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Moving Towards a Regional Financial Organisation
―The Next Step after the CMI [1]―

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1. Foreword

As this is the tenth anniversary of the "Asian financial crisis", there are a considerable number of study groups, symposiums and forums covering the crisis, a phenomenon that had been expected for a while. For example, the Annual General Meeting of the Asian Development Bank was held in Kyoto in May --- the first time an ADB general meeting had been held in Japan in ten years --- and the overarching theme was "Ten years after the crisis".

One notable aspect of all these gatherings is that China is hosting many of these study groups. I had the opportunity to attend two of these seminars, one in Shanghai and the other in Beijing, and the impression was that China does not have an acute or lingering memory of the crisis. On reflection, this is understandable because, as most commentators agree, the Asian crisis was a "capital account crisis" not a "current account crisis", and China, which had not liberalized capital trading, was hit only to a small degree by the crisis. Some may remember clearly that at the 1998 World Economic Forum in Davos, Premier Zhu Rongji received an enthusiastic ovation for a speech to the tune of China playing the role of a dike in the Asian financial crisis by not devaluing the renminbi. Although this comment was merely a restatement of China's fundamental currency and foreign exchange rate policy, which was a strict management of the foreign exchange rate fixed to the dollar and of capital transactions, and therefore not a surprising revelation, the United States President Clinton praised him profusely. However, Zhu's comments could have contributed to the foreign exchange policy package that Malaysia announced in September of that year.

[1] This article was published in "International Finance Journal No. 1179" issued by Institute for Foreign Exchange and Trade Research in August 1, 2007.

In the last several years, China's external balance has changed dramatically. As the country's current account surplus and foreign currency reserve mount rapidly, the voices in the developed countries, especially the United States, urging China to adopt a more flexible foreign exchange rate policy are becoming louder by the day. It seems that ten years after the crisis, the wider community is finally putting their minds to considering seriously what liberalization of foreign exchange rates and capital accounts are supposed to bring about.

In the various study groups and seminars where the key theme is ten years after the crisis, the inevitable item on the agenda is what was learned from the crisis. There are still a number of analysts who provide "the non-transparent nature of financial markets" or "the weaknesses of financial institutions" as the answer. I make it a rule to refer to the comments that were made at the conference in Tokyo in August 1997 to discuss financial assistance to Thailand and its result.

In July 1997, Thailand asked for IMF support. An IMF mission was soon despatched to the country and it calculated the liquidity shortage and as the amount to be extended as an emergency support measure to be 11.0 billion dollars. Since the ceiling of IMF's emergency support was 4 billion dollars, the remainder had to come from individual countries. So the conference was held to discuss how the burden could be shared. Though I do not have concrete evidence, it has been reported that the Japanese government attended the meeting ready to provide the whole of the remaining 7 billion dollars if there were no other providers.

The conference came out with a support package of 17.2 billion dollars. Japan committed 4 billion, partly in deference to the IMF. International institutions such as the World Bank and the ADB committed a total of 6.7 billion (including the 4 billion from the IMF), and the remaining 10.5 billion was provided by the countries of the region including Japan. A fact to remember is that although the United States and European countries, such as Britain, France and Germany, attended the conference, none of them participated in the package. Reuters reported that it was a deal "crippled" by the lack of participation from the US and Europe.

As a result, the first critical lesson was learned by Asian countries, especially Thailand, which was the subject of the conference: when there is a liquidity crisis in Asia, it is only the Asian countries that will extend support. This feeling spread widely among the regional countries immediately after the Tokyo conference for Thailand. This growing consensus must have played a major role in how the idea of an Asian Monetary Fund (AMF) was discussed privately in the corridors during the IMF/World Bank meetings in Hong Kong at the end of September of the same year, and how the idea gathered considerable support and came close to being announced as having reached a basic agreement. I will not dwell much on the ensuing debates on an AMF[2] since that topic could be another paper by itself.

[2] When a regional monetary fund was discussed in Hong Kong, it was given the preliminary name of Asian

As is widely known, the AMF concept, which was shelved in the autumn of 1997, was approached from a different angle and re-emerged as the Chiang Mai Initiative (CMI) and has since been developing impressively.

2. New Trends in the CMI

The fundamental structure of the CMI is for regional economies to sign bilateral understandings for capital financing (swap agreements) and to implement the agreements with the specific country simultaneously to ensure liquidity at the time of an emergency. Soon after the scheme was born, a basic agreement was signed at the meeting of finance ministers of ASEAN plus 3 (APT) held during the ADB Annual General Meeting in May 2000, and the initiative adopted the name of the venue, Chiang Mai. The objective of the CMI is speedy response to an emergency and, hence, to avoid a crisis. This has not changed since the initiative was conceived. The following three years or so were spent on speeding up the signing of bilateral swap agreements and on improving the scheme. The direction in which the CMI was developing was confirmed and various measures were decided to be strengthened at the meeting of the APT Finance Ministers in Istanbul in May 2005. Then, at the 9th APT Finance Ministers' meeting in Hyderabad in May 2006, the total CMI amount was reported to have reached 75 billion dollars and instructions were given to achieve larger perspective for the future. Following are the key components related to the CMI that were announced at Hyderabad.

- Substantial progress has been made in strengthening the CMI.
- A process of reaching a collective will was established in order to implement multiple bilateral agreements speedily and simultaneously at a time of emergency.
- A working group will be established aimed at enhancing the surveillance capacities on regional economic situations, especially to study the early warning systems.
- Deputies were tasked to set up a new group to further study various possible options towards an advanced framework of the regional liquidity support arrangement (CMI multilateralisation or Post-CMI)

Agreeing to study the options for CMI multilateralisation or Post-CMI clearly indicates that there is now an understanding that an expanded perspective will be added to the CMI's basic characteristic of being a compilation of bilateral agreements. The Hyderabad meeting would be remembered as one where an agreement was reached to take a huge step in developing the future concept of the CMI. The actual decision making organ of the CMI is the APT Finance

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Monetary Fund (AMF) and that term is used in this paper from mere convenience that the concept is widely known as an AMF.

Ministers' Meeting held annually in May (around the so-called Golden Week in Japan) during the ADB General Meeting. The Finance Ministers' meeting held in Kyoto this year produced a joint statement which was as important as that of Hyderabad. Following are the items related to the CMI.

- Ministers welcomed the fact that the bilateral swap agreements have totalled 80 billion dollars.
- Substantial progress was made in the activities of the task force on CMI multilateralisation. The task force proceeded with a step by step approach.
- It was unanimously agreed in principle that a self-managed reserve pooling arrangement governed by a single contractual agreement is an appropriate form of multilateralisation. It was recognized that the consensus which had been reached was a significant achievement and a big step towards creating an advanced framework for a regional liquidity support mechanism.
- Deputies were instructed 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.
- The importance of strengthening cooperation on regional surveillance in parallel to CMI multilateralisation was reconfirmed.

If the statement at Hyderabad is regarded as confirming the new conceptual approach to the CMI, then the Kyoto agreement is the first concrete step in that direction and reaffirms the significance of the new approach, and leads the way to further concrete measures. This agreement has a profound significance from this perspective. The areas named as items to be studied in the future are important because along with the arrangement whereby the currency reserve pool would be governed by a single agreement, they would assure efficient implementation of the agreements.

The statement does not mention the total of the reserve to be pooled or the amount to be committed by individual countries. Judging from the way CMI agreements have been made, such figures are likely to be considered by the finance deputies. We can speculate that the pooled amount of individual national commitments would be the total of the bilateral swap agreements signed by those countries. This means that the total of the pooled amount would be 80 billion dollars as of now. There are other possible scenarios based on the arrangements in place. Since the APT ministers could apply the first 20% as the first step of a CMI implementation, and the remaining 80% would be executed as a joint operation, such as with the IMF, it would be reasonable to pool the amount equivalent to the initial 20%. In any case, reserves would be self managed under normal conditions but would automatically be placed under a single agreement when there is an emergency. From this perspective a multilateralised CMI is the old AMF all but in name because of the capacity to deal with liquidity crises and how the objective is met.

3. Developments in regional surveillance

In various study groups dedicated to ten years after the crisis, there are debates about hedge funds as part of the discussions on lessons learned from the crisis. The argument goes like this. Many pointed out that the crisis was initiated by the rewinding of their positions by hedge funds to determine their profit margins. There were numerous and heated debates on the subject. But ten years later, discussions on the transparency of hedge funds or their positions have disappeared completely. At the same time there is a global surplus of liquidity and various funds show signs of speculation or mini-speculation. In such circumstances, strong caution should be taken to assure that another crisis will not occur.

Surveillance gives the impression that countries must streamline their statistical figures and explain macro-economic tendencies, how the country is coping with international developments, its current account balance and foreign reserve tendencies, and other detailed issues as if being subjected to an exam by a teacher. It is true that such aspects are of foremost importance. There may also be countries that conduct questionable foreign exchange rate policies, in which case other regional countries must be vigilant and apply peer pressure. Although all these are important parts of surveillance, the author feels that there are other issues which are just as, or even more, important. And these important aspects would be better dealt with if they were approached jointly with others in the region. The comments on surveillance in the communiqué of the APT Finance Ministers' Meeting seem to take account of this consideration.

Here are some of the issues that are more difficult to be tackled by individual countries.

(1) The so-called global imbalance, which is created by the current account deficit and foreign debt of the United States. This is a shared problem for the Asian countries that hold three fourth of the global currency reserves in the form of US dollars.

(2) The high oil prices and energy. This would be an increasingly complex issue in view of the imbalance between the oil producing and oil consuming countries when Asia has two large countries, China and India, which are developing rapidly.

(3) The overabundance of liquidity on a global scale. This is becoming more and more of an issue as part of the demands for liberalization of capital transactions and foreign exchange policies, and for the internationalization of currencies. After the crisis, mismanagement of sequencing of various measures was repeatedly pointed out as the culprit, and no one is interested in being reminded of it again. This could be a good incentive for the regional countries to take some joint steps. The issue of hedge funds,

mentioned above would be included in this category.

(4) Of the regional issues, foreign exchange and foreign currency policies are those thought to require a shared understanding and approach. I will refrain from repeating my arguments as they have been introduced in previous papers.

It is encouraging that the there is increasing recognition of the importance of surveillance and new agreements are being signed year by year in ASEAN plus 3. This should be noted as the perfect example of how lessons learned from the crisis are being prudently applied.

Another issue that should be discussed starting perhaps next year along with the CMI is the establishment of a permanent secretariat. The East Asian Community, which has been taken up seriously since the turn of the century, has found an ideal framework to develop in the APT. On the one hand, the CMI, which has the objective of being the liquidity supplement mechanism to cope with emergencies, is developing swiftly. On the other hand, surveillance as a means to avoid crisis and as an early warning system is gaining in importance yearly, and an increasing number of issues are being included in surveillance and in more detail. A permanent secretariat is becoming indispensable in order to properly pursue the two inseparable objectives. It is time to consider its establishment seriously and urgently.

4. A new regional organization[3]

As readers will easily recognize, if the APT has a permanent secretariat and has one foot in the CMI and the other in surveillance, then this arrangement would certainly be the resurrection of the old AMF.

Once a permanent secretariat of the APT is established, the first issue to tackle is to rebuild itself as a new organization, i.e. to use funding to become an independent organization. Creating a new regional organization involves complex problems such as choosing member countries. However, in this case, progress is likely to be relatively smooth since the APT, which is an established entity and is known to the outside world as well, would be the core. Obviously, increasing membership is not out of the question but something that has to be decided by the decision making body within the new organization. However, since the organization would, in effect, be an expansion of the CMI, and since the CMI is a network among the APT nations, the most straightforward way to start the new organization would be with the APT members. The new organization would extend liquidity in an emergency, using the paid-in capital and the callable capital that could be used when necessary, and their total would be 80 billion dollars as of now. This figure is comparable to the operational fund which

[3] I am using the term regional "organization" only because when a regional organization was first discussed it was temporarily named Asian Monetary Organization as there were some concerns that if the word fund were used, it might invite the wrath of the other Fund.

was assumed, at the time of an AMF debate, to be 100 billion dollars including borrowings guaranteed by participating members. The capital is likely to be 20% of the CMI total, which would be 16 billion dollars. But perhaps such a large amount may not be required.

Many words are not necessary to explain the Japanese attitude to this scheme since it is clear, when looking at the picture with a longer perspective, that the largest benefactor of the East Asian Community is Japan. East Asian countries would be the source of effective demand and help Japan which is experiencing an ageing and declining population. It is not too much to say that making sure that the regional countries, which have relatively younger economies than Japan, are not hit with a financial crisis again and going out of our way to share the burden when necessary are the most important foreign policies for our country. An AMF scheme was temporarily killed in 1997. But this time Japan must have the strong will not to repeat the incident, and do everything that a developed country can do at every opportunity, as well as being vigilant and strategic. It is abundantly clear that the regional countries would like us to do just that. I hope those responsible in this endeavour will have the deep insight to proceed strategically.

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