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Introduction

East Asian governments are now conducting a regional dialogue on economic and political matters of unprecedented breadth and intensity. They employ several institutions and forums, but rely largely on the group composed of Japan, China, and South Korea, along with the 10 members of the Association of Southeast Asian Nations (ASEAN),[1] together known as "ASEAN+3." Since the first meeting of the leaders of this group in 1997, ASEAN+3 meetings have convened officials with progressively wider sets of substantive responsibilities. Although such dialogues and forums are common in some other regions of the world, and have developed in subregions of East Asia, regional cooperation is just now developing in this set of 13 countries that includes both Japan and China and brings together Northeast and Southeast Asia, yet excludes the United States and other Western Hemisphere members of the Asia-Pacific Economic Cooperation forum.

ASEAN+3 has thus already significantly changed economic relations within the region to a degree that is not fully appreciated in the Western Hemisphere or Europe. If ASEAN+3 could overcome substantial remaining internal conflicts and commit itself to deeper regional integration—the difficulties of which should not be minimized—this new regional entity could transform international trade, monetary, and financial relations. And if it could endure, regional economic cooperation could potentially

1. The ASEAN members are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

serve as the basis for improving political relations among East Asian governments as well.

The financial crisis of 1997-98, among other factors, provided strong impetus for East Asian regionalism. In an effort to avoid repeating that painful episode, East Asian governments, their officials, and academic commentators have proposed numerous enhancements to monetary and financial cooperation. These proposals have ranged from suggestions to create new exchange rate regimes and common currencies to initiatives to build regional financial facilities and an Asian Monetary Fund (AMF). The movement to create a set of currency swap agreements among countries in the region that could contribute to greater stability in the face of another financial shock is the most advanced of these proposals. This movement, which was launched at a meeting of the finance ministers of ASEAN+3 in Chiang Mai, Thailand, in May 2000, is commonly referred to as the Chiang Mai Initiative (CMI).

Several large questions surround the development of the CMI and the possibilities for its future evolution. One set of questions relates to the economic and financial merits of these agreements. What exactly have East Asian governments agreed upon, and how significant are these arrangements? How will they affect the prevention and resolution of financial crises? How do they compare with other plurilateral and regional financial facilities?

A second set of issues relates to the CMI's ramifications for the multilateral institutions, the International Monetary Fund (IMF) in particular. Could they undercut the IMF in its negotiations with borrowers? Could they indulge permissive policies of some governments within the region, risking capital and delaying adjustment? Could the CMI pave the way eventually for the introduction of a regional monetary fund?

Finally, a third set of questions relates to policy action. How should the governments of East Asia build on these financial arrangements? What should be the response of the United States, Europe, and the IMF? This book focuses on the financial aspects of regional cooperation as it examines these three sets of questions.

The United States, the IMF, and even some Asian governments rejected the 1997 proposal to establish an Asian Monetary Fund. These actors feared that an AMF could displace the IMF and undercut its ability to secure policy adjustments from borrowing countries. ASEAN+3 has promoted the CMI not as an alternative to the IMF, but rather as a complement to financial multilateralism. The international community has thus generally been publicly neutral with respect to the CMI, with some officials expressing acceptance of regional arrangements that complement multilateral institutions such as the IMF.

The concept of "complementarity" remains somewhat vague, however. More fundamentally, the 1997 conflict over the AMF proposal casts a shadow over the discussion on financial cooperation in East Asia.

Notwithstanding statements of neutrality, many Western officials and academics harbor an abiding skepticism about financial arrangements in the region. Official support in the West for more robust regional arrangements cannot be taken for granted.

Critics of the CMI can be found at both ends of the spectrum. Some dismiss these arrangements as innocuous, whereas others argue that they are potentially disastrous. This book argues that, contrary to these views (which are mutually exclusive), the arrangements are both significant and beneficial. They are significant because they require important negotiations among governments and central banks in the region and mobilize financing in quantities that are potentially substantial for several countries. They are likely to be beneficial by reinforcing the international safety net for countries experiencing financial crises—at the center of which remains the IMF—and by providing a foundation on which deeper regional economic cooperation can be built.

Some opponents conjure a worst-case scenario in which such arrangements separate from multilateral institutions, reject global standards, disburse funds too generously, and thus magnify moral hazard and delay needed policy adjustments. Some of these analysts are particularly concerned that such arrangements could be used to bail out Japanese banks. Although the original AMF proposal might have carried this danger, and such fears still cannot be dismissed completely, the evolution of the CMI to date provides little basis for this worst-case scenario. This study provides several reasons why US and European policymakers should look beyond such fears and engage East Asia constructively in developing the CMI.

Thus, this study offers strong, though conditional, support for the movement to strengthen financial cooperation in East Asia. The concerns of critics offer valuable caveats and useful guidelines for the development of the CMI. Fundamentally, however, the study finds the rationales for regional cooperation to be compelling. The study concludes that the CMI is considerably more sensitive to multilateral institutions, the IMF in particular, than are comparable arrangements.

The study recommends the further development of the CMI through enhancement of surveillance, the use of prequalification for the IMF Contingent Credit Line, and enlargement of its swap arrangements. The United States and other governments in the Group of Seven should support regional financial cooperation in East Asia and encourage its evolution in ways that are compatible with multilateral institutions.[2]

The study proposes that the members of the IMF formally adopt a set of principles that specify the compatibility of regional financial arrangements with countries' multilateral obligations—the financial equivalent

2. The term "multilateral" is used here synonymously with "global" and in contrast to "regional."

of Article XXIV of the General Agreement on Tariffs and Trade—and explicate how such arrangements should work with the IMF operationally. These principles would perpetuate the presumption in favor of regional arrangements that is embodied in the status quo. But under these principles, among other things, regional financial arrangements would have to consult with the IMF on disbursing funds and could not undercut IMF conditionality. The principles would also provide formally for notifying, and review by, the IMF. The history of regional arrangements and the debates over the 1997 AMF proposal suggest that such principles are needed.

The agreements among the governments and central banks of East Asia are confined, to date, mainly to financial matters—swap arrangements, monitoring of financial flows, and mutual surveillance. They have not yet embarked on robust exchange rate or monetary cooperation. Accordingly, this book will focus mainly on financial agreements rather than monetary proposals. Ambitious monetary cooperation would require correspondingly ambitious financial cooperation. But regional financial cooperation can serve several important purposes in the absence of monetary cooperation, just as the IMF serves useful purposes in the absence of the Bretton Woods exchange rate regime.

The future evolution of regional financial cooperation in East Asia is unclear. The governments in the region could choose to develop present arrangements into more ambitious regional institutions; or disagreements among them could block such developments. The course that East Asia eventually chooses will depend on political and economic factors within the region and at the global level.

This study is based on the premise that the prospects for regional financial cooperation are significant enough to warrant an examination of its desirability. The merits of the CMI and its possible successors, however, are substantially independent from the question of the likelihood that it will expand and evolve in the future. Therefore, although the book touches on positive analysis in places, it mainly addresses the desirability of regional financial cooperation.