The Chiang Mai Initiative Multilateralisation: Origin, Development and Outlook

by

Chalongphob Sussangkarn

Presented at a conference on "Regionalism and Reform of the Global Monetary & Financial System: What Role for Europe and Asia?", February 4, 2010, Brussels, Belgium.

Main Sections of Paper

1. Introduction
2. Origin

   2.1 Perceived Importance of Developing Regional Self-help Mechanism

   2.2 The Chiang Mai Initiatives (CMI)
3. Development
4. Outlook

   4.1 The Provision of Foreign Exchange Liquidity to Needed Countries

   4.2 Regional Surveillance Process

   4.3
5. Conclusions

Origin:
Importance of Regional Self-help Mechanism

- 1997/98 crisis was the major event that led to extensive East Asian (EA) regional cooperation. ASEAN+3, many cooperation initiatives and more recently East Asian Summit.
- Thailand, Indonesia and South Korea became insolvent (not enough reserves to meet their obligations) and had to enter IMF programs. Contagion to the whole region.
- At that time countries were viewing the adequacy of reserves with the wrong paradigm (current account paradigm/months of imports etc.). Need for reserves to also cover the huge amount of short-term foreign debt was not recognized.

Origin:
Importance of Regional Self-help Mechanism (2)

- Region as a whole was a saving surplus region (about US$ 100 billion annually), but deficit countries had to rely on short-term foreign debt.
- Much discussion that if EA financial resources were better utilized prior to the crisis, then may be crisis could have been avoided.
- In addition, frustration that region had very little role in the crisis resolution measures. These were mostly dictated by the IMF with inputs from the US Treasury and Federal Reserves behind the scene.
- Very harsh and controversial conditionality (almost opposite to sub-prime crisis resolution measures).

Origin:

Importance of Regional Self-help Mechanism (3)

- Critics pointed to a number of areas, such as:
  1) stringent fiscal and monetary policies without regard for social/political consequences; <u>one size fits all</u> nature; 2) ignored non-market based interventions. Malaysia and Hong Kong used these types of measures successfully; 3) full guarantee for creditors (mostly foreign) of financial institutions; and, 4) imposition of rapid structural reform measures. “Fire sale” type of policies.
- Again, EA felt that with more inputs, resolution was possible with much less pain.
- All these reasons were important push factors that brought the region together.

Origin:
Chiang Mai Initiative

- First proposal for financial cooperation was the AMF. Unsuccessful as not enough prior consultations for such as radical proposal, also bad timing as IMF had just started Thai program. Much criticism that it will create moral hazard vis-à-vis the IMF.
- However, logic for some form of cooperation was strong, and the “Manila Framework” was developed at a meeting of Finance and Central Bank Deputies from the region in Manila in Nov. 97 which also involved the US, the IMF and the World Bank.

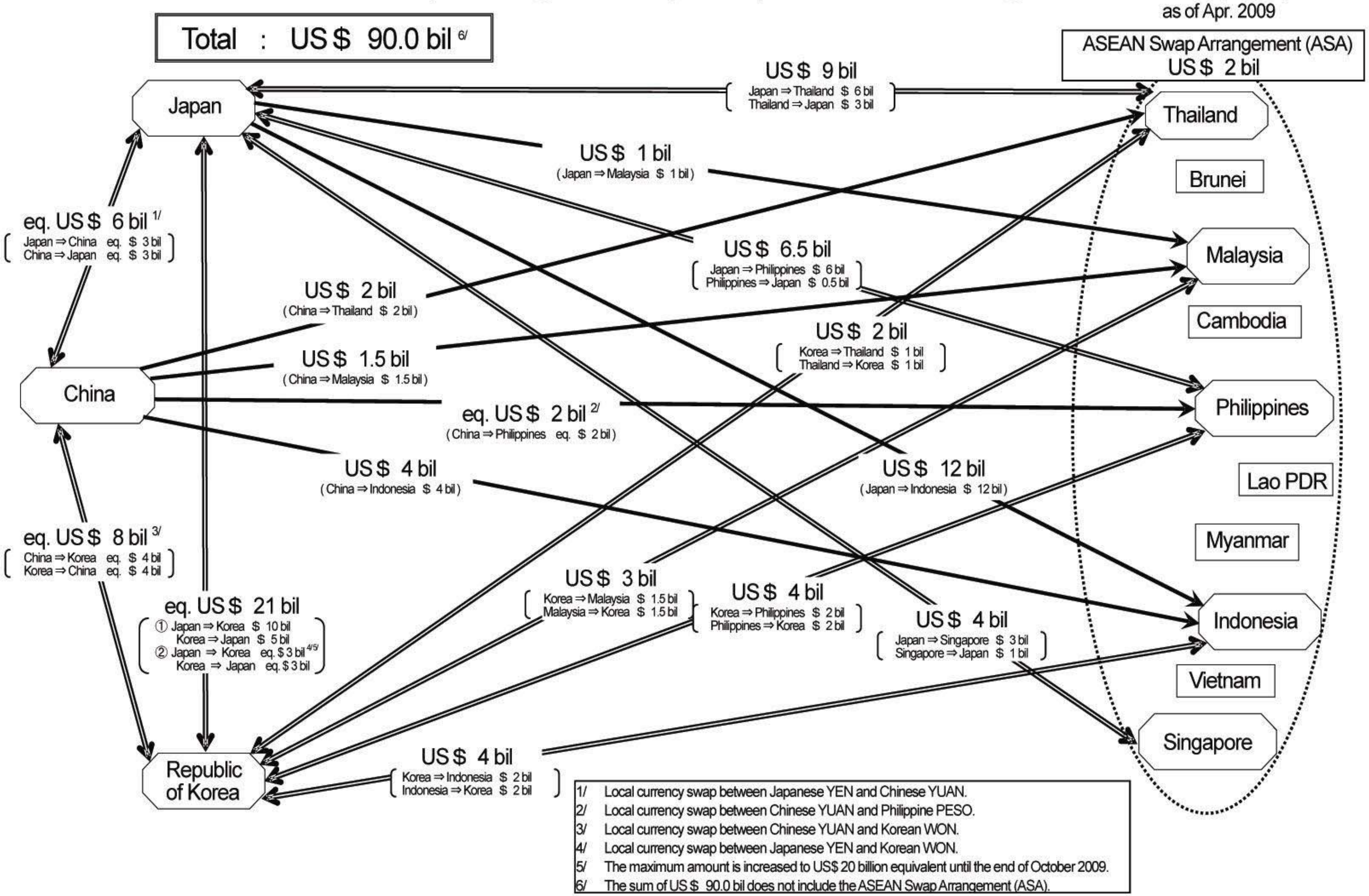
Origin:
Chiang Mai Initiative (2)

- Given involvement of the US and IMF, not surprising that Manila Framework not very radical and still stressed the central role of the IMF.
  "……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."

Origin:
Chiang Mai Initiative (3)

- Regional financing arrangement to supplement IMF resources was eventually agreed in May 2000 at the ASEAN+3 Finance Ministers' Meeting in Chiang Mai, hence Chiang Mai Initiative (CMI).
- CMI built upon existing ASEAN Swap Arrangement (ASA) by increasing ASA to US$ 1 billion from US$ 200 million and adding a number of bilateral swaps between the older ASEAN members and the Plus 3 group (China, Japan and South Korea).
- Given involvement of US and IMF, CMI still closely linked to IMF. Only 10% of agreed amount can be used without IMF link (eventually increased to 20%).
- Most recently, total size of CMI was US$ 90 billion.

Network of Bilateral Swap Arrangements (BSAs) under the Chiang Mai Initiative (CMI)



Source: Ministry of Finance, Japan.

Origin:
Chiang Mai Initiative (4)

- CMI is more symbolic than truly effective.
- It would not have made much difference to Thailand if it had existed before 1997, Thailand would have been able to use about US$ 2 billion without being under an IMF program. This is insignificant compared to Thailand's problem at that time; IMF package was US$ 17.2 billion.
- Thus, CMI is really a work in progress.

Development

- While CMI was developed to provide liquidity support mechanism for the region, as the region recovered from the crisis, it seems that the need for liquidity support became less urgent.
- Export sector played an important role in the post 1997/98 recovery. Share of exports in GDP increased significantly for the whole region. Large current account surpluses (as well as net capital inflows). Countries intervened in foreign exchange markets to prevent currency appreciation and support the export sector. This resulted in large accumulation of foreign reserves, thus increasing the ability of countries for self-insurance.

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).

Development (2)

- Apart from the reserves accumulation, better self insurance resulted from better understanding of the dangers of short-term debt (better paradigm). Better monitoring and control of short-term debt.
- More flexible exchange rate (particularly on the downward side) also contributed to better self protection.
- However, in spite of better self protection, the momentum to evolve the CMI into something more effective remained.
- Also, large reserves meant that the cost of using some reserves in a regional liquidity mechanism became less.

Development (3)

- Finally agreed on the principle of the Chiang Mai Initiative Multilateralised (CMIM) with self-managed reserves pooling governed by a single contractual agreement at the 10th ASEAN+3 Finance Ministers' Meeting in May 2007 in Kyoto, Japan.
- In May 2009, country contributions, borrowing multipliers and broad decision making rules were agreed. Contribution is a sensitive issue and took some time to conclude.
- It was also agreed that an Independent Surveillance Unit (ISU) will be set up, and that the CMIM should be operational by the end of 2009.
- Not yet operational. Location of ISU to be decided.

CMIM Contributions, Multipliers, and Rules

Country	Contribution (USD Billion)		Borrowing Multiplier
Brunei	0.03		5
Cambodia	0.12		5
China	38.4	China (exclude Hong Kong, China) 34.2	0.5
		Hong Kong, China 4.2	2.5*
Indonesia	4.77		2.5
Japan	38.4		0.5
Korea	19.2		1
Lao PDR	0.03		5
Malaysia	4.77		2.5
Myanmar	0.06		5
Philippines	3.68		2.5
Singapore	4.77		2.5
Thailand	4.77		2.5
Vietnam	1.00		5

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

	Issues	Rule of Decision-Making
Fundamental Issues	Review (size, contribution, and borrowing multiples), Re-admission, Membership, Terms of Lending, etc	Consensus
Lending Issues	Lending --- Renewal, Default	Majority

Outlook:
Provision of Foreign Exchange Liquidity

- Even with large reserves and lessons from 1997/98, sub-prime crisis showed that liquidity shortages can develop unexpectedly and quickly.
- In last quarter of 2008, liquidation of assets in emerging markets led to severe US$ shortages in many economies, particularly South Korea, in spite of more than US$ 200 billion in foreign reserves.
- Again, wrong paradigm led to problems. Reserves are needed not just to cover current account transactions and short-term foreign debt, but also short-term contingent liabilities of foreign reserves, such as foreign holdings of stocks and bonds.

Adequacy of Foreign Reserves

- Need to back up short-term contingent liabilities.

	(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)
South Korea	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: Johanna Chua (2009)

Outlook:
Provision of Foreign Exchange Liquidity (2)

- While CMIM not yet operational, CMI was and Korea could have accessed US$ 18.5 billion through its swap agreements. However, only US$ 3.7 was available without having to go under an IMF program. Given the 1997/98 experiences, this would be almost political suicide, even with the much more lenient "Flexible Credit Line".
- Korea instead got a swap agreement of US$ 30 billion from the US Fed. So did Singapore. Indonesia also requested a similar swap, but this was refused, and Indonesia got swaps with China and Japan instead.

Outlook:
Provision of Foreign Exchange Liquidity (3)

- In spite of these swaps and the CMI and CMIM links to the IMF, the region still pushed ahead with CMIM. Likely from realization that 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, which may not coincide with the region's interests.

Outlook:
Provision of Foreign Exchange Liquidity (4)

- To make CMIM truly effective a number of steps are suggested.
- First is to de-link from the IMF, otherwise the CMIM is likely to be useless.
- CMIM borrowing quota may not be enough (Thailand has borrowing quota of $ 11.925 billion for example). Should be possible to supplement CMIM by contributions from countries in the group. This is like IMF borrowing. E.g. Thai package of $ 17.2 billion only contained $ 4 billion from IMF, rest from country contributions. If this is allowed, then resources of CMIM will be more like $ 400-500 billion rather than $120 billion.

Outlook:
Provision of Foreign Exchange Liquidity (5)

- CMIM should also be able to provide swap facilities instead of just pure borrowing. This will make CMIM much more flexible.
- Should be expanded to include India, Australia and New Zealand. Best way might be to make these three countries “Contributing Partners”, that is they will be able to make country contributions to specific lending programs in the future. In this way, they can be allowed to participate in all technical programs under the CMIM umbrella, such as surveillance and activities to support the integration of the region. This will not disrupt what has already been agreed upon and will also make ASEAN+3 and ASEAN+6 activities in the financial area more unified.

Outlook:
Provision of Foreign Exchange Liquidity (6)

- Most importantly the ISU must be set up. Need full time professional staff to operate and provide technical support to countries. This is going to be like a monetary organization for EA, but role will be much broader than just functioning like an IMF in East Asia.
- For example, the Arab Monetary Fund has very broad objectives, including: 1) BOP corrections; 2) Develop current payments among members; 3) support Arab monetary cooperation; 4) advice on investment of members; 5) promote development of Arab financial markets; 6) paving way for single currency; and 7) promote trade among member states.

Outlook:
Provision of Foreign Exchange Liquidity (7)

- ISU will need time to develop expertise and gain credibility.
- Need close links to other regional bodies, such as ADB, ADBI and ASEAN Secretariat. Also to global IFI's. Even though CMIM lending should be delinked from the IMF, the IMF can play an important role in providing technical support and capacity building for the ISU.
- Financial support for ISU should come from pro-rata contributions from the ASEAN+3. For example 0.05% of the contributed amount per year (a tiny fraction of the interest earnings on these self-managed reserves) comes to US$ 60 million (initial amount could be much less).

Outlook:
Regional Surveillance Process

- Current surveillance process in the region not very effective. Limited resources to support the mechanisms, 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.
- Key to the success of any kind of surveillance mechanism within the region is to have a strong professional secretariat supporting the process. Thus, ISU can make a significant contribution by becoming the dedicated technical secretariat of the ASEAN+3 Finance Ministers process.

Outlook:
Regional Surveillance Process (2)

- Should reform the economic surveillance and financial cooperation institutions of the region to make them more integrated and effective.
- No finance ministers meeting under ASEAN+6, and EMEAP (central banks forum) has a different set of membership (Old ASEAN, Plus 3, Hong Kong, Australia and New Zealand). EMEAP also has no permanent secretariat.
- Memberships in the Finance Ministers process and the central banks process should become more unified.

Outlook:

Regional Surveillance Process (3)

- With the proposed expanded CMIM, if EMEAP expanded to include all the ASEAN countries and also add India, then the expanded CMIM and EMEAP will have exactly the same membership composition.
- These two processes should become the focal point 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 (may be also other regulatory heads not covered by the group).

Outlook:
Regional Surveillance Process (4)

- These consultative and cooperation activities around the (expanded) CMIM/EMEAP and the ISU will be important contributions to those at the global level.
- Apart from regional surveillance, the process needs to have input to surveillances of the advanced economies, as EA has huge investment interests in these economies, and EA cannot be isolated from crises in the advanced economies.
- 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.

Outlook:

Regional Surveillance Process (5)

- 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.
- These meetings can also be important forum for policy coordination necessary to solve major global problems such as the global imbalance. If this persist or even widen as global recovery takes place, risk of another major global financial crisis will come back.
- Exchange rates are clearly an important variable, and are more under the control of EA, but cooperation is necessary, and current institutional structures cannot deal with this issue. The proposed new institutional framework can make a real difference.