

# Newsletter



Institute for International Monetary Affairs

(財)国際通貨研究所

## **A Case for Establishing an Asian Monetary Fund Institute<sup>1</sup>**

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Establishing an Asian Monetary Fund is a significant and shared political challenge for East Asia. In order to meet it effectively in the near future, it is critical that an institute should be created which would subsequently become an annex to the Fund. In this paper, I would like to make a case for such an institute, i.e. an Asian Monetary Fund Institute, to be established ahead of an Asian Monetary Fund (AMF).

### **1. Japan-ASEAN Exchange Year**

The year 2003 was Japan-ASEAN Exchange Year. I had the opportunity of attending the First East Asian Congress held in the beginning of August in Malaysia, which turned out to be a significant gathering organized under the leadership of the then Prime Minister Mahathir of Malaysia.

Exchanges between Japan and ASEAN hit a high note at the Japan-ASEAN Commemorative Summit held in Tokyo at the end of December. “Tokyo Declaration for the Dynamic and Enduring ASEAN-Japan Partnership in the New Millennium” and an “ASEAN-Japan Plan of Action” comprising about 120 items were adopted at this meeting.

The “Tokyo Declaration” aims to create an East Asian community which acknowledges the “importance of rich Asian traditions and values” as well as universal rules and principles. It is worth noting that ASEAN plus 3 was recognized as a valuable channel for this purpose. The

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Japan-ASEAN relationship has traditionally been regarded solely as economic, but creating a partnership in the political and security areas was also discussed and accepted.

Japan and ASEAN or ASEAN plus 3 countries confirmed the basic understanding at the political level, among the heads of government, to take steps towards creating an East Asian community. For Japan, this means that it has decided on a basic strategy towards Asia for the beginning of the 21st century. The same can be said by and large for the ASEAN countries as well. The foundation stone has been laid and implementing concrete measures should now begin. The measures to be taken are the 120 plus items in the Action Plan. The campaign can be said to be moving on to the mid-stage.

Innumerable meetings and conferences have been held over the years to enhance partnership and cooperation between Japan and ASEAN. But those gatherings will end with a summary that says something like this. Yes, we understand where we should go. We see some concrete measures to be taken. It now requires the "political will." "Political will" has been a very convenient excuse to hide behind. There were a number of participants who would take the position that since he/she is not a politician, this is the end of his/her role. However, the many fruits of the Japan-ASEAN Commemorative Summit in Tokyo were declared as the will of the highest political authorities and hence the efforts to establish an East Asian community can be understood as nothing less than the "political will". All that is left is to act. It is the role of the "intellectuals", including some bureaucrats, to convey this political will to the public, to spread an understanding of the scheme and to induce them to have the determination to participate in this endeavor.

Because the scheme has come this far, I think it is now in its middle stage.

## **2. Current Connotation of the Asian Monetary Fund Scheme**

Although the Asian Monetary Fund scheme has an unfortunate history, it is still the most important issue for the region. There are two aspects to this "unfortunate history."

First, when the scheme was first discussed in the fall of 1997, the United States and the IMF were against it, and China, felt unable to express a definitive stance to support but chose to say it was neutral. In such a circumstance, neutrality indicated lack of support for the scheme, which had the same effect as opposition. The United States subsequently took advantage of this widely accepted perception and waved the so-called China card, saying that it was not the United States but China that destroyed the AMF scheme. Because the three influential parties were against the scheme --- in China's case by just not supporting it--- a historic first step was aborted at the last minute because

unease spread among the countries involved although a communiqué to establish an AMF was at its final stage of preparation. When the Asian financial crisis spread to Russia and then to Brazil, market participants in developed countries began avoiding risk taking to such an extreme that the two countries and the IMF shifted their ground.

In the fall of 1998, when there was a serious danger that the crisis could spread to its backyard in Latin America, the United States pronounced that Japan should take the leadership on Asian issues. Then the IMF, once the crisis began to spread to other regions and it was faced with a real possibility of shortage of necessary funds and funding position that could be applied, it, too, began to express its support for an AMF, though with the condition that it work in collaboration with the IMF. In the spring of 1999, China declared that it had never been against an AMF, but that it took a neutral position because it did not fully comprehend the scheme, that it was not too late to revive the scheme and that China was eager to study it. Although the three parties had changed their position, many so-called intellectuals in Japan believe that they are still against the scheme because the initial negative reaction had been so vigorous.

The second aspect is that the scheme was too narrowly associated with dealing with the Asian crisis. It is true that it was discussed at the height of the crisis in the fall of 1997. That is why the crisis-management aspect of the scheme was advertised disproportionately and great emphasis was placed on the fact that this was a fund on the scale of 100 billion dollars. The impact of the scale of the fund can easily be understood when the amount is compared with the figure of 4 billion dollars that the IMF committed at the financial support conference for Thailand held in Tokyo just before the AMF scheme became public. But I should emphasize that the AMF was never planned solely as a crisis management institution.<sup>2</sup> It was planned as an institution that would play a valuable role under normal, non-crisis conditions, and as we now seriously contemplate its establishment that will be a major portion of its activities.

The IMF, too, is an institution, which plays an invaluable role under normal conditions. Because there are many countries that had, at one time or other, been the IMF's "patient" in the last 20 years or so, the institution is seen in some quarters as a crisis management organization. However, consultation is only a regular, periodic procedure for the IMF under Article IV. Its main concern is "to promote exchange stability, to maintain orderly exchange arrangements" and to make sure that member countries are pursuing economic policies to meet those objectives. All member countries of the IMF are subject to Article IV consultation, not only those that are short of foreign reserves or

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<sup>2</sup> "Towards an Asian Monetary Fund", Institute for International Monetary Affairs newsletter, March 1999 issue

are about to face a liquidity crisis. It can be said that the normal-time activities are much more important for the IMF than crisis management.

The same can be said about the AMF. Since it is clear that an organization cannot gain confidence internationally or in local markets unless it has proper reserves as part of its ability to deal with crises, it is necessary to maintain the ability to cope with such circumstances. But since the debate about an AMF began during a crisis, and its crisis management ability was highlighted, the rationale for its creation tends to be narrowed to that aspect.

Many of the East Asian countries have carried out steady economic management as a whole, though admittedly there have been ups and downs since 2000 reflecting the economic conditions of the developed countries. Many of them seem to be regaining confidence in themselves as their real economies revive. This may be a factor that decreases the interest in an AMF, which tends to be seen as a crisis management organ.

The fact that the AMF aroused too high an expectation as a crisis management organization is the second part of its “unfortunate history.”

What role should the AMF play during normal times? I would like to mention the following.

- (1) Foreign capital, foreign exchange regime and foreign exchange rate policies of the regional economies. Such policies have their effects beyond national borders and directly influence the foreign exchange regime and foreign exchange rate policies of the region.
- (2) Internationalization of home currencies and taking measures against international speculation.
- (3) Dealing with short-term foreign capital flow.
- (4) Liberalization and stabilization of national financial markets.
- (5) Fostering domestic markets, especially the long-term capital markets, bond markets and stock markets as well as national institutional investors, which is the other side of the same coin.
- (6) Encouraging the use of regional currencies including the home currency. This means the establishment of direct exchange markets among the regional currencies and the development of such transactions. Closely following these developments would be the creation of a settlement system among regional currencies.<sup>3</sup>
- (7) As a shared, regional issue, increasing bond transactions in international markets (i.e. outside of domestic markets)

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<sup>3</sup> “Asian Currency Settlement System,” Institute for International Monetary Affairs newsletter, Issue no. 1 of 1999

Besides these functions, the AMF is expected to establish a mutual surveillance system for the region. This system will be a competing concept to the IMF's Article IV consultation. There are high hopes that it will reflect an Asian rationale and values, and at the same time, be extremely trustworthy. Monitoring to check the stability of financial markets, and the roles and the mutual cooperation among safety net players within the financial markets are also important issues. Looking beyond these areas, there is the determining of conditions for loans when a member falls into a liquidity crisis and the AMF has immediately or in the medium term to calculate the necessary amount of foreign currency for support operation and judge the possibility of intervention. Since these loans will be needed urgently, they will not necessarily be covered by collateral. When a non-collateralized loan is extended, terms besides collateral must be set and the AMF needs to secure the assurance that the borrower will earnestly carry out those terms. The rationale and methodology for such a procedure are very important and they must be spelled out quickly. This is not just to set out the terms for extending funds once the AMF is established. A new arrangement will lead to creating conditions that could replace the IMF conditionality attached to the Chiang Mai Initiative to initiate it and will answer the wishes of the countries that would like to replace the IMF conditionality with Asian reasoning and procedure.

As I have explained, an AMF is certainly not only a crisis management organization. Peace-time activities are more important and by carrying out its functions then, it will have the trust to be able to deal with crises better and more smoothly.

### **3. The Urgent Need to Establish an Asian Monetary Fund Institute**

Prime Minister Mahathir stated as follows at the First East Asian Congress: "We have already passed the point of debating the rationale and philosophy about whether or not to create an AMF. I believe that the all the countries in the region have already come to the conclusion that we must create this organization. Let us now discuss how to go about it." This well reflects how he sees the issue. Since the political will to create an East Asian community among Japan and East Asian countries has been expressed, I feel, on the one hand, that the road towards the AMF establishment may be covered at a dramatic speed but on the other realities are never that simple.

What are the hurdles? First, there is the question of membership. Since a renewed drive came from the opening remark at a Japan-ASEAN meeting, I believe we should start on the basis of ASEAN plus 3. But will such a membership be internationally accepted? Answers to such questions as the balance of capital input and how the financial burden in crisis management should be shared, which affect individual coffers, may not be reached easily.

Academic analysis and theoretical developments of the role of an AMF should be carried out by its think tank, which had been planned to be established at the same time as the AMF, i.e. the Asian Monetary Fund Institute. The AMF itself should study the analysis and recommendations of the Institute, organize them into realistic and practical formats and have them studied by the Board of Directors of the member countries.

The currency regime and foreign exchange rate policy are issues of such urgency for every country so that discussions on those issues cannot wait for the establishment of an AMF. There are any numbers of questions that must be studied in this regard. What should be the foreign exchange rate policy in lieu of a dollar peg system? Which currencies should construct the basket of a basket-peg system? What will be the foreign capital policy suitable for such a system? If a basket-peg system is adopted, how should interventions be made when a national currency diverges too far from the basket? How should currency integration be planned? How should a mutual unit be created as a step towards a mutual currency? How should direct currency transactions be encouraged among regional members? How should direct settlement among regional currencies be carried out?

To help answer these questions, I would like to recommend establishing an Asian Monetary Fund Institute ahead of an Asian Monetary Fund. It is not an orthodox procedure to establish an attached organization ahead of the main body. However, considering the innumerable questions to be answered and the urgency with which these issues must be tackled, I believe creating the Institute should take precedence.

I would now like to outline the framework of the Institute.

#### (1) shareholders and capital

It is not enough to establish just any think tank. Creating an “Asian Monetary Fund Institute” is the key. Although the sequence may be unusual, the AMF Institute will come under the umbrella of an AMF once the AMF is established. So the potential member countries of the AMF must be the shareholders in the Institute. Its capital need not be huge. A NPO format, without capital, is a possibility. But to create a favourable environment for the establishment of an AMF, some capital input is preferable.

The initial members could be the 13 countries of the ASEAN plus 3, Taiwan and Hong Kong. Since the Institute will eventually become an annexed organization to the AMF, commercial or for-profit activities are out of the question. It will be a cost centre for the time being. The cost of running the Institute will have to be shared by the shareholders, but it is estimated to be 3 billion yen annually at the most, not a huge amount. A large proportion will have to be provided by Japan,

which is logical and what other countries expect.

## (2) Personnel and staff

Personnel have to be mainly recruited from the member countries.

Needless to say, they must come widely from within the region but they must also come from different specialized areas, such as academia, business and journalism. I would also like to recommend that, as a rule a large proportion should be seconded from the financial and fiscal authorities of member countries. The reason is simple. This Institute will have a huge and wide range of work to do. The results coming out from the Institute will be distributed to the member countries by the AMF, if the AMF has been established, in the form of recommendations at the time of consultations or during various meetings (such as the meeting of finance ministers of member countries) on specific issues. Until an AMF is established they will have to be conveyed directly to the meetings of the finance ministers or to the meetings of the deputies of the ministers. Discussions there could lead to agreements including commitments. This means that once the recommendation of the Institute is accepted --- for example on such issues as adopting a basket-peg as a foreign exchange rate system --- foreign exchange policies of the member countries will have to be changed. In the case of adopting a basket-peg, foreign currency policy will have to be changed to reflect the make-up ratio of the basket. This is because it is not rational to maintain a dollar-led foreign currency policy (on commerce, settlement, borrowing and investment), pegging the home currency, in effect, to the dollar while the currency basket consists of the dollar, euro and the yen.

Bureaucracies will naturally want to send their own people to an Institute that may come up with such recommendations. As for the Institute, it would not want to draw up bright recommendations that would not be implemented. If its hard work is not utilized, the incentive for the Institute will be lost. Of course there are concerns that those who are seconded from bureaucracies tend to be bound by the interests of the bureaucracy and that research would either not make much progress or its result would be too abstract. A clear guidance would be necessary from member countries at the time of its establishment and a lot will depend on the skills of the director of the institute. The major job of the director of the institute will be securing the budget (donations from member countries) and commitments for the freedom to choose research topics and that the results will be respected from member countries.

After its establishment, the management of the Institute and the choice of research topics will likely be negotiated among the member countries. Its first and initially the most important topic to tackle will be, without doubt, to draw the plans and the concrete methodology for the creation of an AMF,

its mother organ.

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