

<Executive Summary>

Chiang Mai Initiative as the Foundation of Financial Stability in East Asia

(Introduction)

CMI is a network of bilateral swap arrangements and it is one of the tangible accomplishments of ASEAN+3. However it could end up without providing a meaningful regional mechanism if it remains in its present form.

This paper first studies the development of regionalism in East Asia which led to the creation of the CMI, providing the base for discussions on deepening financial regionalism. Then the paper reviews the functions of the CMI and considers what should be done and how the system could be developed as a regional financial arrangement in the medium to long-term, paying attention to its relationship with multilateral institutions such as the IMF.

In order to establish a stronger self-help and support system, the CMI needs to be developed as a multilateral institution. The establishment of a regional institution such as an Asian Monetary Organization (AMO) in the long-run is also studied in this paper. A key element which is necessary for an AMO to function is the establishment of an effective surveillance mechanism in East Asia which is compatible with the global system.

1. Regionalism in East Asia

Regarding the concept of regionalism, Malaysia's advocacy of EAEC (East Asia Economic Caucus) in the early 1990s was significant for Asian countries with the increasing momentum towards regionalism by the creation of EU and NAFTA. However, at that time this idea was not supported by other Asian countries mainly over the concern of the US objection to this idea and instead of EAEC, the framework of APEC was given priority.

Although the concept of regionalism has been focused upon only recently, economic inter-dependence has been accelerated in the region through trade, investment, finance and macro-economic relations. A de facto economic zone has in effect been created in the area of trade and investment based on market principles, despite the political, social and historical differences among the countries in the region.

2. Asian Financial Crisis and Regionalism

However, the Asian currency crisis of 1997-1998 changed this situation dramatically and leaders focused their attention on regional financial cooperation.

When the crisis occurred in Thailand, it was the neighbouring countries and Australia that agreed to assist Thailand.

Japan proposed establishing an Asian Monetary Fund (AMF) as a framework for promoting financial cooperation and policy coordination in the region, which was rejected by the United States and the IMF. Japan also made additional contribution (the New Miyazawa Initiative) to five East Asian countries. Because of various oppositions, the proposal of AMF

was withdrawn. However East Asian governments were fully aware of the need for regional financial cooperation and various forums were created to discuss regional financial cooperation.

3. ASEAN + 3

The basic framework of the ASEAN+3 Meeting has its origin in the EAEC proposal. The ASEAN+3 Summit was regarded as a meeting that plays an important role in promoting regular and it has been held every year since then.

And it must be noted that the United States appears not to have intervened in the establishment of ASEAN+3 and the formation of the Chiang Mai Initiative contrary to its negative reaction to the plans for the EAEC or the AMF proposals while China has also become an active supporter of regional cooperation.

4. Regional Financial Agreements

The CMI currently consists of 15 bilateral agreements totalling US\$37.5 billion (including ASEAN swap US\$1 billion) and itself is significant achievement. However, it still has several shortcomings such as shortage of available amount, dependence on the IMF, inefficient financial arrangement. These shortcomings can be overcome by improving and modifying the CMI. And if these shortcomings are corrected, the CMI can be developed into a full-fledged efficient financial arrangement.

The East Asian economies have become more interdependent as regional trade and investment have increased remarkably. Under such circumstances, regular exchange of information and careful economic policy coordination among the governments are critical to the stability of the regional economy, finance and exchange rates. It is especially vital among others to exchange information frequently on short-term capital flows and to discuss and coordinate regularly on foreign exchange policies in order to prevent regional financial crisis. Setting up of an early warning system is also an important task. Several forums have been formed for the purpose of promoting regional surveillance such as ASEAN Surveillance Process, Manila Framework, ASEAN+3 Economic Review and Policy Dialogue.

It is of vital importance to establish a strong ASEAN+3 surveillance system which can oversee the East Asian region to cope with issues which may arise from time to time before the issue is taken to a global institution. Regional self help and support programs will contribute to maintain regional financial stability and thus help the multilateral process. In order to strengthen the surveillance process, the establishment of a proper secretariat for ASEAN+3 is required.

5. From the CMI to an AMO

The CMI could be developed into a more efficient institution that provides a sufficient amount of financing in a timely and efficient way, underpinned by an effective surveillance to enable member countries to overcome financial crises. When the CMI is strengthened by the arrangement of a regional surveillance mechanism, the creation of a multilateral institution such as an AMO is desirable. Following is the basic image of an AMO.

An AMO could expand the functions of CMI to deal with widely-defined objectives like contributing to the stability of the regional financial and monetary system which will further contribute to the global economic equilibrium. It will oversee short-term capital flows, exchange rate equilibrium, capital account liberalization, monetary and financial policies in the region. An AMO will engage in regional surveillance to foresee and to prevent vulnerabilities which may lead to future financial crisis and in the event a financial crisis should occur, an AMO should resolve the crisis together with the IMF.

As for membership, ASEAN+3 countries are core members but an open membership policy should be adopted and other countries like Australia and New Zealand may be considered.

Regarding the source of fund, it will rely on the contributions from member countries. The amount of contributions should be determined by a quota system which assigns each member, a quota relative to its GDP, foreign exchange reserves, or other economic indicators. If members are to contribute 5% of their foreign exchange reserves, the initial fund would amount to about US\$100 billion.

6. The Relationship between an AMO and the IMF

It should be stressed that the role of an AMO is basically one which complements the IMF. The nature of the crisis differs from case to case, but there are always early signs of monetary or currency problems. The countries that can detect such subtle signs quickly and accurately are usually the neighboring countries which have closer economic relations with the country, provided that there is sufficient information and a data sharing mechanism with room for peer review and peer pressure to work.

The AMO surveillance mechanism would be useful to sense problems at an insipient stage, and to correct them through peer pressure through the exchange of information and ideas among the countries in the region. However, if there are no regional institutions such as an AMO to take the leadership to prevent crises from getting worse, the burden of global institutions will be much larger.

The role played by the AMO and the IMF should be divided according to nature and stage of a crisis; (a)time of normalcy (b)external disequilibrium (c)incipient stages of a crisis (d)financial and currency crisis

7. East Asian Regionalism and United States

The United States perspective on East Asian regional cooperation is based on the strategy that the United States interests are best served through strengthening bilateral relationships with Asian countries. The United States has huge economic and security interests in Asia. Its policy towards East Asia is based on bilateral relationships but it also maintains a presence in Asia through APEC, which the U.S. has supported to play a central role in the region. Consequently, it has objected to any regional integration that excludes the United States in Asia. There were high expectations for APEC in the beginning but it is losing steam now and is gradually becoming obsolete.

It is clear that the United States is no longer continuing to oppose regional integration

nurtured in East Asia. However, it is essential for Japan to discuss with the United States, the movement towards regional cooperation and integration in the region for the sake of the US-Japan alliance.

8. Conclusion

Regional cooperation in East Asia has less than a ten year history, and it is at an early stage of integration. East Asia, unlike Europe, does not have a regional security framework. Accordingly, strong economic integration cannot be built based on a political framework.

It is strongly expected that the up-coming review of the CMI in May this year by finance officials of the ASEAN+3 will reach a broad agreement on deeper regional monetary cooperation in the medium-term, whereby the CMI will be developed step by step towards a more effective and efficient regional arrangement.

The success of the CMI or an eventual AMO will depend upon whether the surveillance system in East Asia can work as effectively as expected.

Economic and financial integration is justified as long as it contributes to the well-being of the people in the region. In that sense, an AMO and the ensuing mechanism to stabilize regional financial and currency systems should be promoted.

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