Asian financial cooperation. If shocks came from within the region, or were insignificant, and the IMF's response was strong, then the momentum behind regionalism was likely to be weak. If, on the other hand, significant shocks came from outside the region and the international response was inadequate, East Asian governments were more likely to set aside their differences and forge agreements on regional initiatives.

The present global financial crisis originated in the US financial system, and the weakness of East Asian economies stems in large part from the recessions in the United States and Europe. Korea has been the most affected as of this writing, as judged by currency depreciation, though others are likely to feel more negative effects. As mentioned above, in response, the US Federal Reserve has extended substantial swap agreements to three key countries in the region, and the IMF has introduced two potentially useful facilities. The G-20 effort to restructure the global financial architecture sustains hope of rebalancing weights within international financial institutions toward East Asian governments. Whether these constructive international efforts are sufficient to address the concerns of the region's governments remains to be seen, however.

It is not clear that ASEAN+3 will agree to multilateralisation of the CMI at their meetings in winter and spring 2009. Expansion of the BSAs and reliance on Fed swaps and IMF facilities remain viable alternatives. ASEAN+3 will probably leave a good deal of ambiguity about their plans in their announcements after the meetings, moreover. Substantial ambiguity has been a characteristic of regional financial cooperation from the inception of the CMI. Ambiguity is in part a consequence of a common desire to project solidarity to the rest of the world while substantial differences remain among the members. But ASEAN+3 agreements are also ambiguous partly by design; it keeps options open and retains bargaining leverage for a better deal in international institutions. As a consequence, the coming announcements are not likely to settle existing disagreements among outside observers over the likely path of East Asian financial cooperation.

CONCLUSIONS AND RECOMMENDATIONS

A "multilateralisation" of the CMI could be a major contribution to the global financial architecture as well as regional cooperation in East Asia. It could supplement the resources of the IMF and streamline the process of negotiating parallel lines of defense in a financial rescue, among other benefits. But this harmonious result depends upon coordinating the construction of the regional fund with the existing international financial institutions, especially the IMF. While in principle one might imagine a regional institution that could mount financial rescues of East Asian states independently of the IMF, ASEAN+3 has not yet and probably

will not soon have the capacity to do so prudently. ASEAN+3's surveillance mechanism is still in early stages of development and is not yet able to fashion appropriate policy conditions for balance-of-payments lending. Even the European Union, with considerably better developed analytical capacity, cooperated closely with the IMF on recent financial packages for Latvia and Hungary. East Asian governments must, therefore, continue to link the existing swap arrangements and link any common fund they might create to the IMF and its surveillance mechanism and analytical capacity—this is the first recommendation.

Second, ASEAN+3 should develop the regional surveillance mechanism further. Management of the surveillance process should be clearly delegated to a secretariat with a mandate to collect information, analyze it, present its conclusions to the group, and lead peer-review sessions at deputies and ministerial meetings. It should draw upon and supplement, rather than duplicate, the surveillance mechanism of the IMF, in which these countries participate, by taking advantage of its geographical proximity and (presumably) greater acceptance of peer pressure from neighbors. Its conclusions should identify economic vulnerabilities in and desirable policy adjustments for the countries under review. This secretariat could also staff a new common fund but should strengthen regional surveillance irrespective of any decision on multilateralisation.

Third, the United States and the rest of the world outside Asia cannot legitimately object as a matter of principle to the development of regional financial arrangements in ASEAN+3. The European Union operates its own balance-of-payments facility and has used it recently for members that have not yet adopted the euro. The United States has used the Treasury's Exchange Stabilization Fund predominantly within the Western Hemisphere and has recently greatly expanded the Federal Reserve's swap agreements both in size and geographic scope. In developing the CMI and considering its regionalization, ASEAN+3 is following the path toward regional arrangements taken previously by other states and regions. If anything, East Asia's arrangements have been more tightly and explicitly linked to the IMF than the others (Henning 2002).

Fourth, however, non-Asians are right to raise questions about the relationship between East Asian arrangements and the IMF. The European Union's Medium-Term Financial Assistance and the US Exchange Stabilization Fund carried less danger of conflict with multilateral arrangements than the regionalization of the CMI because Europe and the United States dominate the IMF and can thereby facilitate consistency between the IMF's response to a crisis and their own. But East Asian governments carry considerably less weight in the IMF, and consistency between Asian arrangements and the Fund might be more difficult to forge in the heat of a crisis. Underrepr-

sentation of Asian countries, in other words, both gives rise to regional financial cooperation and complicates its coordination with the IMF. Officials within East Asia should not wait until they arrive at the threshold of a disbursement under the CMI before consulting with the IMF on technical details of activation and sequencing. At the same time, the full membership of the IMF should implement the 2008 reform package but also pursue more ambitious increases in quotas and redistribution of shares (see, for example, Truman (2006, 2008)).

Fifth, the recent creation of the SLF offers an opportunity for additional synergy between ASEAN+3 arrangements and the IMF. Designed to quickly provide short-term liquidity without the conditionality that the IMF applies to stand-by loans, the SLF could allow qualified countries to borrow up to five times their quota for a three-month period, renewable twice over any 12-month period.¹⁸ ASEAN+3 could make qualification for the SLF sufficient to qualify for activation of the first 20 percent of CMI facilities, whether they remain bilateral swaps or are multilateralised. For ASEAN+3, linking to the SLF in this way would draw on the surveillance analysis of the IMF in determining qualification. For the IMF, whose new facility has lacked formal applicants, such a link would make the SLF more attractive.

Sixth, more ambitiously, the international community should work out the relationship among the IMF, regional financial facilities, and bilateral arrangements. Given the growth of international reserves, the rise of multiple pools of sovereign capital in various forms, and the increase in bilateral and regional financial agreements, the potential for disorganized or inconsistent responses to crises rises accordingly. Elsewhere, I have proposed the development of guidelines for the creation of regional and bilateral financial arrangements (Henning 2002 and 2006). The members of the IMF should agree to a set of criteria that differentiate acceptable regional financial arrangements from unacceptable ones and agree to submit all regional financial arrangements to the Executive Board for review at the time of their creation and periodically thereafter. Regional financial facilities, by these criteria, should (a) create no substantial conflict with members' obligations in the Fund, (b) be at least as transparent as Fund facilities and programs, (c) adopt conventional rules of emergency finance, and (d) apply sound conditionality to medium-term balance-of-payments lending in such a way as to not undercut Fund conditionality, among other things. Conditionality should be decided in light of the economic facts in each case rather than by competition among creditors. Establishing such guidelines should be a high priority in discussions about reforming the global financial architecture.

18. International Monetary Fund, "IMF Creates Short-term Liquidity Facility for Market-Access Countries," Press Release No. 08/262, October 29, 2008, available at www.imf.org.

I do not argue that it is necessary for all balance-of-payments financing to be channeled through the IMF. Although we need strong international institutions, especially during crises, we must recognize that the Fund does not have a monopoly on economic wisdom and that regional lenders can play constructive roles. If regional groups or single governments wish to lend to countries confronting crises, the broader financial community should not block such arrangements—*provided* they adhere to a set of common principles.

The final set of recommendations addresses US and other non-Asian governments. US officials should be applauded for providing swap facilities to several East Asian central banks and for supporting new facilities at the IMF. But they should

also clearly articulate conditional support for the further development of the CMI. In the absence of robust surveillance and analytical capacity in the region, that support should be conditioned on continued linkage to the IMF and operational cooperation with it. US officials would rightly oppose any break with the Fund without the creation of an indigenous capacity to fashion sound conditionality or any break that undercuts Fund conditionality. US officials should also urge Asians to make their arrangements more transparent than they have been so far. American policymakers should make their position clear to East Asian partners before the ministers and leaders approach advanced stages of bargaining rather than after a regional consensus has been reached.

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