Institution Building for Macroeconomic and Financial Cooperation in East Asia

by

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Introduction

- "…Asian regionalism remains 'institution-light,' characterized by few delegated powers, a lack of permanent secretariats, and a lack of formal rules and legal structures." (ADB, *Institutions for Regional Integration: Toward an Asian Economic Community, 2011*).
- True for East Asia (EA) and for *macroeconomic and financial cooperation* in EA.
- However, some important progress recently, particularly the implementation of the Chiang Mai Initiative Multilateralization (CMIM) and the setting up of the ASEAN+3 Macroeconomic Research Office (AMRO).
- Paper focuses on a few issues related to the rationale for CMIM and AMRO and make some recommendations for further institution building to support future macroeconomic and financial cooperation in EA.

Developing a Regional Safety Net Mechanism

- Dissatisfaction with IMF crisis resolution measures after 1997/98 crisis.
- Harsh fiscal and monetary tightening; full guarantee for foreign creditors; rapid structural reform measures and privatization of state owned enterprises and "fire sale" asset sales.
- EA as a whole was financially strong ($700 billion in reserves, and saving surplus of about $100 billion annually), so call to develop a regional foreign exchange liquidity safety net mechanism.
- Asian Monetary Fund (AMF) proposal too radical. Moral hazard concerns. How a regional mechanism can work effectively with the IMF is still an issue today. While EU and IMF seems to work together well, EA is very different given past bad experiences. IMF stigma.

Developing a Regional Safety Net Mechanism (2)

- Regional financing arrangement 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 ASEAN5 members and the Plus 3 group (China, Japan and South Korea).
- To deal with moral hazard issue, 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.

The Chiang Mai Initiative Multilateralization

- CMI cumbersome, but moving to a multilateralized mechanism rather slow. Given post 1997/98 crisis adjustments, urgency declined.
- Exports became more and more important for EA economies.
- Large current account surpluses (also capital inflows).
- Most countries managed their exchange rates by buying up the foreign currency inflows to keep their currencies from appreciating too much and protect the competitiveness of their export sectors.
- As a result, foreign reserves in East Asia increased continually and rapidly, from about $720 billion in 1997 to almost $5 trillion in 2009, accounting for about 53 percent of world foreign reserves.
- Appeared that self-insurance may be adequate for many countries, so need for a regional mechanism less urgent.

Ratio of Exports of Goods and Services to GDP

	1993-96	1997-2000	2001-04	2005-07
China	22.7%	21.5%	27.8%	40.0%
Indonesia	26.4%	39.3%	33.6%	31.5%
Korea, Rep.	27.5%	39.0%	36.3%	40.3%
Malaysia	88.4%	112.5%	110.3%	114.8%
Philippines	35.5%	52.0%	50.0%	45.8%
Singapore	181.2%	185.0%	208.9%	262.6%
Thailand	39.5%	58.0%	66.6%	76.6%
Vietnam	34.1%	48.2%	59.1%	73.2%
Japan	9.3%	10.8%	11.8%	16.5%

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

Total Foreign Reserves (billion $)

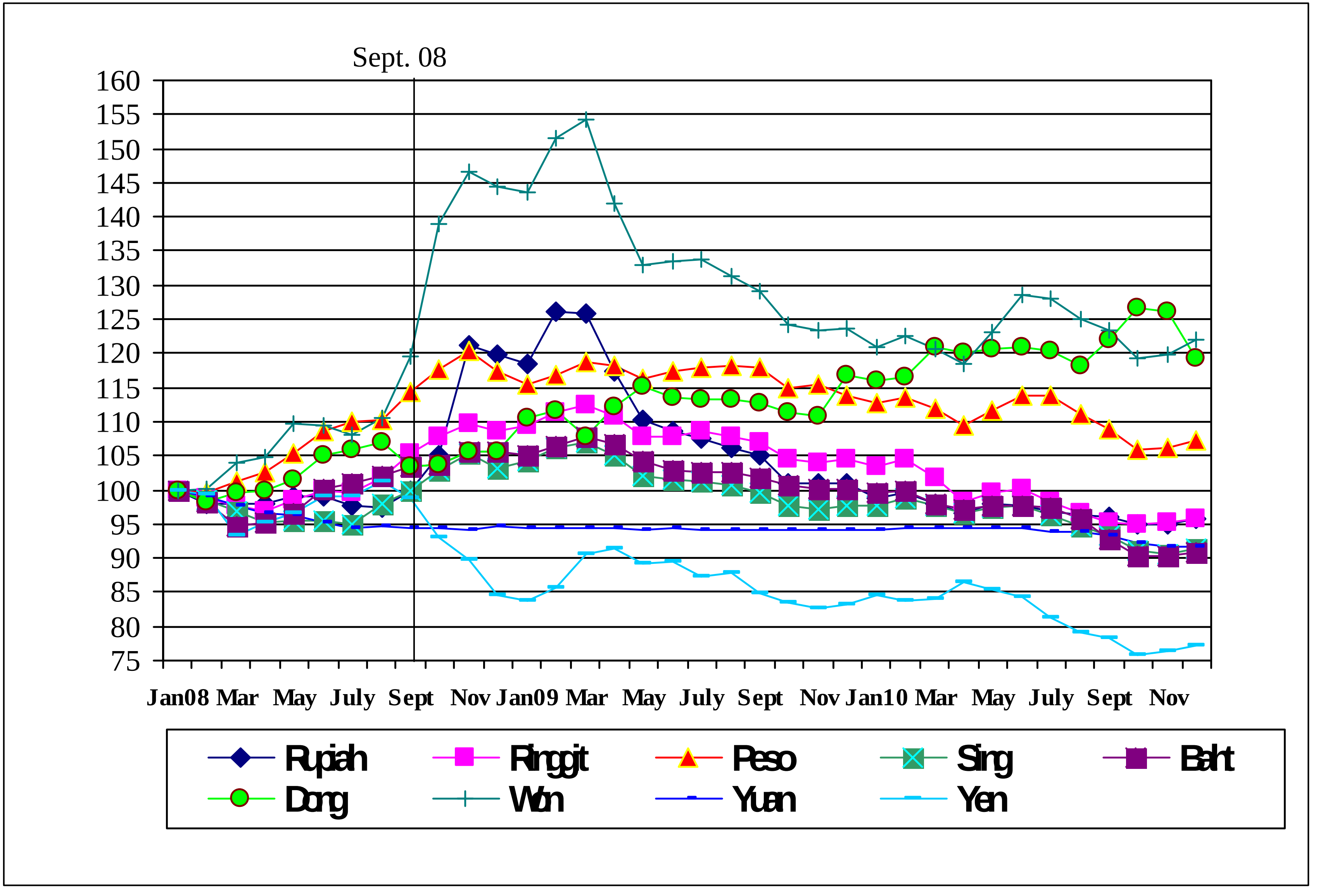
	1997	2000	2003	2006	2009
PRC	146.40	171.80	416.20	1,080.80	2,452.90
Hong Kong, China	92.80	107.60	118.40	133.20	255.84
Japan	226.70	361.60	673.60	895.30	1,048.99
Korea	20.50	96.30	155.50	239.10	270.44
Brunei	0.05	0.41	0.48	0.51	1.36
Cambodia	0.30	0.61	0.98	1.41	3.29
Indonesia	17.50	29.40	36.30	42.60	66.12
Lao PDR	0.12	0.14	0.26	0.46	1.01
Malaysia	21.50	28.70	44.30	82.90	96.70
Myanmar	0.32	0.29	0.65	1.38	n.a.
Philippines	8.70	15.10	17.10	23.00	44.21
Singapore	71.40	80.20	96.20	136.30	187.80
Thailand	26.90	32.70	42.20	67.00	138.42
Viet Nam	2.10	3.51	6.36	13.59	16.80
East Asia	721.16	1,038.06	1,819.23	2,992.57	4,954.84
World	1,904.51	2,167.34	3,385.72	5,494.85	9,388.78
East Asian Share	37.90%	47.90%	53.70%	54.50%	52.80%

Source: World Bank, World Development Indicators (Online through the Global Development Network) and ADB Key Indicators, 2010.

The Chiang Mai Initiative Multilateralization (2)

- However, in spite of better self protection, the momentum to evolve the CMI into something more effective remained.
- Finally agreed on the principle of the Chiang Mai Initiative Multilateralized (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.
- When global financial crisis occurred, CMIM still was being developed. However, the crisis showed that in spite of large reserves, acute foreign exchange liquidity shortages can develop quickly.
- Korea was hit particularly hard, mainly because the amount of Korea’s short-term foreign debt was quite high in relation to foreign reserves, and the won depreciated rapidly.

Exchange Rate Indices (Jan. 2008 = 100)



Source: Bank of Thailand.

The Chiang Mai Initiative Multilateralization (3)

- Korea had swap agreements in CMI totaling $18.5 billion. However, only $3.7 was useable without attachment to an IMF program, and for Korea to go under another IMF supervised program was politically out of the question.
- Korea got $30 billion swap from the US Fed. Singapore also, but Indonesia was refused.
- Korea swap calmed markets temporarily. Strengthening trend for won only after large sustained current account surpluses.
- Would be rash to rely on the US Fed in the future (lesson from Indonesian case), and with large reserves in EA together with IMF stigma, it makes sense to push ahead with the region's liquidity safety net mechanism, i.e.the CMIM.
- CMIM was finally agreed and came into force on 24 March 2010.

The Chiang Mai Initiative Multilateralization (4)

- Total size of CMIM is $120 billion.
- The CMIM is a 90-day swap facility (local currency for US$), which could be rolled over a maximum of 7 times.
- On voting weights, each country is given 1.6 basic votes plus the number of contribution votes equal to the number of billion dollars that it contributes to the CMIM pool.
- On decision rules, fundamental issues, such as size of pool, contributions, borrowing multiples, membership and terms of lending will be decided by consensus at the Minister of Finance level. Executive decision on lending, renewal and default will be done using two thirds majority by the Deputy-level representatives of ASEAN+3 Finance Ministries and Central Banks and Monetary Authority of Hong Kong, China.

Contributions, Multipliers and Voting Weight

<table>
<tr><th>Country</th><th colspan="2">Contribution (US$ Billion)</th><th>Purchasing Multiple</th><th>Voting Weight</th></tr>
<tr><td>Brunei</td><td colspan="2">0.03</td><td>5.0</td><td>1.158%</td></tr>
<tr><td>Cambodia</td><td colspan="2">0.12</td><td>5.0</td><td>1.222%</td></tr>
<tr><td rowspan="2">PRC</td><td rowspan="2">38.4</td><td>PRC , Excluding Hong Kong, China 34.2</td><td>0.5</td><td>25.430%</td></tr>
<tr><td>Hong Kong, China 4.2</td><td>2.5</td><td>2.980%</td></tr>
<tr><td>Indonesia</td><td colspan="2">4.552</td><td>2.5</td><td>4.369%</td></tr>
<tr><td>Japan</td><td colspan="2">38.4</td><td>0.5</td><td>28.410%</td></tr>
<tr><td>Korea</td><td colspan="2">19.2</td><td>1.0</td><td>14.770%</td></tr>
<tr><td>Lao PDR</td><td colspan="2">0.03</td><td>5.0</td><td>1.158%</td></tr>
<tr><td>Malaysia</td><td colspan="2">4.552</td><td>2.5</td><td>4.369%</td></tr>
<tr><td>Myanmar</td><td colspan="2">0.06</td><td>5.0</td><td>1.179%</td></tr>
<tr><td>Philippines</td><td colspan="2">4.552</td><td>2.5</td><td>4.369%</td></tr>
<tr><td>Singapore</td><td colspan="2">4.552</td><td>2.5</td><td>4.369%</td></tr>
<tr><td>Thailand</td><td colspan="2">4.552</td><td>2.5</td><td>4.369%</td></tr>
<tr><td>Viet Nam</td><td colspan="2">1.00</td><td>5.0</td><td>1.847%</td></tr>
</table>

Source: The Joint Ministerial Statement of The 13th ASEAN+3 Finance Ministers' Meeting, Tashkent, Uzbekistan, 2 May 2010.

The Chiang Mai Initiative Multilateralization (5)

- CMIM will be supported by the ASEAN+3 Macroeconomic Research Office (AMRO) based in Singapore.
- AMRO to start small (15-20 staff) under the Director. Director's term is 3 years. Appointment of first Director politically difficult. Finally a compromise: first year, Mr. Wei Benhua, former deputy director of China's State Administration of Foreign Exchange; next two years, Mr. Yoichi Nemoto, a Deputy Vice Minister of Finance for International Affairs at Japan's Ministry of Finance.

Self Managed Reserve Pooling

- CMIM contributions are not actually paid into a common pool but are still owned and managed by the respective country authorities.
- Opportunity cost for each country is minimal, being limited to contributions to a swap drawing, if one were to arise (though there are also possibilities for a country to opt out) and its share of financial contributions to AMRO, which will be small in the initial stages.
- Low opportunity cost makes setting up CMIM easier, and will also make increasing the size of CMIM easier (see below).
- However, the urgency to develop CMIM so that it becomes as effective as possible may not be as high as it should be.
- Nevertheless, real money is needed for AMRO, so domestic political processes should begin to scrutinize effectiveness of money spent on AMRO in supporting CMIM.

The IMF Link

- IMF link need to be modified, otherwise countries will bypass CMIM.
- For those countries that did not have to go through the IMF experience after the 1997/98 crisis, it may be difficult to understand why there is such a stigma associated with the IMF in parts of EA.
- Europe seems to work reasonably well with the IMF and the IMF has evolved a lot since 1997/98, with new facilities with weak or no conditionality (PCL and FCL).
- However, the mistrust of the IMF is deep rooted and widespread to the general public in many countries.
- Of course, this could be overcome in time, but it would be best to design the CMIM to be workable given the IMF stigma.

The IMF Link (2)

- It is possible to combine a crisis prevention liquidity support facility with a more medium term crisis resolution facility for structural imbalance problems under the CMIM.
- The IMF link should not be based on a percentage of a country's swap quota, but rather if a country needs to roll over the 90 day swap more than a certain predetermined number of times.
- A 90 day swap facility cannot logically be viewed as a crisis resolution facility because in cases of a real insolvency crisis, it will take much longer than 90 days to resolve.
- It is designed for short-term temporarily liquidity shortages, like in the Korean case during the global financial crisis. Imposing IMF conditionality designed for crisis resolution in such a case is not logical.
- However, if a country continues to have to roll over the swap, then the likelihood is that the problem is not temporary and more structural.

The IMF Link (3)

- If the problem is structural then bringing in the IMF would make sense. So may be the initial 90 swap as well as the first roll over could be unlinked to any IMF program, covering a six months period, but if a second roll over is needed then an IMF link could be required.
- So, CMIM will be the first line of defense to prevent the situation from developing into a serious crisis, with the IMF joining the battle if it becomes more and more likely that the problem is not simply a short-term liquidity problem but a more medium term structural problem.
- Not having IMF link for the first six months should encourage those with temporary liquidity problems to use the CMIM. Also the threat of the IMF link after 6 months will encourage countries to take appropriate corrective policies.
- Of course, the regional surveillance mechanism through AMRO, needs to establish its capability, credibility and effectiveness.

CMIM Size

- Compared to rescue programs in Europe, $120 billion may seem much too small. However, misleading to compare. Europe is a public debt problem in local currency (Euro), but CMIM is for foreign exchange shortages.
- However, increasing the size of CMIM is feasible, and can be done in two ways: increase contributions and supplementing by bilateral swaps.
- Doubling the CMIM contributions from each country is not far fetch, given that CMIM is self-managed so no real money is paid into a pool and resources will be required only when a swap is invoked (except for AMRO expenses). Also when a swap is needed, the total required will be much less than the total size of CMIM.
- China and Japan, given their huge reserves, will unlikely ever require CMIM swap.
- Take case where Korea and, say, Thailand requires full swaps.

CMIM Size (2)

- The swap contributions under the current CMIM size from the rest will be as follows.

	Swap Contribution	Reserves (2009)	Share of Reserves
	Billion Dollars		
Brunei	0.010	1.36	0.70%
Cambodia	0.038	3.29	1.16%
PRC	12.200	2,452.90	0.50%
Indonesia	1.446	66.12	2.19%
Japan	12.200	1,048.99	1.16%
Lao PDR	0.010	1.01	0.94%
Malaysia	1.446	96.7	1.50%
Myanmar	0.019	1.38	1.38%
Philippines	1.446	44.21	3.27%
Singapore	1.446	187.8	0.77%
Viet Nam	0.318	16.8	1.89%

Note: Reserves for Myanmar is for 2006.

CMIM Size (3)

- Countries should be able to contribute without too much strain. Even if the CMIM size was, say, doubled to $240 billion, the swap contributions (assuming full swap amounts for Korea and Thailand; totaling $61.16 billion) should still be manageable, especially bearing in mind that it is normally just a 90 days short-term facility, and in cases of difficulty in contributing to a swap, there are mechanisms for a country to opt out.
- Of course, if we have a region wide problem, then it will actually be a global problem, given East Asia's importance to the world economy, and a regional facility like CMIM cannot deal with it and global mechanisms will be needed.

CMIM Size (4)

- A second way to increase the effective size of CMIM is to attach additional bilateral swaps from willing countries in the group to a CMIM swap.
- Say, Thailand needs a swap, its quota from the CMIM pool is $11.38 billion. There is no reason why China and Japan (given their huge reserves and close economic ties to Thailand) cannot add bilateral 90 day swaps with Thailand for, say, $10 billion each attached to the CMIM swap program to be managed under the same conditions as the CMIM swap.
- Similar to when Thailand borrowed from the IMF in 1997. In the IMF package of $17.2 billion for Thailand only $4 billion was the IMF's own money (or 23.25%), the rest came from contributions by various countries in the region.

CMIM Size (5)

- Allowing bilateral contributions from non-ASEAN+3 countries is also a way to allow them to participate in various CMIM related activities which will be important for a more integrated macroeconomic and financial cooperation architecture of the region (see below).
- The IMF could also be an additional source of swaps, if an IMF swap facility is implemented.
- If both methods to increase the size of the CMIM is implemented, i.e. doubling the size of CMIM contributions and also allow bilateral swaps linked to a CMIM swap, then the effective size of CMIM could easily be $600-700 billion, and should be sufficient for the foreseeable needs of the future.

AMRO and Regional Surveillance

- Biggest challenge is to quickly develop AMRO's capability, credibility and effectiveness to generate confidence from various parties.
- AMRO is tasked to (i) monitor, assess, and prepare quarterly reports on the macroeconomic situation and financial soundness of the ASEAN+3 Countries, (ii) assess macroeconomic and financial vulnerabilities in any of the ASEAN+3 Countries and provide assistance in timely formulation of policy recommendations to mitigate such risks, and (iii) ensure compliance of swap requesting parties with the lending covenants under the CMIM Agreement.
- How AMRO will fit into the current surveillance process, the Economic Review and Policy Dialogue (ERPD), still needs to be fleshed out.
- ERPD is held at the Finance and Central Bank Deputies Meeting (AFDM+3) level twice a year and is reported to the annual Ministers' Meeting (AFMM+3) with input from the IMF and ADB.

AMRO and Regional Surveillance (2)

- AMRO’s quarterly surveillance reports will obviously be an important part of the ERPD process. An Advisory Panel (AP) will also provide independent advice concerning AMRO’s assessments on a quarterly basis.
- Better if AFDM +3 takes place quarterly, but time limitation of Deputies is a weakness of current process.
- AMRO should work closely with ADB in the initial stages. Also the relationship of AMRO surveillance and IMF surveillance through the Article IV consultations also needs to be developed.
- IMF obviously has a lot more resources and expertise than AMRO in its early stages. However, just as there is no “one size fits all” in economic policy, there is also no “one view fits all” with regard to economic surveillance. So AMRO should aim to provide high quality independent surveillance assessments to those that already exist. It should also cooperate closely with other related agencies, such as the World Bank, the BIS, and the ASEAN Secretariat.

AMRO and Regional Surveillance (3)

- Effective surveillance is not easy. New crises usually happen from different causes to previous crises and are unforeseen.
- Effective surveillance at the official level becomes almost impossible. In official meetings, no country will admit that it is going to face a crisis. Everyone will take the position that things are under control. They have to, as admitting that a crisis is likely may be the very thing that triggers an actual crisis.
- Because of this, AMRO should not limit its working partners to official agencies such as Ministry of Finances and Central Banks, but should also try to develop and utilize networks of independent think tanks and academia to obtain various points of views.
- Modes of networking of organizations, such as the ADB Institute (ADBI) and the Economic Research Institute for ASEAN and East Asia (ERIA), with domestic think tanks and research organizations in various countries of the region could be a good model to follow to supplement AMRO’s networking with official institutions.

Asian Monetary Organization

- The key to the success of any kind of surveillance or financial cooperation mechanisms within the region is to have a strong professional secretariat to support the process.
- Instead of being driven by the AFDM+3 process, AMRO should be developed to become the dedicated technical secretariat to the AFMM+3 and the AFDM+3 process.
- A more substantive change would be to have member countries send their representatives to AMRO as Executive Directors, along the line of the IMF. AMRO would then be like an Asian Monetary Organization (AMO) supporting CMIM as well as other key areas of macroeconomic and financial cooperation initiatives in the region.

Integrating Finance Ministers and Central Banks Processes

- The macroeconomic and financial cooperation architecture of the region should be reformed to make them more integrated and more effective. At present, there are many important topics that should be discussed within the region but cannot be discussed adequately within the existing institutional structure.
- Example is exchange rate, which is an important for the global imbalance, or to for greater exchange rate stability to promote more intra-regional trade and investment and generate more intra-regional growth drivers.
- Minister of Finances cannot easily discuss exchange rate issues as in many countries this is regarded to be the domain of the central bank. On the other hand, in some country, exchange rate policy is not under control of the central banks, so central bank meetings cannot adequately discuss exchange rates either.
- Need to bring together Ministers of Finance and Central Bank Governors and indeed this will happen for ASEAN+3 from 2012.

Integrating Finance Ministers and Central Banks Processes (2)

- This is an important step forward and may also lead to Finance and Capital Market Regulators not already included also attending in the future to form an Asian Financial Stability Dialogue (AFSD) as proposed in ADB (2008), *Emerging Asian Regionalism: A Partnership for Shared Prosperity*.
- Apart from having joint meetings of Finance Ministers and Central Bank Governors, one can go further by developing a common membership structure and secretariat (by AMO) for the Finance Ministers' and Central Banks processes in order to promote more effective macroeconomic and financial dialogue and cooperation.
- Central Bank process under EMEAP involve 11 economies; Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore and Thailand. Also, no permanent secretariat.
- The membership is a subset of CMIM membership, except that Australia and New Zealand are included.

Integrating Finance Ministers and Central Banks Processes (3)

- CMIM membership can also be viewed as a subset of EMEAP except that economies in ASEAN outside of the original ASEAN5 are not part of EMEAP.
- If EMEAP is expanded to include the other ASEAN members apart from the ASEAN5 and CMIM membership is expanded to include Australia and New Zealand, then the membership composition of the two processes would be identical.
- India has participated in the East Asian Summit (EAS) since the very first one in 2005 so India can also be included in both processes (forming ASEAN+6 plus Hong Kong).
- This should be the limit for the group as the whole point of these institutional developments is to deepen macroeconomic and financial cooperation within East Asia, to be a regional complement to what already exists at the global level, so one should not extend the membership structure so far as to make this rationale meaningless (by for example including Russia and US although they will be attending EAS from this year on).

Integrating Finance Ministers and Central Banks Processes (4)

- There does not seem to be strong institutional constraints to adding additional members to EMEAP. CMIM is more difficult. Adding full members will require renegotiation on contributions, voting weights etc., and will require a consensus to be reached. Will be very difficult.
- A feasible way out to this might be to make Australia, India and New Zealand so-called “Contributing Partners” to CMIM swap programs by contributing bilateral swaps to specific swap programs that CMIM has with a country in the way that was indicated earlier.
- As contributing partners, they will not be able to get a swap from CMIM or be part of the decision making process. However, they should be allowed 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 macroeconomic and financial cooperation in the region.

Contribution to the Global Financial Architecture

- 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 a joint meeting of the expanded CMIM/EMEAP Finance Ministers and Central Bank Governors once a year (may also include finance and capital market regulators not already included to form the AFSD).
- Regular meetings of the expanded CMIM/EMEAP could develop into an important focal point of the global financial system; no less important than meetings of the US Federal Reserves or European counterparts because these meetings can play a key role in coordinating the region’s monetary policy, exchange rate policies, and foreign reserves investment policies, with major global implications on important variables such as exchange rates and bond yield curves.

Contribution to the Global Financial Architecture (2)

- The CMIM/EMEAP process may also result in important policy coordination necessary to tackle major global problems such as the global imbalance.
- Without coordination, countries will try to prevent its currency from getting too strong in order to protect its export sector. This would mean that the global imbalance is likely to remain and may even increase.
- 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 AMRO (or AMO) have the potential to make a real difference to the policy processes within the region, with major regional and global implications.

Thank You for Your Attention