The Chiang Mai Initiative Multilateralisation: Origin, Development and Outlook*

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1. Introduction

This paper discusses the Chiang Mai Initiative Multilateralisation (CMIM); its origin, development and future outlook. After this introduction, section 2 discusses the origin of the bilateral Chiang Mai Initiatives (CMI). The perceived need to develop regional self-help mechanism arising from the 1997/98 financial crisis, and the emergence of the CMI. Section 3 discusses the development of the CMIM and agreements that have been reached thus far. Section 4 discusses the outlook for CMIM in two areas; the provision of liquidity support to needed countries, and the regional surveillance mechanism.

Proposals are made on how to make the liquidity support role of the CMIM more effective. It is also argued that the CMIM can bring about major changes to the policy institutional infrastructure of the region, particularly through the establishment of the so-called Independent Surveillance Unit (ISU). This new organization can provide technical and secretariat support to financial cooperation processes in the region which currently lack these support. Consolidation of the main financial forums in the region are also proposed. This can enhance the role of East Asia in the global financial arena and also facilitate policy cooperation, with important regional and global implications.

2. Origin

2.1 Perceived Importance of Developing Regional Self-help Mechanism

The 1997/98 financial crisis was a major event that pushed countries in East Asia to embark on many regional economic cooperation initiatives. It led to the formation of the ASEAN+3 group (ASEAN plus China, Japan and the Republic of Korea), a group that

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was similar to the East Asian Economic Caucus (EAEC) proposed by the then Prime Minister of Malaysia, Dr. Mahathir Mohamad, back in 1991,[1] a proposal that never got off the ground as the idea was too radical at that time. The 1997/98 crisis, however, provided the appropriate push factors and rationales for economic cooperation among the ASEAN+3 group.

The crisis started in Thailand, and at first it was thought that the impacts would be fairly localized. However, soon the contagion to almost the whole region became apparent. Indonesia and the Republic of Korea followed Thailand in having to enter an IMF program, and even countries not needing an IMF rescue package faced severe economic slow down or recessions. It became quite apparent that East Asian economies were inextricably linked to each other and could not afford to ignore what was happening elsewhere within the region.

Basically the countries needing IMF assistance became insolvent in terms of not having enough foreign currencies in their systems to meet their foreign currency obligations. A particularly striking common feature of the three countries when compared to other countries in the region is the very high ratio of short-term foreign debt to foreign reserves (see Table 1). These three countries were the only three in the region where the ratio of short-term foreign debt to official reserves at the end of 1996 was more than 100%. The ratio for Thailand was 110%, Indonesia was 167%, and South Korea was even higher at 195%. Such high ratios are very dangerous, because if these short-term debts are not rolled over for any reason (for example from a loss of confidence), then the countries would go bankrupt through not having enough foreign reserves to repay the debts.

The problem prior to the crisis was that countries were viewing the adequacy of foreign reserves with the wrong paradigm. In Thailand, for example, as short-term debt increased, foreign reserves also increased. The increased in foreign reserves was actually considered by the authorities as a sign of strength. Viewing the situation in terms of a current account perspective, foreign reserves in the few years prior to the crisis covered more than five months of imports of goods and services combined. At that time it was not realized that reserves also needed to cover short-term foreign debt, as these may not be extended once they become due and foreign currencies will be needed to repay these loans. And as was indicated above, the situation be the end of 1996 was

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[1] Except ASEAN+3 does not contain Hong Kong and Taiwan and includes all the newer ASEAN member countries.

becoming very risky as total foreign reserves was les than total short-term debt. not counting the large current account deficit that Thailand was running at the time. The country's economic fundamental weakened considerably in 1996, with a decline in exports compared to export growths of more than 20% per annum in the few years before. Speculators started attacking the Thai Baht, which was under a fixed basket peg at that time, and the situation become untenable as the authorities used up almost all of the foreign reserves to try to defend the value of the currency. By the middle of 1997, Thailand's net foreign reserves (net of forward contracts to sell foreign currencies) was only about US$ 2.8 billion. Compare this to about US$ 30 billion of outstanding short-term foreign debt and a current account deficit of about US$ 1 billion per month, it was clear that the country was insolvent. The Baht therefore had to be floated, and assistance sought from the IMF.

While saving deficit countries in East Asia had to rely mostly on foreign short-term borrowings to fill their saving gaps, the region as a whole was actually a saving surplus region prior to the crisis, with a saving surplus of about US$100 billion annually (see Table 2). The saving surplus of the region was invested mostly in US dollar denominated assets and the deficit countries had to rely on foreign bank borrowings, which were mostly of short-term maturity. [2] There were a lot of discussions in the region at that time that If the financial resources within the region were better utilized, to provide liquidity support and longer-term development finance to needed countries in the region, then a crisis such as the 1997/98 crisis possibly could have been avoided.

Another reason that pushed countries in the region toward greater cooperation was that the region had very limited influences on the IMF crisis resolution measures. These measures were mostly dictated by the IMF, with the US Treasury and the Federal Reserve having inputs behind the scenes. While the IMF programs were meant to restore confidence as well as generate increases in foreign exchange so that the countries under the programs can eventually recover from their insolvency position, the nature of the IMF conditionality that was applied was rather controversial and was much debated in the aftermath of the crisis. [3] Critics pointed to a number of areas, such as; [4]

[2] Most of the lending to developing countries were short-term because under the provisioning requirements of the Basle Capital Accord, a 20% risk weighting is applied to short-term loans to non-OECD banks, while 100% risk weighting has to apply for long-term loans (with a maturity of one year or more).

[3] For detailed discussions of the IMF program for Thailand, see Sussangkarn (2002).

- The harsh nature of the tight fiscal and monetary policies without due regard for social or political consequences. This even led to a change of political regime in Indonesia.
- The conditionality for the various countries tends to be of a "one size fits all" nature without sensitivity to the different political and socio-cultural contexts.
- Unwillingness to allow non-market based interventions such as controls on capital flows.[5]
- Imposition of full guarantees for creditors (mostly foreign) of financial institutions.
- Imposition of relatively rapid structural reform measures, such as stringent financial standards and corporate restructuring, privatization of state owned enterprises and asset sales at what many regarded as "fire sale" prices.

Because of the dissatisfaction with the way the crisis was handled, many in the region felt that if the region had greater input into the crisis resolution measures, the crisis could have been resolved with much less pain than what actually happened.

For all of these reasons, it was logical for the region to come together after the 1997/98 crisis and the first meeting of the leaders of the ASEAN+3 countries took place in December 1997 on the sideline of the 2nd Informal ASEAN Summit in Kuala Lumpur. Since then, it has become institutionalized into an annual event, supported by other ASEAN+3 meetings at ministerial levels as well as meetings among officials. And because the financial crisis was what brought the region closer together, it was not surprising that the first substantive cooperation agreement was in the area of finance, particularly the Chiang Mai Initiative (CMI), economic surveillance and bond market development (Asian Bond Market Initiative, ABMI, together with the Asian Bond Funds). This has expanded to numerous ministerial level meetings in areas such as agriculture, energy, environment, ICT and transnational crime. Regional cooperation has also extended to numerous free trade and "so-called" comprehensive economic partnership agreements at the sub-regional level, with many of these involving ASEAN as one of the parties to the agreement. At the very top level, the annual meeting has also been expanded to include India, Australia and New Zealand, the so-called "East Asia Summit".

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[4] For various discussions, see for example, Sachs (1997), Stiglitz (1998), Feldstein (1998), Krugman (1998), UNCTAD (1998), Chapter 4, and Stiglitz (2002).

[5] Malaysia successfully used capital controls to ward off a severe crisis. It should however be noted that Malaysia did not have as much short-term foreign debt (in relation to reserves) as Thailand.

Overall, the 1997/98 crisis created a major impetus for regional cooperation within the region and the extent of the cooperation is still expanding.

2.2 The Chiang Mai Initiatives (CMI)

The first proposal for regional financial cooperation after the crisis was actually the proposal by Japan at the G-7/IMF meeting in Hong Kong in September 1997 to set up an Asian Monetary Fund (AMF). To have any chance of success, it would be necessary to do a lot of background work and carry out many informal discussions and lobbying of the key stakeholders. However, this was not done and the proposal also came at a time when the IMF was already implementing the rescue package for Thailand, so it was not surprising that it did not receive much support within the region and was strongly opposed by the IMF and the United States. The proposal was quickly pushed aside.[6] It was strongly argued that this could create a lot of moral hazard vis-à-vis the IMF. In fact, regional monetary organizations are nothing new, as they already existed in Latin America and in the Middle East,[7] and they co-existed with the IMF, so this argument was an exaggeration. However, the proposal was simply too radical and came at the wrong time. Yet the idea of East Asia having its own financial and monetary organization did not disappear completely. In fact, such an organization may eventually emerge more than twelve years after the original AMF proposal. This will be discussed further below.

Even though the AMF idea did not fly, the region continued to explore ideas for financial cooperation. At a meeting of Asian Finance and Central Bank Deputies in Manila, Philippines on 18-19 November 1997, the so-called "Manila Framework" was developed. This was to be "A New Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability". Given involvement of the United States and also the IMF,[8] the framework was not very radical and still stressed the central role of the IMF. The official Summary of the Discussions stated:

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[6] For details on Japan's proposal for the AMF, see Lipscy (2003).

[7] In the form of the Latin American Reserve Fund and the Arab Monetary Fund, see, e.g. Sussangkarn (2000).

[8] The countries represented were Australia, Brunei Darussalam, Canada, People's Republic of China, Hong Kong SAR of China, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand and the United States. High-level representatives from the IMF, World Bank and ADB also attended the meeting.

"……Deputies agreed on the need and desirability of a framework for regional cooperation to enhance the prospects for financial stability. This framework, which recognizes the central role of the IMF in the international monetary system, includes the following initiatives: (a) a mechanism for regional surveillance to complement global surveillance by the IMF; (b) enhanced economic and technical cooperation particularly in strengthening domestic financial systems and regulatory capacities; (c) measures to strengthen the IMF's capacity to respond to financial crises; and (d) a cooperative financing arrangement that would supplement IMF resources."

The Manila Framework was endorsed at a meeting of Finance Ministers from ASEAN, Australia, China, Hong Kong SAR China, Japan, Republic of Korea and United States, in Kuala Lumpur, Malaysia, on 2 December 1997. Work on the regional cooperative financing arrangement to supplement IMF resources continued and was eventually agreed in May 2000 at the ASEAN+3 Finance Ministers' Meeting in Chiang Mai on the sideline of the Annual ADB meeting there, and hence the so-called "Chiang Mai Initiative (CMI)".

With the CMI, the ASEAN Plus Three group expressed "a need to establish a regional financing arrangement to supplement the existing international facilities",[9] and reached agreement on an expansion of swap facilities[10] among the ASEAN member countries (the ASEAN Swap Arrangement, ASA) and to include bilateral swap arrangements (BSA) with members of the Plus Three group.[11] The size of the ASA was expanded to US$ 1 billion from the level of US$ 200 million that was in existence at that time.[12] Members could draw up to twice its contribution to the ASA unconditionally,[13] to be repaid within six months, with the possibility of roll over for a maximum period of six

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9 See <u>The Joint Ministerial Statement of the ASEAN + 3 Finance Ministers Meeting</u>, 6 May 2000, Chiang Mai, Thailand, available on the web site of the ASEAN Secretariat at http://www.aseansec.org/.

10 Under the swap facilities, a participating member country with temporary international liquidity problems can swap domestic currency for US$ with agreement to buy back the domestic currency at an agreed date in the future.

11 See reviews and discussions of arrangements under the Chiang Mai Initiative in Manupipatpong (2002) and Rana (2002).

12 The ASA actually started in 1977 with a total amount of US$100 million. The total was increased to US$ 200 million in 1978.

13 Contributions to the ASA by the six older members of ASEAN (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) were US$ 150 million each, while Vietnam, Myanmar, Cambodia and Laos contribute US$ 60, 20, 15 and 5 million respectively.

months. In addition, a number of BSA's between the older ASEAN member countries and each country of the Plus Three group were to be concluded.

The BSA is a facility in the form of swaps of U.S. dollars with the domestic currencies of participating countries. Repurchase agreements were planned to provide liquidity support through the sale and buyback of U.S. Treasury notes or bills with a remaining life of not more than 5 years and government securities of the counterparty country. By October 2003, thirteen BSAs have been successfully concluded with a combined total size of roughly U.S.$ 35 billion. Under the terms of these bilateral swap arrangements at that time 10 percent of the agreed amount could be utilized without any linkage to an IMF program for 180 days. For the rest, the condition was that the country must already be under an IMF program or will be in the near future. The linkage to the IMF program was meant to ensure that the major part of these swap arrangements was not independent of IMF assistance. This was to ease the fear of those who were concerned with potential conflicts with IMF conditionality and moral hazard problems. In 2005, the total amount of swaps under the ASA was expanded to US$ 2 billion. The amounts under the BSA's have also increased, and the latest total amount of swaps under the CMI was US$ 90 billion, with the various bilateral amounts shown in Figure 1. The amount that a country could draw without linking to any IMF program was also increased from 10% to 20%.

While the total of all the various swap arrangements in Figure 1 may appear large, the amount available to each country is in fact not that large, especially if the drawing is not linked to an IMF program. For example, if the latest CMI was available before the crisis in 1997, Thailand would have been able to draw something like US$ 2 billion from the CMI swap arrangements prior to asking for IMF assistance. This amount is insignificant compared to the scale of problem that Thailand faced in mid-1997 or compared to the size of the IMF package for Thailand (US$ 17.2 billion). Therefore, the amount of money available under the current Chiang Mai Initiative is still too small to make a lot of difference. The CMI should instead be viewed as a significant symbolic initiative, showing the countries in East Asia are willing to work together to develop self-help mechanisms to reduce the risk of a future crisis. The CMI was clearly a work in progress, especially given the compromises necessary to bring it about. It needed to be developed into something more tangible and substantive. This has occurred though the evolution of the CMI into the Chiang Mai Initiative Multilateralisation (CMIM), even though this evolution was very slow.

3. Development

While CMI was more symbolic rather than truly effective, the need for a liquidity support mechanism for the region appeared to become less urgent as the region gradually recovered from the financial crisis. The main macroeconomic adjustments of the crisis-affected countries were through currency depreciation and the export engine. The role of the export sector became more and more important after the crisis, and the ratio of exports to GDP increased significantly. For example, in the case of Thailand, the ratio of exports of goods and services to GDP increased from about 40% prior to the 1997 crisis to about 75% in recent years. Most East Asian economies experienced current account surpluses after the crisis, and also large net capital inflows. However, the authorities actively intervene in the foreign exchange markets to prevent their currencies from appreciating too much in case this will negatively affect the export engine. As a result East Asian economies have been accumulating foreign reserves at a very rapid pace (see Table 3). By the end of 2008, East Asian economies have accumulated more than US$ 4 trillion of foreign reserves. This accounted for more than 55% for the world's foreign reserves.

The large accumulation of reserves provided an effective self-insurance against the kind of crisis that occurred in the region in 1997/98. It was not so much the result of a conscious strategy to accumulate these reserves. In fact, reserves accumulation can lead to problems with sterilization and can often negatively affect the central bank's balance sheet. The reserves accumulation was more the outcome of exchange rate intervention to keep the local currency from appreciating too much and negatively affecting the export sectors. Whenever large capital inflows lead to currency appreciation, export businesses complained loudly to the government, and as the export was a major engine driving the economy, or even the only engine in some cases, the political pressure for the central bank to intervene to keep the currency from appreciating too much can be huge. In Thailand's case, for example, even large interventions could not prevent the Baht from appreciating rapidly in the second part of 2006, and the authorities imposed strong controls on capital inflows in December 2006 which led to a stock market crash the next day, and some of the measures had to be reversed, bringing about credibility problems for the authorities and also created undesirable capital market distortions.

Apart from the reserves accumulation, better self-insurance also resulted from lessons learned from the 1997/98 crisis about the danger of letting short-term foreign debt become too large. As a result, most countries in the region carefully monitored the amount of short-term foreign debt of the country and tried to keep the ratio of short-term foreign debt to official reserves reasonably low. For example, in the case of Thailand, the ratio of short-term foreign debt to official reserves have been in the range of about 25-30% for most of the last decade. Another difference to the pre-crisis situation is that most countries have been using some form of a managed float exchange rate regime rather than a fixed rate regime. While as indicated above, most countries also actively manage the exchange rate so that it will not appreciate too much compared to their competitors (who are also mostly in East Asia), the ability to let the exchange rate depreciate when conditions warrant also provide another valuable instrument for the authorities that lessened the risk of a 1997/98 style crisis. This was particularly relevant during the sub-prime crisis when there were large capital outflows from the region, putting depreciation pressures on many country's exchange rate, and countries could use currency depreciation as well as sales of foreign reserves to mange the capital outflows in an orderly way.

Even though a regional foreign exchange liquidity mechanism appeared to be less urgent for the reasons indicated above, the momentum to evolve the CMI into something more effective remained. Actually, while reserves accumulation provided greater self insurance for each economy, it also meant that the cost of providing some reserves for a regional liquidity mechanism became less as the country still had plenty of reserves left for its own self-insurance. So while progress was slow, the region finally agreed on the principle of converting the bilateral schemes of the CMI into a multilateralised self-managed reserves pooling scheme governed by a single contractual agreement, or the Chiang Mai Initiative Multilateralised (CMIM), at the 10th ASEAN+3 Finance Ministers' Meeting in May 2007 in Kyoto, Japan. The Joint Ministerial Statement said "…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 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."[14]

One year later, at the 11th ASEAN+3 Finance Ministers' Meeting in Madrid, Spain, progress was limited. It was agreed that the total size of the reserves pool would be at least US$ 80 billion, and that 80% of the amount would be contributed by the Plus 3

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[14] From the Joint Ministerial Statement of the 10th ASEAN+3 Finance Ministers' Meeting, 5 May 2007, Kyoto, Japan. The author was co-chair of this meeting in his capacity as Thailand's Minister of Finance at that time.

countries (China, Japan and the Republic of Korea) with the rest by ASEAN countries. More substantive agreements were reached at the 12th ASEAN+3 Finance Ministers' Meeting in Bali, Indonesia on May 3, 2009. Parts of the Joint Media Statement was as follows:

"On the Chiang Mai Initiative (CMI), we have reached agreement on all the main components of the CMIM, including the individual country's contribution, borrowing accessibility, and the surveillance mechanism. The agreed components of the CMIM, which is a framework of mutual assistance among ASEAN+3 countries, are consistent with its two core objectives : (i) to address short-term liquidity difficulties in the region and (ii) to supplement the existing international financial arrangements.

…We agreed to implement the CMIM before the end of this year. In this regard, we tasked our Deputies to work out the operation details and implementation plan, particularly the legal documents that will govern the CMIM.

…We agreed that an independent regional surveillance unit will be established as soon as possible to monitor and analyze regional economies and support CMIM decision-making…."[15]

The attachment to the statement gave details of the contributions. The total size is to be US$ 120 billion with 80% contributed by Plus 3 countries and the rest by ASEAN countries, as was agreed in Madrid. A table (Table 4 below) was shown containing individual country contributions and the borrowing multipliers (borrowing quota equals contribution multiplied by the borrowing multiplier). The broad decision making mechanism of the CMIM was also indicated. Fundamental issues (review of size, contributions, and borrowing multipliers, re-admission, membership, terms of lending, etc.) will be decided through consensus of the members of ASEAN+3, while the lending issues (lending, renewal, default) will be decided through majority vote.

The issue of individual country's contributions, particularly among the Plus 3 countries, was particularly difficult and took time to resolve. Countries naturally tended to think of contributions as being related to the voting weights that they will have in the new institution. Thus, each country does not want to be outdone by the others. Many formula could have been adopted with varying implications on the contributions. For example, if contributions were based on the amount of foreign reserves that a country has then China would have the largest contribution. On the other hand, if it was based on the size of

[15] From the Joint Media Statement of the 12th ASEAN+3 Finance Ministers' Meeting, 3 May 2009, Bali, Indonesia.

GDP, then Japan would have the biggest contribution (at least until the size of China's economy overtakes that of Japan, which may be soon). The Republic of Korea, of course, will be smaller than the other two under just about any reasonable criteria, and may be concerned that it will be dominated by the others. The final agreement seems a good compromise. Among the Plus 3 countries, China (including some contributions from Hong Kong SAR, China) and Japan will contribute 40% each, with the Republic of Korea contributing 20%. Equal contributions by China and Japan makes a lot of sense, since there are still sporadic tensions between the two countries and each will find it difficult to accept if the other contributes more. And while the Republic of Korea only contributes half of the other two, this should not matter in practice as Korea is likely to hold the swing vote between China and Japan on many important issues. The participation by Hong Kong SAR, China, as part of China's contribution to the CMIM is also significant. It means that Hong Kong will be a full part of key activities that will take place under the CMIM umbrella. While these activities remain to be developed, some key areas of cooperative activities under the CMIM will be proposed below.

The other important remaining issue to be agreed upon is the establishment of the Independent Surveillance Unit (ISU). The intention to establish one has already been agreed upon, and indeed it would be difficult to see how the CMIM could operate without a dedicated institution to carry out economic surveillance and coordinate the mechanism. The remaining question, apart from details of the Unit's scope of work and operations, is where to locate it. Here again, a number of countries would like to host this new institution. The fact that agreement was not yet reached by the end of 2009 meant that the CMIM could not formally start before the end of 2009 as was declared in the Bali meeting above. It is hoped that an agreement can be reached in the early part of 2010, so that the CMIM can formally kick off.

4. Outlook

The section will discuss the roles that CMIM and the ISU could play in providing liquidity support to needed countries and in regional surveillance. Suggestions are made on how to make these roles as effective as possible.

4.1 The Provision of Foreign Exchange Liquidity to Needed Countries

Given the large accumulation of foreign reserves in the region, and the lessons learned from the 1997/98 crisis about key variables to monitor and manage in order to minimize the risk of another crisis, foreign exchange liquidity shortages should be less of a problem for East Asian economies now compared to the past. However, as the recent experience during the sub-prime crisis showed, foreign exchange liquidity shortages can develop unexpectedly and quickly. During the last quarter of 2008, severe liquidity shortages in money markets in the US and other advanced economies led to a global liquidation of much of the portfolio investments by various investment funds world wide. Proceeds from sales of these assets were then converted into foreign currencies (mostly US$) to take back to the West. This led to severe liquidity shortages of US$ in many economies. The situation for the Republic of Korea was particularly severe, because while Korea had more than US$ 200 billion of foreign reserves, it also had large amounts of short-term foreign debt and large foreign holdings of stocks which could be easily liquidated to take money out of the country. Korea's foreign reserves were not enough to cover short-term foreign debt and short-term contingent liabilities from foreign holdings of portfolio investment which could be quickly liquidated (see Table 5). This was also the case for Indonesia, although to a lesser extent, and Singapore also faced severe US$ liquidity shortages.

While the CMIM was not yet operational, the CMI was operational. Korea could have accessed US$ 18.5 billion under CMI through its swap agreements with various countries. However, only US$ 3.7 billion of this (20%) could be drawn without having to be part of an IMF program. Given the experience with the IMF in the aftermath of the 1997/98 crisis, it would likely have been political suicide for Korea's government to take the country into another IMF program, even though during the sub-prime crisis IMF conditionality had become much more loose under the new so-called "Flexible Credit Line (FCL)", introduced in March 2009, for countries it regarded as having strong fundamentals and sound macroeconomic policy track records. Instead, Korea entered into a swap agreement with the US Federal Reserves for US$ 30 billion. The same was true for Singapore. Indonesia also wanted to have a swap agreement with the US Federal Reserves. The US, however, did not agree to this, and Indonesia ended up with swap agreements with China and Japan.[16]

Given other sources of liquidity support, particularly through central bank swaps, that countries in the region had access to during the sub-prime crisis, the importance of the CMI and CMIM would seem to have declined substantially, especially given their links to IMF programs. However, East Asian countries have still pushed ahead with the CMIM

[16] There are also various other central bank swap agreements (not associated with the CMI) in the region, such as Korea's swaps with Japan and China.

in spite of having other central bank swaps. This is likely from the realization that developing a liquidity support mechanism in the form of a regional public good mechanism is the most effective option, both economically and politically. While the US Federal Reserves is always in a position to provide US$ liquidity if it chooses to do so, it would be a major mistake to rely on such agreements in the future. The important point is that who the US chooses to give swap agreements to will be driven mainly by US interests, for example, the swap may allow US investors to more easily withdraw funds from some country at a time of severe liquidity shortages, such as during the sub-prime crisis, without suffering additional losses from large depreciations of the local currency because the country has foreign exchange shortages. And of course, there is no guarantee that the US will provide the swap, such as in the case of Indonesia. More generally, relying on ad hoc bilateral swap agreements can create political frictions, such as in cases where the swaps are refused, and can also give the impression of bilateral dependence, which can easily develop into a sensitive political issue.

The region has pushed ahead with CMIM, and it is now close to fruition. However, to make the CMIM fully effective a number of implementation steps are suggested. First, the mechanism must be de-linked from the IMF. There is now such a stigma against the IMF in many parts of the region that even with the new FCL it would be politically very risky for a government to enter into an IMF program. So unless CMIM is de-linked from the IMF, countries in the region are unlikely to make use of the CMIM. Instead, they will resort to various central bank swap arrangements, with the US or other regional central banks. This will by pass the CMIM and make the initiative useless.[17]

Second, the CMIM borrowing quota may not be enough if a country gets into serious problems. To solve this problem, one should make it possible to supplement money from the CMIM with additional contributions from countries in the group. This will be similar to borrowing under an IMF package. For example, when the IMF arranged a borrowing package of US$ 17.2 billion for Thailand in 1997, only US$ 4 billion of that was the IMF's own money (or 23.25%), the rest came from contributions by various countries in the region. If similar contributions are possible for CMIM, then the total size of resources available for liquidity support in the region would be more like US$ 400-500 billion and not just US$ 120 billion of the CMIM pool.

[17] De-linking should be agreed at the policy level, but with appropriate sequencing. The IMF can still play an important role for the CMIM through its relationship with the ISU (see below).

Third, instead of just borrowing from the CMIM, countries should be able to also arrange swap facilities with the CMIM in a similar manner as with central bank swaps. This will make it much more flexible and quicker to use CMIM in situations of short-term liquidity shortages.

Fourth, thought should be given to allowing other members of the East Asian Summit not part of the ASEAN+3 (Australia, India and New Zealand) to participate in CMIM activities.[18] Given the difficulty in reaching agreements on country contributions to CMIM, it would be difficult to add these three countries as full contributing members. However, a way of allowing them to participate would be to make these countries "Contributing Partners" or "Associated Members" of CMIM. That is they can contribute to specific future borrowing programs to supplement money from the CMIM fund as other ASEAN+3 members can (as discussed in point two above). By being contributing partners, they will be able to participate in all the technical programs to be carried out in the future under the CMIM umbrella, such as surveillance and activities to support the integration of the region (see below). This might be the best approach to take at this stage as it will not disrupt what has already been agreed upon and will also make ASEAN+3 and ASEAN+6 (East Asian Summit members) activities in the financial area more unified.[19]

Fifth, and most importantly, the ISU needs to be set up. To be effective, the CMIM needs full time professional staff to provide substantive inputs to the member countries on areas such as surveillance and implementing and monitoring mechanisms. Actually, while it is called the ISU, it will be or will evolve into essentially a regional monetary organization for East Asia, similar to the Arab Monetary Fund in the Middle East and the Latin American Reserve Fund in Latin America.[20] It is also important to note that this organization will not simply be performing a role simply like a regional IMF in East Asia, but it should also carry out many activities to support various areas of financial cooperation in the region, which may include macroeconomic policy coordination, regional financial regulatory frameworks, capital market development as well as long-term

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[18] At the sideline of the annual ASEAN Summits, there is now the ASEAN+3 Summit, as well as the East Asian Summit (ASEAN+3+Australia, India and New Zealand).

[19] At present, ASEAN+6 only holds an annual Summit, with no substantive activities below the Summit level, while there are numerous meetings at Ministers and officials levels under the ASEAN+3 mechanism.

[20] It will likely be closer to the Arab Monetary Fund, which has 22 member countries, while the Latin American Reserve Fund only covers 7 relatively small countries.

regional financial and monetary integration. This would be similar to the Arab Monetary Fund, which has a broad range of objectives covering: 1) correcting disequilibria in the balance of payments of member States; 2) striving for the removal of restrictions on current payments between member States; 3) establishing policies and modes of Arab monetary co-operation; 4) rendering advice, whenever called upon to do so, with regard to policies related to the investment of the financial resources of member States in foreign markets; 5) promoting the development of Arab financial markets; 6) paving the way towards the creation of a unified Arab currency; and 7) promote trade among member States.[21]

Being completely new, the ISU (or whatever name this may change to) will need time to develop expertise and gain credibility. It should develop close links with other regional organizations such as the Asian Development Bank, the Asian Development Bank Institute and the ASEAN Secretariat. It should also have close links with the global IFI's, such as the IMF, the World Bank and the BIS, and also monetary organizations in other parts of the world. In particular, even though the CMIM borrowing should be de-linked from the IMF, as indicated above, the IMF can still have an important role to play in providing important technical assistances and capacity building support to the ISU.

Finally, financial support for the operation the ISU should come from pro-rata contributions from the ASEAN+3. The CMIM contributions are "self-managed" which means that the funds are still managed (invested etc.) by the various central banks (or ministry of finance in some cases)) and interest earnings from these funds belong to the various country agencies. To operate the ISU as well as all its related activities, each country should contribute a small amount of interest earnings on these CMIM funds for ISU operations. The could be for example, 0.05% of the contributed amount per year, which would amount to US$ 60 million per year (initially the amount could be much less).

4.2 Regional Surveillance Process

Within ASEAN, the global surveillance process of the IMF was supplemented by the ASEAN Surveillance Process (ASP) after the 1997/98 crisis. This was meant to be an informal process based on a peer review system that would complement the regular surveillance by the IMF. A unit within the ASEAN Secretariat was set up to assist in coordinating the work of the ASP and also to prepare a series of semi-annual ASEAN

[21] See http://www.amf.org.ae/content/objectives-and-means

Surveillance Reports, and the ADB provided technical support for the operation of the ASP. The peer review of the ASP is conducted at the ASEAN Finance Ministers meeting, which has been held twice a year.[22] At the level of the ASEAN+3 surveillance is conducted through the Economic Review and Policy Dialogue (ERPD). This is held at the Deputies' level twice a year to discuss economic and financial developments in the region and is reported to the ASEAN+3 Finance Ministers' Meeting which is held annually.

From the author's own experiences in these processes, the current surveillance mechanisms are not very effective. The resources available to support the mechanisms are very limited and the officials supporting these processes only carry out the tasks on a part time basis with many other regular jobs they have to do. Ministers Meeting also tended to be mostly rubber stamping what the officials have prepared through the Deputies Meetings. Even making slight changes to the Ministers Declaration, which had been drafted by the officials, can be complicated, as officials may have spent a considerable amount of time negotiating over phrases in the Declaration that all countries (as represented by the Deputies) are happy with.

The key to the success of any kind of surveillance mechanism within the region is to have a strong professional secretariat supporting the process. This is presumably a key role of the ISU. The ISU can make a significant contribution by becoming the dedicated technical secretariat of the ASEAN+3 Finance Ministers process. This should aim to provide high quality technical inputs into the regional surveillance process, supporting the Deputies Meetings and the Finance Ministers Meetings. In fact, once the ISU is established, one should take the opportunity to reform the economic surveillance and financial cooperation institutions of the region to make them more integrated and effective. Within the region, although the membership group is slightly different to the ASEAN+3 or ASEAN+6, there is also another important consultative forum among central banks officials, the EMEAP process.[23] Like the Finance Ministers process, EMEAP also has no permanent secretariat, but is a cooperative process with rotating host economies providing local logistics support. Once strong enough, the ISU can also assume the role of secretariat of the EMEAP process as well.

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[22] Manupipatpong (2002) gives details on the development and process of the ASP as well as an evaluation of its potential contributions and limitations.

[23] EMEAP stands for Executives' Meeting of East Asia-Pacific Central Banks. The economies involved are the five old members of ASEAN, the plus three countries, Hong Kong, Australia and New Zealand.

The memberships in the Finance Ministers process and the central banks process should become more unified. As was suggested with the CMIM, Australia, India and New Zealand, could become associated members and participate in important activities of the ISU, including regional surveillance and other regional financial cooperation activities. Hong Kong SAR, China, can already participate in CMIM as it is a contributor within the quota of China. This means that if EMEAP was to be expanded to include all the central banks of the newer ASEAN member countries (Cambodia, Lao PDR, Myanmar and Vietnam) and also India, then the expanded CMIM and EMEAP would have exactly the same membership composition. This will make the two processes the focal points for regional surveillance, as well as other financial cooperation initiatives that may develop in the future. The consultative regional financial institutional infrastructures might be as follows; a meeting of the expanded EMEAP central bank governors every quarter, a meeting of the expanded CMIM Finance Ministers every six months, and then a joint meeting of the expanded CMIM/EMEAP Finance Ministers and central bank governors once a year.[24]

Consultative and cooperation activities around the (expanded) CMIM/EMEAP and the ISU will be important contributions to those at the global level.[25] Because the sub-prime crisis emanated from outside the region but ended up having a large indirect impacts on the region, East Asia's surveillance activities cannot simply be an internal surveillance of the region. The region needs also to have input into surveillance of the more advanced economies that have the potential to cause large indirect impacts on the region. And as East Asia is a major creditor of the Western economies, it is in East Asia's self interest to carefully monitor what is happening in the markets in which East Asia has invested a lot of it's resources.

For this, the CMIM/EMEAP regular meetings of central banks and Finance Ministers can develop to become an important focal point of the global financial system, no less important than meetings of the US Federal Reserves or European counterparts. The CMIM/EMEAP meetings should become much more visible than it is at present. The region's central banks can play a crucial role in coordinating the region's monetary policy, exchange rate policies, and foreign reserves investment policies. All these, particularly

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[24] Heads of other financial supervisory bodies, if any, can also participate in the annual meeting, which might be called the Asian Financial Stability Dialogue (AFSD). See discussions in Setboonsarng (2009).

[25] For a detailed discussion of reforms of the global financial architecture and contributions from evolving East Asian regional financial architecture, see Kawai (2009).

the latter two have major global implications. Given that East Asia is a region with huge financial resources, and can significantly influence important global financial variables, such as exchange rates and bond yield curves, the world should be anxiously anticipating the outcomes of key financial meetings in East Asia in the future.

Regular meetings of CMIM/EMEAP can also lead to important policy coordination necessary to solve major global problems such as the global imbalance. If the sub-prime crisis brings about an easing or reversal of the global imbalance, then all well and good. However, if global recovery brings back the global imbalance or even magnifies it, then the risk of another major financial crisis will come back. This time, the direct cause of the crisis is likely to be very different to the sub-prime crisis. But it will be very rash to think that the global imbalance can continue on without bringing about major disruptive adjustments.

While the global imbalance is a global problem, and adjustments are needed from both those who have surpluses as well as those who have deficits, a major variable affecting the global imbalance, the exchange rates among relevant currencies, are more under the control of East Asia (the surplus region) rather than the US (the major deficit country). Without coordination, each country will try to prevent its currency from getting too strong in order to protect its export sector. So the global imbalance will likely remain and may even become bigger. Under the current regional institutional infrastructure there is no effective forum or mechanism that can deal with exchange rate cooperation or coordination. This is why the new regional institutional frameworks that could be built up from the CMIM, EMEAP and ISU can make a real difference to the policy processes within the region, with major regional and global implications.

5. Conclusions

The CMIM has the potential to make significant contributions to the region's self-help liquidity support mechanism and policy institutional infrastructures. The creating of the ISU will be particularly important. It can fill a major gap in providing dedicated technical and secretariat support to financial cooperation processes in the region, which have thus far been driven by officials on very much a part-time basis.

The paper has made a number of proposals on how to make the liquidity support role of the CMIM more effective. De-linking the lending from the IMF is particularly important for the region, as well as the ability to supplement lending by country contributions, or to use the CMIM for swap agreements. The economies involved in the

CMIM activities can also be expanded in the form of “contributing partners” without having to renegotiate the various contributions and weights that have already been agreed upon.

On surveillance, the paper proposes that CMIM and EMEAP memberships should be expanded to become the same (basically ASEAN+6 plus Hong Kong SAR, China, and the two processes better coordinated to form more regular meetings of Finance Ministers and central bank governors, separately and also jointly. The ISU will provide technical and secretariat to these meetings. These meetings should increase the visibility and impacts of East Asia in the global financial arena, and also facilitate regional policy cooperation and coordination, with impacts at both the regional and global levels.

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Table 1
Ratio of Short-term Foreign Debt to Official Reserves (Percent)

	1990	1991	1992	1993	1994	1995	1996
China	30.8	24.3	64.8	66.5	32.6	29.4	23.6
Hong Kong	23.4	21.7	18.2	17.2	16.4	16.4	22.2
India	164.7	104.1	73.2	26.8	18.5	23.4	28.3
Indonesia	*130.7*	*139.7*	*158.5*	*145.6*	*147.4*	*175.6*	*167.2*
Malaysia	19.3	18.8	21.0	25.4	24.2	30.4	40.8
Philippines	216.2	109.2	98.5	85.0	80.3	67.9	67.9
Singapore	2.7	2.7	2.3	2.0	1.7	1.8	2.6
South Korea	*72.9*	*81.6*	*69.5*	*60.2*	*123.1*	*142.5*	*195.4*
Taipei	20.0	18.9	19.6	21.8	20.3	20.4	20.1
Thailand	*58.3*	*67.8*	*69.5*	*89.0*	*96.4*	*119.4*	*110.3*

Source: Asian Development Bank, Key Indicators 2001.

Table 2
Current Account of East Asian Countries (Million US$)

	Avg. (93-97)	1993	1994	1995	1996	1997
Thailand	-9,143	-6,364	-8,085	-13,554	-14,691	-3,021
Indonesia	-4,776	-2,106	-2,792	-6,431	-7,663	-4,889
Malaysia	-5,310	-2,991	-4,520	-8,644	-4,462	-5,935
Philippines	-3,250	-3,016	-2,950	-1,980	-3,953	-4,351
Singapore	11,859	4,211	11,400	14,800	13,977	14,908
Sum (ASEAN)	-10,620	-10,266	-6,947	-15,809	-16,792	-3,288
South Korea	-8,655	821	-4,024	-8,665	-23,120	-8,287
China	8,225	-11,609	6,908	1,618	7,243	36,963
Japan	107,108	131,640	130,260	111,040	65,790	96,810
Sum (Plus 3)	106,678	120,852	133,144	103,993	49,913	125,486
Sum (Total)	96,057	110,586	126,197	88,184	33,121	122,198

Source: International Financial Statistics, 2005, International Monetary Fund.

Table 3

Gross Official Foreign Reserves

	1997	2000	2003	2006	2008
China	146.4	171.8	416.2	1,080.8	1,946.0
Hong Kong, China	92.8	107.6	118.4	133.2	182.5
Indonesia	17.5	29.4	36.3	42.6	51.6
Japan	226.7	361.6	673.6	895.3	1,030.8
Korea, Rep.	20.5	96.3	155.5	239.1	201.5
Malaysia	21.5	28.7	44.3	82.9	92.2
Philippines	8.7	15.1	17.1	23.0	37.5
Singapore	71.4	80.2	96.2	136.3	174.2
Thailand	26.9	32.7	42.2	67.0	111.0

Source: World Bank, World Development Indicators (Online through the Global Development Network).

Table 4
CMIM Contributions and Borrowing Multipliers

<table>
<tr><th>Country</th><th colspan="2">Contribution (USD Billion)</th><th>Borrowing Multiplier</th></tr>
<tr><td>Brunei</td><td colspan="2">0.03</td><td>5</td></tr>
<tr><td>Cambodia</td><td colspan="2">0.12</td><td>5</td></tr>
<tr><td rowspan="2">China</td><td rowspan="2">38.4</td><td>China (exclude Hong Kong, China) 34.2</td><td>0.5</td></tr>
<tr><td>Hong Kong, China 4.2</td><td>2.5*</td></tr>
<tr><td>Indonesia</td><td colspan="2">4.77</td><td>2.5</td></tr>
<tr><td>Japan</td><td colspan="2">38.4</td><td>0.5</td></tr>
<tr><td>Korea</td><td colspan="2">19.2</td><td>1</td></tr>
<tr><td>Lao PDR</td><td colspan="2">0.03</td><td>5</td></tr>
<tr><td>Malaysia</td><td colspan="2">4.77</td><td>2.5</td></tr>
<tr><td>Myanmar</td><td colspan="2">0.06</td><td>5</td></tr>
<tr><td>Philippines</td><td colspan="2">3.68</td><td>2.5</td></tr>
<tr><td>Singapore</td><td colspan="2">4.77</td><td>2.5</td></tr>
<tr><td>Thailand</td><td colspan="2">4.77</td><td>2.5</td></tr>
<tr><td>Vietnam</td><td colspan="2">1.00</td><td>5</td></tr>
</table>

*Hong Kong, China's borrowing is limited to IMF de-linked portion because Hong Kong, China is not a member of the IMF

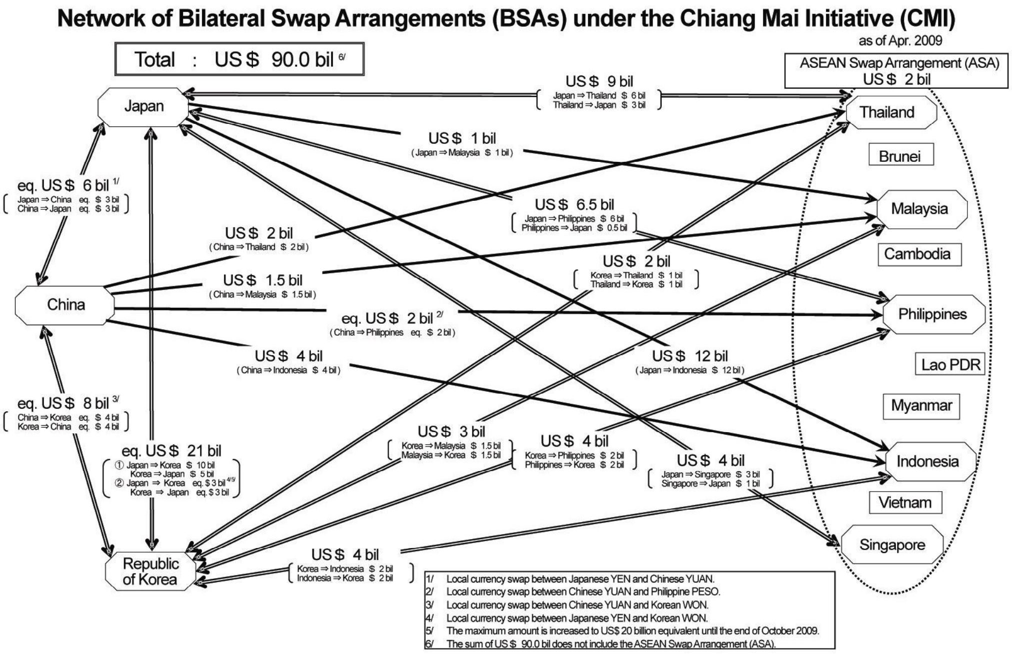
Source: The Joint Media Statement of The 12th ASEAN+3 Finance Ministers' Meeting, 3 May 2009, Bali, Indonesia.

Table 5
Foreign Reserves and Potential Short-term Liabilities (end 2008)

	(1)	(2)	(3)	(4)	(5)
	FX Reserves (Bil. US$)	Short-term Debt (by remaining maturity)	Foreign Holdings of Stocks	Foreign Holdings of Bonds	Ratio of (1) to (2)+(3)+(4)
Korea, Rep.	201.7	191.1	111.0	27.0	61.3%
Indonesia	50.9	33.2	18.0	7.1	87.3%
Malaysia	91.3	42.4	22.3	11.8	119.3%
Philippines	39.6	14.3	11.6	0.6	149.4%
Thailand	112.3	35.1	30.7	1.7	166.4%

Source: Chua (2009), quoted in Table 2 of Huang (2009).

Figure 1: Structure of the Chiang Mai Initiative



Source: Ministry of Finance, Japan.